PHILIPPE HERLIN

Economics detox chronicles

My weekly articles for the Goldbroker.com website from November 2012 to November 2014, from Obama's re-election to the mid-term elections

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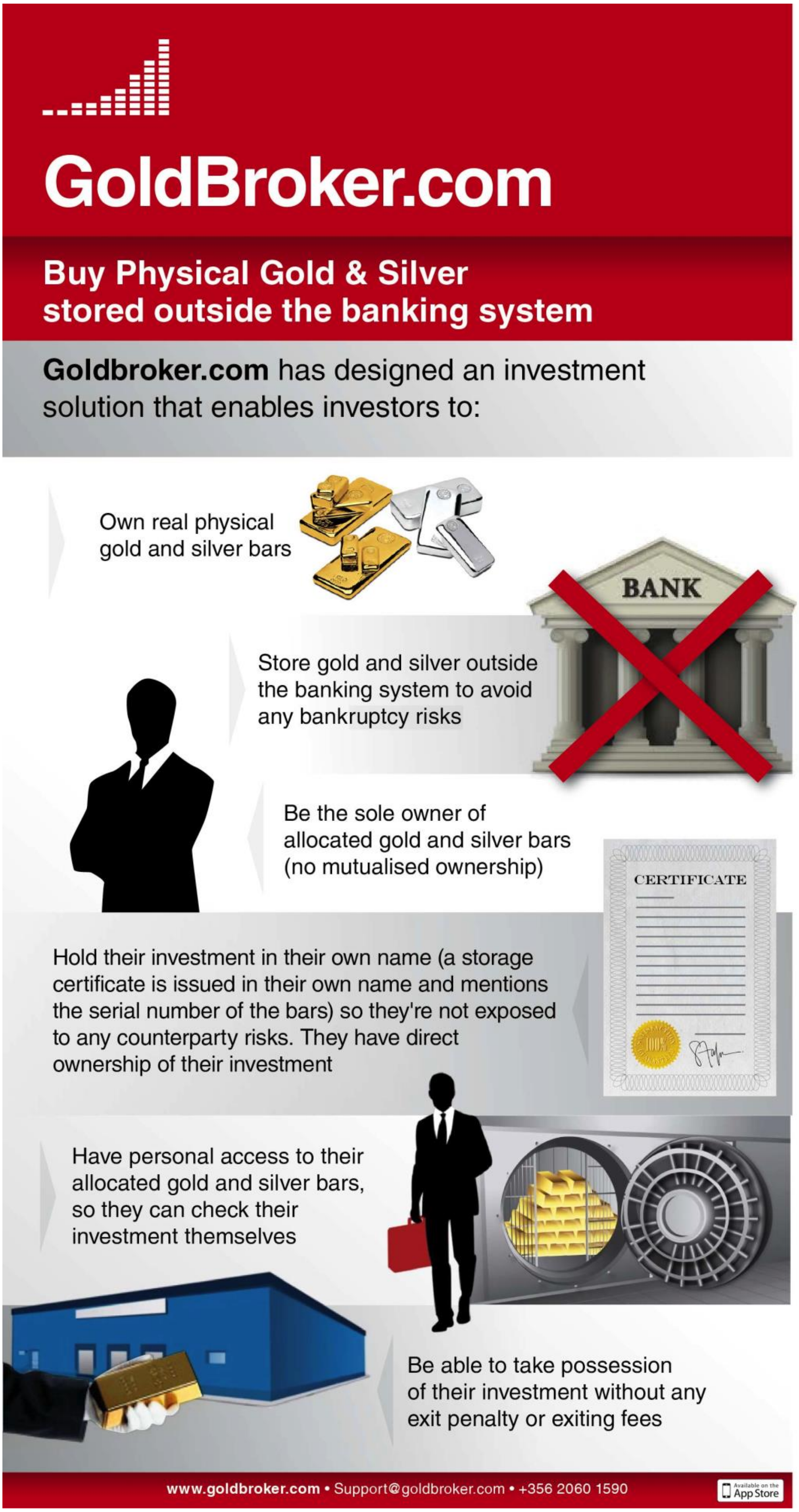
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SUMMARY
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Presentation

The goal of these economics detox chronicles is to propose another view and, first of all, counter the main discourse which permanently paints a rosy picture of the situation. No, the global economy has not recovered from the crisis that started in 2008; no, there is no recovery; no, central banks' interventions do not solve anything and they are, in fact, preparing the next crisis; no, the euro is not a solid currency; no, the bull market in stocks is not due to any improvement in the real economy. It is also important to underscore the risks for the savers, because they won't escape the next crisis unscathed. But these chronicles also aim to propose another read on the economy, a point of view that is still being neglected today although it's starting to recover some of its glow recently: the Austrian school of economics, of which the most prominent figures are Ludwig von Mises, Friedrich Hayek or Murray Rothbard. These advocates of the gold standard had it right because gold, more than ever, has a role to play in our monetary system and monetary expansion, along with interest rates manipulation by central banks, is bound to provoke very serious deficiencies, as has always been the case. Defending economic freedom against crony capitalism and questioning the all-meddling State, having faith in the markets rather than "regulations", that is their message and the message of these chronicles. Other approaches similarly shunned by academia include extreme risk analysis by Benoît Mandelbrot and Nassim Taleb. Those shunned schools of thought have the answers needed to exit this current crisis, the worst one since 1929. We are also in the midst of a crisis in the way we envision the economy, which is now essentially Keynesian and interventionist. This thinking prevails among today's economists, sadly, but they live in a bubble bound to burst one day.
Writing a weekly chronicle entails a healthy discipline forcing one to go further into details and try to captivate an always hurried reader already overloaded with information. This is an exciting challenge for which I would like to thank Fabrice Drouin Ristori, founder of Goldbroker.com, who has offered me this opportunity. I appreciate his trust and the total freedom I am given.

Ben Bernanke re-elected !

Nov 8, 2012

During his campaign, Mitt Romney had stated that, should he win, he would get rid of the FED's Chairman, Ben Bernanke. That strong statement means he was going to address the U.S. economic problems the right way, by slowing and then stopping the FED's debt buy-back program, which is what makes the budget deficit seem painless. Case in point, why worry about balancing public accounts if the FED keeps buying most of the State bonds that finance this deficit ?
Bernanke stands behind this policy of monetizing the public debt, while waiting for an hypothetical growth rally, and does not seem to understand that this huge flow of money, combined with very low interest rates, actually hampers productive investments while, on the contrary, it fosters speculative bubbles on commodities and keeps the stock market artificially going well. Quantitative easing is, in fact, a failure. It only buys time. All those debt buy-backs are realized through newly printed money, which may lead in time to inflation risks. The wake-up call will then be more painful but, hey, the election is over and we'll see what happens later !

Sadly, this easy money policy will continue with Barack Obama. Nevertheless, we know that, starting January 1st 2013, if no deficit reduction agreement is reached until then between the President and the Congress, we will see automatic cuts in spending and the end of the Bush fiscal exemptions : this is what is called the « fiscal cliff ». This drastic accord, negociated in August 2011 at a time the U.S. debt ceiling had to be raised, would bring about a reduction of the budgetary deficit but, on Obama's team, there is talk of reviewing it...

In any case, there will be much friction between the Democrat President and the mostly Republican Congress and that won't help in bringing down the deficit. The printing presses are going to roll for a long time ! The « Japanization » of the USA is happening, with the vicious circle of deficit – debts – monetization – stagnation taking roots progressively, as seen in the numbers.

All this money printing contributes to the devaluation of the dollar, and Mario Draghi's BCE is traveling the same road in Europe. So, of course, all of this is fundamentally bullish for gold. Its price should continue to rise, and it will probably be one of the very few assets that will be able to protect our savings in the years to come. Should we rejoice ? Well, a solid economic growth and a steady price for gold would be preferable to a period of major uncertainty and a bloated monetary/financial system that could explose at any moment... But the choice has been made and, sadly, monetary manipulation will continue.

Japan has now entered its ninth QE... this is a record ! In the four years to come, will Ben Bernanke beat this record ? Well, he just got another mandate, so he's on his way...

France Loses its AAA Rating !

Nov 22, 2012

So Moody's has decided on Monday night to downgrade France's AAA rating. This comes as no surprise, since the agency had already announced that the rating was under surveillance. It is following in the footsteps of Standard & Poor's, almost a year later, which had downgraded France's rating in January 2012. Fitch remains the sole agency with a rating of AAA for France's bonds. As long as two of the three agencies were still rating France worthy of the highest rating, France was de facto considered AAA by the investors. But from now on, this is no more the case. The downgrade from the highest level is real, and it will certainly mean the end of these interest rates.

There are already a number of regular clients who will stop buying France's bonds, in particular those who, by statutory obligations, can only acquire financial assets that have the best possible ratings. In essence, those are the pension funds, because they have to provide retirement on the long term and are not allowed to take on any risk. Also, banks owning France's bonds in their accounts didn't have, up to now, to hedge them because they were considered 100% safe. But it is not the case anymore : the bonds being now considered a little more risky, banks have to put aside some liquidities to cover that risk, in conformity with the Basel II, and soon Basel III, rules. And freezing cash always represents costs, so France's debt will be less appealing.
There is another element we have to take into account : the european help funds are noted AAA because they are, to a great extent, guaranteed by Germany and France. France's downgrade is likely to affect those funds, meaning that the whole buidup of bailout plans for the endebted countries will become more fragile and costlier. The FESF, actually, just cancelled an issuing of funds.

Beyond these mechanical effects, global worries will grow. Just one week after The Economist published a special piece on France, a time Bomb at the Heart of Europe, Moody's downgrade acts as a severe confirmation. A core country of the Eurozone, between the virtuous North, close to a balanced budget, and the lazy or laxist South, France is looking less and less like the former and more and more like the latter.

A French debt crisis would jeopardize all of the Eurozone. And we arrive at this conclusion for a very simple reason : all of the governments are just showing themselves incapable of really tackling the problems, making structural reforms and reducing public spending. By patching things here and there with budget tricks, they were able to maintain the illusion, but now it's over. Up to now, the slide down was a progressive one... it should be accelerating now.

Is Dexia a Foretelling Catastrophy?

Nov 29, 2012

Bad news keep piling up in the Dexia affair... We already knew the existence of « bad banking » of close to 100Billion euros, with heavy potential losses, that won't be liquidated before... 2099.
But this impressive amount is already understated. The bank's board of directors just published a document asking the shareholders (the governments of France, Belgium and Luxembourg) to subscribe to an increase in capital of 5.5Billion euros, next December 21 (L'Express.be). The bank explains that, without this fresh money, it would default on the totality of its debt, 386.5Billion euros, and on its derivatives portfolio, 605Billion euros, a shocking « hole » of almost a Trillion euros ! « Such a bankruptcy would jeopardize the whole european financial system », says the document. Now, that's an understatement, because this amount is greater than Greece's !

Is this risk being taken into account by the regulation agencies ? No, on the contrary, the G20-mandated Financial Stability Council, just took Dexia off the systemic banks list ! This is pure folly. Of course, derivatives are accounted for outside the regular books, so they are not subjected to the normal prudent norms, and the bank is backed by States, so everything is honky-dory, right ?
This tells us a lot about the state of affairs of the european and american banks. Most of them show positive results, but they're sitting on dynamite kegs. How many banks are close to Dexia's situation, or would be quickly close to it, should another financial crisis happen ? The only reason Dexia is making public its derivatives exposure is because it is

about to fail. The other banks, of course, are just as much exposed as Dexia, but we'll only find out just before they default. And let's not hold our breath waiting for the regulators to enlighten us.

Dexia's is not an isolated case; it is just in a worst situation than the average. How many spanish banks (which just got 37Billion euros from Europe) or greek banks are in as bad a situation ? The large american banks, like JP Morgan or Goldman Sachs, have books with gigantic notional value in derivatives... Maybe Dexia is only the precursor of things to come...

Eurozone's Fragile Structure

Dec 13, 2012

We won't be cruel by reminding you that François Hollande, recently, and his predecessor Nicolas Sarkozy, last spring, had declared the Eurozone crisis « over »... All the different bailout plans are only fragile undertakings, and the smallest shock can bring them down, as we know and are witnessing right now.

Greece, again and always, isn't out of the woods. Last week, it secured yet another plan, for 84 billion euros (40B for a debt haircut and 44B of fresh money). Everyone knows this plan won't be the last, and that a massive restructuration is needed. And as for Spain, banks received 37 billion euros, and it's only the first tranche!

We had almost forgotten Ireland and Portugal, but we shouldn't have. Ireland central bank's governor just announced that « it may need considerably more time to repay » the 85 billion euros Ireland has received as part of its bailout plan. In Portugal, the newspapers are writing that the country will ask for the same conditions that Greece got, meaning debt haircuts and more money.

But the big scare of the week comes from Italy. Two events are changing things : Silvio Berlusconi announced his political return, and Mario Monti resigned. There will be anticipated elections in February or March, and this will bring some uncertainty for a while. All the patient work Mario Monti has done with structural reforms might be for naught, and the markets are weary of Italy.

The euro crisis is far from over. We are only witnessing periods of relief that are bought with more bailout plans, which only adds to the mountain of debt and to the instability of the system.

The economic reason has faltered a long time ago; it has been replaced by the political agenda. As the French elections were nearing, it was paramount to avoid a grave Eurozone crisis. Now, the horizon is fixed on the general elections in Germany in September 2013. The institutions of the Eurozone will do everything in their power to avoid a crisis, including showering all the above-mentioned countries with billions of euros. The ECB will oil the machine, and Angela Merkel will be able to say that the euro crisis is over or, as the prudent German she is, that it's about to be solved. And we'll see after the election!

The Fed's Policy is Contradictory and Inefficient

Dec 20, 2012

The Fed has decided, last week, to extend its quantitative easing (QE) policy. After « Operation Twist », which consisted in selling short-term bonds in order to buy long-term bonds, and thus drive the latter down rate-wise, the US central bank is back with pure monetary creation, and to quite an extent : up to $85B a month, i.e. $45B of Treasury bonds and $40B of mortgage-backed securities (MBS). The goal, clearly, is to help the State finance its abyssal deficit and to help a banking sector still knee-deep in the housing crisis. At the same time, the Fed has restated that the base interest rate would remain at the lowest possible.

What is most notable is that the Federal Open Market Committee (FOMC) has stated that this policy would be maintained « for at least as long as it takes to bring the unemployment rate below 6.5% ». Now, what does unemployment have to do with it ? Is the Fed trying to take over the role of the Labour Department ? A little bit of history might help to understand this statement.

In 1978, the United States is in full crisis, unemployment shoots up and Jimmy Carter is thinking about his re-election. What can he do to show his electorate he's taking charge ? It will be the Humphrey-Hawkins Full Employment Act, redefining the Fed's mandate, which now was to contain inflation while aiming for full employment. A government can act towards unemployment because it has the necessary tools and levers (regulation or lack thereof, lowering taxes etc.), including a central bank ! All said central bank can do is to be less and less rigorous in its fiscal policy to achieve this goal. Thus, this decision is a purely demagogic and Keynesian one (they go well together). What president would dare abrogate it ? None so far.

The only Fed president who dared to go against this was Paul Volker, in 1979, who raised the base interest rate to close to 20% to kill inflation, which provoked a short crisis but then ensured the necessary bases for the growth of the 80-90's and a lower unemployment rate. But since then, everytime a storm is brewing (the 2000 dot.com bubble, the crisis since 2008), the Fed's presidents, Alan Greenspan and now Ben Bernanke, throw all rigor out of the window and go ahead with a maximum of monetary easing, under the pretext of not worsening the crisis and keeping unemployment under control. However, this policy has only produced fictitious growth (2000-2007) or no growth at all (since 2008). But this policy produces also... a lot of money, in increasing amounts, which goes totally against the role a central bank should play.

This stupid law and its application just show how much we are living in a confused intellectual state. It also gives the Fed president an all-too-powerful feeling... very dangerous ! And the real laws of economics, not the ones voted by demagogic politicians, but those taught by history, show us that printing paper money in excess always leads to hyperinflation... and to massive unemployment. By chasing too many contradictory objectives, we miss them all.

Our Whole Economy Is a Ponzi Scheme !

Jan 3, 2013

The Boston Consulting Group (BCG), one of the world's most prestigious consulting firms, is making waves by stating something that only a few marginal analysts, generally from the Austrian school, are saying : all developed economies have become giant Ponzi schemes (read the essay). The fraud consists in paying interests to the investors with funds provided by newcomers, which can only lead to bankruptcy, as shown by the Madoff affair, last example to date.

In the same way, developed countries have borrowed tomorrow's riches to finance today's consumption. According to the Bank for International Settlements (BIS), the total debt of governments, households and companies in the OCDE countries has grown from 160% of GDP in 1980 to 321% in 2010. And most of this debt has been used for financing consumption (bureaucrats' salaries, household spending) rather than for infrastructure or investment. Most countries being in deficit, a part of their debt goes to... servicing older debt, which is the definition of a Ponzi scheme. On top of that, those countries are guaranteeing « entitlements » (retirement, health care) that are far from being funded.

In order to avoid this progressive stranglehold we would need some growth to pick up, but the public sector, being too heavy, hinders it. Rather, we are facing stagnation.

The BCG proposes some solutions to avoid this ruin, some that make sense (make the State more efficient, review untenable promises, invest in education and infrastructures), but a fundamental aspect is neglected in their diagnosis and their answers : the monetary situation.

Because, of course, none of this could have happened without this August 15, 1971, event, when the dollar, and thus the international monetary system, was disconnected from gold. Freed from this hindrance, these countries could let their public finances loose. Credit, now only based on promises instead of on real value, has ballooned. Money, which was based on gold, is now based on debt.
The answer to our actual crisis goes through a return to « sound » money. Not necessarily a gold standard, which would be too brutal, but at least we should let gold circulate as real money alongside the fiat currencies. Generally, we should favor any complimentary monies or currencies.

Let's demand that the interest rates be fixed by the market, not by the central banks, and that these central banks stop buying public and private debt. One might say that this is wishful thinking... but 'tis the time of year, so let's go for it ! And a happy new year 2013 !

Bye, bye, Basel III !

Jan 10, 2013

Incredibly, banks' wishes have come true in the very first week of 2013 ! Should we rejoice ? Well, not really, because one of the main dispositions of Basel III, where prudential norms of the world banking sector are being discussed, has been emptied of its substance.

The crisis of 2008 has shown that solvent banks that are short of cash could go bankrupt. A financial crash can be lethal for a relatively healthy financial institution that is short of cash : Money doesn't move around, depositors empty their accounts and the bank doesn't have what it needs to simply keep operating. The idea was to force the banks to have enough to « last » 30 days without any access to the market, and have access to easily movable funds, even in an extreme situation.

The Liquid Coverage Ratio (LCR) was, from the start, to only take into account high quality and very liquid assets like ECB deposits or State Treasury bonds. The banks argued, and rightly so, that Treasury bonds, even the ones from large countries, did not constitute an absolute guarantee.
But, utmostly, all those frozen liquidities « just in case » didn't please the banks, because it represents a cost to them. So they threatened to restrict credit to businesses, which already are struggling, submerged as they are by all the newly imposed regulations... The result of this threat was that other assets would be accepted as guarantee, namely stock shares and, please don't laugh, credit-backed mortgage securities. And, to top it all, the date of implementation has been pushed to 2019 ! Needless to say, one of the

most needed dispositions of Basel III is dead.

But this attack on the LCR may be revealing something more profound. Because, actually, the banks, along with the regulators and the States in Basel, are probably saying to themselves that, should such a crisis arise, the central banks would open the flood gates of liquidities to avoid a severe cardiac arrest for the banking system (a little akin to the ECB's LTROs of Dec.'11 and Feb.'12 for a total of one trillion euros). In other words, let's not worry, let's be happy, central banks will come to the rescue if things go bad. Also, the ECB wishes to oversee the european banks, therefore it will be very well informed, maybe even before the banks themselves, so why worry ?

Thus, this international prudential regulation notion is failing because of the limitless extension of the power of the central banks. Those are no more simply the « lenders of last resort », but rather the ultimate backstop of the whole financial system. Well, actually, they think that they are... From now on, the banking and monetary systems are more inter-connected than ever, without any prudential norms and, finally, with no other tool than the printing press. By kicking the can down the road with this crisis, we're setting ourselves for a much bigger one.

The Fed's Phony Benefits

Jan 17, 2013

There is very significant news that has barely made the headlines : Last week, the Fed has paid $89 Billion in benefits to the U.S. Treasury. It is 18% more than last year's payment and it wipes out the $79 Billion 2010 record (Fed announcement).

By the way, in passing, the most profit-making entity in the USA is not Apple, Exxon or another company; no, it's the central bank, living proof that the economy is upside down !

Once again, this payment is quite normal. The Fed gives back to the State all of its benefits, less its Washington headquarters operating costs and dividends paid to the twelve regional federal banks.
What is less normal is the source of those benefits : interest paid by the State on the Treasury bonds owned by the Fed. The system goes around in circles : the Treasury issues bonds, the Fed buys most of them (through the printing press), then it pays interest on its bonds, the Fed cashes it and then pays back the Treasury ! To be more precise, part of the Fed's revenue also comes from bonds issued by Fannie Mae and Freddy Mac, also bailed out by the State... so it's still a closed-circuit operation.

In other words, this debt acquired through the Fed costs strictly nothing to the State. It's like borrowing at 0% interest. The total weight of the debt (interest paid to all debtors) was $251 Billion in 2011; so, that $89 Billion represents more than a third of the economy.
This is a very perverse mechanism because, as more of the public debt is acquired by the central bank, the less it weighs on the federal budget. It encourages taking on even more debt and have it financed by the central bank or, in other words, the printing press. And there's also another perverse effect : this massive buying by the Fed causes interest rates for all bonds to fall, not only those owned by the Fed but those owned by american and foreign investors as well. Finally, the debt of the State is costing it much less than it should.

This is nothing but a gigantic bubble that, barring a return to balanced budgets, can only lead to hyperinflation.

All discussions on budget deficit reduction have to be understood in light of this reality. In fact, it doesn't cost that much to finance the debt and the deficit if you include the Fed's payment... so why bother cutting expenses ?

Japan's Escape Ahead

Jan 24, 2013

Japan just crossed another hurdle in its escape ahead by monetization of its debt in what can be called a show of strength by the new Prime Minister, Shinzo Abe, against Japan's central bank.
The Bank of Japan (BoJ), for that matter, is the central bank having used the printing press the longest, precisely since the bursting of the stock market and the real estate bubbles of the early 1990's. The Fed, the ECB and the BoE only started using it with the 2008 crisis.
Since the bursting of this bubble, all the different japanese governments have instigated recovery plans, added to the budgetary deficits, and accumulated a public debt that is now the most important of the developed world (220% of GDP). And the BoJ is contributing by buying some of the State bonds to finance the debt.

What are the results of this onerous policy ? None, because there is no growth to speak of. Well, this is one more reason to continue and amplify this movement, says Shinto Abe, the new Prime Minister! The BoJ, after about ten « quantitative easing » plans, is not too willing to go ahead, hence the show of strength by Abe. The BoJ independence, guaranteed by its statutes, couldn't resist. It's a show of strength, consecrated by a « common declaration » about the objectives of the BoJ.

The new adversary has been designated : deflation. Prices only dropped by 0.2% in 2012, but that'll be enough. The target of 2% inflation is proudly written in the common declaration. Inflation is becoming a goal in itself ! And, for that goal, the BoJ will keep its base rate at 0% and will buy more and more State bonds, without any « temporal limits ».

So now the enemy is not the debt, the budgetary deficit, or a drastic reduction of the balance of payments... no, it's deflation, largely imaginary, that is used as a pretext for more monetization. Tragic.

Shinto Abe continues with a policy that doesn't work, with a recovery plan of 20,200 Billion yen (175B euros). Which will cause more budgetary deficits. Despite the different governments, Japan keeps going ahead and is going full steam toward a default or hyperinflation.

The SEC Going Against Freedom of Speech

Jan 31, 2013

The three principal rating agencies in the world, Standard & Poor's, Moody's and Fitch, are well known. But another one has garnered some attention recently... how ? By having more insight, or less fear, than the others. It has downgraded the United States one month before S & P, France before others, and Germany, the last AAA of this historic trio : we're talking about Egan Jones.
Newcomer's arrogance or publicity stunt ? Perhaps. Crime of lèse-majesté ? For sure. This is how one should understand what just happened to it. The punishment is quite

severe : the Securities and Exchange Commission (SEC) has forbidden Egan Jones to publish its rating notes on States for 18 months (SEC's announcement), a stupefying decision.

The Dodd-Franck rulings had called for the SEC to encourage the existence of more independent rating agencies in order to reinforce competition. Let's recall to that effect that the rating agencies had given a AAA rating to the subprime loans right up to when the market collapsed, so they bear a part of the responsibility in the crisis. The SEC is actually doing a u-turn here.

The reasons given by the SEC are grotesque. Egan Jones is accused of not following some rules of homologation, to avoid conflicts of interest; a bureaucrat found some badly filled form. But let's go to the root of the problem : Egan Jones does not charge the States for its services, it does so graciously, contrary to the three others. They are the ones swimming in a sea of conflicts of interest !

This decision, which is a first, reveals something much more dire. When the three top agencies were finger-pointed following the subprime crisis, they explained that their ratings were in fact opinions and, as such, protected by the first amendment of the American constitution guaranteeing freedom of speech. It seems that Egan Jones does not benefit from it.

Doesn't forbidding Egan Jones to publish its notes on sovereign debts equate to a limitation of its freedom of speech ? Will a bank or an analyst be punished the same way tomorrow ? Will they censor a TV station or a newspaper on this subject ?

The bread and butter of Egan Jones is its businesses ratings, but the impact of this decision in terms of image and visibility will be significant. And it will serve as a warning to any newcomer in this business. Crony capitalism, encompassing now regulating organisms such as the SEC, just went one step further by challenging a fundamental right.

Banking risks are far from over !

Feb 7, 2013

Ain't this bizarre... many large international banks, like Crédit Agricole, Commerzbank and UBS are announcing important losses for the last quarter of 2012. Monte dei Paschi, one of the largest Italian banks, is just about to default, and SNS Reaal, from Holland, has been nationalised precipitously. And we thought the crisis was over... truly amazing !

And each time, the bankers talk about « exceptional situations », hinting that it's only an unforeseen accident. Looking more closely at it, one can see that it's not the case, generally.

First, the consequences of the 2008 crisis are far from having disappeared, contrary to what the bankers are saying. SNS Reaal is failing because of the real estate crisis. Not because of the US subprimes, no, but because of Holland's real estate market : prices are quite high and households are quite endebted. But the bubble hasn't bursted yet; what will happen when it does ?

