

# THINGS THAT MAKE YOU GO *Hmmm...*

A walk around the fringes of finance



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“Given a choice  
between you and me  
you pick you and I’ll pick me  
I’ll never forget what you said  
when you left  
Every man for himself

– ARTICLES OF FAITH, EVERY MAN FOR HIMSELF

“Say the word and I’ll turn you loose  
I got mine now you get yours  
Just like you I’ve got my price  
Sure is nice that someone paid  
I’ve got my ticket out of here  
But for you, I fear, it’s much too late  
It’s nothing you can blame me for  
In love and war  
It’s every man for himself”

– Steppenwolf, *Every Man For Himself*

“Now it’s every man for himself tonight  
We’re lookin’ out for number one, tryin’ to get on with  
our lives  
And it’s heart-breakin’ and it’s soulachin’  
When you got nobody else  
So friends it’s good to have you here tonight  
But it’s every man for himself

– Neal McCoy, *Every Man For Himself*



On Sunday, December 4<sup>th</sup>, 2011 on the Chugoku Expressway in Yamaguchi Prefecture, Japan, what Yamaguchi's Expressway Traffic Police Unit's executive officer, Mitsuyoshi Isejima called "a gathering of narcissists" was making its way from Kyushu to Hiroshima in what were later described as 'atrocious driving conditions'.

The gathering, a collection of supercar enthusiasts, were driving approximately 300 million yen's worth (or the equivalent of 2,500 ounces of gold) of precision engineering at what eyewitnesses estimated to be 85 – 100mph on rain-soaked roads.

As the parade of supercharged vehicles approached a tight bend, one of the two Italian cars at the head of the pack suddenly swerved out of control and careened across several lanes of traffic and into the central reservation, leaving debris everywhere and damaging the other Italian beyond repair.

Immediately behind the Italian vehicles was a big, sturdy German car which, upon reaching the same bend and seeing the Italian cars in trouble made the fatal mistake of slamming on its brakes which, on an extremely slippery surface is the very last thing you should do. All the advanced computer technology in the world couldn't stop the German car from being dragged into the chaos as it too slammed headlong into the Italian pile-up in front of it.

Several other extremely expensive German and Italian cars were sucked into the tangled wreckage of twisted metal (luckily, nobody was seriously injured).

Driving along quietly behind the European supercars was a Toyota Prius. Sadly, even though it wasn't part of the speeding cavalcade, the Japanese car too was damaged beyond repair when it found itself part of the pile-up...

The last thing I really wanted to write about AGAIN was Europe but those damn Eurocrats just won't let it go so I find myself staring down the barrel of yet another EU summit that occurred this past weekend and trying to sift through the aftermath in search of any meaningful shift in either the speed or the trajectory of the descent into chaos.

If you look closely enough, you can just about see some meaningful words amongst the usual spouting, but once again those words seem to be backed with either hot air, magical 'money' or promises of accords that will never stand a test of their strength – and believe me, those tests are coming.

In our offices here in Singapore, we jotted a short checklist on the whiteboard going into the Summit last weekend that we felt laid out what was, at a minimum, required to 'fix' the problems facing the Eurozone (fully cognizant of the fact that any 'fix' would be short-term in nature until deficits were brought under control. The purchase of time seemed to be the best-case scenario).

That checklist looked like this:

1. *International coordination*
2. *Actual cash backing*
3. *European lender of last resort*
4. *Fiscal changes/discipline mechanism*
5. *Bank recapitalization/EuroTarp*



The party had, interestingly enough, got started a week earlier as the concerted Central Bank action to loosen up dollar funding lines along with a ‘co-incidental’ Chinese reserve requirement cut pretty much checked off number one on our list well in advance of the summit proper – a little welcome gift, perhaps?

The coordination is important – principally for Germany as they look for a valid reason to allow the printing presses to be activated in the basement of the Eurotower in Frankfurt (previously the Commerzbank Tower).

Having set out its anti-printing stance long, long ago, back when a billion euro was a lot of money, Germany cannot now be seen to be weak to its electorate as the nightmare of Weimar-era hyperinflation lives on in Germany’s collective psyche (the country goes to the polls in 2013 – assuming all goes to plan) and so being part of a new ‘Committee To Save The World’ would play well on the domestic stage and, perhaps, give Frau Merkel the breathing space she so clearly needs if she’s to show any flexibility whatsoever.

The coordination angle received another timely boost the day before the Summit convened as Mario Draghi cemented his role as the anti-Trichet by cutting rates for the second time in as many meetings. More importantly, however, he made a few careful adjustments that were designed to help alleviate clear pressures building up amongst the European banking sector as rumours of an imminent collapse by a major European financial institution swirled around, and it was those adjustments that brought the festive season to the banking sector a little early this year.

It is very much in the language emanating from Draghi’s ECB that the real moving parts were to be found - the Summit would turn out to be, like all the others before it, a totally ineffective package disguised as a damp squib dressed as a solution. We shall discuss the Summit briefly later, but for the time being, let’s focus our attention on the ECB’s chicanery - the magnitude of which was largely either unnoticed or misunderstood.

In his press conference Draghi made some major announcements that WEREN’T outright, unlimited moneyprinting and so were consequently ignored by the markets, but which, when examined, turned out to not only be moneyprinting in all but name, but also have the potential to make the actions of the Fed, the BoE and the SNB look positively Austrian.

**F**irstly, the ECB agreed to adjust the threshold for collateral it would accept from AAA to A and extend their largesse to include bank loans. Now, whilst this doesn’t sound like much of a move, it basically makes just about everything the banks own eligible as collateral – a handy handout for the

struggling European financials to be sure. This move alone mobilizes a huge amount of constrained collateral that ailing banks will be able to pledge to the ECB (thus deteriorating the quality of ITS balance sheet further still, but that's a matter for another day) and, with the National Central Banks of the EU also being given the green light to accept the same loans as collateral, the chances of a major funding crisis striking the banks was lowered significantly.

The other big move the ECB made was to extend loan duration to banks to three years - at a stroke removing immediate fears of insolvencies due to the ongoing crunch in term-funding markets across the continent.

In essence, the ECB told banks to bring them any old crap they had knocking around and they would exchange it for nice, clean, fresh euros for a minimum of three years (a time period you can guarantee will be extended should we get anywhere near it without an improvement in conditions). Hey Presto! Magic Money.

Not only that, but, by supplying these extended credit lines to banks, they implicitly nudged them towards using their newly-loaned cash to buy...guess what? Yup, that's right, European sovereign debt!

You have to hand it to them once again, a very clever solution - even though the markets didn't rejoice.

As I was pondering this last week, an excellent 'Outside The Box' from my friend John Mauldin landed in my inbox. It included the thoughts of GaveKal on the subject and their explanation of the ECB's move was far better than anything I could come up with so I'll leave it to them to explain it:

*The three--year unlimited liquidity operations announced last Thursday could provide infinite monetary support for European banks and through them, their sovereign debt markets. Once these three--year repos get started, banks in the Club Med countries will be able to borrow as much as they want from the ECB at 1% and use this money to buy government bonds now yielding 6% or more. Because of the unprecedented maturity of these repo--operations, banks will now be able to theoretically acquire unlimited government bond portfolios without exposing themselves to rollover or maturity risks. Banks will therefore be able to pick up 500bp of carry, with zero risk--weightings, by hoovering up all the debt their governments can throw at the markets. Of course there would be risks—we cannot say banks will want to jump on this deal, but in theory they can.*

*This Ponzi scheme could potentially result in an even bigger money--printing operation than anything the US, British and Swiss central banks have done on their own accounts. It would allow the banks to rebuild their equity with no dilution to shareholders. And if the banks in Italy or Greece became too "profitable" by using cheap ECB funding to buy up their entire sovereign debt markets, then the Italian or Greek governments could always recover the "excess" profits with special taxes. The governments could thus effectively reduce their own cost of funds to the 1% rate offered to banks by the ECB. Of course if the Italian government defaulted on its debts, Italian banks would go spectacularly bust. But these banks would go bust anyway if the Italian government ever defaulted. All the incentives for Italian bank management will therefore be to go for broke in their sovereign debt markets, making maximum use of the new ECB credit lines.*

You see? Genius.

Oh, one other thing to mention before we move on (GaveKal again):

*And it is crucial to remember that banks are likely to use the ECB credit lines only to buy the bonds of their own national governments, partly in response to political pressures but also for prudential*



*reasons. If the Euro were ever to break up, Unicredit would not want to own any Greek or Spanish debt, since this would entail unpredictable currency risks. An Italian bond, by contrast, would be redenominated into the new Lira and would be matched perfectly against Unicredit's borrowings from the Bank of Italy, which would also be redenominated into Lira.*

*Thus, the result of the ECB's covert QE via the banks will be gradually to re-nationalise the banking systems and the sovereign debt structures in Europe. This process will help Club Med countries avoid sovereign debt defaults, but it will make eventual breakup of the euro much less painful – and therefore more likely.*

Every man for himself.

**N***aturally*, myopic markets focused on some other Draghi soundbites that dashed hopes they had for more upfront monetization. In particular, his hardline stance against bending the rules of the Maastricht Treaty were seen as borderline betrayal by an audience clearly embracing pantomime season and casting poor Mario as the villain:

*Draghi: "It's legally complex. The spirit of the treaty is that one cannot channel money in a way to circumvent the treaty provisions..."*

*The key thing is that we should not try to circumvent the spirit of the treaty no matter what the legal trick is. What matters for the people and what matters for the confidence and the credibility of the institution is this spirit...*

*If the national central banks want to lend to the IMF and the IMF wants to lend to Indonesia or China, that is fine; if they wanted to lend exclusively to Europe, we think it would be incompatible with the treaty...*

*Let's not forget that the ECB is not an IMF member ... more generally, the mechanism by which money is being channeled to the European countries should not obscure the fact that we have a treaty that says no monetary financing to governments..."*

*Markets: "Boooooooo!"*

*Draghi: I was surprised by the implicit meaning that was given to the 'other elements will follow.' ... A new fiscal compact, comprising a fundamental restatement of the fiscal rules together with the fiscal commitments that euro area governments have made is the most important precondition for restoring the normal functioning of financial markets...*

*The ECB has an important role, as the guardian of stability ... what is happening is a redesign of the fiscal agreement in a way that would enhance, rebuild confidence in the euro area. We have our own ideas, views, and we have collaborated but the ultimate decisions are in the hands of the leaders...*

*We shouldn't refrain from wishing for great progress toward common fiscal rules, controlling, ex ante, budgetary legislation. I wish all our leaders the best, and the ECB is here ... But that doesn't mean the ECB will respond, by the way."*