Monte dei Paschi is failing because of the CDSs. We thought that bankers had learned their lesson... well, I guess not. For that matter it can be noted that when banks are on the brink of failing, they then reveal their exposure to derivatives, as a way of saying

« Bail me out or I may cause everything to blow up ». Dexia did just that recently. We know that all the banks are exposed to derivatives, some of them potentially explosive in nature but, for the moment, they're managing... Don't you find this reassuring ?

Crédit Agricole is paying back its bad investments in Greece (Emporiki Bank) and seems close to being done, but all the banks that have branches in battered countries are exposed to significant losses.

More wrongdoing is coming out : Barclays is suspected of having loaned many billions of dollars to Qatar's sovereign fund so that it could have cash, to prevent back then from being partially nationalised, like many other British banks...

No, the 2008 crisis is far from having been resolved, and more risks are showing up.

There's the Libor scandal, that has already resulted in large fines (11 billion euros for the five large British banks), and it's not over, many cases still pending in court. As for Euribor, Société Générale has just been accused in Italy. We haven't heard the last of the manipulation of reference rates.
In England, another scandal is hitting the banks : Barclays, HSBC, Lloyds and RBS are being accused of having sold derivatives to small businesses, which is against regulations. According to some experts, the fines could reach between 1.5 and 10 billion sterling pounds. This will be in addition to the 12 billion pounds already slated to relieve the households that were victims of forced selling of Personal Payment Insurance (PPI), a form of borrower insurance.

Other things are coming out, some a bit darker, like the one about Spain's governing party and its head Mariano Rajoy having received illegal paybacks from banks during the real estate bubble. The same kind of accusation is coming out in Portugal with BPN bank.

Real estate, malinvestments, derivatives, all kinds of manipulation... the risks are still here. But what's worse is that the banks have not become more virtuous after the crisis of 2008. There is a « moral » component at work here : Banks and their bankers have not paid the price of the 2008 crisis... so why then would they change their way of doing?

Scoop : Ireland Restructuring its Debt !

Feb 14, 2013

European leaders, the ECB, the Commission, the heads of States had proclaimed it loud and clear : The Greek debt restructuration will remain an exception, the first and only of its kind; no other country shall benefit from such largesse. Their goal was to avoid contagion, because if every country experiencing difficulties were to ask for a debt restructuration (which entails a net loss for investors), the whole trust in the Eurozone would stand on shaky grounds.

Nevertheless, away from the cameras, without invoking a « last chance summit », another country just benefited from a restructuration, namely Ireland. Wondering why the mainstream media kept quiet about it ? Well, actually, that was the goal. True, things were made easier, because the ECB was the sole payer; no private investors, who would have been more vocal, were involved.

Ireland has benefited from 85 billion euros for the bailout of its banks in 2009. But, last December, the governor of Ireland's central bank had clearly let it be known that it could not meet requirements. He said, in an « all-or-nothing » tone, 'The reimbursement time span should be considerably expanded'.

So the European central bank (ECB) was stuck with accepting (on Feb. 7) an extension of the mean terms (from 7 to 34 years) and a lowering of the interest rates. Thus, the ECB is forfeiting 20 billion euros in interest rates over ten years... which is quite a gift, considering that, with Greece, it had forfeited 8 billion euros in interest rates. The first payment on the principal will be made in 2038, and the last one in 2053, which will leave ample time for more « discussions ». Well played, Dublin !

Since Ireland was planning to come back to the markets before the end of this year, it had to avoid any psycho-drama. Sure, the country has made some real efforts that are starting to pay off, exports are on the rise, the expected growth for 2013 is 1.3%, which is not so bad. But the real estate bubble crisis hasn't been solved yet, and delinquent mortgages are parked with the Bad Bank NAMA (National Asset Management Agency), funded by the State. There are still risks.

We understand the need to keep this accord out of the public eye in order to keep investors focused on European sovereign debts. But Portugal is already knocking at the ECB's door and asking why it could not benefit from the same arrangements that Greece and Ireland got. And Spain must be following with interest what its neighbor is doing... Well, it's not such a scoop anymore !

Alert : Gold in Backwardation Again !

Feb 21, 2013

What is backwardation ? With gold, or any commodity, the price of a future, or a term contract, is usually higher than the spot price. Because, to ensure delivery of a commodity in the future, one must borrow money to acquire it today and store it for an eventual delivery at a later date. This represents a cost which is reflected with a future price higher than the spot price.

That is in a normal situation. However, it sometimes happens that the spot price is temporarily higher than the future price : it may happen when strong demand is coupled with low supply. Supply can't cope with demand, and we get what is called backwardation (the opposite of backwardation is contango, which corresponds to a normal situation).
This phenomenon is understandable with a commodity, because stocks can become almost exhausted, but it's less understandable with gold, which is not a commodity. It is not destroyed or transformed when acquired, but simply stored.

The quantity of gold in the world never diminishes; it even increases regularly with mining extraction. Thus, normally, gold should never be in backwardation. One must understand that such a phenomenon is theoretically impossible, because all one has to do is sell one's gold for cash and buy it back through a future contract to pocket a profit without any risks. At a time when the market is monitored day and night by thousands of professional investors using more and more sophisticated tools, such an anomaly should only last but a few seconds, right ? But it has lasted several days, at times.

Only one thing can explain the backwardation in gold : loss of confidence. Potential buyers of futures reckon there is a significant risk that the contract might not be fulfilled, i.e. that the physical gold might not be delivered. Even if they could make a profit, they don't use arbitrage, and they hold on to their precious physical gold.

Backwardation lasts as long as the confidence crisis endures. And we're talking about confidence in the monetary system itself here ! So, if backwardation becomes permanent, then gold will not be for sale at any price. Those holding gold bars won't want to sell whatever the price, simply because they will not trust the paper money that will be offered in exchange for them (and this will certainly be the prelude to hyperinflation).

Historically, the gold market has always been in contango but, since the start of 2000, it has followed the interest rates movement and has continued its downward movement (the cost of money diminishes, so future delivery is less costly). Gold was in backwardation for several days the first time in December 2008, right after the Lehman Brothers bankruptcy, when there was tremendous pressure on the markets. And again in May 2012, when the Eurozone crisis expanded to Spain and Italy. And it’s happening at this very moment (Zero Hedge), which is a telling sign of major tensions, even though the prices are relatively stable now... but for how long ?

Anyway, this is a phenomenon worth keeping an eye on that confirms, once again, that gold is really the money of reference for the paper currencies.

European Banks Still Under Perfusion From the ECB

Feb 28, 2013

We have already explained that risks to the banking system in Europe remain elevated (read this article). There is another element to consider, one that shows the depth of the crisis : The interbank market is still not working, and the european banks are still under perfusion from the ECB!
In order to face this stalling in the interbank market and the risk of banks defaulting, the ECB had already made two giant loans, in December 2011 and February 2012, of a total amount of a trillion euros on three years at 1% yearly interest. Those were called Long Term Refinancing Operations, or LTROs. A real gift for over 500 european banks!

This giant money printing press brought about some real easing on the debt rates of Italy and Spain. And most political leaders and news editors had concluded that the crisis was over... But no, it was just suspended for awhile.

The banking sector and the European authorities say that the crisis is over. They show this confidence by pointing out that certain banks have started to pay these LTROs by anticipation. But let’s put things in perspective : Up to this moment, only 212 billion euros have been reimbursed, or one-fifth of the total amount, and the rythm of repayment is slowing down, which is worrisome. Citi’s analysts are unhappy about this slowing down and consider it could bring about some doubts on the perspectives of the banking systems of Europe.

Even though the ECB did not make public which banks got the loans and how much each got, we know that the southern countries (Spain, Italy, Portugal, Greece) profited largely from this manna from Heaven. But, alas, their situation is getting worse! The proportion of defaulting loans is dangerously rising, and the banks can only hide this for awhile, but not forever. We can be sure that the banks from those countries will not reimburse their LTROs ahead of time and, one wonders, will they reimburse at all on time? That is not even certain, and the ECB will probably have to do more quantitative easing... again.

Another thing to worry about : The situation, in Italy, is stalled after the last elections, with no clear majority as the outcome. And let’s not forget that more than half of the votes went to candidates who want to exit the euro (Silvio Berlusconi and Beppe Grillo)!

If only the healthy banks are able to reimburse LTROs ahead of time (for only 1/5 of the total), we should be worried about it. In any case, the european banking system remains entirely dependant on the ECB for its daily operations, and this is not good news.

QE and Inflation

Mar 7, 2013

A great amount of money is being created by the central banks, that we already know. The Fed, the Bank of Japan and the European central bank are monetizing quite a lot of public and private debt; in the case of the Fed, we're talking about $85 Billion a month, a sizable amount. Nevertheless, we're not witnessing, for now, any real increase in prices, even though we are paying more for food and energy, a fact more or less disguised in official statistics. But one thing is clear, we're not seeing a strong inflation.

The Austrian school economist might be put off balance, knowing that any excess money creation leads to higher prices. Sure, but first, higher prices start with commodities (asset inflation), and then they move on to the grocery cart, following a five-year pattern of 5% a year for food and energy.
But, foremost, one has to take into account another element : money velocity. The economist Irving Fisher (1867-1947) had put that into evidence. Because, if the amount of money in circulation rises, but it gets around at a slower rate, both effects nullify, and there is no impact on the prices. And, precisely, this velocity hasn't stopped slowing down since the 2008 crisis.

The slowdown in growth, as noted in the last few quarters in the U.S. and Europe, contributes to the diminishing money velocity. Central banks are printing like crazy but the money isn't moving around : lending hasn't picked up because the economic outlook is bleak, and we only see speculation on commodities, as we said, and on the stock market.

But should we feel satisfied that these two effects nullify themselves and are not bringing runaway inflation? Of course not, because this balance is fragile : money velocity is very sensitive to psychological factors.

Let's take the most common example, that of a wage earner. In general, he gets his paycheck every month, and he makes his groceries once a week. But if he realizes that the prices are going up within a month, his natural reflex will be to do all of his groceries at once, as soon as his paycheck will be available in his account. And, if millions of people start doing the same thing, then it is easily understood how money velocity explodes. That is the moment the country faces hyperinflation, because people are running to spend (get rid of) their money, it's an « escape from currencies », denominations are askew, and those who own stocks are waiting for prices to go up still a bit more... and scarcities and black markets proliferate... The result : the economy collapses, unemployment soars, and savers are ruined. A single black swan event or any irrational fear might trigger the shift from inflation to a price explosion and, once it starts, it's already too late.
What could trigger such a move? Hard to say. When will it happen? Impossible to predict. But, the more « sleeping » money there is, the more the monetary system becomes sensitive to any shock at all.

Cyprus : The Day After

Mar 21, 2013

In the history books, March 16, 2013 will be marked as the day where bank accounts in a Eurozone country started to be pilfered.

As always, prior to this, it was « unthinkable ». The European commission had harmonized deposit insurance guarantees throughout Europe to the 100,000 euros level, and the President of Cyprus had sworn that bank accounts would be left alone. And, as always, later, it becomes « unavoidable », absolutely necessary for saving the financial system. And, of course, it will be « exceptional », one time only, in Cyprus and nowhere else...

Never mind the confusion surrounding the plan, as it was at first targeting all bank accounts (6.75% under 100,000 euros, 9.9% above), and then exempting accounts under 20,000 euros, or the assurances given on the exceptional character of this measure; only fools will fall for that. Even if this taxation fails at the outcome – the Cyprus government opposed it on March 19 – it doesn't matter... the bell has tolled, and we have to hear it : from now on, bank accounts in weak countries are under threat of spoliation.

If we look back at History, this is not surprising at all, because State bankruptcies have always turned into their people being ruined. Only the modalities differ : bankruptcies, hyperinflation, spoliation, bank defaults... alone or together. But, since March 16, it has suddenly become concrete. However stupefying this announcement is, one must now realise that this risk is very real.

How can such a measure solve the problem? What will foreign depositors, attracted by tax advantages, do? They will surely try to avoid a second hold-up and leave. What will Cypriots who hold significant capital do? They will certainly try to protect it by taking it out of the country. And this capital fleeing the country will only hinder the situation of their banks hoping for a bailout from Europe and the IMF. And how will react those, residents or not, who hold large capital assets in Greece, in Italy, in Spain or in Portugal? This is only going to accelerate the kind of bank-run that we have been noticing for a few months.

But where to go? Germany, where the banking system is not so strong, and which has a lot to lose with a disintegration of the Eurozone (via Target2 credit, since Germany's commercial surplus is expressed by the credit extended to the importing countries' central banks)? England, with the printing press running full steam?

Risks are increasing everywhere and the situation is becoming more and more confusing. We need to get back to the fundamentals : ideally we need to get out of paper currencies and into gold, get out of the banking system to avoid all confiscation, and get out of the Eurozone toward a country that really respects ownership rights, like Switzerland.

Or else? We could always follow Francis' example, the new Pope, and become poor... we'd have much less complicated questions to ask!

Cyprus : Arbitrary Decisions and Confusion

Mar 28, 2013

So Cyprus has been bailed out, for the time being, but we must ask the question : Isn't the new plan worse than the first one? Given, of course, that both plans are nothing

short of theft of private and company savings by incompetent political leaders, it's like comparing pestilence with malaria.
The first plan entailed taxing all deposits (6.75% for accounts under 100,000 euros and 9.9% for accounts above). The chypriot government rejected it... because it was targeting all the voters. By not touching deposits under 100,000 euros, only the « rich » are targeted... and hit hard, because the new tax will have to be hiked to account for the loss.

Also, the first plan was calling for a single rate, whereas, for the second one, the rate varies according to the banks : 30% if you're with Bank of Cyprus, the main bank, and more, maybe even 100% if you're with Laiki Bank... we'll see when they liquidate it. Those two banks hold about 80% of bank accounts on the island. It's one thing having shareholders pay for losses, but depositors?! And, with rates that border on confiscation, many businesses won't be able to pay salaries or keep operating.

The russian banks' cypriot branches are not touched by this plan... thus a few of those « mean » tax-evading oligarchs will be spared! Since the troubles brewing at the two main banks had been known for awhile, a number of those had already left the country. Also, we've seen that the London branches of both main cypriot banks have stayed open as if nothing had happened, thus making massive withdrawals possible. Just another way for the oligarchs, and also the British, much present on the island, to avoid the tax.

We also learn in passing that the Banque du Pirée is taking over three greek branches of the Cyprus banks for 524million euros. Depositors at those banks will not be affected by the « tax » on the main banks. With the greek banks close to bankruptcy and under perfusion from the BCE, how can one of them shell out half a billion euros in cash? Are certain privileged clients being protected?
At the end, for deposits over 100,000 euros, the loss will be anywhere from 0% to 100%, depending on which bank you're with and if you've been tipped the right way or not... it's like an inverse lottery!

And then, those who will have been racketed will have but one idea in mind, leaving Cyprus for more hospitable countries (or invest in a foreign country for the residents). And a problem to come will be the strict capital controls that Cyprus is implementing to avoid another banking crisis. How long will they last? No one knows. We can also wonder if the euros from Cyprus will have the same value as those from the other member countries, since they will be closely monitored and will not be able to travel. Are we still talking about a « unique » currency?

When the banks reopen, we might realize that the local businesses will pay a hefty price, which will be catastrophic for the Island's economy. But what's most worrisome today is the contagion effect. How will those holding significant funds in Greece, in Spain, in Portugal, in Italy, in Ireland react? And the list is expanding (Slovenia the next one?).

And, throwing a bit of oil onto the fire, Jeroen Dijsselbloem, president of the Eurogroup, has declared that the restructuration in Cyprus was a « model »... and then retracted himself. Michel Barnier, commissionner of the Internal European Market, has indicated there could be a new european initiative calling for the contribution of bank deposits over 100,000 euros in case of bank bailouts. Therefore, we can be sure this method will be used again, of course.

Insured Deposits Under 100,000: a Myth

Apr 4, 2013

Today's news takes the place of yesterday's news and, already, there's less talk about Cyprus in the media. They would even have us believe the bulk of the crisis is behind us, since there hasn't been the expected bank run when these reopened. Well... that's only because the restrictions have been maintained! There's no need to run to your bank if withdrawals are limited to 300 euros per person per day! The bank run will come sooner or later because, of course, many investors are looking to leave the island for good.

In Cyprus, confusion is growing, and there is talk of a 60% tax on bank accounts exceding 100,000 euros! Actually, no one knows, and we have to wait. The central bank has indicated that the final decision would be made « in no more than 90 days after the end of the evaluation »... And whatever amount is left won't be available to the account holder, but rather put in a frozen account for six months to prevent any withdrawal. But we can't know for sure, because many local businesses could not survive such conditions.

Meanwhile, we learn that many well-informed Cypriots took their money out in the days preceding the crisis (the President has promised an exemplary investigation, so we can rest assured...), and that clients of the british branch of cypriot bank Laïki, whose accounts were transferred to its competitor, Bank of Cyprus, will not be touched. We know that the Russians are all tax evaders... and that the British are all honest, retired people, of course.

But there's a myth the european authorities and the media have instilled into the minds of Europeans that we have to deal with : deposit insurance for deposits under 100,000 euros. As a matter of fact, in Cyprus, those won't be touched, but only because Europe and the IMF brought in 10 billion euros! The island's needs amounting to 17 billion, 7 billion had to be provided, thus this tax on the « big » accounts. But, if it hadn't been for that 10 billion euros coming in, all accounts would have been in jeopardy.

If such a banking crisis were to happen, say, in Spain, it would not call for 10 billion euros of bailout money, but for hundreds of billion euros... in other words, impossible. Eurogroup's president, Jeroen Dijsselbloem, boasted of Cyprus's re-structuration as being a « model ». The « model », in reality, is the financing of banking losses by the depositors, not insurance for deposits under 100,000 euros! Let's recall that, in the first version of the plan, those deposits were taxed (by 6.75%).

For any account holder, believing in this 100,000 euros number and feeling out of harm's way may prove to be a fatal mistake.

Is Christine Lagarde Really Speaking For the IMF?

Apr 11, 2013

We have already talked about Japan's escape ahead through the use of the money printing press, notably since the new Prime Minister, Shinzo Abe, named a new director for the central bank and forced the institution to do even more monetizing. Japan has stubbornly stuck to this policy since the crisis of the '90s, albeit with no tangible result, because growth is not picking up. But, on the other hand, public debt has grown to unheard-of levels until now : 230% of GDP! But, no matter, let's continue... faster.

But the Prime Minister just received some strong support, quite unexpectedly, from Christine Lagarde, head of the IMF. Last Sunday, she « saluted the restructuration of Japan's monetary policy, which constitutes a welcome support to world growth », according to Marketwatch. At a conference in South China, she declared « Monetary policies, including non-conventional measures, have contributed to support the advanced economies and, thus, world growth ». Bank of Japan has announced last week its intention of injecting the equivalent of 1,400 billions of dollars of liquidities in Japan's financial system within two years (BoJ's balance sheet should reach 60% of GDP at the end of 2014, compared to 30% at the end of 2012!). And this, according to Christine Lagarde, is good for growth?

Are we dreaming? The IMF has always been a proponent of balanced public budgets at all costs. It has always played the role of the « bad guy » coming to the rescue of a country as a last recourse, while demanding a drastic austerity plan, especially in public spending. One need only recall the riots in many countries against this international institution accused of empoverishing the people. Obviously, this reputation was too much for it to bear and, from now on, the IMF will follow the trendy ideas. The very ideas that are driving us toward bankruptcy.

True, on the short term, such a policy might give the impression that it's working. In the last four months, the yen has dropped 20% to the dollar, while the Nikkei gained 40%, anticipating a recovery in exportations. But, what will really happen? It's not as simple as devaluating one's money to generate a surplus! But, on the other hand, this currency war coaxes other countries into more monetizing, to avoid any appreciation of their currency...

The IMF has its reputation at heart and wants to stay in good terms with the great developed countries. It hadn't approved openly the use of the printing press in the past, but now it's doing it, and with the country that has most abused it! She will now be treated like a rock star in the world's greatest capitals and, thus, benefit from an excellent image in the media. Hmm... but wait, the French media is talking more and more about Christine Lagarde as a potential candidate in the 2017 presidential election. We heard that she has just put together an 80 person committee in Paris for that reason (an association called « La Grande Dame », for real!). But there's nothing to see there, of course...

Depositors Not Protected Anymore in Europe

Apr 18, 2013

As time goes on, we must bring ourselves to the evidence : Cyprus did serve as a general rehearsal for the experimentation of a plan that will be reproduced elsewhere. Eurogroup President Jeroen Dijsselbloem's declaration about Cyprus being a « template », followed by a retractation, is actually a true one.

The European Commission, more specifically Michel Barnier, the commissioner in charge of banks, is preparing a proposition to include deposits over 100,000 euros in bank bailouts. This is a laudable intention, since it keeps taxpayers from contributing, but might this argument only be a pretext?
With this proposition, in case of a bank failure, the losses will first be incurred by the owners and shareholders, followed by « junior » and « senior » debtors and, lastly, depositors over 100,000 euros. Only if the whole of these contributions were insufficient would public money be used, through the European bailout fund, the MES.

Well, that's the theory, but what of it, really? When a bank shows bad results, it means that shareholders have already been hit! Large European banks have already lost around 90% of their stock value since the crisis (for example, Société Générale's stock was 170 euros in 2006, and is now 25 euros), so not much is left there. And the debtors are gone.

The only real wealth remaining is in the bank accounts. So let’s not delude ourselves : they will bear the grunt of the needed money.
But are bank accounts under 100,000 euros really safe? Surely not! We have to understand that the only reason those smaller accounts in Cyprus have been left unscathed is that Europe and the IMF have agreed to bring in 10 Billion euros. If the crisis were to hit a large country like Spain, Italy or France, way more than 10 Billion euros would be needed, probably hundreds of Billions of euros. Who can believe such a feast would be accomplished? Who can believe that Germany would have its debt explode to save the bank accounts of the Spanish, Italian or French people?

Furthermore, those who were holding more than 100,000 euros are busy emptying their accounts and spreading them over smaller ones, so the number of such accounts will dwindle like snow under the sun. Also, this directive will bring about a bank run at the first serious signs of crisis.

By refusing to go against the great banking oligopolies and the opacity of their operations, against this « too big to fail » logic that encourages irresponsability, the European Union is avoiding troubling questions. This proposition is actually an admission of lack of power, and the depositors will pay for it.

Is the Euro a Monster With Multiple Heads?

Apr 25, 2013

The euro is a really bizarre currency. For the first time ever in the history of money is ONE currency being managed by MANY central banks! Because when the European central bank (ECB) was created, it did not cause the national central banks to disappear or to be transformed in regional branches, it was rather superimposed on them. The group is now called the European Central Banks System (ECBS). In fact, the national central banks of the Eurozone are the shareholders in the ECB. The ECB is, of course, in charge of the monetary policy, but each central bank is autonomous to a certain point.

The ECB can come directly to the rescue of ailing european banks, as we’ve seen, for example, with two gigantic loans of 500Billion euros each (LTRO’s) in December 2011 and February 2012. But these central banks can come to the rescue of their own banks in their respective countries, using their own criteria... And if a central bank re-finances a commercial bank by accepting worthless assets as collateral, it’s like printing money! And this is done with the blessing of the ECB, but it’s nevertheless worrisome.

This autonomy of the national central banks is no more under the radar and is starting to cause some problems. For a few weeks, the German media has been accusing the Banque de France of unduly propping up French banks, with the tacit accord of Mario Draghi. A re-financing tool called STEP (Short Term European Paper) amounts to 445Billion euros for the whole of Europe, but half of it has to do with France! According to the Deutsche Wirtschafts Nachrichten, « There is, in France, under the radar, a gigantic financial bubble in the making ». According to the French paper La Tribune, « We know that the ECB had mentioned, without ever revealing its name, that a large French bank was on the verge of bankruptcy due to its over-exposure to risks ».

And, mind you, we’re only talking about France, here. Who knows what’s really going on in the back rooms of the national banks in Greece, Portugal, Spain, Italy and so on? And even in Germany, where they are quite reluctant to the banking supervision planned by the ECB? Whether it be re-financing, risk control or compliance with the law, each central bank does things its own way, with its little arrangements and secrets. These constitute as many time-bombs that are growing larger as the banking crisis worsens.

By wanting to respect each country's whims and maintaining the fiction of « national » central banks despite the creation of a unique currency, the euro promoters have created an explosive internal systemic risk.

Deutschebank : The Bank With the Most Derivatives Exposure In the World

May 2, 2013

This is the small news that stayed under the radar this week, but we have to get back to it : The bank with the most exposure to derivatives is not JP Morgan, as we thought, but Deutschebank. As indicated in its 2012 annual report, the bank is exposed to, hang on to your seat : 55,605,039,000,000 euros or, if you prefer, 55,605 Billion euros, or 55.6 Trillion euros... wow!
By way of comparison, Germany's GDP in 2012 was 2,644 Billion euros, which means that the country's first bank's exposure to derivatives is twenty times higher than all the wealth created by the European economic powerhouse in a year. Converted into dollars, the exposure amounts to $72.8 Trillion, a little more than JP Morgan. Europe holds the record, due to the most solid country's best bank... congratulations!

But, according to the German bank's accountants, we should not worry, because all of those engagements are compensated for and, at the end, net exposure is only 20.3 Billion euros. This is what large bank managers always say when the subject is brought up : positions are balanced; when a bank takes a position on a derivative, it also buys some protection (the inverse position) to hedge itself.

But... who does it buy this protection from? Well, from another bank, of course. The reality is that all the large banks are selling one another derivatives, which means that if one of them goes bankrupt, the rest of them will plunge with it! The protection bought from a defaulted bank vanishes and other banks just watch their net exposure explode and then go bankrupt as well. This is what almost happened in 2008 with the failure of AIG, which was counterparty to several financial institutions, which was bailed out at the last minute by theUS government. So the calculation of net exposure is purely theoretical. Deposits at Deutschebank are only 1/100th of those 55.6 Trillion euros in derivatives. Cyprus pales in comparison.

All the large banks are trying to keep their balance atop a mountain of derivatives, and we know that derivatives become very risky in times of crises. But hey, here is one positive point in this whole thing : Deutschebank's headquarters are located in Frankfurt, just like the ECB's, so Mario Draghi will only have to walk a few blocks should a problem arise!