*Markets: "Hisssssssssss!"*

*Draghi: "[The ECB] foresees annual real GDP growth between -0.4% and 1.0% in 2012 ... These [significant downward] revisions mainly reflect the impact on domestic demand of weaker confi-*

*dence and worsening financing conditions, stemming from the heightened uncertainty related to the sovereign debt crisis"*

*Markets: "Be-HIND youuuuuuuuuuu!"*

Given the mood of the ratings agencies in the aftermath of the previous week's concerted action, lowering the minimum acceptable credit rating for collateral was a smart preemptive move to get ahead of what is likely to be a raft of downgrades that would bring a LOT of AAA and AA paper down to A in very short order:

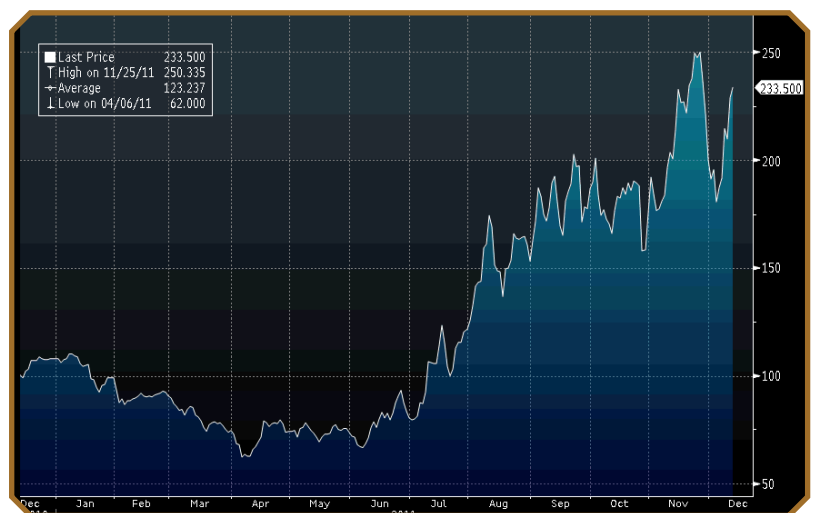
*(Axxess News): Standard & Poor's placed the long-term sovereign debt of 15 Eurozone member countries on Creditwatch ... while Greece was spared Creditwatch status by the rating agency.*

*The news came after ...the second day of rising stock indexes after last week's news from Central Bankers worldwide of their intervention, though the Rating Agency was indifferent to the move citing concerns over those Eurozone countries placed onto Creditwatch status with negative long-term outlook.*

*The countries cited by Standard & Poor's were: Italy, France, Spain, Portugal, Luxembourg, Ireland, Austria, Belgium, Finland, Netherlands, Estonia, Malta, Slovenia, Slovak Republic and Germany.*

*"We expect to conclude our review of eurozone sovereign ratings as soon as possible following the EU summit scheduled for Dec. 8 and 9, 2011," the Rating Agency noted. "Depending on the score changes, if any, that our rating committees agree are appropriate for each sovereign, we believe that ratings could be lowered by up to one notch for Austria, Belgium, Finland, Germany, Netherlands, and Luxembourg, and by up to two notches for the other governments."*

Those 'other governments' it turned out, included France – something that seemed to catch a few people off-guard despite the likelihood of some form of downgrade being common discussion for quite some time. French CDS (chart, right) soared again on the news (despite the fact that the debacle in Greece demonstrated just how ineffective a hedge these instruments could well turn out to be in the event of a sovereign default - assuming it was allowed to be called such).



SOURCE: BLOOMBERG

But a potential downgrade for France (amongst 'the others') was not, in and of itself, the big problem, as the FT pointed out a few days later:

*(FT Alphaville): In the event of a downgrade, S&P's rating on EFSF will be downgraded to the lowest rating of the previously triple-As countries backing the structure (except Luxembourg). Since France could potentially be downgraded by two notches, EFSF could potentially be downgraded to AA. If France is ultimately only downgraded by one notch, then EFSF will also only be downgraded*

Euro area Country	Current S&P Rating	Likely downgrade
Austria	AAA	1 notch
Belgium	AA	1 notch
Cyprus	BBB	2 notch
Estonia	AA-	2 notch
Finland	AAA	1 notch
France	AAA	2 notch
Germany	AAA	1 notch
Greece	CC	-
Ireland	BBB+	2 notch
Italy	A	2 notch
Luxembourg	AAA	1 notch
Malta	A	2 notch
Netherlands	AAA	1 notch
Portugal	BBB-	2 notch
Slovakia	A+	2 notch
Slovenia	AA-	2 notch
Spain	AA-	2 notch

SOURCE: RBS/BLOOMBERG

one notch since the downgrade of the five triple-As backing the structure will be limited to one notch according to S&P.

Currently, the ESM would have 58.1% share of AAA shareholders. If the six AAA euro area countries are downgraded, then this will drop to zero and it seems highly unlikely that the ESM would be able to achieve an AAA. If France is downgraded to AA flat then we see a significant risk that the ESM will not be able to be rated above that level, particularly if the lending volume significantly exceeds the paid-in capital.

Uh-Oh!

The EFSF - saviour of the European sovereign debt markets - could become just another AA-rated piece of paper - or worse - because France (for example) loses its AAA-rating. Of course, one of the main REASONS for France losing it is the size of its contribution TO the EFSF.

Circularity breeds contempt.

A look at the potential downgrades in S&P's ratings of EFSF contributors (table, left) shows just how tenuous the entire house of cards has become.

Lo and behold, last night, the fun and games began in earnest as Moody's jumped the gun and downgraded Belgium two notches whilst Fitch (never ones to see a train leaving the station that they didn't want to jump on) warned Spain and G7 member, Italy, that, to use the words of the great Irving Berlin, 'there may be trouble ahead':

*(UK Daily Telegraph): Spain and Italy were both told to brace for a debt downgrade after a leading rating agency concluded that a "comprehensive solution to the eurozone crisis is technically and politically beyond reach".*

*The eurozone's third- and fourth-biggest economies were warned by Fitch of a "near-term" downgrade, alongside Ireland, Belgium, Slovenia and Cyprus.*

*In a further blow, Belgium separately saw its credit rating downgraded two notches, to Aa3, by another leading agency, Moody's.*

*It cited the "sustained deterioration" in funding conditions for eurozone countries with relatively high levels of public debt, like Belgium, and new risks stemming from the country's troubled banking sector.*

*The downgrade and warnings, delivered after the markets closed last night, came as Spain said its debts had soared; talks with Greece's private bondholders stalled; and Hungary broke off talks with the International Monetary Fund (IMF).*

*Pitching itself firmly against Germany, the rating agency warned that the European Central Bank (ECB) needed to give a "more active and explicit commitment" to prevent "self-fulfilling liquidity crises" ripping through the eurozone. The ECB's support for eurozone banks was praised but Fitch said the central bank's "continued reluctance to countenance a similar degree of support to its sovereign shareholders" was undermining the efforts to create a firewall to stem the crisis.*

Even Fitch are calling for QEU now!

To increase the pressure, they upped the ante just a little more:

*\*FITCH SAYS 'COMPREHENSIVE' FIX TO EURO CRISIS IS BEYOND REACH*

And, finally, they lowered the boom:

*\*FITCH AFFIRMS FRANCE AT 'AAA'; OUTLOOK REVISED TO NEGATIVE*

No matter if it's a few years too late, religion is always a powerful thing to find.

**A**fter the announcement by the ECB, all eyes turned to the following day's summit and we didn't have to wait long for the party to get started as it was announced that Herman van Rompuy (the man Nigel Farage once so beautifully described as having ["...the charisma of a damp rag, and the appearance of a low-grade bank clerk"](#)) would be holding a press conference at 2am CET after the welcome dinner that the leaders of Europe had attended the previous evening.

Now, I learned a long time ago that saying anything at 2am, especially after a long dinner with a bunch of friends, is generally NOT a good idea and so I waited for Herman's appearance with some trepidation.

I waited.... and I waited..... and I continued to wait as even the organizing of a press conference proved too much for the Eurocrats. Perhaps the dinner menu had gone horribly wrong and, instead of serving French food and Italian wine, the attendees had been presented with Estonian food and British wine?

But no.... an hour later than advertised, and in a perfect example of the problems facing Europe's leaders we were treated to not one, but at least four simultaneous press conferences - and it was at THAT point, that we were served the British whine.

While Nicolas Sarkozy, van Rompuy, Jose Manuel Barroso all began to talk about the new 'fiscal compact' (a phrase that is already beginning to grate on me every time I hear it), David Cameron also stepped to a spare microphone to announce that Britain had vetoed the you-know-what as it contained no protection for the City of London - the much-maligned and supremely important area of the UK that seems to generate most of its revenues:

*(Politics.co.uk): "What is on offer isn't in Britain's interests, so I didn't agree to it," Mr. Cameron said early this morning.*

*"Of course, we want the eurozone countries to come together and solve their problems. But we should only allow that to happen inside the European Union treaties if there are proper protections for the single market and for other key British interests.*

*"Without those safeguards, it is better not to have a treaty within a treaty but to have those countries make their arrangements separately. That is what is now going to happen."*

Cue fallout.

History will judge Cameron with its cold and unflinching eye so there's no point in me doing so now, but leading a less pragmatic charge was Nicolas Sarkozy, who was clearly agitated by Cameron's decision to hop into the lifeboat and leave the SS Europe sailing off into an uncertain future:

*(UK Daily Mail): 'Cameron behaved like an obstinate kid, with a single obsession: protecting the City, which wants to carry on behaving like an offshore centre. No country supported him. That is*



*the mark of a political defeat.'*

French dissatisfaction with Cameron and Britain quickly escalated into a full-blown war of words as French Central Bank Governor (and ECB policymaker) Christian Noyer attempted the old 'Look! Over there!' trick - explaining why, as perilous as France's financial condition is, Britain's is much worse:

*(UK Daily Telegraph): "The [S&P] downgrade [of France] does not appear to me to be justified when considering economic fundamentals," Mr. Noyer said in an interview with local newspaper Le Télégramme de Brest.*

*"Otherwise, they should start by downgrading Britain which has more deficits, as much debt, more inflation, less growth than us and where credit is slumping," he went on.*



And there, in that little vignette, is a clue to the big problem that lies at the heart of the European experiment; namely, that Europe is a collection of disparate countries with centuries of history between them - the vast majority of which, they have been at war with one another.