Interest Rates Manipulated to Hide Risks

May 9, 2013

After the LIBOR scandal, are we witnessing the ISDAfix scandal? This time it's not about interbank lending rates, but rather about interest rates for swaps. It is estimated that the ISDAfix is active in a $380,000Billion market, just about the same size as LIBOR... and it appears that it, too, is manipulated! The Commodity Futures Trading Commission (CFTC) is enquiring on the matter.
Whether it's LIBOR or ISDAfix, rates are fixed in the same fashion : a few banks, the largest ones, decide among themselves of a rate and it applies for everyone! These banks

thus have an undeniable advantage, a step forward of the market, the possibility of colluding or hiding their difficulties by underestimating the numbers.

However, let's not forget that the greatest interest rates manipulators are the central banks! With their « monetary policies », they always fix the lending rates at the lowest, supposedly to bolster the economy and to encourage credit. We've all seen the results... it doesn't work. If central banks were to abstain from any intervention, interest rates would be much higher.

In any case, these rates do not reflect the reality of the market, the real state of the economy and the financial sector. The « cost of time », or the cost of capital, should constitute a fundamental variable for all the actors in the economy, but their decisions are affected by this bias.

Another thing disappearing with the manipulated rates is the risk premium. The central banker must not acknowledge that his country has trouble financing its budgetary deficit or that its banking system is failing. The trader must not acknowledge that his bank has difficulties refinancing itself, so he will declare a lower interbanking rate than the real one, thus contributing to a lower LIBOR than what it should be.

But, of course, eliminating the risk premium doesn't make the risk itself vanish magically. It just gets spread somewhere else (in the central bank's balance sheet, in the bond bubble and God knows where else). It speads without being clearly identified, as borrowers and investors believe it has disappeared. This is a tragic misunderstanding that leads to bubbles and, later, to a more serious crisis.

This manipulation of the rates goes hand in hand with the money printing : both serve to hide the reality, to make us think everything is hunky-dory, to give optimism to the planners, to foster a bullish stock market, in the hope that, finally, growth comes back. But lying lasts only for so long before the next crisis hits, more and more violently.

Bubbles Everywhere?

May 16, 2013

Are we witnessing the emergence of bubbles everywhere, or isn't the whole thing becoming a gigantic bubble? All financial assets are going up at the same time, whether it be stocks, sovereign debts, or corporate bonds! And the issuers that are considered low-risk ones, like the USA or Germany for bonds, or blue chip companies, offer very low yields, even negative ones. This results in investors looking for yield on riskier products, which makes said products more costly and yielding less.

We thus see a rush toward high-risk corporate bonds or products that remind us of the sub-prime era, like CLOs (Collateralized Loan Obligations). The risk premiums are getting flatter everywhere but, globally, the systemic risks are on the rise...

In normal times there is a natural arbitrage between assets, as « risk-free » State bonds get out of favor and people invest in stocks, but it isn't happening now. True, central banks, notably in the USA and Japan, are acquiring a major part of their respective country's debts, but that doesn't explain everything.

Developed countries as well as emerging ones are benefiting from this general hike. Commodities, even if their course has been erratic, have benefited as well. Oh, yeah... there is one asset going down a bit these days, gold. Gold hasn't joined the party. Is that good or bad?

Let’s go back a little... All this rise all over the board in financial assets is happening in a zero-growth (Europe), weak-growth (USA), or slowing-growth (China) environment. In other words, it is not tenable on the long term. This rise is happening on the hope of a recovery, which was particularly well « sold » in the USA, but which is not materializing. Consequently, sooner or later, there will be a more or less brutal « landing ». At that point, many will be crying, but not those who own gold.

When will this happen? Hard to say, of course, but up to now central banks have been explaining that they were in control of the situation and that they would not hesitate using all available tools in case of dangerous imbalances. However they, or at least Ben Bernake, now seem to be a little worried about it. Last Friday he stated : "In light of the current low interest rate environment, we are watching particularly closely for instances of ‘reaching for yield’ and other forms of excessive risk-taking, which may affect asset prices and their relationships with fundamentals". If the head of the Fed is starting to be worried about bubbles, one should be really scared!

The New Great Wall of China : Gold

May 23, 2013

When the crisis hit in 2008, China’s reaction was very communist-like : instead of turning to money printing in the hope that credit and investment would pick up (which is still the dream of Western central banks), both the central power and the regional ones have launched gigantic infrastructure plans while forcing banks to lend them money. Credit, as a result, has effectively picked up : orders from Beijing! While credit was going down in Europe and the United States, China’s total credit went from 100% of GDP in 2008 to 125% of GDP in 2010. Large infrastructure works have been started in China and growth has maintained its rythm in 2009 and 2010.

Of course, the problem with this kind of socialist policy is investing without any return on investment. Whole suburbs and cities are empty, the high-speed train network is oversized etc. At the end, all of that affects growth, which is far from the 10% it used to be, while generating unrecoverable debts, thus fragilizing the whole financial system. A dangerous situation.
In the end, China is ending up with almost the same problems as those who have chosen to print but, at least, it’s left with a fine network of high-speed trains instead of a stock market bubble. We know the railroads will remain, but what about Wall Street’s records?

But, furthermost, the Chinese were smart enough not to bet everything on monetary and banking policies. While all of this is happening, China is buying important quantities of gold. China’s central bank is buying gold, and citizens are encouraged to do the same. Official numbers are not available, they remain State secrets, but it can be estimated that, between their internal production (400 tonnes) and imports (800 tonnes), China holds around 4,000 tonnes of gold (one of the highest holdings in the world), and maybe much more. In 2009, a group of bureaucrats and economists got together to discuss necessary measures to increase the country’s gold reserves, and they suggested that they should reach 6,000 tonnes within three to five years, and maybe 10,000 tonnes within eight to ten years.

A little known fact is that the world’s oldest paper money was created in China by Gengis Khan’s grand-son, Kubilai Khan (1215-1294), whom Marco Polo, incidentally, met during his voyages. That first experience ended in bankruptcy, just as John Law’s would in France, many centuries later. China did experience other monetary bankruptcies in its history, notably in the 20th century (when the Communists took power), so it knows about it (as does Germany, by the way).

In any case, China knows it has created a credit bubble. But its effects are subsiding and, contrary to the Western governments who keep printing and printing, China has put in place an emergency strategy that is the exact opposite of the actual bubble-creating policies. All bubbles can explode, in China and elsewhere, and of course the economy will suffer, but Beijing will be able to hang on to the ultimate asset, the one asset that is unalterable and trusted worldwide. Not too many will be in the same situation...

Japan : Advance Warning of the Coming Crisis

May 30, 2013

Nikkei's 7% plunge, last Thursday, and the way it happened, gives us a glimpse into how the next crisis will play. As we know, any market crash is always preceded by warning signs : the subprime crisis exploded on September 15, 2008, with the Lehman Brothers bankruptcy, but there had been warning signs as early as the 2007 spring (New Century Financial's bankruptcy and many mortgage houses going under).

Japan is ahead of Europe and the US because it has been in crisis for a longer period (the bursting of the stock market and real estate bubbles dates back to 1990) and it has used the same methods to try and get out of it (with debt and money printing). We all know that it doesn't work, of course, but Shinzo Abe, the new Prime Minister elected on December 26, 2012, has decided to go ahead with this policy, but full steam ahead, this time!

But Shinzo Abe went overboard with it, and here's how the crisis developed : the stock market goes up, but at an unrealistic rythm (+50% between January and the end of April!); this « free » money shed by the central bank is put in the Nikkei by the banks, for some quick profits; some of those holding State bonds want to join the party, so they sell their bonds and turn to the stock market. As a result, the bond prices fall and, thus, their yield increases (the bond's coupon is fixed, so it becomes proportionally more important in relation to its price). But these falling prices for bonds put great pressure on insurers and japanese banks, which are loaded up to their necks with these public debt products, so they are exposed to gigantic losses. On the other hand, if yields go up, Tokyo would have to raise the interest rates at which it refinances itself, which is impossible because the servicing of the public debt is already eating up almost half of its revenues! As a consequence, the central bank quickly intervenes and buys some bonds to appease the market. And, in this over-heating atmosphere, bad news comes out (slowing growth in China, in this case, but it could have been anything else) and, bang, the Nikkei loses 7%. Since then, things have been see-sawing back and forth, but one can say that, within four months, Abe's mirage seems to have already dissipated.
Add to this the fall of the yen (losing 16% to the dollar since the start of the year!), which helps a little for exporting goods, but does a lot for importing goods. This creates inflationary pressure and, if confirmed, it would pull down the price of bonds and the State would have to hike interest rates to refinance...

This is the kind of crisis we could be facing, but at a much larger scale and with the authorities losing control of the situation. Tying together the bond and stock markets, both in bubble territory, thus very unstable, creating imbalance, and then the central bank kicking the can down the road, the currency falling, the return of inflation... We'll have to keep close tabs on what the apprentice-sorcerer in power in Japan is doing.

Europe : Zero-Growth

Jun 6, 2013

The european economy's landscape looks sad... The Eurozone saw its GDP lose 0.2% in the first quarter, and the OECD revised to the downside its forecast for 2013 and sees a 0.6% recession ahead. The OECD and the governments are hoping for a return to a positive rate, a meager 1%, in 2014, nothing more. Europe looks stalled.
Here are three observations that make this poor result even worse :

1) All European countries are concerned by this stagnation, even Germany (+0.1% in the first quarter) and the virtuous countries like Austria (0%), Finland (-0.1%) and the Netherlands (-0.1%). The South of Europe is suffering, but the North isn't making up for it.

2) The people in charge in the governments and in the European union don't really know why Europe is sinking into this economic slowdown. They blame the « austerity » measures and immediately come to the conclusion that they cannot refrain public expenditures to any significant degree, thus shying away from any meaningful structural reforms.

3) There is no clear perspective of recovery but the belief that, once the crisis is over, growth will come back, and all we have to do is wait. France represents the archetype of this behaviour, a mix of blindness and wishful thinking.

So, what do we do, with unemployment rising, debt growing and on-going deficits? We sit and wait, while patching holes with the monetary press. Worst of all, the OECD is encouraging this monetary laxism. This international institution did indeed declare, on May 29 : « New unconventional measures could be necessary in order to improve the transmission of monetary policies. Particularly, more asset buying could be envisaged. » Say what? The ECB will have to buy even more toxic assets?

Growth is much more than just an economic issue; there has to exist a certain ambition. What is Europe's ambition today? Let's recall that, in 2000, the European union had launched the « Lisbon Strategy », with the stated objective of making Europe « the economy of the most competitive and dynamic knowledge of the world from now to 2010, able to have durable economic growth along with improvements in employment, both quantity- and quality-wise. » One should always take such grand state programmes with a grain of salt, but at least there was some kind of will in there. Such a declaration would bring about a smile today. What are the ambitions of the young bachelors today? For those from France and the southern countries, it is to leave their country or become a government bureaucrat.

The absence of growth in Europe is looking like a resignation : resignation in the face of the weight of the State which seems impossible to scale down, resignation in the face of laxist monetary policies, resignation in the face of globalisation issues and international competition, which few countries attack head-on. In such a context, zero-growth is our only horizon.

France : Public Deficits Getting Out Of Control

Jun 13, 2013

France is losing its footing. It just fell to the other side of the Laffer Curve : tax increases not only did not produce any revenue, but we're witnessing a decline in fiscal revenue. Arthur Laffer, the american economist (born in 1940), became famous by having modelized this phenomenon : When taxes are already high, raising them some more leads to a decline in fiscal revenue because the economic agents, already over-taxed, are encouraged to work less (or work in the underground economy). A clear indication of this is that 30 billion euros in taxes voted by the Hollande government haven't done anything, there are no traces of it to be seen! Though income tax is rising a little, sales (VAT) tax revenues are declining, as well as the taxes on gas and corporate tax. At the end of the day, fiscal revenues are less than what they were last year.

What's worse is that the Ministry of finance cannot explain why this is happening because, according to its own calculations, the economy's stagnation should produce the same fiscal revenues; but, for the first four months of 2013, revenues from the VAT tax fell 2.3% from the same period last year as the Minister is saying that consumption has stagnated. We would rather conclude that the economic models being used don't make the grade and that the recession is stronger than anticipated. Consumption, the last engine in the French economy (largely fed by public debt), is slowing a lot more than what the official numbers are showing.

These numbers are worrisome. Let's recall how, at the start of the debt crisis in Greece, everyone was making jokes about the Greeks' inefficiency in fiscal matters and we'd hear stuff like 'We wouldn't see this in France!' because, in fact the French have, or rather had, because it's over now, a reputation of being able to levy taxes, which was a strong point with international investors.

Could we at least hope for this situation to provide an electric shock to the government and bring it to put structural reforms in place? Non, monsieur. The french political class is addicted to public spending, whether from the left or from the right. We could even get more tax increases!

The consequences of this mess are clear : France will not reach its public deficit target for the year. Even worse, the State's budget will be less balanced than in 2012. The markets surely won't like this, and France's debt may lose its status of preferred investment that it still holds.

This may cause a brutal change for France because, so far, it was like a buffer between the northern countries, the « virtuous » ones, and the southern ones, more laxist. Up to now, this government-produced fiction, accepted by the markets, was putting France on the right side. But, with public accounts going massively haywire, as it seems to be happening, the credulous will come back to Earth. All of the Eurozone will be shaking then.

French Banks Represent the Most Systemic Risk of Europe!

Jun 20, 2013

Along with its public deficits going the wrong way, as we wrote about last week, France has now to contend with its banking sector. According to Euromoney, a study from the Center for Risk Management de Lausanne shows that french banks represent the most important systemic risk of Europe!

In order to evaluate this systemic risk, the Lausanne institute measured the amount of capital a bank would need if a global financial crisis were to occur, such a crisis being defined by a 40% fall of major stock indices within six months. Crédit Agricole comes in first, needing 86 billion euros, followed by Deutsche Bank (82 billion), Barclays (71 billion), and BNP Paribas (68 billion). Société Générale comes in sixth, Natixis 13th and AXA Insurance 14th. And, although Dexia is considered a belgian bank, France guarantees 45.5% of its assets. All in all, french banks would need up to 217 billion euros in such a situation! They are followed by the United Kingdom (206 billion), Germany (135 billion) and Italy (90 billion).

This worrisome first place is notably explained by the amount of leverage in France, the highest in Europe, according to the Lausanne Center for Risk Management, at a rate of 31 to one (31 euros of liabilities for every euro in cash)... The Netherlands are next (29), then Italy (27) and Germany (25). The best ones are the United Kingdom (16), Switzerland (14) and Sweden (10).

This high systemic risk can also be explained by the high concentration in the banking sector.

Indeed, three banks share most of the activity : Crédit Agricole (which bought back Crédit Lyonnais in 2002), BNP Paribas (born from the fusion of BNP and Paribas in 2000, and which bought back Fortis in 2009), and Société Générale. This concentration makes for a fragile structure. Let’s remind in passing that BNP Paribas’ total balance sheet equals that of France’s GDP. So we’re stuck with three giant creatures that the State will have to help come what may... The french banks have properly understood the theory and applied the « too big to fail » concept!

That being said, all european banks are fragile and, even though the french ones top the list, the other countries’ are at risk as well. Also, the fact that the banks’ balance sheets are so dependant on the stock markets reflects a breaking-up of the financial sector, a movement of banks toward market financing (with better returns and higher risk), at odds with their traditional activities of credit lending (with lower returns but more stable).

Above all, the study’s hypothesis (a 40% stock market fall within six months) is far from improbable, quite the contrary. With the printing presses going full steam in the United States, in Japan and, to a lesser extent, in Europe, everyone understands that the stock indices are on an artificial high. The question isn’t even knowing if such a fall can happen, but when. At that moment, systemic risk will no more be an object of study and it will be very real.

China Showing Some Cracks

Jun 27, 2013

What’s happening in China? The interbank market succumbed to two panic attacks, on June 7th and last week, immediately doused by monetary injections from the central bank, the People's Bank of China, but tensions remain. Two big commercial banks, ICBC and Bank of China, have had their online services cut for some hours, so rumours abound and there is more and more talk of a banking crisis...

In fact, China is trying to get itself out of a gigantic credit bubble. According to Fitch, for the last five years, the credit/GDP ratio has gone from 75% to 200%, a never-seen progression on the planet. In response to the 2008 crisis and to avoid a collapse of production, the Chinese authorities vigorously intervened in the credit market in order to sustain real estate construction and infrastructures. Where did this lead to? To many unproductive investments (whole parts or entire cities are empty, like in Spain). In other words, growth is falling, but this debt has to be repaid!
Credit is so off its tracks that an officious market has taken place : large companies that have easy access to credit are borrowing, not to invest but to lend to smaller companies. This is a dangerous behavior, which is typical of a bubble.

The People's Bank of China wants to stop this never-ending race and, of course, certain cracks are appearing. Credit must be restrained while the banking system must be cleansed, and this has to be done without having the real estate bubble explode... quite a feat! Even if, as we've explained recently, China is virtuously buying large quantities of gold, this will not be enough to face this mountain of existing debt.

China is confronted to the same problems that Japan, the US and Europe are facing, i.e. how to get out of laxist monetary policies that have proven their inefficiency (no recovery), while avoiding a crash... is it possible? We can certainly doubt it, given the massive accumulated debt, numerous bubbles, murky banks balance sheets, and the amount of bad investments. All around the world, stock markets are trembling at the mere talk of a possible tapering of the rythm of the money printing. They have become entirely dependant on the central banks' monetary injections, not taking into account any real factors.

But, in the case of China, we must add the problems of lack of transparency, strict government control of information, untrustworthy public accounting, incestuous relationships between large corporations and the government, and a GDP growth rate which is more akin to propaganda than to an objective measure. There's nothing we can see. We can only perceive the symptoms, like these liquidity crises on the interbank market. The State controls everything, thus it has more possibilities of manipulation, but the day it will have to let go, we'll be expecting some mighty shocks.

« Draghigate » looming?

Jul 4, 2013

Weirdly enough, the media didn't dwell on this amazing issue, and the TV people didn't even talk about it in their news bulletins. Of course, it's about one of Europe's most powerful man, Mario Draghi, head of the European central bank.

La Republica and the Financial Times revealed last week that a report from the Italian Treasury showed that it used risky derivatives to discreetly bring in some money in order to qualify Italy for the Eurozone. According to the italian newspaper, those instruments were « Off-Market Swaps » which would entail italian and foreign banks to provide cash for the Italian Treasury in exchange for variable-rates payments based on market rates.

Just like Greece did, Italy cheated to get in the Eurozone. True, Italy had shrunk its 7% of GDP public deficit in 1996 to 2.7% the next year, a tremendous performance that raised some eyebrows... Since those swaps were off the banks' balance sheets, they were undetectable and...voilà! But this shrewd structure had minimized the risks, and the report reveals a current 8 billion euros loss on a notional total of 31.7 billion euros. And, guess what, who was in charge of the Italian Treasury at the time?... Mario Draghi (precisely from 1991 to 2001)! He's the one who directly put in place this manipulation.

After that, between 2002 and 2005, he went on to work for Goldman Sachs (which had been in charge of the same operation in Greece, which he couldn't have ignored), and then he headed the Bank of Italy from 2006 to 2011 before taking over the ECB in 2011.

During his hearing before the European deputies June 14, 2011, Mario Draghi was asked about his stint at Goldman Sachs, but he denied any knowledge of the bank's shenanigans with public accounts in Greece, which didn't convince many people. Had this situation been known at the time, there is no doubt it would have prevented him from being nominated to the ECB presidency.

The Enron bosses ended up in jail for having hidden their enterprise balance sheets, but we are still looking for anybody in the public arena to get the same treatment (some were arrested for corruption, but that's another story). The problem is that public accounting seems to be above the laws, which explains in part the enormous deficits and debt.

This situation is extremely serious, and it's happening at a time when there is talk of European banks supervision by the ECB, which represents an unacceptable conflict of interest (the ECB being both judge and party by financing the banks and being in charge of controlling them), especially if put in the hands of someone used to manipulation. The pressure on Mario Draghi should continue to rise. And, anyhow, can we have any guarantee that he's not doing any manipulations now? No. In any case, those who don't like him (essentially Berlin) just found a reason to kick him out.

Gold Prices Like In 1976

Jul 11, 2013

Peter Schiff, a well-know entrepreneur and economist, is a proponent of the Austrian school of economics, and he had predicted the subprime crisis. This gives us two good reasons to listen to him. According to him, the actual downside move for gold looks quite a lot like the one in 1976, which had only been temporary. As a matter of fact, after President Nixon closed the « gold window » on August 15, 1971, the price of gold kept rising, from $35 an ounce to close to $200 at the end of 1974. In an inflationary context (11% in 1974), gold was playing its role of protecting against prices rising. But the Fed reacted by hiking its rates, and succeeded in bringing back inflation down to 5% in 1976. Gold went back down to close to $100/oz. There was much optimism in 1976 : the first oil crisis was over and recovery seemed imminent. We now know that it wasn't so, because the crisis was much deeper than a single rise in the price of an oil barrel, and there was no real recovery until Ronald Reagan liberalized air transportation, the telecoms etc. Meanwhile, gold turned to the upside, from 1977 to 1980 (peaking in 1980).

The context, today, looks the same. A « recovery » is being sold to the public by the mainstream media, financial counselors and political leaders. French President François Hollande announces « the crisis is behind us »; he must have made a u-turn without realizing it! In the United States, GDP growth for the first quarter has been revised down from 2.4 to only 1.8%. Does 1.8% sound like a recovery? It's not, but many people believe in it and that weighs on the price of gold. And we know, of course, that manipulations occur with massive selling of « paper » gold (certainly initiated by central banks), while physical gold sales are doing very well. That plays a role as well.

« Gold's plunge is saying a lot about consumers' confidence in global recovery », wrote the New York Times on August 29... 1976. Some are writing the same things today, so let's not fall for it. As in 1976, we are only in a remission, due to massive monetary printing from the central banks of the US, Japan and Europe. There is no inflation yet, but we are witnessing asset bubbles (sovereign bonds, commodities), which boils down to the same thing, more or less (« asset inflation »). So, while we hear a little less about the crisis, public debts are soaring, banks' balance sheets are still degraded, and there is no recovery at all. There will be no recovery, and the actual crisis is much worse than it was in the '70s.

Investors must remain calm and keep a critical mind permanently. They have to go beyond the big media noise. And now is really not, really not the time to sell one's gold.

A New Danger Looming For Banks : Interest Rates Going Up

Jul 18, 2013

The central banks of Japan, the Eurozone and the United States hold major sovereign bonds portfolios. This represents 20% of GDP in Japan, 18% in the Eurozone and 12% in the United States. Since acquiring sovereign bonds is not part of the central banks' mission, why are they doing it? Mostly, because it serves the countries. They have to finance their deficits, thus they have to find buyers, locally if possible, that they know and on whom they can exert a certain influence.

How? As an example, the backstops negociated in Basel stipulate that, when a bank makes a loan to a business, it must keep some liquidities as collateral. But, on the other hand, it doesn't have to freeze any cash if it buys sovereign bonds from a well-rated country! So, why bother with lending into the economy when they can make as much with these bonds? Generally speaking, the large indebted countries have developed relations with their big banks that may be qualified as incestuous. Since a good many of them have been saved from bankruptcy in the 2008 crisis, they're easily convinced of participating in their own bailing out...

We are right in the midst of a self-perpetuating mechanism in closed circuit or, in other words, that is inducing a bubble. The bond bubble is not just a concept. Everything could go on for quite a while if interest rates were to stay low. And, precisely, we're seeing a generalized hike on the rates, not only in battered countries, but also in Germany and the United States. The reasons for such a hike are many : expansionary monetary politics end up generating high inflation anticipations, the continuing crisis makes for a higher risk premium, the projected « recovery » isn't happening... And, as we know, higher interest rates cause a decline in the value of bonds portfolios, which in turn creates losses of capital value, thus less money for the banks.

The Natixis Bank did the math on what higher rates would mean for the banks' balance sheets. Supposing all bonds portfolios are priced to market, a 1% hike on long-term interest rates would reduce actual banks' funds by :
14% in the Eurozone
16% in the United States
160% in Japan.

For Japan, this is not a typo. This result comes from the size of their portfolio combined with their lack of proper funds. The situation is thus untenable in Japan and can only be contained in the States and the Eurozone if rates go just slightly up. The ten-year Treasury bonds were yielding 2% before the recent hike, but let's recall that they were yielding 6% in 2000 and 8% in 1990, so those are numbers we should keep in mind. In any case, the cost of rate hikes will be quite severe for the banks' proper funds... and these funds are there to cover all kinds of other risks...

Libor, Euribor, ISDAfix, Energy Prices, Gold Spot Prices... What If All Prices Were Manipulated ?

Jul 25, 2013

We are now familiar with the Libor manipulation scandal, which extends into other related rates, like Euribor. More recently, we've seen the ISDAfix, the reference rate for rates derivatives, make the headlines for the same reasons : large banks getting together to manipulate it. Not too long ago, we learned that JP Morgan and Barclays were accused of manipulating energy prices. The price of gold has been falling for a few months, due to « paper » gold selling, while physical gold buying is on the rise... isn't this a bit weird? Is there an end to this list?

Or, let's ask the question another way : Is there still « real » price discovery, today, and in which markets? Unfortunately, the answer is close to a resounding 'no'. As Ron Paul, the Austrian school american politician and economist, says, this manipulation of interest rates by the central bank affects all prices, the same way price controls do in centralized states, the difference being that, in the latter case, armies of government employees are needed to enforce price control with the businesses, while, in the former, a decision by the president of the central bank is all it takes.

Because, as we know, the short-term interest rate is fixed by the central bank, and mid- to long-term interest rates are influenced by it. The $45B monthly infusion of Fed's QE (the remaining $40B being used to acquire mortgage-backed securities, or MBS) is helping in keeping them lower than they should be, which is, by the way, Bernanke's objective.

And the interest rates constitute a price on « time », so to speak. Thus, they affect most everything in the economic process, from production to consumption to savings. The price, or value, of everything is affected one way or the other : your credit, your smartphone, your car, your groceries, your wealth... Consequently, all economic decisions, whether in businesses or in households, are affected somehow. The real estate bubble in the United States, from 2000 to 2007, was due in part to Greenspan taking down interest rates in 2001 (under the pretext of avoiding a recession from the bursting of the Internet bubble in 2000 and the 9/11 attacks). We've witnessed the result of that... and the central banks are pushing lower rates still!

Maybe the time has come to take the Fed to court... because it's certainly not doing any better than those banks that are manipulating LIBOR or energy prices. But, hey, central banks are doing this « for our own good »... aren't we feeling better now?

Forward Guidance : Another Aspect of Central Banks Going Off Course

Aug 1, 2013

« Forward Guidance » is the new « in » phrase with central banks. It is supposed to reassure the market a few years in advance so that it can « anticipate » properly. The first one to have come up with this theory and implemented it is Ben Bernanke, who announced on September 13, 2012, that the Fed would not raise its interest rates before 2015. And, recently, Mario Draghi followed the same path while, until now, the ECB had refused to take any engagement spanning more than just a few months.