I have written about this at length before, but it bears restating: As soon as a situation arises that requires a choice between national interest and European interest, each and every country in the EU will choose country over continent.

Every man for himself.

Cameron refused to be drawn into a tit-for-tat row with France, but Andrew Lilico, member of the UK Shadow Monetary Policy Committee was less diplomatic:

*(UK Daily Telegraph): Can we take it that it would now be OK for British politicians, civil servants, or members of the Monetary Policy Committee to call for France to lose its AAA rating? When can we start?*

*French government budget plans are almost incidental. What places the French sovereign in particular distress is its commitments to the banks. Whereas in the UK the Coalition government has taken significant (albeit still inadequate) steps to disentangle the government from the banking sector, such as the Vickers proposals and the treatment of the Southsea Mortgage and Investment Bank, the French government is more entangled with the banks than ever. Furthermore, there is a material risk of the euro collapsing entirely, with the consequence that the French repay their debts in New Francs or something - a currency that might well be devalued relative to the euro (because of the loss of Germany)... The question France should be asking is not whether its credit rating can be justified as lower than the UK's. Instead it should be asking whether it's credit rating can really be justified as higher than Italy's.*

The other key move from the Summit came from Van Rompuy who, in his 3am press conference, almost as an aside, explained that the concept of private sector losses on Sovereign debt was one which was a nice idea, but not one that would be continued:

*"[van Rompuy] also acknowledged that the EU's policy during the crisis in Greece of making pri-*



*vate investors assume losses of their holdings of Greek debt was flawed and had been scrapped.*

*This policy, which he admitted had had “a very negative effect on the debt markets” was “officially over,” he declared.*

Moral Hazard. Official sponsor of Europe.

As the days have passed since the summit, the commentary has taken a familiar path from uncertainty to criticism to borderline despair and finally, the realization appears to be dawning that the Eurozone's days could well be numbered.

Britain's veto and subsequent ostracism from the EU will one day be seen to be the first step in the dissolution of the Eurozone. It will be held up as an example by ambitious politicians in other countries whose electorate - sick of forced austerity - are angry and want change and, one by one, as governments fall (France goes to the polls in April and Sarkozy's chances of even making it through the first round seem to be diminishing by the day) the pressures on the Eurozone will become too strong and it will capitulate.

The Euro has suddenly started to act like a currency in danger of extinction this past week as it has broken the 1.30 level (chart, left) and seemingly, more and more people are starting to doubt the future of the European Union (at least in its present form). The fact that the 'Fiscal Com...' no, I can't say it, does absolutely nothing to address the current debt levels in Europe (which, let's face it is the REAL problem) has been recognised far quicker this time than after the previous 'last chance' summit in October and Britain's bold move has highlighted the fact that the peripheral countries will be forced to unilaterally give up a degree of sovereignty with absolutely zero in the way of quid pro quo.

The bottom line is this:

France and Germany need to be prepared to foot the bills that are coming due and, by 'France and Germany', I mean Germany because, with a budget deficit of 7.1%, and debts of 83% of GDP, France WILL be downgraded shortly and will be in no position to chip in to the EFSF as their own ship begins to take on a serious amount of water in the shape of rising borrowing costs.

That leaves the intransigent Germans.

With a budget deficit of 4.3%, a record of having exceeded the mandated deficit limit in seven of the past eleven years a debt-to-GDP level of 85% and climbing, not to mention an economy that is on the verge of a recession (I told you not to MENTION that), Germany may soon have to go and sit somewhere quiet in order to reflect on what to do next.

So, at the end of another tumultuous week in Europe, our whiteboard looked like this:

- |  |  |
|--|--|
| 1. International coordination          | yes  |
| 2. Actual cash backing                 | sort of... but only for banks                |
| 3. European lender of last resort      | definitely not                               |
| 4. Fiscal changes/discipline mechanism | unenforceable promises that will get nowhere |
| 5. Bank recapitalization/EuroTarp      | sort of - but not enough                     |

Hardly a 'comprehensive solution'.

Of course, when push comes to shove, if the ECB's stealth monetization policies don't work, there's always the machine in the basement of the ~~Commerzbank Tower~~ Eurotower...

**B**efore I leave you for the Christmas holidays, events of the last 12 hours have dictated that I pen a quick word about the other subject I wanted to write about this week, but that took a back seat, once again, to Europe - gold.

The action in gold the past week was - even by its own standards - quite extraordinary. Once the dust has settled we will pick apart the machinations behind this week's action in the COMEX futures pit (and, mark my words, that is EXACTLY where the action was), but the story on page 21 of today's Things That Make You Go Hmmm..... should give every reader both pause for thought and cause for concern.

If physical gold and silver as well as COMEX warehouse receipts (which are as good as physical ownership) are to be pooled by the trustees and sold at a price that has been strangely and swiftly decimated in the futures market, then even those with the greatest conviction in 'the system' owe it to themselves to recheck their logic.

Although I have my own views on many of the peccadillos of the precious metals markets, I try to stay away from trumpeting conspiracy theory logic in these pages as best I can because I feel as though taking the Keiser route can alienate more people than it attracts. Instead I prefer to take a more balanced approach regardless of the strength of my own feelings where certain matters are concerned.

However, when PAPER gold and silver flood the markets relentlessly for a week, before the announcement of a possible major liquidation of PHYSICAL metal which will no doubt find its way into the hands of the very sellers of those paper contracts, then I'm sorry, but I call 'Foul'. I call it publicly and I call it loudly.

*(Barrons): The trustee overseeing the liquidation of [MF Global] has proposed dumping all remaining customer assets—gold, silver, cash, options, futures and commodities—into a single pool that would pay customers only 72% of the value of their holdings. In other words, while traders already may have paid the full price for delivery of specific bars of gold or silver—and hold “warehouse receipts” to prove it—they’ll have to forfeit 28% of the value.*

If this trustee sale of precious metals goes ahead as advertised at the prices currently flickering across computer screens around the world then 'the system' is finally and officially broken. Even physical gold and silver held in safe deposit can no longer protect you.

Anyone holding physical gold and silver had better buy themselves a shovel or a much bigger mattress because clearly, holding your protection in the belly of the beast from which you seek it is a strategy fraught with danger.

The number of lawsuits we will see resulting from this action will take the breath away. Not only that, but the plaintiffs will include some very deep-pocketed, very smart, very powerful and extremely well-connected people indeed and so, unless those orchestrating this particular sequence of events are either richer, brighter, more powerful and better-connected or have the backing of someone (or something) meeting those criteria, then they are going to find themselves in the battle of a lifetime - a battle that will fundamentally affect many aspects of the financial landscape.

Who could possibly be richer, brighter, more powerful and better-connected? Well, ultimately, I can only think of one obvious candidate...



This week's Things That Make You Go Hmmm..... is longer than usual but hopefully you'll all have

plenty of time over the holidays to relax and do a little reading and so, with that in mind, you'll find all kinds of interesting material in the pages that follow.

Destinations this week include Spain, where expensive cars are being jettisoned and mortgage valuations are, as has been widely believed, horrendously wide of the mark, China, where we visit a half-built, fake Disneyland and hear from Ambrose Evans-Pritchard that an 'epic hangover' has just begun, Poland, where thousands took to the streets to express their displeasure at the EU and Portugal, where the socialists are threatening to detonate a 'nuclear default' (get used to this kind of talk from opposition parties across Europe).

We hear how financial institutions the world over are being forced to turn their backs on American citizens, find out why the TBTF banks are continually able to break the law and get away with it, expose a rift within the ECB courtesy of the old staple the 'disgruntled former employee' and we hear why, despite a headline to the contrary, Deutsche Bank analysts fear rising oil prices.

In gold and silver news we hear from the great Egon von Greyerz whose piece, 'Deus Ex Machina' is a must-read for anyone interested in precious metals, while the story of the MF trustee debacle is also not to be missed.

The IMF warn of a 1930s-style slump, my good friend Mike Krieger talks to 'Turd Ferguson' we hear the wise words of Bill Fleckenstein and, in a rare interview, the afore-mentioned Egon von Greyerz discusses 'Deus Ex Machina' and gives us his views on the world today. Lastly, we look at a possible bank bailout and find out that controversy can also stalk German politicians.

Our charts include a look at a strikingly similar pattern in gold (courtesy of Jesse), a view of the Chinese telecom sector and an amazing snapshot that shows how people of retirement age in America are flocking back to work at the expense of the young.

Finally, I am absolutely delighted to be able to introduce you to the work of Richard Ross of Auerback Grayson. Rich's charts are always a highlight of my week and he has been kind enough to allow me to include them in Things That Make You Go Hmmm..... For those of you unfamiliar with his work, you are in for a treat as I shall be featuring it regularly.



Before I (finally) take my leave, may I take this opportunity to thank all of you for your support this year and for the tremendous feedback I have received. It is always a treat to hear from readers and I have made many new and fascinating friends who, through our correspondence, continue to educate and inform me not only about the markets, but on a far wider range of topics.

For each and every one of those emails, I am extremely grateful.

I wish all of you a Merry Christmas, a healthy and prosperous 2012 and very much look forward to continuing our dialogue next year.

Grant

As a result of my role at Vulpes Investment Management, it falls upon me to disclose that, from time-to-time, the views I express and/or the commentary I write in the pages of *Things That Make You Go Hmmm.....* may reflect the positioning of one or all of the Vulpes funds - though I will not be making any specific recommendations in this publication.

*Grant*

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18 December 2011

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## The Gonnies, Gonnies Banks

#	Bank	Assets (\$m)	Deposits (\$m)	Cost (\$m)
91	Premier Community Bank of the Emerald Coast, Crestview, FL	126.0	112.1	31.2
92	Western National Bank, Phoenix, AZ	162.9	144.5	37.6
<b>Total Cost to FDIC Deposit Insurance Fund</b>				<b>68.8</b>

**R**oberto Murga, a construction manager from Barcelona, loved his platinum gray Porsche Cayenne until the debt crisis made the sport-utility vehicle's leather interior and electronic seats expendable.

The 66,370-euro (\$88,800) status symbol is now unnecessary ballast for Murga, 33, who like other Spaniards has been forced to cut spending because of the country's weakening economy. Car demand, which has halved since peaking in 2007, probably won't recover this decade, analysts predict.

"I can't splurge anymore, and maintaining my precious Cayenne is just too expensive," said Murga, who made as much as 8,000 euros a month before the real estate bubble went bust three years ago, forcing him to fire half his workers. "We have no profit at all. We just try to survive."