So the markets can rest assured that the rates will remain low until there is a real economic recovery, and no one seriously believes that will happen. So the party continues, with banks getting free money from their central bank and the stock market having a ball.

But, after all, isn't it only a cosmetic change? Not really. Let's take a closer look. This means that the central banks take their decisions according to the stock market conditions. In other words, they are losing the initiative, or the power to create a surprise. This is actually a great change because, up to then, they were really proud of that power. Let's just recall Alan Greenspan, quite the showman, who once said, 'If you understand everything that I've just said, I haven't said it correctly'... these days are gone.

But, more fundamentally, « forward guidance » translates into a fear, almost a manic panic for the central banks : the rising of long-term interest rates. Its effects would be devastating on the banks' balance sheets and on insurance companies, as well as on the financing of public deficits. These rates have already, albeit moderately for now, risen in the United States and Europe, Germany included. If they kept rising, this could become dangerous rather quickly. Central banks can influence the short-term rates, the ones used to re-finance the banks. And, by keeping them close to zero and stating, as a matter of fact, that they will keep them low for the coming years, they are trying to weigh down on long-term rates. But, even though this influence may be real, it is still limited and would even be more limited in the face of inflation or more elevated risks.

This new central bank policy just goes to show that they're kicking the can down the road and that they don't know how to get out of their woes. Money printing and low rates are not creating growth, are not solving public debt problems, are only helping banks' balance sheets on the margin and, above all, are creating still more dangerous bubbles than the 2008 subprimes one. In this context, « forward guidance » is just another expedient which, once again, doesn't solve anything basically.

Schizophrenia

Aug 8, 2013

The economic landscape has rarely been this schizophrenic. If we read the mainstream media, like Les Échos, France's foremost economic daily paper, we learn that « gold will be hurt by a better-than-expected recovery » and that the resulting higher interest rates stemming logically from this recovery will keep pressure on the precious metal's price.
Yes, you've read correctly, there is a « better-than-expected economic recovery »! I wonder on which planet the people writing such drivel live... This recovery is being sold to us by the mainstream media and the political leaders, but what of it, really? As a reminder, in the United States, GDP growth for the first quarter has been revised to the downside, from 2.4% to only 1.8%. This is not a recovery! And let's not forget that this weak growth is being bought by massive QE from the Fed, to the tune of $85Bn a month. All that money created out of thin air is only resulting in a paltry 1.8% growth!

But then we are told that the unemployment rate is declining. Sure... But if we dig deeper, we see that most jobs created are part-time low-paying ones... so what gives? It's the Obamacare effect! Businesses with over 50 employees working 30 hours a week have to pay Obama's health coverage for them, and it's too costly and complicated. So, instead, these businesses have fired their paid employees and re-hired them for under 30 hours, adding a few more employees to compensate. This is why we're seeing many bartending jobs or the likes being created. But, on the other hand, there are no quality full-time jobs, either in administration or manufacturing. Recovery?

In Europe, growth is globally zero. Italy is going through its eighth consecutive quarter of recession! Not to say anything about Greece, Cyprus, Spain and Portugal. Even Germany is slowing down, and France is hovering around zero growth. But all political leaders are talking recovery. Of course, they're always campaigning to get re-elected, so they have to promise better tomorrows...
So, there is no recovery. But, since the mainstream media and the governments keep repeating it over and over again and since we prefer believing good news than bad news, a majority of people believe in this so-called recovery. This is why the stock market is up

and gold is down.

Such schizophrenia cannot last forever, and the wake-up call will be painful. The smartest ones, notably those who own gold, will do well, but those who « bought » this recovery might pay a very hefty price.

The Great Rotation : A Trap

Aug 15, 2013

There is an idea, the "Great Rotation", that we hear a lot about since the beginning of the year, a great underlying movement that should be happening in the markets: investors moving from bonds to stocks.

In order to understand this movement, we have to go back a few years. The stock market went through two major crashes, one in 2000 (mainly tech stocks) and the other in 2008 (subprime crisis). At the same time, the sovereign bonds of the major countries (USA, Germany, UK, emerging countries) were doing well, and lower and lower rates made for substantial gains for bond holders. As a consequence, bonds are overweighed in investors' portfolios with regard to stocks.
Now that interest rates are at their lowest and are even starting to rise, and that the economy seems to be gaining some traction, if we are to believe the leaders of the United States and Europe, we should be witnessing a re-balancing of portfolios in favor of stocks, an outflow of capital from sovereign bonds toward the stock market, thus sustaining growth, along with a reduction of budgetary deficit and less stress on the bond market… In any case, such is the daydreaming of our monetary and political leaders.

But, what of it, really? There is no recovery, as we've mentioned here before, Europe is stagnating and the United States is still below 2% growth, despite an abyssal budgetary deficit and $85B of quantitative easing each month. But it would seem the "Great Rotation" is under way!

According to Thomson Reuters Lipper, investors have withdrawn $3.27B from U.S. Treasuries in the first seven days of August, the highest amount ever recorded since 1992, while, at the same time, $6.28B were invested in stock market funds. This movement is also taking place in Europe, especially in the South, to the point where the bourses of Milan and Madrid are progressing by 8% monthly, three percentage points higher than London or Paris, and six points more than the S&P 500! And these two countries are in a recession!

It looks like the "Great Rotation" is underway, but for the wrong reasons: shying away from bonds because of rising rates, and a return on the stock market due to an illusory recovery, and the belief that the eurozone crisis is over… Many will be cruelly deceived when the last hopes of economic recovery will definitely vanish and everybody realizes that they have grossly overpaid their stock shares. For example, the Norwegian sovereign fund has indicated that, as of the end of June, its investments in the stock market stand at 63.4% of its total investments, a record, and its investments in bonds have fallen to 35.7%. This kind of risk taking might be qualified as exorbitant.

So, when will we see a "Great Rotation" toward gold or, more generally, toward real assets, which would be more reasonable? We will surely have to wait for another crash before the bankers understand…

Emerging Countries : The End Game?

Aug 22, 2013

Last week, we talked about the « Great Rotation », e.g. investors moving from bonds toward the stock market. But there is another move that seems to be happening at the same time : funds getting out of emerging markets and coming back into developed countries. According to Morgan Stanley, in the week starting August 14, $760 million have been withdrawn from emerging countries funds, $590 million of which in Asia, for both stock shares and debt obligations. And this is the third consecutive week of withdrawals (L'Agefi).

Is the tide turning for emerging countries? For sure, there is bad news after bad news : growth is slowing in China, in India, Indonesia and Thailand, inflation is back in Argentina and Brazil. What's worse is that national economic statistics are doubtful, like in China. More and more experts are drawing attention to the growing discrepancy between the GDP numbers published by Beijing and more concrete statistics like power consumption or railway freight...

This brings to light a basic problem in emerging countries. When a country has a long way to go and lets go of the planified economy that was the norm, up until the '80s, and that it liberalizes production and commerce, growth is clearly happening. But what about later on? For the economy to keep growing, the big State monopolies have to be dismantled, measures have to be taken so that corruption doesn't become endemic and that contract rights and ownership rights be recognized... But, sadly, it's not the case, often. And the « sanction » is growth reaching a ceiling.

In India, like many other countries, the land registry is quite incomplete. It is estimated that 80% of court matters (and 10% of murders!) are related to land ownership problems. How can agriculture really grow under these conditions? Having to tackle these economic problems, New Delhi is reacting the worst way, by implementing coercitive measures like currency control (individuals will only be allowed to withdraw $75,000 a year, compared to $200,000 before). No wonder investors are leaving the country! Argentina and other countries have implemented currency control (as well as Cyprus, a member of the Eurozone). In India, where gold is one of the main investments, especially for the poor who do not have access to the banking system, the government has decided to raise import taxes for the precious metal by 10%! This tax will not make up for the economic slowdown, far from it.

So, the news is bad, it just shows that this model of development has run its course and, what's worse, that there is no way to get to another phase, one that would lead to a more « intensive » growth.

It seems that American and European funds are flowing back to their countries of origin... but where are they going? For the most part on the stock market, highly overvalued and kept afloat by the central banks. Severe disillusions are bound to materialize... but this is another story.

Goldman Sachs Is Above the Law!

Aug 29, 2013

Now it's clear, and we got proof, even though we sort of knew already : Goldman Sachs is above the law. On August 20th, this prestigious business bank is stung with a giant computer bug : their program sends out false orders in great quantities on the american options market and on certain quoted index funds. Which de-stabilizes these markets, and just goes to show how big the glitch was.

The same kind of mishap happened last summer to a lesser-known financial business provider, Knight Capital. The same way, a whole bunch of false electronic orders were sent in cascades on the market. They lost about $476 Million, which put them out of business, and they were brought back by a competitor.

For Goldman Sachs, the potential losses amount to hundreds of millions of dollars... not enough to sink the bank, of course, but enough to give it some trouble with its standing. So, then, why not try to get an arrangement with the market control mechanism to cancel those orders? And what's worse, they succeeded! The regulating organism accepts to erase those orders and, in the process, considerably reduces the firm's losses. But there were tens of brokers who had positioned themselves on the other side of those trades, and were hoping to win big, who will not reap those gains, sadly. Even worse, once Goldman Sachs' orders were cancelled, the brokers' orders became irrational, so to speak, and they'll even lose some money!

We're surely not in a free market, here; rather, the strongest wins. The fact that « The Firm » has been and is involved in many manipulation scandals in the commodities and energy sectors should have played a role against it, but it was not the case... which goes to show the magnitude of its power and, more generally, the power those « Too Big to Fail » banks have acquired.

Was there any negotiation, in terms of strength ratio, between the investment bank and the regulator? We could well imagine a « scratch my back and I'll scratch yours » kind of swap scenario, like 'You go ahead with leaning on the price of gold and we'll help you', or, I'm just thinking, 'With the help of your algorythms, the stock market index always finishes in positive territory in the last minutes of trading... I owe you one'. The number of consecutive sessions pushed to the upside is much greater than a few years back. No one is talking about stock market manipulation... is it that the regulating organisms finds their interest in it? I'd bet they do and, furthermore, they profit from it, since it brings new investors in.

Case in point : complaints of market manipulations rarely come from the regulators, the ones in charge of orderly market conduct, but rather from cheated investors or operators. With regards to aluminum, a collective suit has been brought against Goldman Sachs AND the London Market Exchange, on the first of August, in which they're accused of artificially inflating its price.
After all, the stock market bourses are businesses like other ones; they have all been privatized during the financial liberalization of the 80-90's... which wasn't such a good idea, really. We are now seeing the result of this liberalization as suspicions abound concerning an agreement between the markets and the largest banks. And let's bet that the central bank isn't far behind... It's not a matter of falling into a « conspiracy theory » trap, but rather a matter of analysing the facts. And these facts show that we have reasons to worry about the orderly conduct of markets.

What If the Money Printing Presses Were Poised to Run Faster?

Sep 12, 2013

The general feeling, or « sentiment », is leaning toward a tapering of money printing by the large Western central banks, due in part to the official statements of the Fed indicating it might taper its quantitative easing (QE). For now, it's just an hypothesis invoked by its Chairman, Ben Bernanke, but it was enough to rattle the markets, notably with the outflow of funds from emerging countries, which is putting much downward pressure on their currencies. In any case, everyone agrees that the american central bank cannot continue injecting $85 Billion a month out of thin air into the economy.

But this sentiment has also created another effect, the rising of long-term rates in the United States and Europe. The U.S. 10-year rate is getting close to 3%, and Germany's is close to 2%. Nothing catastrophic yet but, if the rates keep rising, the weight of the debt will become really unbearable for the U.S. federal budget. But there is one effect that has not been created by all this quantitative easing : a real economic recovery, even though the government and the Fed are trying to sell us the idea, the « sentiment » of it.

With these legitimate worries, does the Fed have any leeway? It can't reduce its prime rate, it's already at zero! What else, then? QE, QE and more QE! It could (of course) be « exceptionally and temporarily » augmented to kick the can down the road again. This is exactly what the Bank of Japan has been doing since the start of this year. It doesn't create any tangible results, it only creates bubbles and volatility, but it perpetuates the illusion.

In Europe, the ECB doesn't buy the countries' debt like in the USA; instead it lends enormous amounts to banks which in turn buy their countries' debt. This has exactly the same result, but it goes through the banks (which, by the way, weakens them, because their balance sheets are full with sovereign debt...). We have witnessed two LTROs of 500 billion euros each, at the end of 2011 and the start of 2013 (3-year loans at 1%). And we are hearing more and more rumors about another LTRO if interest rates keep rising...

In the United States, we will have to wait to see who the next Fed Chairman will be on January 31, 2014, but it's hard to imagine the new Chairman playing « bad boy » by tapering QE and thus rattling all the stock markets and the whole financial world. Instead, why not bring out the champagne for everyone, along with a « temporary », of course, speeding of the printing press? We'll then have to fasten our seat belts... made of gold.

After the German Elections... Back to the Eurozone Crisis?

Sep 19, 2013

With the upcoming German national elections, the problems in the Eurozone have been left aside. Angela Merkel doesn't want to lose some voters by talking about it. Her finance minister slipped, during the campaign, saying that Greece will have to be helped again but, not to worry, with only 10 billion euros.

But on Sunday, this comedy will end. Greece will not need only 10 billion euros, it will need much more. The country is getting deeper in crisis; it will not be able to reimburse its debt, and a new restructuration plan will have to be put in place. And it will be even more complicated than the last time because the major part of that debt is held by the European central bank (ECB), which will have to be refunded to avoid being depleted of its own funds. The rest is held by some relief funds guaranteed by the European countries (FESF, MES), and they, too, will have to put some money back in those structures.

Also, there is Portugal having trouble meeting its obligations, and it won't be able to reimburse the 78 billion of aid brought by the European Union and the IMF in May 2011. The ten-year rate is over 7%, the situation is untenable. Again, there will have to be some kind of restructuration, and some of this debt will have to be erased. The European relief funds will, after Greece, be downgraded, and the countries guaranteeing them will have to inject more funds into them... Municipal elections are coming September 29, and after that, these things will have to be taken care of.

And let's not forget these two small countries, Cyprus and Slovenia. Cyprus is going deep into recession; an 8% drop in GDP, at least, is predicted in 2013! There is no way this country will reimburse the 10 billion euros of its bailout plan! And Slovenia is suffering with its banking system, with toxic debt amounting to 20% of its GDP... quick, a bailout plan!

Next? Spain and Italy will make news as well. The spanish banking sector is still very sick; all the losses associated with the real estate bubble haven't been taken into account, far from it. Italy's chaotic political situation makes for an uncertain future. And those two countries aren't back on the road to growth, while their public debt keeps growing. Italy has just experienced its eighth consecutive quarter of recession!

And next? Well, in France, up to now, everything is okay, the rates aren't too worrisome for now. But when the markets realise that the budget deficit of this year will be way off the mark, the financial climate may change. We shall see what happens when the markets understand that there is no serious structural reform being implemented...

The parenthesis is being closed and certain issues will now have to be dealt with openly. The relative calm we've witnessed these last few months in the Eurozone had nothing to do with any improvement in the economic fundamentals... it had to do with Germany's wish to keep quiet about it, and since they're the ones paying the bill... We shall see what Monday brings.

Bernanke Confessing QE Tapering Impossible

Sep 26, 2013

Last Thursday, there was quite a surprise : contrary to what the majority of market participants were anticipating, Ben Bernanke decided not to taper his QE (quantitative easing). Thus, $85B a month is still being created by the Fed to keep buying $45B of federal debt and $40B of mortgage-backed securities. Markets have been caught wrong-footed.

As we had mentioned here, two weeks ago, we thought QE would go on and even at a greater pace when the next Fed Chairman takes over, this coming January 31. We shall see. But, by having renounced to any tapering, even symbolically, like $10-15B, which would have been nothing, really, Bernanke is in fact confessing to the gravity of the crisis in the United States and to the fact that there is no serious economic recovery to speak of.
Bernanke is also recognising, implicitely, that there are too many bubbles in the US (Dow Jones, real estate in certain areas) and in the world (many commodities, emerging countries, currencies and stock markets), and that even a meager tapering could well provoke a series of crashes.

Bernanke also knows that the Eurozone is in temporary remission but that its basic problems remain. His ECB collegue, Mario Draghi, just announced he wouldn't exclude some new enormous long-term loan (LTRO) for the european ailing banks. Obviously, those 1,000 Billions of euros loaned at the end of 2011 and the start of 2012 aren't enough. This is quite worrisome… And we just learned that Monte dei Paschi, an Italian bank (the world's oldest bank, founded in 1472… quite symbolic !), just defaulted on the payment of the interest on its debt and was urgently looking for private investors lest it be nationalised by the Italian state, itself crumbling under its own debt… In fact, the global financial and economic system is fragile to the point that a tiny change in the Fed's policies could provoke its shipwreck. This is the situation.

There was also some good news on Thursday that was only a few lines long : the price of gold surged. Now, this is a sane reaction, because gold can't be printed ! Amidst all this liquidity, we can rest assured it will keep afloat.
The stock market also reacted positively to Bernanke's announcement, but not for the right reasons. Of course, it's benefiting from all this liquidity, it's one of many bubbles. Ben Bernanke is stuck and his only leeway is in maintaining his QE until his successor takes over, and hoping that a crash doesn't occur until then. The only ambition of the Fed Chairman is to save (his and) the Fed's face.

Ben Bernanke, the Apprentice-Sorcerer

Oct 3, 2013

Let's take a long look at the Fed's Quantitative Easing, or QE, that we've been talking about regularly, to really appreciate its importance and meaning. By looking at this graph, we can see its implementation after the crisis hit, on September 15, with the Lehman Brothers bankruptcy. Prior to that date, the Federal Reserve held around $500 Billion in Treasury bonds, and today, it holds around $2 Trillion of them, an increase of $1.5 Trillion. The Fed wasn't holding any mortgage-backed securities (MBS), and it now holds $1.2 Trillion of them. Since the crisis started, the Fed has thus acquired from the federal government (Treasury bonds) and the banks (MBSs) a total of $2.7 Trillion of assets (1.500 + 1.200).

The Fed's actions have insured that the State could continue borrowing at a very low rate (a little above and sometimes below the inflation rate) and that the banks could get rid of their toxic real estate debts which are filling their balance sheets. The initial bet was that, with recovery happening, this buyback program would be stopped without any consequences... but there is no recovery happening!

As we know, these $2.7 Trillion asset buybacks were made possible by the creation out of thin air of that amount, with the « monetary press ». $2.7 Trillion without any real counterparty asset, based on neither any goods or services... in other words, counterfeited money made legal because it's issued by the central bank. At first, the Fed was explaining that its interventions were sterilized, in that an equivalent amount of money was frozen (with banks increasing their deposits at the central bank). That has never been credible and, today, the Fed isn't even talking about it anymore.

Just like the « Apprentice-sorcerer » in Fantasia, where magic brooms are multiplying and getting out of Mickey's control, those $2.7 Trillion are seeping through the economy and creating bigger and bigger bubbles, notably on the Dow Jones and the Nasdaq, but also outside the United States. With all the leverage on financial products, this $2.7 Trillion becomes a much larger sum... Bubbles are getting bigger, prices do not correspond anymore to the real economic conditions, they become erroneous and provide false information, which make even less possible a real economic recovery. On the contrary, those monetary manipulations have the makings of a new crisis.

And this race is gathering momentum. The third QE plan, started in December 2012, amounts to $85 Billion a month ($45B for Treasury Bonds and $40B for MBSs), or exactly $1.02 Trillion a year. By comparison, the U.S. GDP is a little over $15 Trillion... So the Fed's interventions are big enough to influence the whole of the economy. For the moment the Fed is barely keeping the economy afloat, and Bernanke can't even taper these monetary injections, as he had promised. Just as it is with drugs, the addiction is very strong, which will make a return to reality that much more violent.

LTRO = QE, or How the ECB Is Pursuing the Same Policy As the Fed

Oct 10, 2013

Although we often read in the press or hear from banking and political leaders that the ECB doesn't buy back sovereign bonds, contrary to the Fed, thus hinting that « we Europeans are more virtuous than the Americans », it's totally false.

The ECB, like the Fed, does finance part of the sovereign debt, but it uses another vehicle : the banks. In fact, the ECB does not acquire any sovereign debt directly, but it loans out large amounts of money to the banks which then buy their countries' debt, so the result is the same.

Last April, Slovenia had to issue 1.1 Billion euros to finance itself. But nobody wants to buy that debt with the country's catastrophic situation. Its bad debt amounts to 20% of GDP and its banking system is practically bankrupt. But that didn't stop the ECB from lending this 1.1 Billion euros to the Slovenian banks which then turn around and buy their country's bonds! So, tell me, what's the difference with the Fed, which directly buys the federal debt? There is none. And, on top of that, what do the Slovenian banks offer as collateral for the ECB loan? Well... the sovereign bonds they just acquired, because that's all they have! And thus the ECB is stuck with Slovenian debt on its balance sheet, even though it doesn't appear on the same line as if it had acquired it directly, but the difference is very tiny (if the Slovenian banks have to re-structure their debt or go bankrupt, the ECB will in fact own those banks, but they'll be worth nothing because the Slovenian state will be in jeopardy).

But, beside these case-by-case loans, the ECB is offering giant loans, « open to any bank that wishes it and for the amounts desired », as has explained Mario Draghi : LTROs, or Long-Term Re-financing Operation(s). There have been two, so far, in December 2011 and in February 2012, of 500 Billion euros each! These loans helped with lowering Italy's and Spain's interest rates, which were then rising dangerously, which just goes to show that a great portion of that money has been recycled by the Italian and Spanish banks into their countries' debt. The mechanism is the same one as we just described for Slovenia.

These LTROs are 1% loans on three years, which means they'll have to be reimbursed within a year and a half. According to the latest ECB figures, only 352 Billion have been reimbursed so far, and there is still 666 Billion euros to be reimbursed. And the banks which have profited the most from these loans were, of course, the ones in worst shape.

As a consequence, who would believe that these Italian and Spanish banks could eventually reimburse those amounts? And, to the point, in his last press conference, Mario Draghi suggested that another LTRO might be in the cards... Call it bravery... or Quantitative Easing, in central bank « lingo ».

I have to say there is, indeed, a little difference between the Fed and the BCE. For the former, at least, we know the numbers (QE3 is $85B a month, $45B for Treasury bonds and $40B for mortgage-backed securities, or MBSs), but with the ECB, we cannot know precisely how much of this Trillion euros is being invested in sovereign bonds, because it is disseminated throughout many different European banks (and the ECB also uses other tools than LTROs, as in Slovenia). The ECB is doing just like the Fed, but it is adding more opacity...

IMF Condoning the Plundering of Bank Accounts

Oct 16, 2013

As we've been saying at the time, the spoliation of bank accounts in Cyprus this last March to save their banks was but a general rehearsal. We've also learned that there is a european proposal on the table to have depositors of over 100,000 euros contribute should there be a bank bailout in a Eurozone country. And now, the IMF is contemplating a 10% tax on all deposits (for every household, not only those over 100,000 euros) in order to diminish the sovereign debt.

In its last report on public finances, the IMF is clearly eying this solution (page 49). Since the public debt of the major european countries surpasses 100% of their GDP, a red line, the institution led by Christine Lagarde is contemplating a 10% tax on all private savings. Just like that. A giant hold-up.

This idea is making inroads, it's just a matter of getting used to it. The differences are meaningless. For Cyprus, it was a matter of saving the banks, and the IMF, here, is looking to diminish the sovereign debt. The result is about the same, since the countries and their banks have incestuous relationships (european banks own a large part of the public debt). The IMF doesn't even mention the 100,000 euro limit, which is just a smokescreen. In case of a crisis, everyone will be hurt. On the other hand, no one takes any responsibility... Is the European Union contemplating taking down or dismantling the TBTF banks to lower systemic risk? Not at all. Is the FMI demanding, as counterparty, that the States slim down and balance their budgets? Ditto. They're just trying to plug a hole that's getting deeper and deeper.

This 10% spoliation of the savings proposed by the IMF would only bring us back to the same public debt/GDP ratio of 2007, before the crisis. But even then, at that time, the debt was approaching the red zone and most european countries already had budget deficits. Much ado for not much! Plundering european depositors just to get back to the same situation of a few years back... without changing anything to the functioning of the financial system and the public sphere!

And now, with this idea of savings spoliation being validated by one of the most prestigious international institutions, we should expect it to be more and more on the minds of our leaders. We have to draw all the consequences from it: our bank accounts are less and less safe. What to do? We should definitely turn to tangible assets (to avoid this particular tax... but not income tax) like real estate, artwork, farmland, commodities... and gold, of course, the safest, simplest and most liquid asset. Better start thinking about it now before the hatchet falls... then, it'll be too late.

U.S. Debt Becoming A Riskier Asset

Oct 24, 2013

With the shutdown absurd showdown – temporarily – over, we are now faced with having to re-evaluate the U.S. debt in depth. Is it still a safe, risk-free asset, with the Fed backing it forever with new money? This is an important question.

The media have often made fun of the Tea Party's « extremist » stands on the matter, but the fact is that the federal budget situation is truly worrisome. For each $100 of spending there is only $65 coming from fiscal revenue, thus $35 of deficit. Clearly, this budget is going the wrong way. Even with the dollar being the international reserve and trading currency, such an imbalance isn't tenable. But between a democrat President who doesn't want to let go of anything and a republican Congress bent on cutting expenses, no agreement is being reached. The two sides have only agreed to kick the can down the road for a few months more.

Even though its absolute objectivity may be questioned, Dagong. the chinese rating agency, in its October 17 statement, uses some numbers that should make us pay attention : Between the start of the crisis in 2008 and the end of 2012, « debt increased by 60.7%, while nominal GDP only increased by 8.5% and fiscal revenue declined by 2.9% ». Dagong conludes : « Fiscal revenue cannot represent the main source of debt re-payment anymore ». Really? So what's left, then? Default? The printing press?

We are told not to worry because the Fed can always create more dollars. Not so, according to Dagong : « The dollar depreciation has caused a $628.5Billion loss for foreign debt holders between 2008 and 2012 ». Such a situation causes those creditors to move away from U.S. debt. And the logical consequence of it is that, with traditional buyers shying away from U.S. debt, the Fed will have no choice other than continuing with its Treasury bonds buying, and it might even have to speed it up...