Murga has lots of company. The end of the property and construction boom, fueled by a speculative bubble and low interest rates during the previous decade, caused Spain's unemployment rate to more than double to 22.8 percent. The economy, which stagnated in the third quarter, may contract in the final three months. The Cayenne, Porsche SE's best-selling model, has become a symbol of the excess,

... "The real issue is that there appears to be no quick fix on the horizon," said Poskitt. "The euro-zone crisis is hammering confidence in the region, and Spain in particular has a massive problem with the unemployment rate."

with the scaling back of expectations dubbed the "Cayenne crisis," said Victor Conde, marketing professor at Madrid's Universidad Nebrija.

"This car was the paradigm of how we lived above what we could afford," Conde said. "Banks were giving way too many loans and everybody here was driving a Cayenne."

Those days are over and may never be coming back. Porsche sales in Spain and Portugal have fallen 34 percent from the 2007 peak to 1,900 cars last year. Deliveries of Bayerische Motoren Werke AG's namesake brand have dropped 47 percent to 32,500.

It's not just luxury brands that are suffering. Its local auto industry, a rare source of manufacturing jobs in an economy dominated by services and tourism, has also been hard hit. That represents a particular challenge for Volkswagen AG's Seat, the only Spain-based carmaker.

Overall car sales in Spain will likely total 810,700 vehicles this year, down 51 percent from 2007, when 1.61 million cars were sold in the market. That level won't be reached again this decade, according to Jonathon Poskitt, an analyst with LMC Automotive in Oxford, England.

"The real issue is that there appears to be no quick fix on the horizon," said Poskitt. "The euro-zone crisis is hammering confidence in the region, and Spain in particular has a massive problem with the unemployment rate." The European car market has fallen 13 percent over the past four years.

★ ★ ★ SF CHRONICLE / [LINK](#)

**A**long the road to one of China's most famous tourist landmarks – the Great Wall of China – sits what could potentially have been another such tourist destination, but now stands as an example of modern-day China and the problems facing it.

Situated on an area of around 100 acres, and 45 minutes drive from the center of Beijing, are the ruins of 'Wonderland'. Construction stopped more than a decade ago, with developers promoting it as 'the largest amusement park in Asia'. Funds were withdrawn due to disagreements over property prices with the local government and farmers. So what is left are the skeletal remains of a palace, a castle, and the steel beams of what could have been an indoor playground in the middle of a corn field.



SOURCE: REUTERS

Pulling off the expressway and into the car park, I expected to be stopped by the usual confrontational security guards. But there was absolutely no one to be seen. I walked through one of the few entrances not boarded up, and instantly started coughing. In front of me were large empty rooms and discarded furniture, all covered in a thick layer of dust, along with an eerie silence that gave the place a haunted feeling – an emotion not normally associated with a children's playground.

Once outside again, I came across some farmers who originally owned the land and are now using it to once again to grow their crops. Their tracks and plantations can be seen running through and surrounding the uncompleted buildings. Walking further, I came across a rather farcical sight of some farmers digging a well next to a castle; a moment I will always savor as a photographer in a place like China where castles are not in huge supply. I explained this to the

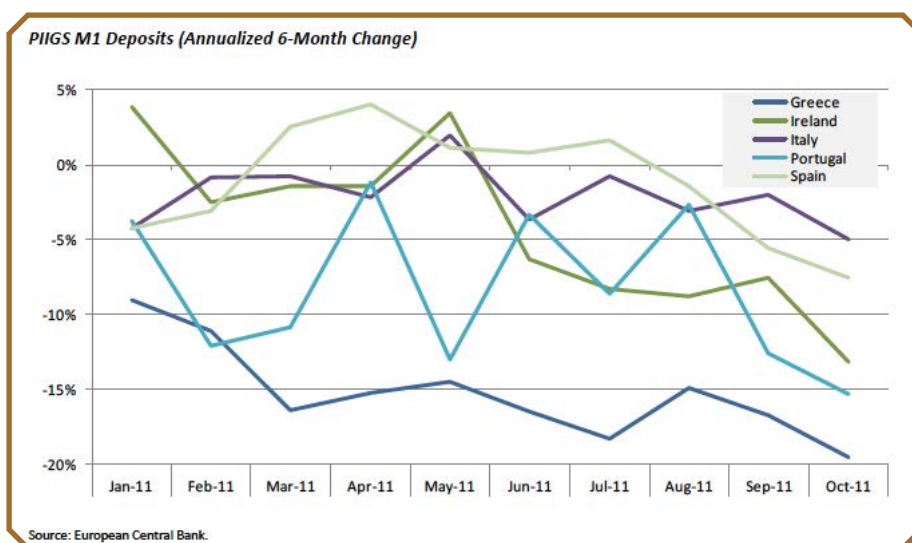
farmers and they just shrugged their shoulders, oblivious to a photographer's happiness. I asked them what happened, and they simply answered the developers ran out of money, and they are getting back to doing what they do best. They are even slowly starting to plant trees and build shelters near the buildings, adding they think it is now safe to think the developers are never coming back. This I can believe, as the absence of any security (something very rare in China) leads one to think that even the developers have given up on what is already there.

☆☆☆ REUTERS / [LINK](#)

**T**he spectacle on display this past weekend in Latvia is a reminder that old-fashion bank runs are not entirely a thing of the past. The reality, however, is that modern bank runs often take the form of deposit flight from one institution to another – which begs the question: if you were a Spaniard, a Portuguese, a Frenchman, a Latvian, a Greek, or an Italian, why on earth would you leave your euros deposited in your home country's banks (that are most likely insolvent)? If there was any risk of your deposits being redenominated into pesetas, escudos, francs, un-pegged lats, drachmas,

or lira, why not move them immediately to a more stable banking environment? With the current mobility of capital, why not open accounts in Switzerland, Canada, Norway, or at the very least in Germany? Why take the risk that you end up like the Argentines who were restricted to withdrawing a pittance per week after the authorities changed the rules regarding the mobility and the value of the peso?

Just as Latvians ran to the ATMs this weekend, so will depositors all over peripheral Europe in the months



SOURCE: ECB

ahead. Below is a chart of the most recently published data regarding bank withdrawals in the PIIGS. As you can see, deposits are now declining at an accelerated pace. What's surprising is that it hasn't happened much sooner.

Capital mobility is an essential precondition to default as capital rushes out of a problem jurisdiction in the final phases of a sovereign spiral. Professors Reinhart and Rogoff, whose work we have referenced many times in the past, assessed the correlation between the liberalization of capital mobility and the incidence of banking crises across the globe. They concluded that "periods of high international capital mobility have repeatedly produced international banking crises, not only famously as they did in the 1990's, but historically."<sup>2</sup> We note that their data set, which begins in 1800, only covers through 2007 (this paper was published in April 2008). At that time, capital mobility was at its highest point ever and we all know how that turned out.

★ ★ ★ KYLE BASS (THANKS AR) / [LINK](#)

**C**hina's credit bubble has finally popped. The property market is swinging wildly from boom to bust, the cautionary exhibit of a BRIC's dream that is at last coming down to earth with a thud.

It is hard to obtain good data in China, but something is wrong when the country's Homelink property website can report that new home prices in Beijing fell 35pc in November from the month before. If this is remotely true, the calibrated soft-landing intended by Chinese authorities has gone badly

"... Chinese stocks are flashing warning signs. The Shanghai index has fallen 30pc since May. It is off 60pc from its peak in 2008, almost as much in real terms as Wall Street from 1929 to 1933"

wrong and risks spinning out of control.

The growth of the M2 money supply slumped to 12.7pc in November, the lowest in 10 years. New lending fell 5pc on a month-to-month basis. The central bank has begun to reverse its tightening policy as inflation subsides, cutting the reserve requirement for lenders for the first time since 2008 to ease liquidity strains.

The question is whether the People's Bank can do any better than the US Federal Reserve or Bank of Japan at deflating a credit bubble.

Chinese stocks are flashing warning signs. The Shanghai index has fallen 30pc since May. It is off 60pc from its peak in 2008, almost as much in real terms as Wall Street from 1929 to 1933.

"Investors are massively underestimating the risk of a hard-landing in China, and indeed other BRICS (Brazil, Russia, India, China)... a 'Bloody Ridiculous Investment Concept' in my view," said Albert Edwards at Societe Generale.

"The BRICs are falling like bricks and the crises are home-blown, caused by their own boom-bust credit cycles. Industrial production is already falling in India, and Brazil will soon follow."

"There is so much spare capacity that they will start dumping goods, risking a deflation shock for the rest of the world. It no surprise that China has just imposed tariffs on imports of GM cars. I think it is highly likely that China will devalue the yuan next year, risking a trade war," he said.

China's \$3.2 trillion foreign reserves have been falling for three months despite the trade surplus. Hot money is flowing out of the country. "One-way capital inflow or one-way bets on a yuan rise have become history. Our foreign reserves are basically falling every day," said Li Yang, a former central bank rate-setter.

The reserve loss acts as a form of monetary tightening, exactly the opposite of the effect during the



boom. The reserves cannot be tapped to prop up China's internal banking system. To do so would mean repatriating the money – now in US Treasuries and European bonds – pushing up the yuan at the worst moment.

The economy is badly out of kilter. Consumption has fallen from 48pc to 36pc of GDP since the late 1990s. Investment has risen to 50pc of GDP. This is off the charts, even by the standards of Japan, Korea or Taiwan during their catch-up spurts. Nothing like it has been seen before in modern times.

★ ★ ★ [AMBROSE EVANS-PRITCHARD](#) / [LINK](#)

**A**bout 5,000 Poles protested in Warsaw against closer European integration after the government agreed to a new EU treaty for closer fiscal cooperation to tackle economic crisis.

The protesters waved Polish flags and at one point chanted “Disgrace!” during the rally organised by the main opposition, the conservative, euro-sceptic Law and Justice (PiS) party.

The peaceful demonstration took place on the 30th anniversary of a crackdown by communist authorities against the pro-democratic opposition led by the Solidarity trade union, Reuters reports.

“... As he addressed the crowd, PiS leader Jaroslaw Kaczynski drew a parallel between the 1981 Poland's subjugation under the Martial Law to the Soviet Union and the current government's support for deeper EU integration.”

As he addressed the crowd, PiS leader Jaroslaw Kaczynski drew a parallel between the 1981 Poland's subjugation under the Martial Law to the Soviet Union and the current government's support for deeper EU integration.

“PiS will lead the fight for a truly sovereign Poland where Poles themselves can decide on what is most important for them, can build their prosperity on their own, because we can afford that,” he said.

Poland, the largest former communist state in the EU, is still outside the euro zone and has so far avoided the recession engulfing much of

the 27-nation bloc.