To that, according to Dagong, we have to add the risk that those perpetual discussions and institutional failures bring : « The vulnerability of the chain of debt is such that a technical default may happen at any moment ». This risk is reinforced by an important element that the agency doesn't mention, i.e. the fact that the average maturity of U.S. debt is of only four years (compared to seven years for France or Germany). This means that, in four years, the Treasury will have to renew about half of its actual debt holdings (close to $17Trillion) or, in other words, issue over $8Trillion of debt, on top of which one should expect more budgetary deficits to come. We're in a crazy race.

So the U.S. debt is becoming a riskier and riskier asset for those holding it or looking to hold it. It is not enough to say that the Fed will use its printing press, should a problem arise, because the value of that debt is declining, the usual clients' appetite for it is declining as well, the risk of a technical default is real, and there seems to be no political solution on the horizon to get back to a balanced budget. For the moment the markets in Europe and the United States remain largely confident and optimistic about a resolution to the budgetary conflicts between Obama and the Republicans, but one of these days this risk will become material... And that day, an earthquake will happen.

How Basel III Rules Augment Systemic Risk

Nov 7, 2013

Even if its goals are laudable, a tough regulation always generates perverse effects. Such is the case with Basel III, and it's a shame, because it's the solidity of our banks that is concerned.

Fitch, the rating agency, just published an article that sheds some light on those distortions. By aiming to limit the amount of risk the banks can take, Basel III rules apply a ratio to each type of asset. For real estate loans to individuals, banks must keep a certain percentage of the total amount in liquidities, for credit to businesses, another percentage and so forth. The intention behind the rules is to force the banks to keep a cushion of liquidities in case of a crisis or a change in economic circumstances.

Very well. But, with sovereign bonds from the Eurozone being considered as safe, banks do not have to freeze any cash as counterparty to their agreements. We're witnessing here the results of the lobbying of the States, which must find buyers for their growing debt. But the consequence is that it's much less costly for the banks to invest in sovereign debt than it is to buy stocks or make some loans, because there is no need to hold any liquidity for them!

Fitch has measured the effects of these rules since their inception in December of 2010. Since that date, the 16 most important european banks, the G-SIBs, or « global systematically-important banks », have raised their exposure to sovereign debt by 26%, to reach 550 Billion euros. At the same time, they have reduced their stock holdings by 9%, to 440 Billion euros. Business loans have dropped by 9%, to 275 Billion euros. Real estate loans are the only ones to have risen in that period, by 12%, to 275 Billion euros.

This is really a tragic evolution : Banks are getting out of productive investments (business loans and stock market) and into State financing and real estate. And, after having provoked this state of affairs behind the curtains, political leaders are complaining about the absence of economic recovery!

But the main risk is more systemic risk for the financial system, even though the intention was to have less! With banks holding more and more sovereign debt, if either the country or the bank falls, the other one falls as well. If a country (let's say Italy, or Spain) must restructure its debt, its banks will fail. And each of those banks is « systemic », meaning its default would impact the whole european financial system...

This goes to show, in any case, that the Basel III rules are not bringing an answer to the actual financial crisis... they're actually making it worse. This is smokescreen politics at best.

Bitcoins : Another Symptom of Loss of Faith in Fiat Money

Nov 14, 2013

Bitcoins : it's new, it's in, so to speak, and we keep hearing a lot about this virtual money that was created in 2009 and that is breaking record after record. What should we think about it?
Let's briefly recall its modus operandi : this virtual money circulates on a peer-to-peer network, e.g. without a central server or any « hierarchic authority », without a central bank. To avoid any counterfeiting, each bitcoin is traced since its creation by the electronic signature of each of its successive owners. And this verification work is accomplished by the « miners », who are paid... in bitcoins and also by the (very low) transaction fee. Thus, the system is perfectly autonomous and self-regulated.

The use of bitcoins had been limited to a few alternative computer communities until 2013, when it sarted to gather some steam. The bankruptcy of Cyprus in the spring and the looting of bank accounts opened many people's eyes about the absolute protection supposedly offered by the banks for one's savings, whereas no one has any authority to loot a bitcoin account. At the same time, Argentina is implementing currency controls to avoid capital flight, and we discover that bitcoin transfers are not affected at all by borders. On top of that, many articles in the anglophone papers have drawn attention to bitcoins, which value was under ten euros in 2012, and then went up to 100 euros this summer (after a bubble to 200 euros followed by a crash in April). We're witnessing a new fever since the end of October (almost 300 euros November 13!), after Baidu (the first search engine in China) decided to accept bitcoins as payment and eBay (owner of PayPal) showed some interest... bitcoins are being institutionalised, so to speak.

There is also a basic element that pushes it higher : the number of bitcoins in circulation is rising regularly but will never surpass a certain number (21 millions), which is baked into the algorithm itself (this will not impair transactions, since bitcoins are divisible to the eighth decimal). Consequently, this prevents any « printing press » recourse or any inflation. It's a « commodity money », comparable to some « digital gold ».

But, contrary to bitcoins, gold is familiar to everyone. As more and more users discover bitcoins, some traffic jams happen sometimes. Actually, 12 million bitcoins have been issued, but it is estimated that 80% of those aren't circulating, they're being saved. At 300 euros each, all existing bitcoins total 3.6 billion euros (12 million X 300), which is really very little on a global scale. So, some hickups are to be expected! Also, « digital gold » means the use of computers, thus the danger of hackers, and a few thefts have already happened...

Bitcoins offer real advantages as payment intermediaries and for wire transfers (low cost commissions, border-free), but one must exercise caution when investing in them (price volatility and computer security).

Bitcoins having been only recently created, the « financial system » hasn't (yet?) engineered any derivatives controlled by the big business banks with the loving help of the Fed, in order to « reign in » its price from time to time, as they do with gold. If ever you start hearing about « paper bitcoin », beware! In the meantime, what the strong rise in its value is showing is that there are more and more people using it, as we've said, but also that more and more have faith in a non-manipulated currency, a very rare occurence these days.

European Banking Authority President : Too Many Banks Have Survived the Financial Crisis

Nov 21, 2013

« Too few european banks have been dismantled and left the market. » These words weren't uttered by some anarchist wanting to bring down capitalism, but rather by Andrea Enria, president of the European Banking Authority, in an interview with the Frankfurter Allgemeine Zeitung. He goes on : « Only 40 european banks have disappeared since the 2008 financial crisis, compared to almost 500 in the United States. The governments have decided to keep their banks alive, and this has caused the healing process to slow down. »

The European Banking Authority is not particularly known for its clairvoyance. It's even been accused, and rightly so, of negligence and denying reality when it realised some stress tests in 2011, coming to the conclusion that only nine european banks were in need of reinforcing their own funds, for a total amount of 2,5 Trillion euros. A ludicrous number, that the EBA is denying today, without recognising its mistake. Better late than never...

This declaration means that too many zombie banks are still operating in Europe, that too many bad loans haven't been purged, and that the crisis is still looming in the banks' balance sheets. It also means that the States are propping up banks, not for any economic reasons, but solely for political reasons. And EBA's president wants to end this guilty complacency by explaining that Europe, within its banking union, must put in place re-structuration and dismantling mechanisms for the banks, but that, as of now, European leaders haven't succeeded in deciding what shape this « resolution » will take, who will have decision powers, and who will finance it. One can thus expect quite a few battles in the coming months.

So we should expect some banks to fail or, more exactly, to be « re-structured »... and we know what that means, now : by looting depositors' accounts, as it's been done in Cyprus first, and as it's being formalised by a european directive. The States and the banks will agree to have the savers pay, and too bad for them. The countries are all too indebted, the banks have taken too much risk, but they're still in charge and no one should expect they would pay for their own mistakes.
At least, we're being forewarned. This declaration is also a warning. After Cyprus, after the IMF « suggestion » of looting 10% of bank accounts to reduce sovereign debt, we now have the European Banking Authority telling us that many banks are in a situation of virtual bankruptcy. As I said, we have been warned...

Says Bernanke : QE Not Causing Dow Jones Bubble

Nov 28, 2013

Don't laugh, but Ben Bernanke refutes the fact that easy monetary policy from the Fed has favored Wall Street... he even goes as far as saying it has helped the middle class! Quote : « Even though this may come as a shock, I don't agree. Our monetary policy has helped american households to improve their financial situation. The Fed has contributed in a significant manner to the well-being of the middle class and of the poorest Americans. » This is what he said on November 19, according to AFP.

This is no more only willful blindness... it's pure bad faith. When he evoked a possible tapering of quantitative easing, last June, the stock market plunged. His decision, in September, to keep the printing presses running full speed, contrary to what the markets were afraid of, led to the indices marching higher. Without these $85 Billion being created out of thin air each month, the stock market would collapse; it's grown addicted to this drug. What else could be pushing stocks higher? Businesses profits or growth perspectives? Come on...

As for the American population... they're better off, really? The « official » unemployment rate is 7.3% in October, but everyone knows that this number doesn't take into account the long-term unemployed. Poverty? It's getting worse, with close to 50 million Americans on food stamps, compared to 29 million in August, 2008... this is the sad state of affairs.

What should keep us worrying is the perversion of Bernanke's reasoning, that he sadly shares with his successor : « I agree with the opinion expressed by my colleague, Janet Yellen, that the surest road to a more normal approach of the monetary policy is in doing all that is in our power to promote a strong recovery. » Now, there is a fundamental confusion in this kind of reasoning, and an inversion. The confusion consists in affirming that the Fed must promote economic recovery; this is not the function of a central bank! It's rather the function of the economic agents to promote a recovery or not, depending on productivity, savings and investments. Then the government can help by easing market conditions (for example, Obamacare is weighing heavily on labor costs...). What can a central bank do? It can lower the base rate... and thus discourage savings, the foremost engine of an economy. The inversion consists in waiting for the recovery to raise the rates, while it should be the opposite... raising the rates would stimulate savings.

And this vicious reasoning is set to continue : « The Federal Open Market Committee (FOMC) will continue its highly accommodative policy for as long as it will take. » 'As it will take'? Until the recovery? It won't come any time soon! But all bubbles, after a while, end up bursting...

The ECB to Open Liquidity Spigots

Dec 5, 2013

As we've explained before in this article, LTROs, those gigantic loans, totalling $1 trillion euros from the ECB to the european banks, are akin to the Fed's quantitative easing plans or, in other words, the use of the printing press. A large part of that money cannot be reimbursed, and the ECB will have to « roll over » the debt, e.g. to propose another gigantic loan.

Terms are approaching. LTROs are three-year loans that were issued in December 2011 and in February 2012. So they are due in December 2014 and next February, meaning very soon. According to the Bank of Italy, of the 255 billion euros borrowed from the ECB through the LTRO, italian banks only reimbursed 15%, or 38 billion euros. So, there still remains 217 billion euros to be paid in 2014... and for Spain, the amounts are just about the same.

Will the italian and spanish banks be able to reimburse those amounts? Serious doubts arise when we discover the contraction of their activities : credit for non-financial businesses is down 5.7% (by October 2013, year-to-year) for the italian banks and 19.3% for spanish banks! Consumer loans and mortgages are also down. Credit is an essential component of banks' business bottom lines, and it's sharply on the way down, as can be seen.

These poor statistics also contradict the ECB's discourse, which explains that the liquidity provided by the LTROs, as well as its base rate close to zero (0.25%), are meant to sustain credit creation... It's obviously not working, so let's keep on trying! As a matter of fact, the ECB has no choice but to offer another LTRO, lest the italian and spanish banks go bankrupt. Thus, there is an urgency to avoid this risk, with a new quantitative easing plan. Markets which, in fact, have a tendency to mistake liquidity for solvency, will be reassured, Mario Draghi will lead the parade and government leaders will proclaim that « the crisis is behind us ».

All this, of course, doesn't go well with Germany. The problem is, however, that it's losing the upper ground with the ECB, its position becoming the minority's. There are now more countries hoping for or satisfied with quantitative easing policies than worried about them... the « doves » have taken over the « hawks ».

The trick is now, for the ECB, to cajole Germany... There is talk about a LTRO which would be issued only to banks willing to augment business credit, but how can one force a bank to lend more? The ECB could buy titles from small businesses (in exchange for fresh money for the banks), but is it the role of a central bank to be holding such assets? In any case, the ECB will be counting on the sentiment of urgency facing the situation of the italian and spanish banks to impose a new deluge of liquidities.

Banks Do Not Like Either Bitcoin or Gold... It Makes Sense

Dec 12, 2013

It's interesting to see what is happening with the bitcoin phenomenon : The banking lobby is getting nervous. We've already written about bitcoins in a former article and we explained, in short, that they acted a bit like « digital gold » units. Compared to gold, bitcoins are considerably less known, there are just a few of them, and they are more or less secure (hacking risks, thus theft, are high). On the other hand, this digital currency has some characteristics akin to gold : the absence of a control organism (thus no possible manipulation) and a limited quantity (no monetary press). Another advantage of this virtual currency is its close to zero trading costs.

That’s a lot for the banks to digest and it makes them nervous. Bitcoin has already started to compete directly with the banks by replacing debit cards for payment means. BitPay, the U.S. leader, has already signed 100,000 businesses (as compared to 10,000 in 2012). Not to mention that savings in bitcoins represent money leaving the banking system.

So they’re reacting : Some banks in the U.S., Canada and Australia have closed accounts of clients dealing in bitcoins. The Bank of China realised that the electronic currency was used to avoid currency controls, and it asked chinese banks to stop using it for their transactions. But all of that will not stop, if ever so lightly, bitcoin’s rise; it’s already too late. They managed only to stop its rise (temporarily) under $1,000. They will most certainly use the means of derivatives, some kind of « paper » bitcoin, to try to manipulate its price. Those who follow the gold market know what I’m talking about.

The parabolic rise of bitcoin’s price ($100 this summer to almost $1,000 today), its growing adoption by businesses and the media hype surrounding it all point to a distrust in the overall banking system and paper money. It looks like a general rehearsal, on a very small scale, of what would happen with gold if people were to lose confidence in the euro or the dollar...

The « bitcoin-as-mafia-money » scare is not working anymore, and the central banks of China and France published, on the same day (what a coincidence!), a series of cautionary notes, such as calling bitcoin « unregulated money », « value not guaranteed », « speculation driving concept », « marketing stunt », etc. Quick, let’s find solace in our beloved paper currencies held by our all-knowing central banks!

All the hooplah around bitcoin, the banking lobby maneuvers (central banks and large banks), are quite reminiscent of what is happening around gold. Bitcoins and gold share some common points and differences. They have a different nature and yet they both represent alternatives to paper money, in different ways. They both bear witness to the growing distrust in paper currencies manipulated by central banks. Too bad... they will continue, loud and clear!

Warning: European Guidelines for Looting Your Bank Accounts Are Now Official

Dec 18, 2013

We’ve already talked about what happened in Cyprus last April : the confiscation of bank accounts over 100,000 euros to shore up local failing banks. We also explained that it was but a rehearsal for future settlement of banking crises : directly looting depositors’ accounts. And, case in point, there is a project being put in place to formalise this procedure.

Let’s say it again : This is nothing but pure and simple theft, a frontal attack on property rights. Involving shareholders is one thing, and it’s normal. But if this is not enough, the banking laws have to be reviewed so that savings banks cannot also be business banks, so as to avoid deposits be put in jeopardy. But what is happening, really, is that banks are not kept from getting bigger and accumulating more risks (faith in Basel III rules is overblown) and, if there’s a problem, all they’ll have to do is rob the depositors! Will the account holders be notified? Certainly not, because this could cause a panic movement...

In the night of December 11-12, the 28 member States, the Commission and the European Parliament reached an agreement on the wording of these directives. They will be implemented on January 1st, 2016 : we have been warned.

Many could shrug this off because of the 100,000 euro floor, but this would be a tragic mistake. Effectively, in Cyprus, accounts holding less than 100,000 euros have been spared, but only because the European Union and the IMF brought in 10 billion euros in the bail-out plan. For countries like Spain, Italy or France, hundreds of billions would be needed to spare those accounts. Who could bring in such an amount? Moreover, the directives forbid this type of outside help (bail-out), as a matter of fact, to force countries to solve the crisis hitting them by themselves (bail-in). I would bet that ALL accounts would be looted.

Obviously, with these guidelines coming into effect, all of those with accounts over 100,000 euros, up to a million euros, let’s say, will just open several accounts in order to remain below this amount. Multi-millionaires, on the other hand, will either leave the country or transfer their wealth in some financial montages to protect it. Only businesses will be left... But looting part or the whole of businesses’ accounts, their treasury, so to speak, only leads to making it impossible for them to pay their employees for the coming months and to have them face hardships or even bankruptcy, and thusly provoke a major economic crisis.

This 100,000 euro figure is just a smokescreen destined to reassure 95% of the population (the voters!), but it obviously won’t hold in case of a banking crisis. These directives are just another reason to seek shelter from the banking system.

Disinflation Risk and the Gold Price

Dec 26, 2013

Deflation fears persist and, with it, the impact it would have on the gold price. Many observers believe the gold price would go down. Let’s try to clarify things a little.

Though deflation sounds scary, it hasn’t always been the case. A general fall in prices is even a normal thing in a gold-backed system : The money in circulation being constant, prices of goods and services fall as they integrate productivity improvements (one’s money goes farther). Ron Paul reminds us that in the United States, from 1879 to 1900, prices have fallen by 47% while economic growth averaged close to 4% a year. Sound growth that we may never see again...

But deflation may also happen with a brutal contraction in asset prices. In such a scenario deflation happens after a bubble, and plunging prices are the signal of a grave crisis. So, which type of deflation do you think is threatening us? This one, of course.

There are so many bubbles today (stock market, and especially the sovereign bond market), and they’re being inflated by the central banks, as we often explain here. These will pop more or less brutally, one day, and it will bring a plunge in asset prices.

On the other hand, in the « real » economy in Japan, Europe and the States, what we see is not deflation, but disinflation, with almost stagnant prices, which reinforces the fear of real deflation. Mainly, the economy is in a thrombosis and there just is no recovery. All that money created by the central banks doesn’t reach the real economy; it stagnates (in bonds or as reserve), as can be seen in the money velocity which, in the United States, has reached its lowest level since the Second World War!

One must be aware that deflation is lethal for the highly-indebted one : his income becomes less, the value of his assets becomes less, so the real weight of his debt increases, bringing financial death. And today, there is way too much debt, whether sovereign or in the banking system. So deflation is clearly not an option for the central banks of Japan, the United States and Europe. They would rather risk hyperinflation... which, at least, would help in devaluating the debt!
Should such a mortal deflation scenario prompting the banks go all-in and to open the spigots to try to drive prices higher, one can only imagine where the gold price could go... Gold would then be the only available lifeline.

How the ECB is Lying About Future Bank Stress Tests

Jan 2, 2014

The European central bank has conducted bank stress tests in the past, and it missed the mark entirely by using rosy scenarios that couldn't help detect anything wrong. Let's just recall that the irish banks, or Dexia, had passed those tests with flying colors just a few months before going bankrupt. But this time, the ECB and the EBA (European Banking Authority) are telling us that things will change, that the criteria will be more rigorous, that they will not hesitate in naming banks having problems and that they will not be hanging out gifts.

However, as we learn in this note from Natixis (a bank that was close to bankruptcy but has a decent study department), a close look will be taken at the bad loans... without taking into account sovereign debt! Notwithstanding the fact that banks are holding major amounts of it and that any hike in interest rates would bring considerable financial losses, it will not be counted.

On the bad loans front, things are already shaky. In Italy and Spain, the default rate on both household and business credit is up since 2008, and the trend is picking up. But on top of that, the amount of public debt owned by the banks has gone from 12% in 2008 to 28% today, in Italy, and from 7% to 30% in Spain over the same period. This could be enough, on its own, to explode those countries' banking systems should interest rates rise significantly. But the ECB has decided to keep its eyes closed...

The Natixis study tries to evaluate this risk : A rise of only 1% in interest rates would cost 28 billion euros to the italian banks, or 16% of their own funds, and 20 billion euros to the spanish banks, or 12% of their own funds. Only 1%, and the alarm bells are sounding...

Why is the ECB acting this way? We're here at the heart of the conflict of interests that we have denounced in the past, e.g. the central bank being the banking sector's regulatory organism : the ECB is judge and party. Because the ECB is responsible for the behaviour of the Eurozone's interest rates. It set its base rate at the lowest, 0.25%, and generously lends to struggling banks (two LTROs for 500 billion euros each, and many other types of aid). Any rise in interest rates in southern european countries, or in France, would bring its failure, thus it refuses to let it happen.
The ECB, just like the Fed and the BoJ, is stuck : Either it keeps buying government debt indefinitely (even if indirectly, for the ECB), which will lead to hyperinflation, or it stops monetising the debt, which will lead to a rise in interest rates that would bring about bank failures and a severe depression. In both cases, savers will be punished, of course. So, in the mean time, they're trying to save face, and that includes running rigged stress tests.

Virtual Wealth and Real Wealth

Jan 9, 2014

The rich are getting richer. According to the last Bloomberg list, the fortune of the 300 wealthiest people in the world increased by $524 billion in 2013, reaching a total of $3.7 trillion, while Bill Gates, number one on the list, saw his personal wealth increase by $15.8 billion, which makes him now worth $78.6 billion. Let's bring out the champagne!

Well, the middle-class will not be drinking champagne... In the United States, there are close to 50 million people on food stamps, almost double the numbers preceding the 2008 crisis. Why are things so distorted? Some would like the « filthy rich » to pay, but that wouldn't do any good (an integral re-distribution of those $524 billion to the world's middle class would be but a drop of water for each family!). Also, it would hide the real problem.

Essentially, the rich have gotten richer because their assets consist of stock shares, and the stock markets have done well in 2013. This is the main reason. But the rise in shares has much less to do with the real performance of businesses (which would be reflected in the middle class) than with the Fed + BoJ + ECB QE plans. A lot of this « free » money (0% int.) sees its way to the stock markets which react by (don't hold your breath...) going up! Well, actually, this money is without interest for banks being refinanced by their central bank, but not for households and businesses that wish to borrow and have to pay the full rate, of course, to their bank.

This is known as the Cantillon effect, from the Irish economist of the 18th century who first brought the phenomenon to light. It has become a key concept of the Austrian School, and Ron Paul has often denounced this pervert effect of quantitative easing that causes an artificial « wealth effect » for the wealthiest, while the middle-class earnings are not improving. This analysis is worth its salt : as a matter of fact, one doesn't need to be a marxist or a statist or even a fan of the « Occupy Wall Street » movement to be against this unjustified distortion of wealth and income. A liberal (in the Austrian sense) analysis can aptly explain this phenomenon and bring forward an answer (sound money management) that could solve this problem at its roots without intervening in the markets.

All this wealth is mostly artificial, being the result of a bubble, a stock market bubble. A virtual wealth that may well be lost should the stock market reverse... The moral of the story : Wealth cannot be measured by a single number, especially if it's accounted for in an overly-printed money; this is all too volatile. One must ask, what is real wealth made of? A piece of advice : gold cannot be printed, so there is no Cantillon effect possible with it!
Happy New Year to all for 2014!

French Government Hikes Gold Taxes

Jan 15, 2014

Bad news. Well, it had to be expected, because this government (and the former one) keeps rising taxes of all sorts; one couldn't hope for gold to escape them. The amounts involved are extremely small but, as far as the symbol goes, gold could not go through the net's mesh. Starting January first, the length of holding time necessary for total exoneration from taxes on plus-value has gone from 12 to 22 years. The 10%-a-year allowance after the second year thus becomes a 5%-a-year one. The tax on plus-value remains at 34.5%. The flat tax (for those who own « grandmother's napoleons », i.e. with no receipt) goes from 8% to 10.5% of the total amount. Now, basically, gold remains a choice investment, of course, and even a cheap one, given its undervalued price. Gold is also an insurance investment not to be shunned (read the article that I'll publish tommorow on my blog).

It is estimated that the French own approximately 3,000 tonnes of gold in the form of napoleons and ingots (515 million napoleons have been minted between 1802 and 1914. If we multiply each coin by its weight of 5.8 grams of gold, it amounts to 2,990 tonnes. Part of it has been lost, of course, and we have to add the ingots for which there is no estimation available). At a price of 30,000 euros a one-kilogram bar, this amounts to 90 billion euros. A smart government would abrogate all taxes on gold in order to favor its coming back in circulation, albeit partially, which would bring in several billion euros in the economy and, hence, important fiscal revenue, considerably more than with this miserable flat tax of 10.5% or the one on plus-value. Smart government...? Of course, it was a joke, sorry.

IMF, EU, Basel... Bank Accounts Under Threat As Never Before

Jan 16, 2014

What kind of game are the banks and the states playing? Here are four news items that should alert anyone still having faith in the european banking system.

Firstly, the european guidelines for using bank accounts in case of bankruptcy (bail-ins) have been adopted and will come into effect January 1st, 2016 (we've written about this last December 18).
Secondly, last week, the IMF came back with the idea of using bank accounts and implementing a universal tax on savings in order to reduce public debt. The institution had previously mentioned these (we've written about it last October 16). This time the IMF brings two famous Harvard economists to the stage, Carmen Reingart and Kenneth Rogoff, to explain that public debt has reached new summits not seen in 200 years and that, inevitably, we'll have to resort to a cocktail of measures, including re-structurations, defaults and inflation...

Does the simple fact that these threats are uttered deter the banks from taking on as much risk? Is the Basel Committee, in charge of writing the prudential norms for the european banking system, hardening its position, as much as it could, to avoid having to resort to such extremes? Not at all, and this is the third news tidbit from Monday : Banks have obtained an easing of their leverage ratio which is coming into effect in January 2018.

What are we talking about here? Certainly not about the usual pondered ratio that we're used to, about 7 to 10% (pondered because the debt of a AAA-rated country would rate zero, being considered without risk...), but about a « dry » ratio in which all banks' assets are taken into account without questioning their risk level (in any case always difficult to measure). A more prudent ratio, sort of. And it should be at 3%.

But even 3% isn't such an improvement, it's even dangerous. It means that a bank can be involved in 33 euros with only one euro in the bank... If these involvements (state bonds, business and household credit, stock portfolio, derivatives) lose just 3% of their value, its reserves are taken away and the bank goes bankrupt. Let's recall that Lehman Brothers had 30 : 1 leverage before it went under.

Well! It seems that 3% is still too much for the large european banks and, accordingly, they just obtained some easing of that rule! Which consists mainly in technical accommodations taking into account such things as net positions versus gross ones, maximum loss levels instead of total losses... we're swimming in a sea of « anything goes » and of total irresponsibility!

But hey, why worry, why should we become prudent if, in case of banking failure, banks and states can use savers' accounts directly? And, and this is the fourth piece of news, to make sure that the people won't have time to protest, the procedure will be greatly accelerated. Sabine Lautaenschläger, Bundesbank's vice-president and the German candidate to replace Jörg Asmussen, another German, as director of the ECB, stated on Monday that the Eurozone should be able to define in one weekend a re-financing and re-structuration plan of a failing bank. Just one weekend.