Kaczynski accused Prime Minister Donald Tusk's government of betraying the nation's interests by giving Germany whip hand in the EU, to the cheers of the crowd.

Tusk, at the helm of a centrist, pro-business party, believes deeper EU integration is essential to Poland's security and prosperity. PiS and other euro-sceptic parties have accused him of surrendering the country's hard-won independence.

But, partially thanks to Poland's still-resilient economy, PiS and other euro-sceptic parties have, until now, failed to make political capital from the current European malaise.

“This is not the appropriate time for some Poles to play people off against each other,” Tusk told a news conference on Tuesday, referring to the still-divisive Martial Law issue.

Some 44 percent of Poles believe declaring the state of emergency was right, while 34 percent believe it was wrong, according to a recent survey by CBOS pollster.

“This is an anniversary that should make us reflect on the obligations and the limits of power, both in the communist times as well as today,” he said. “The memory of these events should unite us.”

★ ★ ★ [REUTERS](#) / [LINK](#)

**M**ove along, nothing to see here.

That's been the Wall Street line on the financial crisis and the calamitous behavior that caused it, and that strategy has been spectacularly successful. Since Spring 2010, financial institutions' predatory practices have fallen off the front pages of newspapers, replaced by manufactured fears of over-regulation and -- thanks to an assist from the European continent -- an Orwellian belief that government debt lies at the root of our economic problems.

Occasionally, a news event brings the need for financial reform momentarily into the partial spotlight, like last week when Judge Jed Rakoff rejected a proposed settlement between the SEC and Citigroup over a complex security called a CDO (actually, a CDO-squared) that the bank manufactured and pushed onto investor clients solely so it could bet against it. In

“... As is common in these cases, the SEC and Citi negotiated a settlement in which the bank would pay \$285 million (\$190 million for its profits plus a \$95 million penalty) but neither admit nor deny the allegations”

April 2010, when the SEC sued Goldman over similar behavior, that was big-time news for weeks. But Citigroup's behavior in “Class V Funding III” was far worse.

The issue in the Goldman case was whether the bank properly disclosed that John Paulson, a hedge fund manager, was involved in the selection of securities for the deal, because he wanted to bet against them. This time, Citigroup's own proprietary “trading desk” asked its CDO “structuring desk” to create

a debt instrument that it could bet against. The trading desk came up with a list of securities to include in the new CDO and passed it on to the structuring desk, which in turn sent it to a supposedly independent third party that would manage the CDO itself, called CSAC.

In one email, the person on the structuring desk overseeing the deal wrote, “This is [the CDO trading desk]’s prop trade (don’t tell CSAC). CSAC agreed to terms even though they don’t get to pick the assets” (SEC complaint against Brian Stoker, paragraph 32.) Half of the eventual CDO was based on securities chosen by Citi’s trading desk (paragraph 42). (Yves Smith has more, from the SEC’s order against CSAC--which, by the way, is part of Credit Suisse, another big bank.) Of course, the structuring desk didn’t do this just as a favor to the trading desk: “On November 14, 2006, Stoker’s immediate supervisor informed Stoker that Stoker should take action to ensure that the structuring desk received ‘credit for [the trading desk’s] profits’ on Class V III” (complaint, paragraph 33).

As is common in these cases, the SEC and Citi negotiated a settlement in which the bank would pay \$285 million (\$190 million for its profits plus a \$95 million penalty) but neither admit nor deny the allegations. Judge Rakoff (who previously gave the SEC a hard time over a settlement with Bank of America over the closing of the Merrill Lynch acquisition) refused to approve the settlement, saying that it offered no factual basis on which to even decide whether it was fair, adequate, reasonable, and in the public interest

★ ★ ★ THE ATLANTIC / [LINK](#)

**T**he world risks sliding into a 1930s-style slump unless countries settle their differences and work together to tackle Europe’s deepening debt crisis, the head of the International Monetary Fund has warned.

On a day that saw an escalation in the tit-for-tat trade battle between China and the United States and a deepening of the diplomatic rift between Britain and France, Christine Lagarde issued her strongest warning yet about the health of the global economy and said if the international community failed to co-operate the risk was of “retraction, rising protectionism, isolation”.

She added: "This is exactly the description of what happened in the 1930s, and what followed is not something we are looking forward to."

The IMF managing director's call came amid growing concern that 2012 will see Europe slide into a double-dip recession, with knock-on effects for the rest of the global economy. "The world economic outlook at the moment is not particularly rosy. It is quite gloomy," she said.

Since arriving in Washington in the summer, Lagarde has been forced to cut her organisation's forecasts for global growth next year and is now putting pressure on countries outside the eurozone – including Britain – to play their part in containing Europe's sovereign debt crisis.

An IMF plan, agreed at the Brussels summit last week, involves obtaining €200bn (£168bn) from European countries and then asking the rest of the world to contribute. Beijing has so far proved reluctant to join in a rescue of the eurozone and has said it is up to Europe to sort out its own problems.

Speaking at the State Department in Washington, Lagarde said: "There is no economy in the world, whether low-income countries, emerging markets, middle-income countries or super-advanced economies, that will be immune to the crisis that we see not only unfolding but escalating.

"It is not a crisis that will be resolved by one group of countries taking action. It is going to be hopefully resolved by all countries, all regions, all categories of countries actually taking some action."

Lagarde said that the scale of the eurozone crisis, and its implications for other countries, meant that Europe's governments could not tackle it alone. "It is going to require efforts, it is going to require adjustment; and clearly it is going to have to start from the core of the crisis at the moment, which is obviously the European countries, and in particular the countries of the eurozone," Lagarde said.

★ ★ ★ UK GUARDIAN / [LINK](#)

**A**nalysts at Deutsche Bank believe that there are many perplexing and seemingly bullish elements in the current oil markets as production is very high in OPEC with Saudi Arabia reporting around 10 million barrels per day in November 2011, essentially an all-time high. They state that however, demand is weak, seasonally with warmer than average weather and economic weaknesses in Europe, the U.S., and China.

“... oil prices are not at the point of demand or economic destruction, which they take to be \$4 per gallon in the U.S. market. They add that right now prices in the U.S. are at \$3.30 per gallon, implying 20 percent upside before oil prices enter the demand destruction phase

DB analysts' state that among major OPEC countries, Iraq is at a 10-year high and Nigeria is showing its best trailing quarterly since fiscal 2007. They add that Kuwait is nearly at 30-year highs and Libya is returning rapidly. They add that non-OPEC regions including Kazakhstan, Canada, and North Sea have recovered from summer outrages. Analysts comment that despite a weak demand and strong supply, oil prices are backward rated at \$107 per barrel, implying a tight market. They add that and OECD inventories have been drawing and with Saudi Arabia's production on a high, there is plenty of potential

for cuts in production should oil prices fall towards their estimate of the country's oil price break-even, now at a record high of \$92 per barrel. They state that at the same time, oil prices are not at the point of demand or economic destruction, which they take to be \$4 per gallon in the U.S. market. They add that right now prices in the U.S. are at \$3.30 per gallon, implying 20 percent upside before oil prices enter the demand destruction phase.

Analysts state that they just see 2.8 million barrel per day of OPEC production capacity between fiscal 2010 and fiscal 2015 driven by Iraq and United Arab Emirates, which is well below their global demand

forecast of 5.8 million barrel per day even with non-OPEC additions of 1.8 million barrel per day. They state that producing just over 40 percent of world oil supply from 75 percent of stated reserves, OPEC capital expenditure intensity is low, with spending levels around one-fourth of the level of intensity undertaken by major oil producing companies. They still believe that Saudi Arabia's target oil price is now around \$100 to \$110 per barrel.

☆☆☆ NEWSYSTOCKS / [LINK](#)

**E**uropean banks are dumping clients with US citizenship due to a new American law meant to curb tax evasion. The law would require financial institutions around the world to report on certain client activities. Compliance, say many banks, is way too expensive.

The idea was to ensure that US citizens were paying their taxes on investments made through overseas banks. The result, however, has been that Americans in Europe may have difficulties finding banks who want their business.

According to a report in the Wednesday edition of the Financial Times Deutschland, several European banks have elected to no longer serve American securities investors due to stricter reporting requirements pushed through last year by the administration of President Barack Obama.

German financial institution HypoVereinsbank has informed its customers that it will no longer offer certain services to its US-based clients or to US citizens as of Jan. 1. Deutsche Bank told the paper that it already cancelled such accounts held by American citizens in the middle of 2011. Germany's

second largest bank, Commerzbank, is considering a similar move. Customers with normal checking or savings accounts in Germany are not affected, however.

British banking giant HSBC has also reported that it will no longer serve US investors as has the Swiss bank Credit Suisse.

“... several European banks have elected to no longer serve American securities investors due to stricter reporting requirements pushed through last year by the administration of President Barack Obama.

The reason for the sudden reticence to serve American clients is the Foreign Account Tax Compliance Act (FATCA), which was passed in 2010 and will go into effect in January of 2013. The act requires all foreign banks to identify and report on US citizens with accounts holding more than \$50,000 in an effort to clamp down on tax evasion. If banks refuse to comply, they could face a punitive 30 percent withholding tax on all payments from the US. The law is expected to increase tax revenues by \$8 billion over the next 10 years.

Banks say that the law is already resulting in significant costs and that compliance will ultimately be exorbitant. “With FATCA, there is a cost on us in Europe but the benefits are in the US,” James Broderick, a senior manager with JP Morgan Asset Management, told Reuters in November.

He says that some financial institutions face one-off costs of up to \$100 million. “It would be easier to just write a check to the Internal Revenue Service,” he said.

An official for DWPBank, which takes care of securities transactions for 1,600 banks in Germany, estimated that total cost of compliance in Germany alone could amount to €10 billion. Furthermore, some German privacy laws may actually prevent some institutions, particularly insurance firms, from compliance, the official, board member Karl-Martin im Brahm, told the Financial Times.

“Strict laws (for insurers) make it illegal to reveal some customer data,” he said. “They are in a very difficult position.”

☆☆☆ DER SPIEGEL / [LINK](#)



**W**ith most of the world's major economies as well as the financial system bankrupt, there is only one solution that can save the world economy. Like in the Greek tragedies, Deus ex Machina is now the only way that the world can avoid a total economic collapse. This would involve God being lowered down onto the world stage and miraculously saving the plot.