A bank, in which the government was telling everyone to trust, is suddenly declared bankrupt on a Friday night and, on Monday, your account is cut by half. Simple, clean, efficient. One cannot stop progress...

Italy and Spain : Risks Are Hidden But Very Real

Jan 23, 2014

Rates on the debt of Italy and Spain have reached high levels in 2011 and 2012, even 7% at times, a rate considered as « mortal », because it could snowball into quick defaults. But in 2013 and the start of this year, these rates have been around 4%, in the midst of weak volatility. Does that mean that the crisis in Southern Europe has ended?

Not so fast!... Things appear to be going better, CDs on italian and spanish banks have come down, and stock indices are up. But what about the real economy? Industrial production, investments, household and business credit, construction permits, all taken to the shed in the 2008 crisis, remain lifeless and are not showing any signs of recovery. Unemployment is exploding, so are business bankruptcies, as well as default rates on real estate loans to households. About the latter, also a determinant in the banks' health : In Spain, loan delinquency is estimated to be around 192 Billion euros, and in Italy, 150 Billion euros. Let's recall that the european bailout plan for the spanish banks in June, 2012, amounted to 41 Billion euros... a far cry from what is needed. One should hope they'll be able to generate enough revenue and benefits to cover these charges... In Italy, the oldest bank in the world, and one of the most important ones, Monte dei Paschi, was supposed to raise its capital reserves by 3 Billion euros in December, but has been delaying compliance to this requirement until next June, which puts the institution under pressure.

So where is the good news, what indices are on the way up? Property prices, stock markets, as we've said, and of course sovereign bonds (lower rates, from 7% to 4%, mean their prices are going up). This really looks like a bubble! Is there any « real » good news? Spanish businesses profits are on the way up, well above their pre-crisis levels, and the same is true in Italy, albeit at a slower pace. Good news, but a little on the soft side.

A sovereign debt at 4% is not akin to the Eldorado. It is not even sustainable on the long term if GDP growth remains close to zero, which is the case, and if budgetary deficits persist, which is also the case in both countries.

And we know how these low rates happened : with the help of a deluge of liquidities from the ECB with the December,2011, and February, 2012, LTROs (totalling 1 Trillion euros loaned to the european banks on three years at only 1% annual rate) from which the

italian and spanish banks have largely profited, namely to acquire sovereign debt which, in turn, helped drive the rates down.
In conclusion, we are facing a bubble. Too few real elements make for optimism. Also, the LTROs will come to terms soon, in December of this year and February of next year. We shall see if the banks will succeed in reimbursing their debts... If not, we might be talking about Italy and Spain in more worrisome terms.

Crisis in Emerging Countries : After So-Called Global Recovery, Back to Harsh Reality

Jan 30, 2014

« The whole scenario of global recovery is being put into question ». This is the heartfelt cry of a banking analyst in Paris, as quoted by Le Figaro last Friday, after the stock markets fell worldwide. The specter of a crisis in emerging countries is back. A veritable tsunami is sweeping through their currencies : The argentine peso has lost 20% to the US dollar since the start of the year, the turkish pound has lost 30% over the last twelve months. The mexican peso, the brazilian real and the south african rand are caught in this downward trend as well.

Emerging countries aren't the Eldorados they used to be! And China, the main one, is showing signs of weakening... Everyone realises that China's growth is the driving force of emerging countries. Also, the main bank of the country, ICBC, might actually default. It was selling a fund promising a 10% yearly return, a much higher performance than classic bank offerings, but that promise evaporated, because the money invested in the fund was not used to exploit a mine , as was supposed to be the case. Even though ICBC had been the seller, it first refused to acknowledge any responsibility in the incriminated product before finally settling on an agreement in order to avoid capital losses for the clients. The highest authorities had to intervene to avoid a confidence crisis, but the whole thing illustrates just how much this shadow banking system has grown in China and has become dangerous.

Markets are plunging, not surprisingly, because worries were already surfacing a few months ago. We had written Emerging Countries : The End Game?, this last August, when there were already capital movements appearing. We are witnessing a crystalisation of those worries, an amplification of mistrust, an acceleration of the crisis. In Argentina, the central bank is no longer trying to support the peso and is keeping its reserves for the buying of first-necessity products that need to be imported. The result : The peso is tumbling again, and the 28% inflation rate seen in 2013 might very well be beaten in 2014.

Should we fear a contagion effect toward the industrialised countries? Not at all, are quick to state several European leaders through AFP (Agence France-Presse), one of which, Eurogroup president, Jeroen Dijsselbloem, said, « I don't think there will be any contagion of the risks weighing on emerging economies toward the Eurozone ». Really? Not even in Spain and Portugal, with their economies having strong links with Latin America? If it ever were the case, it would be game over for this very timid and discreet recovery that keeps being touted incessantly, as if believing strongly in it could make it happen for real...

Is this a secondary phenomenon or a first bubble starting to pop, as a precursor to others? We shall see, though we think the latter is the case. Regardless, this crisis reflects the fragility of the global economy. This crisis also demonstrates that central banks can lose control of the situation and become powerless before the devaluation of their currencies and out-of-control prices. Could this be a warning shot to the Bank of

Japan, the Fed and the ECB?

Bernanke Tapers QE Before Leaving the Fed : Can This Be Sustained?

Feb 5, 2014

So, the Fed has started tapering its QE. From $85 Billion a month, the monetary press slowed down to $75 Billion a month, last month, and then down to $65 Billion a month, last Wednesday. To understand what is going on, one must know that, when QE was cruising at $85 Billion a month, $45 Billion was going into buying Treasury bonds, and $40 Billion into buying mortgage-backed securities (MBSs). Only the Treasury bonds buying is being tapered, going from $45 Billion to $20 Billion, and the MBSs will continue to be bought at the same pace.

The tapering of Treasury bonds buying can be explained by the lowering of the budget deficit, which has gone from the abyssal level of 10% of GDP in 2009 (proportionally like Greece, with more than $1 Trillion) to 7% in 2012, with an optimistic forecast of 4% in 2013-2014 (budgetary year starts in Septembre). On the other hand, not tapering on the $40 Billion a month of MBS buying just goes to show that banks' balance sheets are still full of toxic real estate debt that only the Fed is willing to acquire.

We shall see if Janet Yellen follows in Ben Bernanke's footsteps, now that she's officially in charge of the Fed since January 31, because at this pace (- $10 Billion a month), QE would be down to zero, come this summer. But the rotten MBSs will still, in part, be there; will the banks be able to go it alone? The budgetary deficit will not have disappeared this summer, of course : will the State be able to get financing solely on the markets without causing the rates to rise? These are tough questions.

Furthermore, Bernanke justifies this QE tapering by a lower unemployment rate (6.7%), but everyone knows that this rate is less the result of jobs creation than the result of many unemployed leaving the work force and, thus, the statistics. This QE tapering is also justified by the return of growth, surpassing 2% annually, but still anemic. What is happening is that a « wealth effect » has been created by the rise of Wall Street, but the businesses haven't started to invest again... this is all too fragile.

Ben Bernanke might have left his successor with a poisoned gift... Didn't he taper so that he could leave the Fed with a positive image, all the while knowing it wouldn't be tenable? Also, this hypothetical stop to Quantitative Easing would leave whole the problem of all this liquidity injected into the economy by these QE plans since March, 2009, that will have to be withdrawn some day (by selling these Treasury bonds and MBSs that the Fed bought). The Fed's balance sheet is blowing through $4 Trillion, or a quarter of the United States' GDP, from less than $1 Trillion in 2007, before the crisis. Those $3 Trillion in liquidity are threatening price stability and the whole economy as well. Furthermore, risks remain in banks' balance sheets, in the Dow Jones bubble, and in the absence of any real recovery... and the emerging countries are in a crisis, which does not bode well. So, yes, I would say this looks like a poisoned gift...

There is Still no Recovery in the United States!

Mar 6, 2014

We've said it before... but here we go again : THERE IS NO RECOVERY OF THE AMERICAN ECONOMY! There. This « recovery » has been touted these last few months with the mass media repeating it ad nauseam, and « no one should doubt it ». And quarterly growth numbers seemed to confirm it; for two quarters in a row, the third and fourth of 2013, the United States' GDP had grown over 3%... victory!

Unfortunately, the numbers for the fourth quarter have been revised to the downside, and sharply so, going from 3.2% to 2.4%. But, as could be expected, this revision was good for only a few lines in the media and was quickly buried by other « breaking » news. We should always keep in mind that being well informed starts by not being limited to headlines.

Twice in the past we've seen two consecutive quarters with a little over 3% (2nd and 3rd quarters 2010, 4th quarter of 2011 and 1st quarter 2012), bringing hope of a recovery, but each time the trend lost steam, though the media were selling us the end of the crisis!

It's been the same story since March 2009, when Wall Street started to recover after the long slide triggered on September 15, 2008, by the failure of Lehman Brothers. And why, do you ask, stocks started to rebound in 2009 (exactly five years ago)? Was it because the worst of the crisis was behind us and that outlooks were becoming more encouraging, like was explained at the time? Not at all. It was for a very simple reason : That date marks the start of the Fed's first quantitative easing (QE) plan.

Since March 2009, QE is what makes Wall Street tick. Each time QE stops or simply tapers, like now, the stock market breaks or becomes indecisive. This goes to show that there is no real self-generated endogenous economic recovery (investments, profits and salaries), but only bubbles in some assets (namely stocks and bonds) that create artificial wealth for their owners.

We must see the reverse side of the coin : Despite a $65Billion-a-month QE and an important budget deficit (more than 4% of GDP), growth hardly exceeds 2%... With the U.S. population growing by 1% a year, this corresponds to a real growth rate of 1% a year. And that is if those are the real numbers... but that's another problem (inflation is underestimated... if we only add 2% to it we get to zero growth, because it is calculated by substracting nominal GDP growth from rises in prices). Well, to sum it up briefly, the situation is not progressing well. Meanwhile, debt and risk are certainly progressing very well.

How QE and Stock Buybacks Reinforce Each Other

Mar 13, 2014

In the United States in 2013, stock buybacks broke all records : companies on the stock market bought back $600 Billions of their own shares. Since 2009, $1,000 B have thus been bought back, about 10% of market cap, which shows the scope of this phenomenon. Businesses that are doing well or, more simply, that are reducing their costs, are accumulating cash but, since growth prospects are dim, they are not investing and are sitting on tons of cash. The best example would be Apple, with about $160 B in cash, that, having relented for a while, finally started to buy back some of its own shares, to the tune of $40 Billions so far. A stock buyback generally translates into an increase in price : the company's value stays the same, but the number of outstanding shares shrinks, so the price of each share goes up. It’s like a gift to the shareholder.

The scope of those stock buybacks constitutes another hint as to the lack of a real economic recovery in the United States. Furthermore, this $600 Billion figure must be put in relation to another one : the $1.2 Trillion created by the Fed during 2013 with its QE plan ($85B/month X 12). On the one hand, the Fed creates paper money, and on the other hand businesses destroy paper... not money, but their shares. On the one side, liquidity is created, and on the other, it is destroyed, as if it had to be compensated for.

As a matter of fact, both phenomena reinforce themselves, pushing stock prices up. On the $85 B of QE in 2013, $45 B go to buying Treasury bonds, thus financing the budget deficit, and $40 B go to buying back dubious mortgage-backed securities (MBS), in order to prop up the real estate market. This way, $40 B go to the banks, and they can also borrow from the Fed at 0%. Then the banks reinvest these monies in the stock markets, notably on Wall Street, which helps boost the shares... It’s like a two-tiered rocket, sort of : more money is circulating and, at the same time, less shares are available.

This liquidity funnels through the stock markets and finds its way into the shareholders’ pockets, i.e. wealthy households, societies of funds. For those entities this produces a « wealth effect », an increase in their assets, but based on artificially created liquidity, a bubble waiting to explode. This mechanism is, of course, very unstable. A little of that « new-found » money is spent, stimulating a little jolt of economic growth which, in turn, is good enough for the Fed, the politicians and the media to proclaim that the economy is on the mend... but this is all a smoke screen.

Funny how the Fed and Big Business are not true to their primary function (guarantee the value of the money, invest and increase profits) and would rather manipulate the tools at their disposal, for which they are responsible, that must be used to establish objective measures (dollars, stocks)in the economy. They’re acting as if there were nothing else left than subterfuges with this depressing situation in the real economy...

FOREX and LIBOR Manipulations : The Work of Central Banks, As in Gold?

Mar 20, 2014

The Foreign Exchange (FOREX) manipulation scandal is growing in scope. In 2013 many large banks (Barclays, Deutsche Bank, UBS, Royal Bank of Scotland and HSBC) set aside 16.4 billion euros to cover « legal expenses », e.g. the probable amount of fines they will have to pay after their trials. In 2014 five of the largest european banks are expected to set aside between 8.5 and 10.5 billion euros for the same reason, according to the Financial Times of March 10.

Traders/manipulators on the FOREX would agree through their instant messaging service to place orders just a short time before currency price fixings and, thus, take advantage of it. The amounts involved are so astronomical ($5.3 trillion in daily transactions) that the merest spread becomes significant. The investigation is mainly centered on the City, in London, the world’s foremost exchange hub for foreign exchange, but it is being spread to continental Europe, the United States and Asia. It is believed that no large international bank should avoid scrutiny.

But things are getting more serious yet with the Bank of England itself being investigated. The Bank’s governor, Mark Carney, was questioned on March 11 by the House of Commons Finance Commission and he had to explain the quite ambiguous attitude of its chief of « currencies » department, Martin Mallett, who has been suspended pending results of the internal investigation. It seems that Mr. Mallett would have been aware of the manipulation by certain traders but that he wouldn't have acted on it...

This news of FOREX manipulation comes after news on LIBOR and EURIBOR. Those large-scale malversations have been going on for several years, most large international banks are concerned, and central banks wouldn't be aware of that? Come on!

Gold market specialists have been sounding the bell for a long time about direct central bank intervention in concert with large bullion banks. For a long time they have been hailed as crackpots or conspiracy theorists, but proofs are starting to come out, investigations are initiated and guilty verdicts are pronounced. The London Gold Fix has been manipulated for ten years, explains Bloomberg. Finally, gold advocates were precursors. They understood well ahead of others that prices were being manipulated, and we're only discovering today the scope of this lie : It is colossal, because LIBOR and the foreign exchange market affect colossal volumes and are used as reference points for a vast array of financial products, including your mortgage.

The irony in all this is that it's gold, the « barbaric relic », now demonetised and hailed as just an « accessory », according to those who pretended we could go without it, that has played the role of spark plug. There are still many things waiting to be discovered but, the closer we get to the central banks, the more « fun » will be in store.

Facing an Enormous Public Debt, Japanese Starting to Change Attitude Toward Gold

Mar 27, 2014

In Japan, nothing is going well : the trade deficit is growing, recovery is not happening, and public debt continues to soar. Why? Is Japan doing things differently, economically, than the other great industrialized countries? Not at all, and this is what is troubling, because it's doing the same, but on a much worse level!
When Shinzo Abe took power in December, 2012, he made it clear that he would speed up the accommodating policies in place : more deficit, and even more money printing. More deficit, supposedly, to sustain demand, but nothing is showing on the recovery side. More money printing to finance the deficit, but also to bring the yen down (that lost 20% to the dollar in 2013) and, thus, jumpstart its exports. But things are never that simple... Exports have barely budged but, on the other hand, the cost of imports has risen substantially and, at the end, their trade deficit has grown larger!

One thing is doing better, though : the Nikkei is on a bull run since the start of 2013... Nothing to rant about, since it's a bubble, of course, and it's the only result achieved from the central bank's money printing...

Japan is only ahead of us : it lived through a great crisis (real estate and stock market bubbles exploding) at the start of the '90s. Since then, it has had laxist policies that Shinzo Abe has just taken to a higher level. The result of all this is a public debt equivalent to 240% of GDP, an astonishing number (double that of Italy, and Greece's is « only » 160%). How can this country support such a debt? Well, simply by buying it massively. The Japanese are high savers and they invest their savings in Treasury bonds, which they trust, and they own 93% of the debt. There is no need to convince foreign investors with such a national savings rate.

However, this model is starting to show some cracks. Since there are more and more Japanese off the work force, it mechanically reduces the rate of savings. More fundamentally, people may be starting to doubt these policies of public debt and money printing.

And, worthy of note, is another evolution that, although marginal, volume-wise, might be revealing : the Japanese people are back buying gold (the people, of course, not the central bank). If we are to believe the World Gold Council's « Gold Demand Trends Full Year 2013 », after seven years of negative net investment demand (generating cumulative outflows of 266.1 tonnes), Japanese investors generated net positive investment demand for three consecutive quarters (page 12).

Up until now, Japan was the exception among Asian countries that are hungry for gold (China, Vietnam, Thailand, Indonesia), and even seemed odd, because Japanese people would get rid of their gold, to the point that Japan was showing a negative balance. These days seem like they are over and that awareness has risen in the course of 2013. Does this bode for a big change? Too early to tell but, obviously, faced with a public debt seemingly defying the laws of gravity, a little good monetary sense is appearing in the « Country of the Rising Sun ».

Why Are We Being Told that Deflation Is the Absolute Evil?

Apr 3, 2014

Why is deflation depicted as an absolute horror? Journalists, economists, politicians and central bank chairmen are all warning us against a general and durable price deflation, equating it to the Apocalypse, as they explain it. This unanimity is very troubling, so let's stay on the alert. Why... when prices fall, it's great, we can buy more! The price of flat-screen TVs and electronic components in general, the price of gas falls a little, and the slowdown in emerging countries should put a damper on the price of commodities... should we complain? Why should the consumer fear a fall in prices?

There is someone panicking about a general price fall : the very indebted one. In fact, the relative weight of his/her debt increases as prices fall; its nominal value stays the same, but it becomes proportionally heavier when prices all around are getting lower. If you're over-indebted, a prolonged fall in prices is like a death warrant. So who is concerned? Well... the industrialized countries : the United States, Europe and Japan. This is the real reason : over-indebted countries. So they're « selling » this fear to everyone to mask the fact that they're the only ones paying the price...

And then, on TV shows, a bunch of economists explain that falling prices automatically trigger a recession and a fall of GDP. Why? They say it's because consumers wait for lower prices to buy... what a joke! So these economists would have the power to refrain from eating, lighting and heating, and travelling for several months in order to benefit from falling prices? Give us a break... this would be a great performance, but I don't think anyone could do it.

And how about discretionary buying of goods, like those flat-screen TVs, for instance? At first, they were very expensive, but did consumers wait until prices would come down? Not at all : those who had high income bought some, then prices came down, targeting a larger consumer base, and so forth, until today, where almost everyone has one. This is nothing but the normal process with any new technology : it's alway expensive at the launch, and it becomes cheaper later on. So this explanation of consumers waiting for lower prices is a myth.

We are getting used to inflation, with fiat paper money, but, as Ron Paul states, under the gold standard in the United States, retail prices fell by 47% from 1879 to 1900, while average economic growth was close to 4% a year, which proves that one does not exclude the other. But what's true is that, then, productivity gains were not cancelled by an inflation caused by printing money out of thin air.

Deflation does not cause a recession, it's the opposite. Our countries, in Europe, Japan and, to a lesser degree, the United States, have lost the keys to growth and the thrombosis of our economies manifests itself, among others, by dis-inflation, and then a possible deflation. There are multiple causes, but the main one is the oversize of a public sector that is choking businesses. So... what will the countries do to fight deflation? You guessed it, more money printing and zero interest rates or, in other words, more ways to finance their deficits and their debt and, thus, kick the can of restructuring down the road... Let's not fall for this crude and blatant trap.

How « Too Big to Fail » Thinking Trumps Competition and Increases Risk of Banking Crisis

Apr 10, 2014

We are aware of the problems of « Too Big to Fail » banks : They are so big that, if they were to fail, it would cause such economic havoc that they can rest assured to be bailed out by the State. And they're taking advantage of this situation by taking on even more risk! This perverse effect, this « moral hazard », makes for a much less stable financial system, more exposed to a crisis.

In the third chapter of its last « Report on Financial Stability » of April 2014, the IMF writes about this phenomenon and tries to measure it. One shouldn't consider that this Too Big to Fail principle would only have concrete effects the day one of those banks would declare bankruptcy. As the IMF very aptly explains, those banks benefit permanently from that principle : This implicit guarantee lets them borrow at lower interest rates, raise more money from clients reassured by this State guarantee, and chase yields that are riskier, but more profitable.

The IMF thus estimates that this State guarantee is equivalent to an implicit grant to those banks of 300 billion euros in the Eurozone, 110 billion in the United Kingdom, 110 billion in Japan, and 70 billion in the United States. These numbers are for 2012. Of course, those are only estimations, and they could be challenged, but their high level shows that those large banks have a considerable unfair advantage over other financial institutions.

Consequently, the whole free market competition game is rigged. Smaller banks, for their part, have to take into account bankruptcy risks and act more prudently, less aggressively, with less leverage, having less risky positions on the markets. Having to do so, they are less competitive than the TBTFs and lose clients who opt to go with those... which, at the end, brings yet more global instability to the financial system.

What makes this worse is that the 2008 crisis exacerbated this phenomenon. Several large banks were swallowed by other ones (Bear Stearns by JP Morgan, Fortis by BNP-Paribas, etc.), and their number was reduced. Paradoxically, the failure of Lehman Brothers, abandonned by the Fed and the government (the one exception to the TBTF rule!), provoked such a market crash that the belief that States will do whatever it takes to prevent this from happening in the future was much reinforced.

To fight this perverse effect, the IMF suggests the obligation for the banks to strengthen their liquid reserves and for the shareholders and creditors to absorb losses in case of failure. We could add to that the necessity of punishing CEOs who act wrongly, and of returning to a separation between deposit banking activities and market activities. The IMF states that governments have a long road ahead to « protect tax payers (and I would add the savers), insure equal opportunities and promote financial stability. » Hear, hear!

IMF Confirms European Banking Sector Still Getting Worse

Apr 17, 2014

Let's go back to the IMF's Global Financial Stability Report that we mentioned last week, but this time let's take a look at the first chapter, in the section regarding european banks (starting at page 39). And the international institution's assessment is rather worrisome because, it says, the number of non-performing loans on the european banks' balance sheets has doubled since 2009, going from 400 to 800 billion euros. Of course, as can be expected, most of those banks are from the most indebted countries (Italy, Spain, Portugal, Greece).

So, an ominous threat looms on the banking sector in the southern countries, and there is a risk of contagion to the northern ones. Are there any reasons to hope for any improvement? No, on the contrary, states the IMF, estimating that 20% to 30% of italian businesses cannot generate enough cash flow to pay the interest on their debt. In Spain and Portugal, it's even worse with a proportion of 30% to 40%! With debtors struggling, the situation can only get worse.

In Germany and France, « only » 15% of businesses do not have enough cash flow to service their debt. France had record bankruptcies in 2013, and its economy is obviously less performing than Germany's... one could think that the french banks have the prescience to « turn off the faucet » very quickly as soon as the first signs of problems arise from their client businesses... In any case, the banking sectors in these two countries are less affected on this point.

With the help of those numbers, we can better measure the chronic incapability of QE plans or other LTROs to produce any bounce in the real economy. The real economy is doing so poorly and the banks are already stuck so much with non-performing loans that the last thing to hope for is more loans to businesses! All this money created out of thin air ends up as reserves at central banks or as speculation on the stock markets, but it certainly does not create wealth. This money is primarily being used to make the banks solvent again, while this 800 billion euros of bad loans should have bankrupted them.

Furthermore, these numbers have to be evaluated in the actual context of the lowest interest rates of the last decades. Would these rates increase significantly, so would the cost of that credit, the number of businesses going under would increase still, bad loans would explode, and those banks would be doing even more poorly...

And, finally, these numbers, either for businesses or for banks, show very well that there is no real self-entertained economic recovery in Europe (except in Germany with its exports), and that only consumer spending, supported by public debt, is saving face. Decidedly, the european banking sector is poised to surprise us again...

A Dangerous Game : France Is Playing with Words Regarding its Deficit

Apr 24, 2014

« 50 billion euros in savings », stated Manuel Valls, the new Prime Minister, on April 15th. The announcement hit like thunder : After many hesitations, France is becoming aware of its difficult situation and takes vigorous action. Public spending has never decreased in 40 years and, for the first time, it's going to happen... the spiral of deficit and debt is now stopped, hear, hear! Well, in any case, this is how the government wishes this announcement to be perceived, especially by those buying France's debt, in Europe and in the rest of the world. This is, above all, an exercise in « communication ».

One has to recall that two thirds of France's debt is owned by 'non-residents', i.e. foreign investors; it is thus crucial for France to maintain their trust to avoid the crumbling of the whole thing. If those foreign investors only read the headlines of the major international newspapers, they may see a decrease of public spending and a return to a balanced budget, but if they read a little more, they might discover another reality...

What does this statement really say? A bet so risky that it could be called a lie... Actually, contrary to what one could think, there will be no reduction in spending : No cutting or decrease in social welfare, no budget cuts, no structural reform that could generate savings, no big onerous project stopped (Lyon-Torino high-speed train, windmills at sea, Greater Paris underground... each costing tens of billions of euros, with no real usefulness), nothing at all.

So, where does that 50 billion euros number come from? Manuel Valls simply decided not to re-evaluate social welfare and State spending, with the result being that public spending, in absolute terms, will not change. And low inflation expected (2%), plus an optimistic growth of 2% in the coming years (exactly 1.7% in 2015, 2% in 2016 and 2.25% in 2017) will continue to grow State fiscal revenue by 2 to 3% yearly. The difference between this stagnation of spending and this little increase in revenue amounts to 17 billion euros in savings for the next three coming years, for a total of 50 billion.

There we have it : there won't be 50 billion in savings all at once, but 17 billion over three years, which is not a lot, considering the total amount of public spending in France (1,150 billion euros). And they're betting these savings on optimistic previsions, because France is being hit, just like other european countries, by disinflation, and their growth previsions are way too optimistic. Nothing bodes for growth to pick up soon, with businesses the least profitable they've been, weak investments, record bankruptcies. The most likely scenario is growth stuck around zero and, with it, « so long » to those 50 billion euros of savings.

President François Hollande likes the Coué « method ». He stated, « On a psychological level, it is very important that the French feel like 'it can work', because faith will bring back consumption and investment. » That was last year and, since, nothing has changed. And I don't think there will be any improvement in 2014 and 2015. By constantly playing with words and abusing its people, the french government may face some violent consequences. The fall may be more brutal. France is the pivot country between Europe's south and north, and a crisis surrounding the trust on its debt would spread to all of the Eurozone...

Contrary to the Media Spin, Greece Keeps on Sinking

Apr 30, 2014

These last few days, the media would have us believe that Greece is doing better, that the country is on its way back up, and two irrefutable proofs are brought in for that demonstration : Greece is now experiencing a primary budgetary surplus, and it has regained access to financial markets. Let's see what the reality is.

Let's start by this so-called primary surplus. It is defined by revenue exceding spending, without taking into account the interests to be paid on the debt. Such a surplus is a sign of a relatively sound situation because it means that the country's spending is auto-financing and that only the interests on the debt are putting the country in the red. France is not there yet, Italy just about, and now Greece, with 0.8% of GDP. But, in order to obtain this result, the Troïka (via its European Commission representative in Athens) did not account for the « exceptional » bailout plan for the greek banks! In total, Greece's budget deficit for 2013 is at 12.7% of its GDP; without accounting for the bailout plan, it falls to 3,2% of the GDP and, finally, it shows 0.8% of GDP by taking out the interests on the debt.

In fact, the situation in Greece is worsening. The budget deficit went from 8.9% of GDP in 2012 to 12.7% in 2013, as we've seen, while public debt went from 157.2% of GDP in 2012 to 175.1% in 2013. This rapid increase along with untenable rates will definitely force another restructuration plan, because a near-zero growth isn't enough to face these terms. The banking sector is near bankruptcy, due to the first debt restructuration that was very costly, with the economy crumbling (and credit default rates exploding), with savings escaping the country and, let's not forget, with the default in Cyprus, where it was quite involved. Without a doubt, the 2013 « exceptional » bailout plan shall be renewed. But this will not be mentioned before the european elections on May 25...

Another so-called « good news » : Greece is back in the bond markets with a placement of 3 billion euros on five years, at a rate close to 4.95%. But when one looks at who the buyers of those bonds are, one notes the absence of any european financial institution (burned once, not twice!). The buyers are mainly foreign investors, certainly some hedge funds looking for risk (and they'll get it...), and... greek banks. It's getting almost comical : Greece re-monetizes its failing banks (with european money) that, in exchange, buy sovereign bonds. It's like the blind leading the disabled.

In reality, Greece is still sinking without any possibility of getting back afloat, but these two annoucements just serve the purpose of entertaining the illusion before the European elections and maintain the hope of recovery in Europe, the thinking being that, if Greece is doing better, it should bode well for the other european countries to start growing, right? Well, no, there is no recovery, and we shall hear more about Greece soon, in less favorable terms.

What's New in the United States? Still Questioning the « Recovery »

May 8, 2014

So what's new in the States? The recovery... which needs more and more time to become a reality. Judge by yourself : Growth in the first quarter plummeted to a meager 0.1%. The explanation from official sources? Snow... Yes, the stuff that falls in winter. They say that, this year, there was a little more than usual, keeping Americans at home and away from the stores... As if Americans were using dogsleds to travel! The credulous who believe such an explanation can keep their stock shares, but others will start to ask themselves some serious questions.

We've often stated here that there is no self-entertained recovery in the USA, but rather only bubbles and « wealth effects » caused by the Fed's QE plans, and nothing else. The dynamism of innovation or shale gas (with revised lower estimates) exploitation are not enough to pull forward the whole of the economy. We will be anticipating with interest the second quarter numbers to see if there is a rebound, albeit only technical, or a confirmation, in which case real worries could arise.
One has to see, also, the « screenplay » of this information : The very bad growth number for the first quarter is barely relayed and analysed in the media, as if it were an aberration that had to be forgotten quickly. But on the other hand, the next day, we're told about an upward revision of the job creation numbers for April... Finally, is the recovery here?

Let's dig a little, here. We know how the lowering of the official unemployment rate is obtained : By not taking into account the discouraged workers (who no longer look for work). The percentage of active workers to the total population went from 62% in 2007 to 59% today. Only 59% of Americans of working age do have a job. Another way of looking at it, 102 million Americans of working age do not have a job. Another significant statistic : 20% of American families do not comprise a single worker! And they would have us believe that unemployment is falling?

Meanwhile, Janet Yellen has confirmed the tapering of QE by $10 Billion. The spigot is being turned off little by little. For the month of May, the Fed will buy $25 B worth of Treasury bonds and $20 B of mortgage-backed securities. Since the tapering started, the Dow Jones is a little more hesitant and is not going up as much as before. Which makes sense, with less « fuel » coming in. It will be quite interesting to watch what happens next.

With a pseudo-recovery going nowhere, real unemployment persisting, a hesitant stock market and a slowing monetary press, the United States is entering a crucial period. Come September, the whole Quantitative Easing plan should be entirely extinguished. If, by then, there is still no real recovery, it will be a very risky period...

Seems Like the Buba Will Finally Let the ECB Use its Printing Press

May 15, 2014

So here it is, the Bundesbank is cracking! According to the Wall Street Journal, Germany's central bank would accept a move by the ECB in June if the outlook on inflation warrants it. The Buba now is siding with the general assumption that we have to fight deflation risks by turning on the printing press. After having resisted for a long time, the Buba will not resist anymore before Mario Draghi, before all the southern countries and France, that are all claiming for a more laxist monetary policy.

There will be no sovereign bond buybacks, forbidden by the constitutional Treaty, but rather acquisitions of titled bank loans or, in other words, credit to businesses that is put in slices, packaged and resold, a little à la subprime, which was for real estate credit. One does not need to have a wild imagination to think that failing banks would take advantage of this to unload their toxic debt to the ECB... Banks in Spain, Portugal, Ireland, Greece and Italy must be impatiently waiting for this possibility to materialise, since it would represent for them a dream opportunity to lighten their balance sheets in exchange for some liquidity.

This change also means that the Bundesbank now accepts the general idea that there has to be (a little) more inflation in order to sustain economic activity. This is grotesque! It's as if lower prices would break this little residual growth when, in reality, they are only one symptom of our congested economies. We would be better off asking about the level of taxation, the weight of public spending, the bureaucratic weight of the European Union and of the national administrations, and on the lack of competitivity of the european economies. But that would involve too much questioning for our leaders... so much simpler just to ask the ECB to run the printing press!

What's worse is that this policy will have beneficial effects in the beginning : The stock markets are going to go up, the euro is going to go down, and everyone will be happy. This will just create more bubbles! We already have a substantial one with the lowering of interest rates on debt in Spain and Italy... so let's have more! Once again, we'll be told that this will jump-start growth. Sure, let's just look at Japan and the United States, where there is no real recovery on the horizon.

That being said, the german economy is doing rather well (balanced budget, very low unemployment, strong exports), so why is the Buba abandoning its legendary rigor? Here's my hypothesis : The european banking sector is in much worse shape than we think, with both LTROs (500 billion euros at 1% on 3 years, twice) of December 2011 and February 2012 coming due in this year's December and February 2015, and spanish and italian banks cannot reimburse them. Also, banks from other european countries may be experiencing difficulties that are not known today as yet. Germany wants to have some time in order not to have to act hurriedly. So it will let the ECB use its printing press for a while, and it will give it time to assess the viabiity of the Eurozone in its actual form. Whatever the case may be, the first decisions by the ECB will have to be very closely monitored.

Growth Slowing Everywhere : Another Crisis Looming?

May 21, 2014

Even though the indicators for growth in large industrialised countries are just quarterly ones and could be nullified by the next quarterly statistics, they still are quite worrisome. Because they almost all confirm the slowing trend, for one, but above all, this trend is worldwide : Only +0.1% in the United States, +0.2% in the Eurozone, and a lower number in China (+7.4%) that is still high, but everyone knows that this number is inflated (in reality, it should probably be divided in half).

Let's take a look at the Eurozone : Actually, its growth is at zero, if we take out Germany with its +0.8%. But even then, these numbers do not tell the whole truth : German financial institutions and the Bundesbank are expecting a clear slowdown for the coming quarters due to decelerating exports. The only thing explaining this growth is local consumption, but it will not maintain itself at this rythm. And exports are falling, notably because their first clients, other Eurozone countries, are either in stagnation or in recession (0% for France, -0.1% for Italy, -0.7% for Portugal). The only exception would be Spain, with a meager +0.4%.

What is even more worrisome and, really, astounding, is that the Netherlands are in a 1.4% recession for the first quarter of 2014! This dynamic country with high productivity, very open to international trade, is showing a lower GDP (just like Finland with a comparable profile, at -0.4%).

This is really starting to look like an advanced indicator of a global economic contraction...

The only exception to this somber picture... Japan, showing +1.5% growth for the first quarter, a bit higher than the previous ones. Of course, this performance is fictitious, because it is based on budgetary deficits and money printing, and this country has left all sanity behind with a public debt amounting to 250% of its GDP. This kicking the can down the road will probably end badly but, in the meantime, saké for everyone!

This simultaneous crumbling of an already teetering growth is cause for concern. And, needless to say, the threat of deflation, that so obsesses the media and the economists, is a symptom here, certainly not a cause. The real reasons are both deeper and more obvious : We have not come out of the 2007-2008 crisis yet... we've only been buying time with debt and QE plans.

There always is this media noise, constantly repeating itself, about optimistic growth predictions, but only real results should count, and they are not good at all. We'll have to wait for the second quarter's numbers to confirm or infirm this trend; a technical bounce may occur, but this slowing of growth seems to be announcing something worrisome. Because when even the governments and central banks cannot succeed in creating illusions, the situation is getting out of hand...

Amount of Derivatives in the World: 710 Trillions of dollars

May 29, 2014

The Bank for International Settlements (BIS) just published a statistical study on the amount of derivatives worldwide at the end of 2013, and they reach the astronomical amount of $710 Trillions ($710,000,000,000,000). For comparison purposes, the United States GDP in 2013 amounts to $16 Trillion, or 44 times less. And this mass of derivatives beats by 20% the preceding record, dating just before the 2008 crisis... We hear a lot about bubbles these days, in the stock market, the bond market or in the commodities market, but this one is without a doubt the greatest one.

What is a derivative? It's a contract between two parties, which value is determined by variations in the price of an underlying asset (bond, stocks, commodities, currencies). It is used to either protect against price or interest rate fluctuations, or to speculate. Another type of derivative, the CDS (Credit Default Swap), is used for protection against a default event (from a borrower, a State or a business). The majority of those contracts are negotiated one on one, and not on a market, in other words, in total darkness.

Another reason to be worried : In the United States, the largest portion of those products is owned by only four banks (JP Morgan, CitiBank, Goldman Sachs and Bank of America). In Europe, there is also a high concentration with, notably, the Deutsche Bank (we wrote about it) and the french banks. There is an enormous volume, but trades are done among very few actors.

When we voice our fears about these amounts, the bankers explain that we have nothing to worry about since these bets are compensated for and, at the end, net exposure is close to zero. They explain that positions are balanced, because when a bank takes a position on a derivative, it also purchases the opposite position for hedging... but who does it buy it from? From another bank.

Thus, all the big banks sell one another derivatives, which explains the monopolistic concentration discussed above, and which means that if one of them defaults, they all go under! That's what almost happened with AIG's bankruptcy in September 2008 : AIG was the counterparty to many banking institutions, and it had to be saved at the last minute by the american government.

The best known of those products are the CDSs, but they only make for a small part of the whole. The main part of those derivatives (82% exactly), according to the BIS, is made of interest rate derivatives, of a globally equivalent amount in the United States and Europe, and this is where it becomes interesting. Fundamentally, interest rates in the United States and in Europe do not result from free market interactions; they are being manipulated lower by the central banks (the Fed and the ECB) who are doing everything to maintain them at the lowest possible. Any change in their monetary policy is communicated way ahead of time, which gives everyone time to readjust their previsions. This way, they provide false insurance to the market operators, who then engage in more risky operations. If ever the central banks were to lose control, if some crises or crashes would prove too hard to reign in or would render these institutions untrustworthy, these interest rates could experience brisk moves that could surprise the markets. And the mountain of derivatives would explode. And the aftermath would be just as hard to imagine as it is hard to fathom the amount mentioned at the start of this article.

Mario Draghi's Announcements: The ECB Puts on a Show

Jun 12, 2014

Mario Draghi came out with several announcements on June 5 which have been very well received by pundits. These measures are supposed to encourage banks to make loans to businesses and, thus, help in sustaining the recovery. Let's see what these measures really entail.

Many of the announced measures are purely anecdotical, even though they are « firsts », like lowering the base rate to 0.15% (the lowest rate ever reached by the BCE), when it was... 0.25% just before. What is this going to change? Nothing, of course. Another « first » : a negative deposit rate of -0.10%. Banks will now have to pay (just a little) to park their cash with the BCE. Okay... but if banks choose to park some of their liquidities with the BCE instead of loaning them out, as it should be the case normally, to other banks (this is the interbank market), it just means that they don't trust their peers, that they fear their default and, consequently, the loss of loaned out sums. The ECB decision will not change a lot of things, albeit encourage them to put more of that money into stocks and, thus, keep this bubble going...

After those cosmetic measures for media coverage, it is time to tackle serious business : New LTROs (Long-Term Refinancing Operations), i.e. gigantic loans to banks with reduced rates. The ECB is talking about 400 billion euros... serious business, I'm telling you. The ECB didn't have a choice : The first two 500 billion euro LTROs date from December 2011 and February 2012 and were for three years. They are coming due in December 2014 and February 2015, and everybody knows that italian and spanish banks, notably, that have gobbled a large part of those loans, cannot reimburse them all. The ECB is, hence, just putting on a show and, what's more,is offering better conditions (four years instead of three, and 0.25% interest instead of 1%). Champagne! Or, rather, Prosecco and Porto! We have explained several times (in this article, for instance) that the ECB would have to rollover the debt of european banks... here we are.

These very advantageous loans will be tied to the amount of loans the banks will have made. In other words, the more a bank makes loans to businesses and helps with growth, the more it will be able to draw from the LTRO, the ECB explains. We think that this is just sugar coating so as not to scare the Germans, who are never too keen on printing money, and also to please the keynesian governments in power in most Eurozone countries (the French government loudly applauded these measures). This way, failing banks may continue to stay afloat with their rotten loans.

To top it all off, the ECB reaffirmed its forward guidance of keeping interest rates at the lowest « for a long period of time », which assures us of an accommodating policy for quite a while... All of this shows that the european banking sector is still ailing and that the ECB has to keep it under perfusion. But by making believe these measures will jumpstart growth and recovery, Mario Draghi has proven he is a top communicator. What an actor! Bravo!

Austria Struggling with its Banks in Crisis

Jun 19, 2014

We often talk in these pages about the difficult situation facing Europe's southern countries, but the financial crisis is also affecting countries that are considered sound and that have a good reputation. This is the case with Austria, facing difficulties with its banking sector.

One bank in particular is getting the government's attention : Hypo Alpe Adria (HAA). In the 2000's the bank went on an acquisition and expansion spree, notably toward the Balkans. Its balance sheet then exploded eight-fold in less than a decade to reach 40 billion euros in 2009. Since HAA was backed by both Carinthia Land and Bayern LB, a german regional bank owned by Bavaria, it seems the leaders lost all common sense in regard to risk management. Another example of capitalism gone bad by public intervention, or better yet, crony capitalism.

As could be expected, with the 2008 crisis, the bank went into default. And the costs have been heavy : As of now, Vienna has spent 5.5 billion euros to prevent HAA's bankruptcy and has to add to that 4 billion euros just to pay for its losses and to cover its re-financement needs for this year. And this is far from over. These amounts are starting to seriously eat into the federal State's budget capacities, which is looking for solutions to limit the losses (it has already reduced the education budget, which has been very badly perceived by the population).

Within this restructuration, in order to keep its costs down, the government has decided for a very risky and new measure... plain default, just like a country from South America! In fact, those who bought HAA secondary products, or non-priority debt, will see their claims simply and purely canceled... But the problem is that those claims were guaranteed by the Carinthia Land; it doesn't matter... the federal State will just pass a law to effectively cancel this guarantee. Just like in Argentina! And, just like in Argentina, creditors will likely sue the State, considering that Austria has reneged on its promises.

With this situation, the reputation of Vienna's banking sector is in jeopardy. Standard & Poor's has already placed Vienna's financial institutions under negative surveillance following this decision. The government keeps repeating that this is an exceptional case but, in reality, the whole of the austrian banking system is ailing. Austrian banks have assets totalling 1,090 billion euros, or close to three times the country's GDP (335 billion euros), and they have a ton of exposure in the Balkans, Russia and Ukraine, the latter virtually bankrupt...

However the case may be, we are witness to the fact that rules can change in a heartbeat in times of crisis. What is happening in Austria isn't as bad as what happened in Cyprus, surely, and the depositors are not involved this time, but just the fact that a State can decide to forgo its engagements should be cause for worry.

Amazing: Central Banks are Massively Buying Stocks

Jun 26, 2014

The Fed's chairwoman, Janet Yellen, confirmed last week the tapering of money injections into the economy. Quantitative easing has been tapered by $10 billion a month since December 2013, having gone from $85 billion last year to $35 billion in July, and should be totally extinguished come September, if things go as planned. This progressive QE tapering is justified, according to Yellen, by an economic recovery predicted for 2015-1016... while, at the same time, she revised on the downward side the growth previsions for 2014 (between 2.1 and 2.3%, instead of 3 and 3.5%). As a matter of fact, since the 2008 crisis, the Fed's growth previsions are systematically revised to the downside, but this is not going to get in the way of the financial institution's unreal optismism...
This anemic growth, this ever-delayed recovery and this QE tapering should normally be worrisome for the stock market, but things are staying put for now. How is that? An important element to that answer is brought to light by the Financial Times (quoted by Zero Hedge) that points to a study by the OMFIF (Official Monetary and Financial Institutions Forum). The information therein is astonishing : Central banks invest in the stock markets; they do it secretly and for amounts that place them among the principal global investors. This is absolutely not part of their functions and they are in the middle of a conflict of interest, since they take part in monetary policies, but who's to say anything? On the other hand, they contribute to this artificial hike in the stock markets, and this is the desired goal.

Central banks do not always act in their own name, but rather do it through subsidiaries such as China's « State Administration of Foreign Exchange », which is part of the Bank of China and has become the world's most important public structure in the world owning stocks. Sometimes they do it in their own name, like central banks of Switzerland (allowed to invest up to 15% of its balance sheet in stocks) or of Denmark (holding $500 billion in stocks). The OMFIF has indentified 400 public investors spread throughout 162 countries that hold a total of $29 trillion in stocks... To have an idea of the size of it, this number roughly equates to twice the U.S. federal debt. At such a level, it is obvious that these interventions are pushing up stock prices... in other words, central banks contribute in creating an enormous bubble on the financial markets.

Manipulation, lies, dissimulation... words are missing, conspiracy theorists are overwhelmed! There is absolutely nothing that justifies the acquiring of stock shares by a central bank, and especially in such a quantity; this is not part of its mission, which is to ensure the stability of the money and the financial system. These actions, on the other hand, translate into a forward escape, the will to create an optimistic environment through the progression of stock indices, in the hope that households will pick up consumption and that businesses will invest, in order to jumpstart an economic recovery. But this recovery ain't coming and, in the meantime, the stock market bubble continues to inflate... this will not end well.

Collapse of Growth in the United States for First Quarter: -2.9%

Jul 3, 2014

The official GDP growth numbers in the United States are calculated by the Department of Commerce, and they are progressively re-adjusted as more data is collected. For the first quarter of 2014, the first estimate was at +0.1% (annualised), which was already indicating a stalled economy in comparison to previous quarters. This estimate has been revised a first time at -1%. There only remained the third and last revision, the definitive number. The analysts' consensus was predicting -1.8%, but the real numbers came out much worse, at -2.9%! A real recession, the worst result in five years, since the first quarter of 2009, when the American economy was hit by both the subprime crisis and the Lehman Brothers' bankruptcy. In January of 2014, economists were predicting a 2.6% growth, and we get a result of -2.9%, which says a lot about the magnitude of the collapse.

Let's take notice of the infinite discretion of the mainstream media and the government leaders in the United States and Europe as well. There have been very few articles on this catastrophic number and the leaders keep on selling us this recovery that is just around the corner... The last revision came out last week, thus at the end of the second quarter. We are being told this is already old news, just a little bump on the road that will be smoothed out by the next three quarters... But this scenario is unlikely, as we do not see any major rebound on the many conjectural indicators for the months of April, May and June.
For the first quarter, all of the economic engines of the American economy have stalled: consumption is up by less than 1%, businesses have not been investing, people have not been buying houses, while goods and exports both contribute in equal parts to the GDP decline. Surely the replenishing of inventories will drive the next quarter into positive territory, but there are no signs of all the engines re-starting at the same time, and no signs that at least one of them could perform. Therefore once again, we can say bye, bye, "recovery".

The roots of this dire situation are deep: Productivity, which is at the heart of the growth mechanism, has decreased by about 30% in the first quarter... Job creation is inferior to the annual 1980s average rates, investment is stalling, as we've seen. Less new businesses and less investment lead, at the end, to less innovation, less new products, and this is what explains this decline in productivity. Even though credit has never been this cheap, business people aren't taking advantage of it. This is what the Fed was counting on, and they lost their bet, i.e. to maintain interest rates as low as possible as an incentive for businesses to invest and for households to take on more debt, in order to stimulate growth. But the American central bank is really off track by considering a mean (a loan) as an end in itself. If there is no real growth, why invest, low rates or not?

This catastrophic number has been totally ignored by the markets and talked down by the Fed, of course, but this will make the return to reality that much more painful.

Danger Warning: Banks Knowingly Underestimate their Risks

Jul 10, 2014

We shouldn't worry about our economies anymore, the banks explain, the crisis is behind us and the solvability ratios have clearly gotten better. Banks like to tell us that the risks are under control and that their cash cushion is comfortable enough.

The problem is that this risk reduction assessment does not come only from a more virtuous attitude, but also in part from dissimulation. As a matter of fact, "according to certain analysts, banks have revised their risk models in order to reduce the amount of unencumbered funds required by underestimating their risks and estimating their assets at optimal value". And where do you think we read this? In an obscure publication from some conspiracy theorists? Far from it, really: This comes from no less than the 84th annual report of the Bank for International Settlements (BIS), the "central bank of central banks", in charge, notably, of determining the prudential norms for commercial banks in the world (Basel III).

The report goes on, thereafter, noting that "this phenomenon is perhaps one of the causes of the ongoing sub-rating of banks stock shares versus their unencumbered funds' book value. This preoccupation has been exacerbated by the realisation that risk weighting for similar assets varied considerably from one bank to another (page 107)". Market commentary indicates that investors are not buying this clear improvement in the banks' situation and are shunning the shares of this sector.
The BIS report also stresses the blindness of banks toward sovereign debt, and especially the one of their own country: "For the most part, banks attribute zero-risk weight to over half of sovereign debt instruments they hold (page 108)", which means that banks keep no liquidity in reserve to cover for more than half of the sovereign debt they own. I guess that what happened in Greece and Cyprus has already been forgotten... right? And which are the countries particularly concerned? The report tells us, "Banks attribute considerably lower risk weighting to their own country's sovereign debt than do banks from other countries. This bias in favour of the country of origin is particularly pronounced in the case of Portuguese, Spanish and Irish banks and, at a lesser degree, of the French, British and Austrian banks". We'd like to thank the BIS for all this information!

And, wouldn't you know, last week, one right after the other, the main Austrian bank (Erste Bank) and the main Portuguese bank (Banco Espirito Santo) announced they were both facing some serious difficulties (problems tied to Romania for the former, an inheritance war and some accounting shenanigans for the latter) that drove their stock down and, worse, are causing systemic problems in their countries' banking system. So if we understand clearly what is going on, we realise that banks have not really taken preventive measures against sudden changes in their environment, and that their gross underestimation of risk puts them in a fragile position, should anything unexpected happen. Even though this news is not comforting, we have to assess it very seriously because it stems from a particularly well informed organisation that, for once, is not using double-talk.

What the $7billion Fine to Citigroup Reveals

Jul 17, 2014

The American bank Citigroup has just been condemned by the Department of Justice to pay a fine of $7billion for its role in the subprime crisis. "Citigroup knew about serious and generalised deficiencies with the more and more risky loans it was transforming into bonds" and, nevertheless, it kept on with it, explained Eric Holder, the United States' Attorney General. The big banks are being investigated by American justice for their responsibility in the subprime crisis: JP Morgan has already paid $13 billion in fines and there is talk of about a $17 billion fine that could be imposed on Bank of America, pending discussions. Banks would rather pay a large fine than have to face potentially lengthy and risky civil procedures.

One could be tempted to applaud these hefty sanctions on wrong-doing banks... and think that they will be more prudent in the future; it's a possibility. But one could also decry several elements that are going against this possibility. Firstly, solely the bank's moral responsibility is at stake, and not the one of the former CEOs, including the CEOs of failed companies like Angelo Mozziloo's Countrywide (one of the worst examples). If, at that time, the courts would have seized all of their salaries and stock options, this would have, arguably, deterred the actual CEOs from doing the same thing! But this is not how things went.

Secondly, when we take a look at how this $7billion fine is distributed, there appears another reason to worry: $4billion goes directly to the Department of Justice, which gives the impression that the federal State is looking for extra revenue to reduce its budget deficit, and $500million is split between State attorneys involved in the process and the Deposit Insurance Fund. In other words the latter, that is supposed to limit the impact of financial crises and protect the depositors, will only get a few crumbs... a funny way of preparing for the future! The rest of the fine, $2.5Billion, will be used to finance the softening of credit conditions for individuals trapped by the real estate crisis. Now, again, this is incredible! The federal State is subsidizing first home buying, i.e. it's doing the same mistake that caused the subprime crisis!

In the case of the subprime crisis, there are more than one culprit: Banks were reselling products that they knew were toxic but, at the beginning, it's the U.S. government that pushed for easy access to a home by limiting the banks' power to refuse credit (with the Community Reinvestment Act) and by largely subsidizing and guaranteeing two public agencies, Fanny Mae and Freddy Mac, both acting as super laundry machines for mortgages.

With these hefty fines being imposed to the banks, the State thereby exempts itself from any responsibility or any self-criticism. Worse, it is repeating the same errors. And, again, it will not be surprising to see the current bankers pocket large bonuses (banks are making their highest profits), while neglecting the risks that are there for them to see. They will let their successors and other governments try to solve this problem. Meanwhile, this toxic mix of Keynesian policies and short-term greed continues, along with all the havoc it causes to the economy.