For those few who believe in this, may God bless them. But since this is a very unlikely solution most people will instead rely on governments and central banks to save us. But how can anyone possibly believe that totally incompetent and clueless politicians and central bankers could solve anything. They created the problem in the first place and are therefore totally unsuitable to play the role of Deus. The main objective of governments is to stay in power and thus to buy votes. Therefore they are incapable of taking the right decisions. And the opposition, aspiring to power is even less suitable since they will lie through their teeth and promise the earth in order to be elected. (We know that there are exceptions like Ron Paul, but the voters will most probably find his medicine too strong to swallow.)

What about central bankers, can't they save us? Unfortunately any sensible person who becomes a central banker loses all his senses and becomes a prisoner of the political system.

So if there is no Deus ex Machina and if governments or bankers can't rescue the world, who can and what is the solution? Let us return to the wise von Mises to look at the options available now:

“... To stop the money printing and credit creation would be the only sensible way of ending the failed quasi-capitalist, socialist experiment which is in the process of destroying the structure of the Western world.” *— Ludwig von Mises*

*“THERE IS NO MEANS OF AVOIDING THE FINAL COLLAPSE OF A BOOM BROUGHT ABOUT BY CREDIT EXPANSION. THE ALTERNATIVE IS ONLY WHETHER THE CRISIS SHOULD COME SOONER AS A RESULT OF A VOLUNTARY ABANDONMENT OF FURTHER CREDIT EXPANSION, OR LATER AS A FINAL OR TOTAL CATASTROPHE OF THE CURRENCY SYSTEM INVOLVED”*

Mises is absolutely correct: “There is no means of avoiding a final collapse of a boom brought about by credit expansion”. Whatever politicians, bankers, economists or others experts say, there is no solution to this crisis. We have reached the end of the road and are now staring into the abyss.

The credit manufacturing system that started in 1913 when the Fed was founded, began its terminal phase in 1971 when Nixon abolished gold backing of the dollar. It has been clear to us for at least 20 years that the outcome was inevitable. It was never a question of “if” but only “when” it would happen. It is now clear to us that the false prosperity that the world has experienced by printing unlimited amounts of money will very soon come to an end. Thus the “if” and “when” conditions are now satisfied so the remaining question is HOW?

To try to answer this let's return to Mises: “The alternative is only whether the crisis should come sooner as a result of voluntary abandonment of further credit expansion ....”

To stop the money printing and credit creation would be the only sensible way of ending the failed quasi-capitalist, socialist experiment which is in the process of destroying the structure of the Western world. For almost 100 years we have lived on a system based on debt. This has created a false prosperity as well as false values. The transfer of capital from private enterprise to government by massive taxation is approaching 50% in many countries (see table). The average for 18 industrialised countries is almost 40%. This means that on average 40% of the productive economy is transferred to a non-producing entity (government) which wastes most of the money in the process of redistribu-

tion. But not only that, since the state has taken over up to 50% of the economy in these countries, the desire to work, to strive, to take risk and to invent has been taken away from a major part of the population.

★ ★ ★ EGON VON GREYERZ / [LINK](#)

**T**he eurozone was facing fresh splits today after one of the European Central Bank's most senior figures said the bank should not be used to fund national debts and that if it was forced to, it would mean the end of the single currency.

Executive board member Juergen Stark, who announced his surprise resignation from the ECB earlier this year, said disagreements over the central bank's bond-buying programme was behind his decision.

In an interview with German weekly WirtschaftsWoche to be published on Tuesday, Mr Stark said he did not agree with the way the euro crisis has been handled. He particularly criticised the use of monetary measures, or the wholesale purchase of sovereign bonds by the bank, to contain the crisis.

“... Mr Stark said he did not agree with the way the euro crisis has been handled. He particularly criticised the use of monetary measures, or the wholesale purchase of sovereign bonds by the bank, to contain the crisis”

The statement is in contrast to what the Bank said in September to explain his surprise resignation, which was put down to “personal reasons”.

In the interview he said: “It is the fundamental arrangement of this currency union that it does not allow the monetary funding of sovereign debt by the ECB. Without these rules, there would be no economic and currency union.”

So far the ECB has bought €210bn (£176bn) of state debt. The controversial move has been supported by the UK, France and the USA, but opposed by Germany. The reasons behind Mr Stark's resignation go some way to revealing how deep the opposition to monetary intervention runs.

“This instrument is limited in terms of the timeframe and volume,” Mr Stark said. “We cannot indefinitely expand our balance sheet.”

Mr Stark is not the only economist to oppose buying national debt. Four members of the ECB voted against the recent revival of the programme.

In February, the head of Germany's central bank, Axel Weber, quit the race to become the ECB's next president because of the bank's policy of buying government debt.

Mr Stark said that instead of relying on the ECB to bail them out, governments need to implement urgent fiscal and structural reforms. “The swift implementation of the December 9, Brussels summit decisions is crucial,” he said in the interview. “Italy has high refinancing needs, but these must be shouldered. Italy must create the basis for this itself with a comprehensive programme of reforms and consolidation measures.”

★ ★ ★ UK DAILY TELEGRAPH / [LINK](#)

**T**he bottom line is that apparently some warehouses and bullion dealers are not a safe place to store your gold and silver, even if you hold a specific warehouse receipt. In an oligarchy, private ownership is merely a concept, subject to interpretation and confiscation.

Although the details and the individual perpetrators are yet to be disclosed, what is now painfully clear is that the CFTC and CME regulated futures system is defaulting on its obligations. This did not even happen in the big failures like Lehman and Bear Sterns in which the customer accounts were kept whole and transferred before the liquidation process.

“... How more plainly can it be said? The US financial system as it now stands cannot be trusted to observe even the most basic property rights as it continues to unravel from a long standing culture of fraud”

Obviously holding unallocated gold and silver in a fractional reserve scheme is subject to much more counterparty risk than many might have previously admitted. If a major bullion bank were to declare bankruptcy or a major exchange a default, how would it affect you? Do you think your property claims would be protected based on what you have seen this year?

You always have counter-party risk if you hold gold and silver through another party, even if they are a Primary Dealer of the Federal Reserve. As Ben said, the Fed offers no seal of approval.

If a Bankruptcy Trustee can pool your bullion into the rest of the paper assets and then liquidate it at prices that are being front run by the Street, you will have to accept whatever paper settlement that they give you.

The customer money and bullion assets are not lost, or rehypothecated or anything else. This is a pseudo-legal fig leaf, a convenient rationalization.

The customer assets were stolen, and given to at least one major financial institution by MF Global to satisfy an 11th hour margin call in the week of their bankruptcy, even as MF Global was paying bonuses to its London employees.

And now that powerful financial institution does not want to give the customer money back. And they are so powerful that the Trustee and the Court is reluctant to try and claw it back. And so in the great Wall Street tradition they are trying to force the customers and the public to take the loss. The regulators and the exchange are aghast, and are trying to imagine how to resolve and spin this to preserve investor confidence and prevent a run on the system.

‘Let them eat warehouse receipts.’

For many this would have been unthinkable only a few months ago. They had been cautioned and warned repeatedly, but chose to trust the financial system. And now they are suffering loss and anxiety, frozen assets, and the misappropriation of their wealth.

How more plainly can it be said? The US financial system as it now stands cannot be trusted to observe even the most basic property rights as it continues to unravel from a long standing culture of fraud.

Get your money as far away from Wall Street as is possible. And if you want to own gold and silver, take delivery and store it in a secure private facility outside the fractional reserve system.

★ ★ ★ JESSE / [LINK](#)

**R**epossessed houses in Spain are worth 43 percent less on average than the valuations assigned on the mortgages for the properties, according to Fitch Ratings.

Price declines range from 20 percent to 58 percent, analysts Juan David Garcia and Carlos Masip in Madrid wrote in a report analyzing 8,235 properties funded by loans from banks including Banco

Santander SA (SAN) and Bankia SA. The mortgages are in asset-backed securities with high loan-to-value ratios.

“Fitch does not expect lending to recover in 2012, as financial institutions are more focused on optimising their balance sheets, while their access to funding is limited,” the analyst wrote. “Lending is likely to remain concentrated on existing high-quality borrowers and on potential buyers of banks’ repossessed properties.”

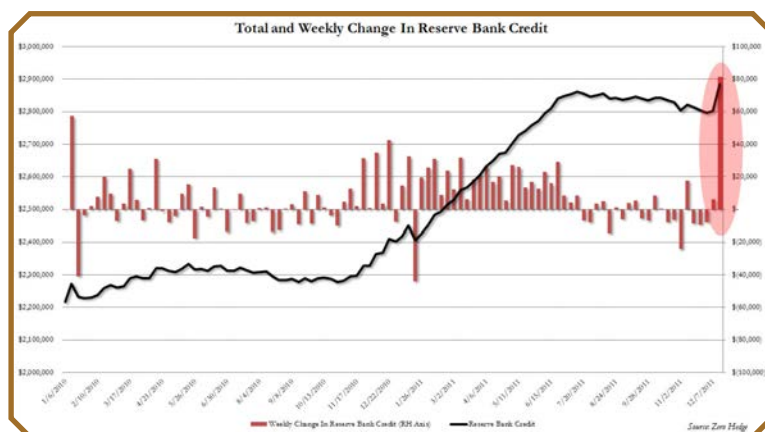
The impact of falling house prices on mortgage-backed securities has been cushioned by some banks that bought defaulted loans from the deals at above-market prices, Fitch said. That support will wane as lender liquidity dries up.

Spanish home prices fell for the 14th consecutive quarter as unemployment surged and a drop in mortgage lending crimped demand for property. The average price of houses and apartments dropped 7.4 percent in three months ended Sept. 30 from the same period a year earlier, according to the National Statistics Institute in Madrid.

★ ★ ★ BLOOMBERG / [LINK](#)

Over the past month we have been closely documenting a major funding squeeze in the all important shadow economy - the “synthetic liquidity” conduit which far more than traditional sources of cash, has become all important for proper bank functioning over the past decade. Courtesy of adverse development in Europe, one by one various components of this unregulated funding scheme have become frozen necessitating the first of many central bank interventions on November 30 to provide liquidity to global banks, primarily to offset such shadow conduits as locked up commercial paper, repo and money markets. Logically, as noted over a week ago, European banks scrambled to obtain cheap dollars by borrowing over \$50 billion from the Fed, and plug dollar shortfalls. Yet as all band aid measures designed to offset a broken liquidity equilibrium fail eventually, it was only a matter of time before we saw a direct bail out by the Fed of one or more banks in the aftermath of the November 30 global “bail out.” Sure enough, we have our first clue that “something” happened in the week ending Wednesday December 14 that involved an upgrade of the Fed’s indirect (and thus untargeted) bailout of global banks, to a focused, and very much targeted rescue of one (or more) banks. And with some additional diligence, it may be possible to narrow down the date of an actual bank bailout: Tuesday, December 13.

Exhibit A - Reserve Bank Credit



[CLICK TO ENLARGE](#)

SOURCE: ZEROHEDGE

Two years ago, when discussing the transition of the world to one coordinated, centrally-planned regime we said that the only financial statement of any importance, updated weekly, is the Fed’s H.4.1, or the “Factors Affecting Reserve Balances” which traces that flow of “last resort” cash from the Fed to the various organization that make up the reserve bank, primary dealer, and various other financial entities under the Fed’s Lender of Last Resort umbrella. Simply said, anything abnormal in this weekly report of “flow and stock” (a simplistic distinction where the Fed is far more focused on what the absolute level of



reserve numbers is, whereas Zero Hedge and the market believe it is the “flow”, or marginal change, that determines, artificially, asset prices) would confirm our speculations that the Fed has stepped into its now traditional role of bailing out the world.

The first thing that caught our attention was the all important total reserve bank credit - the most important big picture metric announced by the Fed on a weekly basis. As the chart below shows, after having plateaued with the End of QE2, and remaining stable during the duration of the “sterilized” Operation Twist (as it should), in the week ended December 14, total reserve credit soared by a whopping \$81 billion or the most since May 27, 2009 when the Fed was actively undergoing the early stages of QE1 damage control.

★ ★ ★ ZEROHEDGE / [LINK](#)

**I**nconsistencies have emerged in statements made by German President Christian Wulff as a loan scandal surrounding the head of state continues to unfold. According to information obtained by SPIEGEL, the loan came from a businessman friend and not from his wife, as Wulff has claimed.

“... According to the entrepreneur, they specifically chose a way to transfer the money without having the names of the involved parties come to light”

Who loaned Christian Wulff €500,000 (\$660,000)? Was it entrepreneur Egon Geerkens, or his wife Edith? The answer to this question will determine the credibility of the German president, but it appears that Wulff has not been forthcoming with all the details.

Wulff has maintained that he accepted a private loan from Edith Geerkens while he was still governor of Lower Saxony in 2008, and has denied having business ties with her husband. But now new information has emerged revealing that the money for the loan came de facto from Egon Geerkens himself.

Egon Geerkens, 67, told SPIEGEL that he, not his wife, led the negotiations over the loan. He said that he had considered “how the deal could be handled.” Furthermore, the friendly connection between the two families was based on the relationship between Wulff and him, Geerkens added.

The payment of the loan was conducted via Edith Geerken’s bank account, as stated by Wulff, but Egon Geerkens had power of attorney over the account. The repayment of the loan in 2010 was done through an account that belonged to both spouses.

A further circumstance suggests that the original owner of the large sum was Egon Geerkens himself. When he married Edith in the 1990s, Egon was already wealthy, while his new partner, who was an employee at his jewelry store, brought only a small income to the relationship. After they married, she quit working. Additionally, the two agreed to separation of property.

According to the entrepreneur, they specifically chose a way to transfer the money without having the names of the involved parties come to light. “We are both very well known in Osnabrück,” Geerkens told SPIEGEL. “And I didn’t want some bank trainee to see that so much money was flowing from me to Wulff.” Thus an anonymous Bundesbank check was issued and given to Wulff to cash.

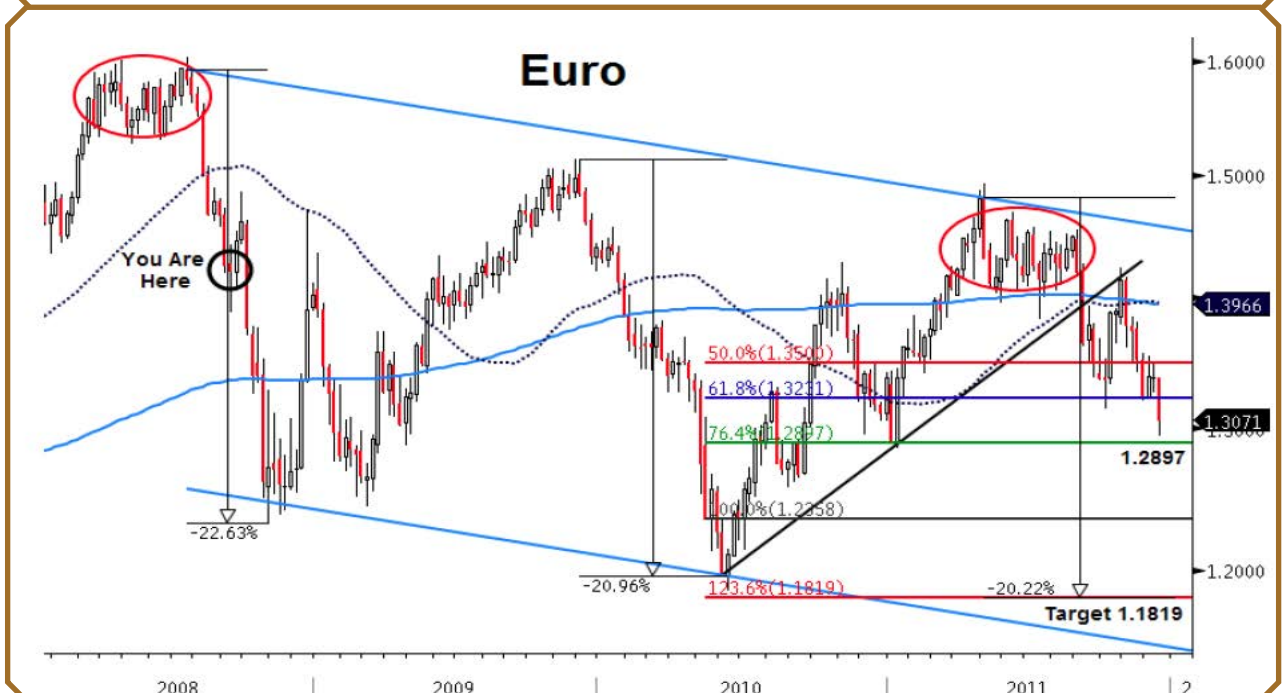
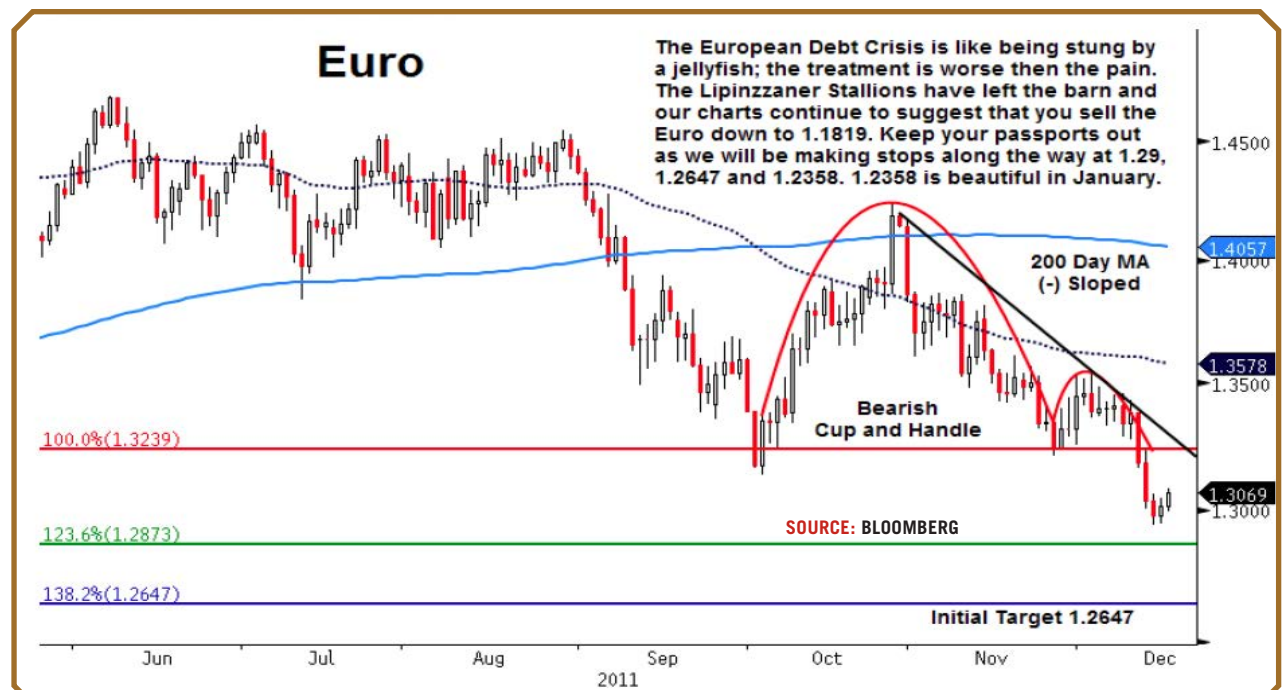
Another detail involving real estate reveals that Egon Geerkens typically took care of financial matters in his marriage. In 2008, his wife Edith purchased a Florida home for about \$1 million. It was the same home where Wulff reportedly vacationed during the Christmas holidays in 2009. The money for the home had been transferred to Edith from Egon via a notarized loan contract.

★ ★ ★ DER SPIEGEL / [LINK](#)

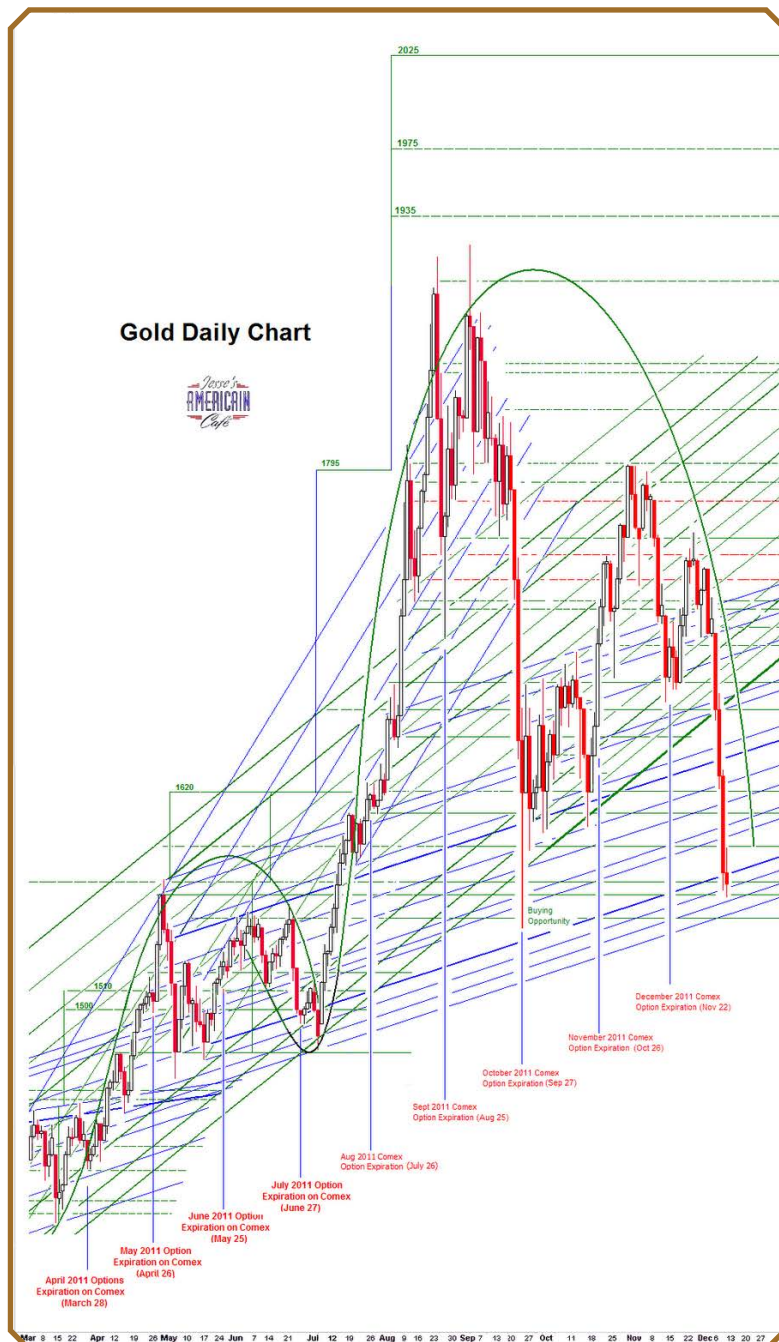
Every week, my favourite collection of charts is put together by Richard Ross of Auerbach Grayson who was introduced to me by my great friend Mike B. Rich has graciously given me permission me to use some of his work in Things That Make You Go Hmmm..... and I will be regularly featuring his work on these pages going forward.

Rich's work is exceptional and his commentary both pithy and incisive. Each week he highlights a group of charts that he feels tell a story and, each week he is right - they do!

Rich can be contacted at: [rross@agco.com](mailto:rross@agco.com)



**SOURCE:** RICHARD ROSS/BLOOMBERG



CLICK TO ENLARGE

SOURCE: JESSE'S AMERICAN CAFE

volve it. Will it be a major quantitative easing in the dollar and euro, or a further liquidation and collapse in the banks and stock markets?

I would prefer a measured bull market move higher, but we must carefully observe and accommodate the changes in the structure of world currencies and the evolution of what we call 'money.'

This is a major engagement in what we have come to call The Currency Wars.

**T**his formation, if activated and valid, would target gold to a much higher level than the previous high.

Let's see how this develops. I will be tracking both this and my normal scenario obviously. Both are bullish but this alternative view promises a wilder ride.

The similarity between the big accumulation-liquidation cycle and the previous cycle from March to July is remarkable in many details.

That does not necessarily mean that the next move will be of the same magnitude. But if that pattern holds we get a target of between \$2,800 and \$3,000 for the next leg up.

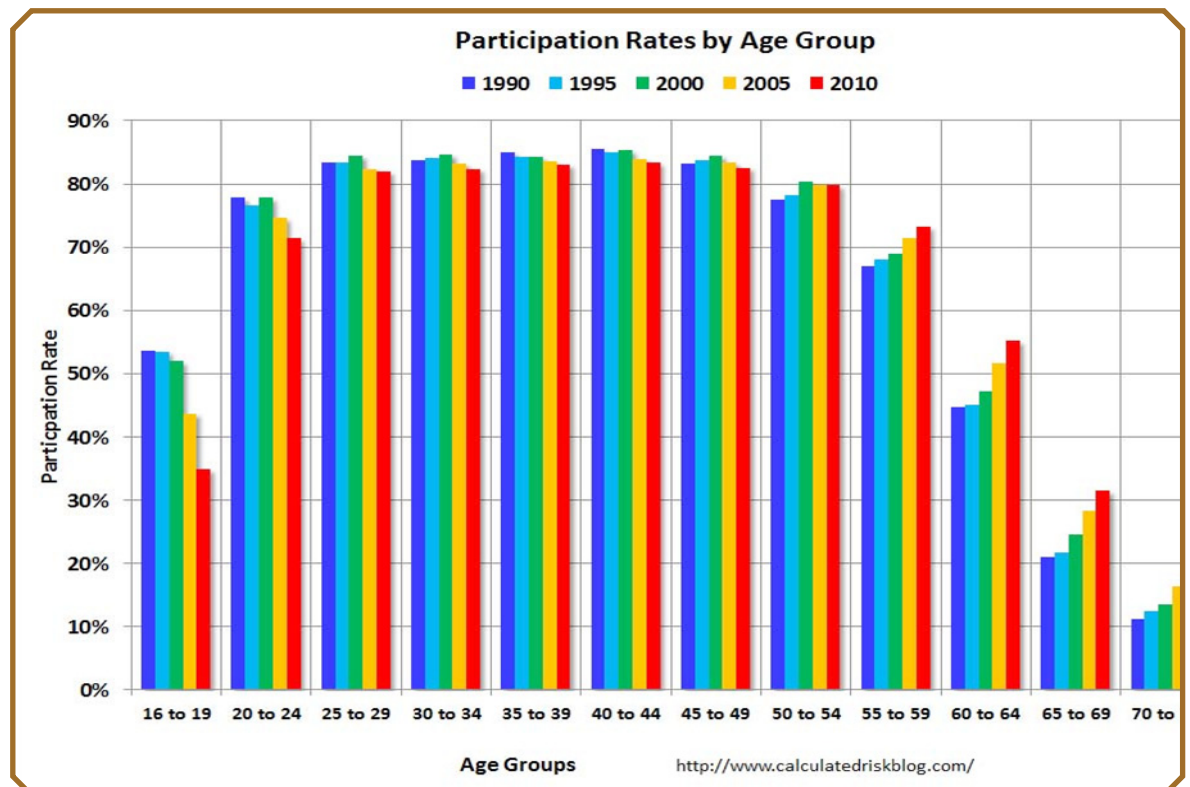
I would wait for this to unfold therefore and strongly advise that you not try to get ahead of it. Any successful trader would gladly give up the first ten percent of the next bull move to wait for confirmation to make sure, as Bernard Baruch used to say among others. The first level of key resistance is \$1620.

Once the current decline is over and the positions have been liquidated, market participants will be sitting on their piles of paper in fear and trembling of what comes next. And 'what comes next' is the key variable. Will it be a continuation of this pattern, or a repetition of a series of formations in complete recycle?

That is hard to see now, and what might pro-

★ ★ ★ JESSE / LINK

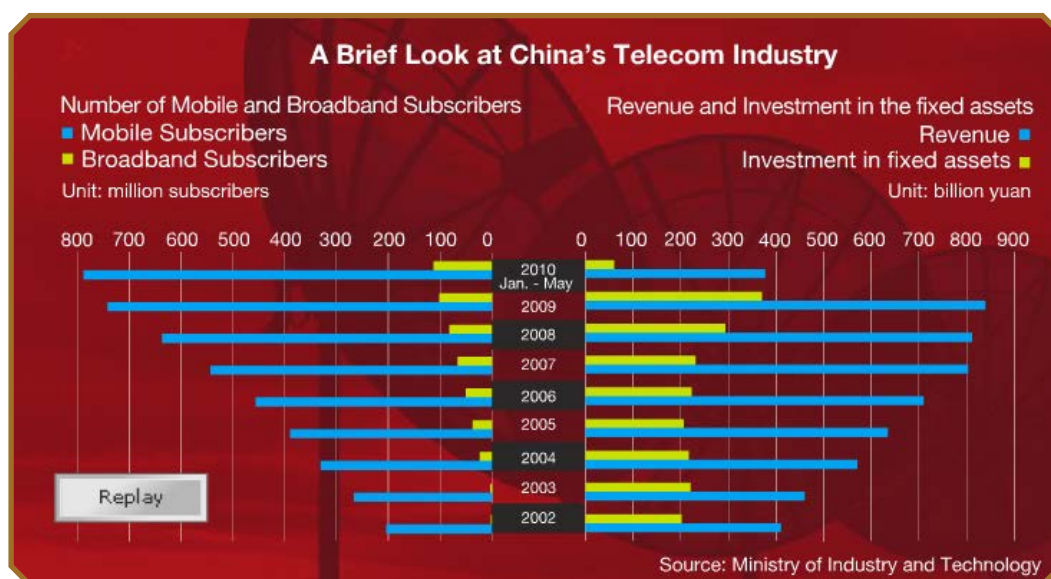
## CHARTS THAT MAKE YOU GO *Hmmm...*



[CLICK TO ENLARGE](#)

SOURCE: CALCULATED RISK

This chart needs no comment. Staggering.



[CLICK TO VIEW INTERACTIVE GRAPHIC](#)

SOURCE: CAIXIN

China has 1.1 billion telephone subscribers and 800 million mobile subscribers. Caixin takes a look inside the industry that is being eyed lasciviously by many multi-national telecommunications firms





**M**y friend, Mike Krieger, is one of the most astute observers of the passing parade that you'll find and this week, in a great podcast with the TF Metals report, Mike discusses his background as well as casting an eye over the recent madness and sharing his fears (and hopes) for America.

Mike is *always* worth listening to...

**A**nother of my favourite commentators is Bill Fleckenstein. 'Fleck' is always sanguine, never prone to hyperbole and always casts a reasoned eye over events. Today he discusses Europe, gold, money printing, MF Global's collapse and the stock market and offers some great insight into all of them.

Reading between the lines, I suspect that Fleck is no fan of Congress...



[CLICK TO LISTEN](#)



[CLICK TO LISTEN](#)

**A**rare treat this week as Egon von Greyerz of Matterhorn Asset Management talks about gold, hyperinflation and his recent piece of work 'Deus Ex Machina' (see page of this week's Things That Make You Go Hmmm.....).

A terrific interview...



*and finally...*

**A**<sup>h</sup> the joys of the Nativity play....

Merry Christmas everybody



[CLICK TO WATCH](#)

*Hmmm...*

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