The Great Manipulation of Financial Markets Seems to be Reaching its Limits

Jul 25, 2014

The great manipulation of financial markets seems to be reaching its limits; bubbles are at their highest, and so are risks. The central banks' money printing machines, along with interest rates kept on the floor, are working perfectly well: The yields on sovereign bonds are at historical lows in the United States, Germany, the UK and France. They, in fact, are working too well: those bonds do not even match the inflation rate, an obvious sign of a bubble.

Then where is the money going, if sovereign bonds are under-performing? To the stock market, of course, which is establishing new records. The Dow Jones surpassed its 2007 record, just before the 2008 crisis started, and all around the world the Bourses are doing just fine. Another sector where money can find shelter: real estate. But the situation is more contrasted because, even if we observe tensions or bubbles here and there (China, emerging countries, certain areas in the United States and Europe), investors are not quite ready to take the plunge, just a few years after the subprime crisis.
So we observe that, with large asset classes, limits have been reached: Central banks cannot lower their prime rates, already at nearly zero, sovereign bonds cannot durably yield less than price inflation, and the stock market cannot make believe the economy is on the mend, better than it was in 2008, and finally, the real estate market is making a little progress and still constitutes an alternative, but players remain prudent.

The problem is that those high indicators are betting on the economy's capacity to rebound and the States' capacity of undoing their debt... which is absolutely not happening for the moment. To the contrary, public debt in the United States, Europe and Japan continues to climb, and growth is not making any comeback (1st quarter GDP was +1.6% in Japan, +0.2% in the Euro zone, and -2.9% in the United States...). There is a blatantly growing disconnection between the real economy and the financial markets, and this cannot last for a very long time. The tiny growth achieved is through the "wealth effect" (those who own assets feel richer and consume more), whereas only an improvement in productivity followed by a rise in income may give birth to durable growth. But, tough luck, corporate investment remains depressed.

During the last great period of growth, bought with credit (2000-2006), gold played its role of warning signal by clearly rising; by doing so, it was showing that credit was exceeding the economy's capacity, that too much money was being created. This time, its price is more erratic... but it is under surveillance. After discreetly staying around $300 an ounce in the '80s and '90s, its rise, starting in 2000, put it in the spotlight. And, when it got too close to $2,000 an ounce in August, 2011, central banks and sovereign states didn't appreciate their paper currencies being so utterly ridiculed. Since that time, as we know, the price is more or less manipulated to the downside but, according to Egon von Greyerz, the gold manipulators are desperate: "With empty coffers, central banks and bullion banks are getting desperate". Hmm... wouldn't this be the perfect moment to get away from stocks and bonds, for those who still own them, and to switch to gold, physical gold, that is?

Whatever may be, we might soon see the reversal occur. We will have to watch American growth, see if the Fed succeeds in ending its Quantitative Easing plan and starts to raise its rates, as Janet Yellen promised. The main world economic power will again, of course, set the tone.

U.S. Authorities Starting to Worry about Deutsche Bank's Mountain of Derivatives

Jul 31, 2014

We know, since last year, that Deutsche Bank has become the bank with the most exposure to derivatives in the world, slightly ahead of JP Morgan. The total amount of the German bank's derivatives is astounding: 55 Trillion euros, a sum equal to 20 times Germany's GDP, or five times the Euro zone's GDP. Obviously, the bank could not face any hard depreciation of those products, since they represent 100 times its clients' deposits, or 150 times its own funds...

What's new is that financial authorities are starting to worry. Well, it's about time! Even though, as we would have thought or hoped, these worries are not emanating from German or European authorities, but from U.S. authorities. In a letter to Deutsche Bank, in fact, the New York Fed states an "important operational risk", and goes on to say that financial reports from the bank concerning derivatives "are of a low quality, imprecise and unreliable. The sheer size and scope of errors strongly suggest that the whole regulatory reporting structure of the bank should be thoroughly revised." The New York Fed also deplores that, despite its former warnings, it has not noted any improvement. And, as confirmation of this scary picture, KPMG, Deutsche Bank's auditor, has also noted some "deficiencies" in the bank's financial reporting.

A spokesperson for Deutsche Bank replied that "we are working diligently to reinforce our control systems and are striving to achieve best-in-class status." To that avail, 1,300 people will be hired, 500 of which in the United States, for conformity, risk and technology. And how, may we ask, is this statement supposed to be reassuring? If they need to hire 1,300 more people in order to manage this mountain of derivatives, doesn't it mean that we should be worried about the situation?

The usual reply we get from banks regarding their derivatives exposure is that their different positions are compensated and that, at the end, their net exposure is only a few billion dollars. Well, yes, but where do they buy those derivatives? From other banks, of course. Hence if only one of those banks goes under, the domino effect will have an impact on the other ones. This almost happened with AIG's bankruptcy: AIG was counterparty to several financial institutions, in September of 2008, and it was bailed out at the last moment by the American state. So, calculating net exposure is purely theoretical and one must calculate real exposure.

It's a good thing that the Americans are doing (a little) the work that the ECB and the national regulation agencies should be doing. In truth, in its preceding stress tests, already very lax, the ECB wasn't even taking into account the amount of the banks' derivatives, and it will likely be the case again in the upcoming ones. Refusing to see is much worse than being blind. Beyond Deutsche Bank, we must understand that the large banks of the world are holding inordinate amounts of derivatives, beside which their own funds are ridiculously low. And this constitutes an endemic risk that is largely underestimated by the shareholders, as well as the depositors.

Interest Rates at their Lowest: Another Reason to Buy Gold

Aug 8, 2014

One of the main arguments used by your banker to dissuade you from buying gold is that "it's not generating anything", either interest or dividends. It has been true, in a way, for some time. But, now that interest rates are at their lowest and that savings accounts and life insurance policies practically yield close to zero, you could use the same argument against his products. But I don't think your banker will reply by telling you to keep your money because his products are worthless...
This argument is, of course, erroneous. One has to compare comparables. A bank note does not yield any interest either; you have to give it to the bank and invest it in a savings account, a life insurance policy, or a stock portfolio. Similarly, if you were to loan your gold to a business (in need of liquidity, or that has to pay someone with gold, or for other cases), said business would pay you some interest, it goes without saying.

But immediately comes to mind the question of risk: "If this business goes bankrupt, I'm going to lose my gold." So we understand that the interest (or dividend) acts as counterparty to that risk. When you put your money in the bank, into several financial products, from the simple savings account to elaborate investment vehicles, you are taking the risk of losing a part or all of your capital. For a long time – in fact, since the 1929 depression – this possibility has been out of the picture, but it made a strong comeback since the 2008 crisis. That crisis was triggered by the bankruptcy of one bank (Lehman Brothers), and several others either failed or were saved in extremis, from Northern Rock to the Banco Espirito Santo. Even sovereign States can go bankrupt and ruin the depositors, as we've seen in Cyprus, or again be bailed out in extremis without solving the problem of a debt that is too heavy, as we're seeing in Greece.

Hence, for those who would like to avoid investments yielding low interest and that could bring their invested capital to close to zero if the State goes bankrupt, there is the stock market. Stocks are doing great, of course, but we must be aware of the risks. On the Dow Jones, we are now at the third peak in the last two decades, and the first two (the internet bubble in 2000 and the sub-primes crisis in 2008) were followed by precipitous falls... Yield and risk are inseparable, and thus they must be addressed smartly, with lucidity. And, currently, the low yield on most financial vehicles does not compensate enough for the high and generalised risks globally– stock market bubbles, over-indebted States, failing banks. Systemic risk is very well present.

As a matter of fact, it is for this reason that central banks are doing all they can to maintain interest rates at the lowest possible. Depositors lose, but the over-indebted States are quite intent on not seeing the servicing of their debt exploding and the banks do not want to have to refinance themselves at higher rates, which would expose a lot of them to some serious problems... and, at the end, they're the ones who make the decisions.

And this is where gold comes into play. It's always good to own gold at all times, but especially when systemic risk is high, because gold cannot go bankrupt, it won't go under. As far as safe preservation of capital for the long term, we can rest assured. As far as the yield... although gold does not pay interest, it has a price, a spot price that can go up a lot when assets and currencies are devalued or in crisis. So, finally, yes, gold can "yield" something and, at the very least, it protects your wealth. What could be better? Ask your banker!

Is the Euro Zone Headed for a Recession?

Aug 14, 2014

The United States has just announced a 4% (annualised) growth for the second quarter, following a disastrous first quarter showing (finally revised, for the third time, at -2.1% instead of -2.9%). Though this sounds like good news, we should wait for the official revision of this 4% number that looks miraculous... We'll get back to it.

In Europe, on the other hand, the trend is much clearer, going from broken hopes of weak growth to stagnation, and then to the first signs of recession. In Italy, the Matteo Renzi "miracle" is turning out to be another flop: the country is experiencing its second quarter of recession in a row, -0.1% and -0.2%. In reaction to those numbers the Minister of economy, Pier Carlo Padoan, acknowledged, in an August 6 interview with Il Sole 24 Ore newspaper, that Italy finds itself "in a very arduous going-out-of-recession phase, because this recession is very deep."

As far as France is concerned, it is not officially in recession, but its growth horizon remains desperately flat. François Hollande has declared he was expecting "a stronger support for growth" from Germany, notably by investing more. Berlin's response: "The declarations coming from Paris, which are of a very general nature, do not provide any reason for the German government to correct anything in its economic policies," according to Christiane Wirtz, a spokesperson for the government. Another aggravating element for Paris, when compared to Rome, is that its public accounts are still far from that 3% deficit figure, and Brussels may start to lose some of its patience.

But the most worrisome number, also the most revealing, comes from Germany. According to the Federal Statistics Office, orders from German industries have fallen to a record low, mid-2014.

After slumping by 1.6% in May, they fell by 3.2% in June. At the national level, demand is falling (-1.9%), which constitutes an advance indicator of a slowing economy. But, above all, orders from outside the country are falling considerably (-4.1%) and, especially, orders from the Euro zone, that have crumbled in June (-10.4%). This proves that the growth fundamentals (productive investments from businesses) are in the red in the Euro zone. Outside a few occasional jumps caused by consumption, itself financed by public debt, which France knows really well how to do, no real growth will be achieved... and the game is nearing its limits.

We are now seeing the German locomotive, the only source of growth in the Euro zone, being hurt. This reversal of industrial orders, both internally and abroad, shows that the engine of growth is broken. And, on the long term, this will only reactivate the debt and euro crises...

A Ferrari Sold for $38,000,000... What?

Aug 21, 2014

In Pebble Beach, California, during The Quails "Concours d'Élégance", a 1962 Ferrari 250 GTO was sold at auction by Bonhams for $38 million, which constitutes an all-time record for a collector's automobile. The price paid is 100 times that of the most expensive new Ferrari in their catalogue (F 12 berlinetta) and 30 times that of their latest special series car (F 150, limited to 499 units). What to think of this exorbitant amount?

This is reminiscent of the art market in general, which is also establishing new records: in late 2013 a triptych from Bacon fetched $142 million. A collector's automobile is akin to the art market with its great names, its benchmark products, its myths. However, this phenomenon is more recent, younger, thus explaining the price explosion, albeit with a more "mono-maniac" culture: seven out of the ten most expensive cars ever sold in an auction are Ferrari's! Speculators will have a choice between worrying about a bubble in a fashion trend and buying cars that are not quite as mythical as Ferrari's yet... This craze reminds me a little of the recent craze for Chinese artists, whose standing exploded at the same rate as the number of new multi-millionaires in China. What will remain of it? It's hard to say.

These record prices and clear increase in global sales volume show that investors are looking for markets with room left for progression. The stock market is at its highest and many feel that a crash is more and more likely, with growth still stalling. Sovereign bonds are almost over-performing... the yield is paltry. Real estate is peaking in London and in China's large cities... what's left to speculate on? The art market and used Ferrari's are fetching all-time records... there lie the opportunities!

There is another reason that motivates investors: those are real assets, unlike pieces of paper showing you own a share in a company's capital or a share of a country's debt. Not at all. Real stuff... a painting, an automobile. In other words, an asset without any counterparty risk: it has intrinsic value; its owner is not dependant on anyone (a company, a country); ownership is direct. Obviously, the market price may vary, but it cannot go to zero: a painting cannot go bankrupt. A rare Ferrari, a Picasso, a Bacon, an impressionist painting... will always be worth something, especially with paper assets losing trust.

Real estate boasts the same qualities but its high financing needs (most often bought with credit) makes it more sensitive to the environment, thus to bubbles, as has been seen with the sub-primes crisis. The asset of choice is gold, of course, as it has been forever. Gold also has a fundamental advantage over other assets: it is perfectly homogenous, whereas a car, a painting or an apartment will never be worth exactly the same as another. Basically, one should own gold, of course. And then, other assets may be interesting, but the markets are complex and one has to be on the lookout for potential bubbles (Chinese artists...) and the obvious traps. But, from now on, we will have to monitor the value of used Ferrari's!

Stock Markets in their Third Bubble Since 2000

Aug 28, 2014

The S&P 500 just passed the 2,000-point psychological threshold, an absolute record for that index, created in 1950 and comprising the 500 largest companies traded on the U.S. stock market, thus being more representative than the famous Dow Jones Industrial Index, with its 30 companies. This new record would seem to show that the U.S. recovery is under way... but let's step back a little in order to evaluate these numbers.

As can be seen on this 1950-end of 2013 graph (reaching 1,600 points), the S&P 500 has been quite erratic since the 2000s, with two bubbles that burst! But let's get back to the '80s... Back then was the triumph of Ronald Reagan's "conservative revolution", which led to a vast liberalisation of the economy with whole sectors being allowed to compete (air transportation and telecoms, notably), while at the same time income tax was reduced, thus encouraging wealth creation. Sound growth takes place and the United States comes out of the '70s crisis on the way to two wealth producing decades.

In all logic, the S&P 500 starts to rise in 1982, with the 1987 October crash being just a glitch quickly forgotten. But, starting in 1995, the trend picks up, with the start of the "internet bubble". Much hope is placed in the nascent network and heads are spinning a little too much. The bubble burst, beginning of 2000, and the S&P 500 went from a peak of 1,527 to a trough of 800 in 2002, almost down by half. And the September 11 attacks added to the ambient dire straits. That is when Alan Greenspan decided, in order to sustain economic activity, to lower the Fed's base interest rate... a lethal mistake! Growth did make a comeback, but it was on the back of housing starts and the infamous subprimes, a pure credit bubble. The rest is history: the S&P 500, again, went from a peak of 1,561 in 2007 to a trough of 683 in March, 2009.

Why has the S&P 500 been rising since March, 2009? Has growth made a comeback? Barely... The only thing that can explain it is the Fed's QE plans that began at that time. Since then, the index has been progressing at the same rate as with the two former bubbles, which is both revealing and worrisome. There is no sound growth in the economy that could justify such a progression: from one quarter to another, GDP variations are hesitant, with a trend around 2%. Not what one can call a recovery in the United States. The lower unemployment rate is due, essentially, to long-term workers leaving the work force, as shown by the decline in the number of people looking for work in the statistics.

All the signs are pointing to a third stock market bubble, albeit much bigger than the other two (at least 2,000 points, compared to 1,561 in 2007 and 1,527 in 2000)... why? The "fuel" for the first stock market bubble was an outsized belief in the disruptive nature of the internet (which, finally, will have taken more time to get set); the "fuel" for the second bubble was real estate credit to individuals, a large portion of bank credit. The "fuel" for our actual bubble is much more powerful, since it is the United States central bank, the Fed, with its QE plans (buying Treasuries) and its base rate near zero, already having been going on for four years. This lax policy should soon end, according to the Fed's chairwoman, Janet Yellen. We shall see... but the fall may hurt quite a bit.

France has no problem borrowing... because it will not hesitate to plunder its citizens' accounts!

Sep 5, 2014

On Monday, France borrowed at a negative rate, which means investors are losing money... they're paying to deposit their money! Even though this is for short-term loans (3, 6 and 12 months, for a total of 8.2 billion euros) at rates slightly below zero (-0.002% to -0.004%), this hadn't occurred since May of 2013.

At the same time, Germany also borrowed at negative rates, while its economic situation is quite different than France's: Germany experienced a budget surplus in the last quarter, whereas France couldn't even manage to keep its deficit at 3% of GDP; unemployment in France is double that of Germany; Germany's commercial balance had a 200-billion euro surplus, whereas France's had a 60-billion euro deficit. And this list could go on and on (businesses profitability, percentage of exporting small companies, level of investment, quality of professional formation, etc.). How can two countries with so little in common borrow with the same ease on the international markets?
Well, actually, they do have one thing in common: the euro... which helps, especially in the case of France. With that being said, how to explain that investors are buying debt from France at the same conditions they do from Germany? Analysts talk about the "flight to quality": Much of the abundant liquidity looking for appreciation around the globe is fleeing the emerging countries, mostly unsafe with weak currencies, and, in the Euro zone, avoiding the peripheral countries, leaving only Germany, Northern Europe and France.

While this may be true, it is not the sole explanation; there is another: The French are great savers. Compared with the European average of 10%, the French save around 15-16% of their income, which translates into a tantalizing 3.6 billion euro total in savings (bank accounts, savings accounts, life insurance) parked in banks and insurance companies. In an answer to a journalist asking him if France could go bankrupt, François Baroin, a former finance minister in 2012, said that France's debt was a "no-risk investment", notably because "France has a high level of savings". This minister who, of course, didn't last long, had committed treason to the powers that be, beyond political lines, by stating that the State will not hesitate to plunder its citizens' savings in order to face its obligations (3.6 billion euros of savings on the one hand, and 2 billion euros of debt, on the other hand...). And the universally-recognised quality of France's fiscal police leaves no doubt as to the reality of this threat. This is what is reassuring for international investors... but not for savers, for sure.

We already know that failing banks will be able to help themselves into their clients' accounts if need be, according to a European ruling, but a non-written law authorises the State to do the same; we have to be aware of that. And, as the situation in France is inexorably deteriorating (deficits are not reduced, there is zero growth, unemployment keeps rising), this scenario may very well play itself out. Where large international investors are concerned (U.S. pension funds, Middle-East sovereign funds, China's central bank), it is not good policy to estrange them; hence, the French people will have to make sacrifices in order to defend "the State's superior interests"... One can only picture our highest leaders on television explaining in a compassionate, but firm, tone, that "there is no other solution". The more time passes, the more the French economy is sinking into recession, and the more this scenario becomes plausible.

Danger warning : Mario Draghi to restart ECB's money printing press!

Sep 11, 2014

Mario Draghi spoke, last Thursday, and everyone must have thought his announcements were important... because right after his speech, stock markets went up and the euro fell against the dollar! What caused this abrupt temperature rise in the markets? Let's recall the announcement: The base rate goes down from 0.15% to 0.05% (who can believe this will change anything?) and the deposit rate for banks depositing with the ECB goes down from -0.1% to -0.2% (the intent of which is to discourage banks from depositing and encourage them to make loans to businesses)... Again, no one thinks that this could jumpstart credit.

Then comes the important announcement: the ECB will buy new assets, starting this October, and will do so in large volumes. The European central bank will be acquiring asset-backed securities, or ABSs (business credit, commercial notes, real estate loans etc.). This is called securitization: the bank puts together small business loans in a "package" that becomes, thusly, a new autonomous financial product generating money flows (loan payments from businesses) that it sells back to the ECB in order to recuperate some liquidity. As a funny aside, the U.S. equivalent, in real estate, was the "subprimes"... The ECB will also be buying bonds issued by banks (a bank may finance itself by issuing bonds, like a corporation or a sovereign country).

This makes it very interesting for banks, for two reasons: one, unload some of their bad loans and, two, raise some fresh money, all thanks to the ECB. And, in order to finance this asset buying, the ECB will, of course, create money out of thin air... After the LTROs and other bailout plans for banks, the ECB keeps on going full steam ahead with "quantitative easing".

The amounts announced are quite high and they will push the ECB's balance sheet from 2 trillion euros to 2.7 trillion, or 700 billion euros more of assets, most of which are of an average or unsound quality... On the other hand, this represents 700 billion euros of fresh money for the banks, and this money will not be used for loans to businesses, with the economy in stagnation, but rather for their profitable "market banking" sector. This is why markets liked Drahi's announcement: because it will not create growth, but it will create bubbles, for sure.

In so doing, the ECB is going against Germany, the staunch guardian of monetary orthodoxy, at a time when the all-new anti-euro party (AfD) is making its first electoral gains. Angela Merkel, seeing her party and its conservative allies being attacked on their own ground, cannot accept that. It will be interesting to watch her arm-wrestling with Mario Draghi.

There is another problem that needs to be addressed, that of the deep conflict of interest of the ECB: In order to fulfill its banking supervision mission, the ECB will begin to evaluate the balance sheets of European banks in November. It will be judge and party, comptroller, with the power to force a bank to re-capitalise while, at the same time, will be the one with the liquidity to buy their assets. This is exactly the process by which things degenerate into bubbles and crashes, when there is too much concentration of power, there is hardly any counter-power in existence, and when market logic makes way for crony capitalism. Mario Draghi is leading us on a more and more perilous road.

Staying Invested in Cash Is Not Such a Sure Thing After All

Sep 18, 2014

According to a study by Deloitte, cash reserves of corporations located in Europe, Africa and the Middle East (EMEA zone) are reaching record highs, totalling 936 billion euros. This is 40% more than in 2007, just before the crisis, and this is where the problem lies: businesses are making money, but they don't know what to do with it.

In normal times, profits go toward investments. As Helmut Schmidt, former Chancellor of Germany from 1974 to 1982, famously said, "Today's profits are tomorrow's investments and day-after-tomorrow's jobs". But this is not how the economy is working nowadays, especially since 2008. Businesses are not investing (as much as they could) because there is hardly any growth or demand.

Instead of investing, these companies choose to pay more dividends to their shareholders or go on merger/acquisitions sprees (Astra Zeneca-Pfizer, TWC-Comcast, General Electric-Alstom, Lafarge-Holcim are some of the important ones of the last months). Paying dividends does not create value per se, it's just a simple transfer, and merger/acquisitions, as can be observed these last decades, rarely create any value as well. The objective is, mainly, for the predator business to strengthen its position in the market.

But large corporations are not the only ones hoarding tons of cash... so are central banks of countries with commercial surpluses (China, oil-producing countries) or sovereign funds (these same oil-producing countries). And, furthermore, the central banks of the United States, Europe and Japan are creating money with their QE plans in the hope of boosting economic activity... which all leads to an excess of liquidity across the globe. And this "preference" for liquidity essentially translates into a defiance of the real economy and its gloomy outlook. The results are clearly seen: Investments having the blessing of the rating agencies, those benefiting from all this liquidity, are the ones faring best – stock markets are at their highest and rates on sovereign debt of large countries are at their lowest.

At a time when it is difficult to invest in the real economy, it might seem like a good bet to be holding cash when there is little or no inflation; it might even be a winning strategy if deflation were to occur (money's purchasing power would rise). But, let's be cautious, because the present situation is far from normal; on the contrary, it is showing a sick, off-balance and unstable economy that is not, as yet, out of the 2008 crisis, and in which central bankers are playing apprentice sorcerers. There are several hazards that need to be taken into account: First of all, this cash is being deposited in banks, thus there is the risk of losing much in case of a banking crisis. Secondly, there is too much liquidity for not enough assets, and this usually produces bubbles (stocks and bonds, at this moment) that eventually blow up one day or another. And, thirdly, the value of a currency could plunge at any time if there were to be a general mistrust happening (one thinks of Japan, with its debt at 250% of GDP and a free-wheeling central bank, as a serious candidate). So let's simply remind ourselves that the best way to avoid those risks consists, of course, in acquiring physical gold. Gold has tangible value and it remains liquid, contrary to other assets such as real estate... gold is like cash, but without the risks that come with cash. Those holding cash at the moment should take heed.

Why Isn’t Innovation Driving Growth Anymore?

Sep 25, 2014

Average growth in Europe, Japan and the United States keeps slowing down when compared with previous decades: It is near zero in Europe and Japan, and 2% in the U.S. Inasmuch as, in those countries, innovation is still thriving, many new services are being offered, many start-ups are going public and raising funds, and scientific research is still leading to new discoveries. So why isn’t this inventiveness (being able to do more with less) producing any economic growth?
Sadly, of course, there is one purely economic reason: The growing weight of government in the economy, high taxation and a mountain of red tape to discourage entrepreneurs and stifle initiative. But let’s get back to innovation...

Innovation has drawbacks, one of which would be “creative destruction”, a term coined by the economist Joseph Schumpeter: At first, it renders obsolete products that were selling well, thus pushing some complacent companies toward bankruptcy and destroying jobs. This is how capitalism normally functions in a society under economic freedom. This is the only way to bring wealth to a country, a higher standard of living and full employment, notwithstanding any growing pains.

However, more and more, governments are trying to intervene in order to protect existing corporations. We’ve seen it with the banks in the 2008 crisis, and this goes on today with central banks keeping interest rates near zero in order to facilitate the re-financing of the banking system. The United States government has also helped General Motors and other large corporations. It can be seen as well with disruptive innovations having to fight the power of States or corporations, such as Uber, for instance, seeing its growth tampered in several countries because of the taxi industry’s lobby, or Airbnb, facing the wrath of many municipalities. This type of alliance between big business, corporations and government in order to maintain the status quo is what is meant by “crony capitalism” and, sadly, it’s happening more and more.

But there is worse: Governments think they can and should be the drivers of progress and they put an awful lot of money into it, to the point of totally going against the market fundamentals (unwarranted demand, subsidies, satisfying the call for tender instead of focusing on consumers’ needs). That would be the case of climate changes and the astronomical amounts engaged in wind and solar energy and the fight against greenhouse gases. Without digging deeply into the matter, we will note, however, that an international organisation has been created specifically in order to prove global warming, the Intergovernmental Panel on Climate Change, and that if it were to invalidate this warming trend it would lose all of its subsidies... this doesn’t bode well for scientific objectivity.

Governments intervene more and more with innovations, in the sense they want to be the ones to decide what the applications will be in society, which way they should go, by either regulating or handing out subsidies. The market, entrepreneurs and consumers, have less and less their say in the matter. Is it any wonder then that innovation is not enough to give the economy what it needs?

Headed toward a conflict between Germany and the ECB?

Oct 2, 2014

Tensions are rising between Germany and the European Central Bank and, this time, concerns are raised openly through an intervention by Germany’s finance minister Wolfgang Schäuble before the German parliament, the Bundestag. Angela Merkel’s strong man has been in charge of this key ministry since 2009, so one should take what he has to say very seriously.

Wolfgang Schäuble started by stating his reluctance at the ECB's intention, as recently announced by Mario Draghi, of buying securitized loans and bank bonds or, in other words, continuing to bring liquidity to the banks and inflating the ECB's balance sheet. And then he pointed to a real problem, one that we've talked about in the past, i.e. the conflict of interest in which the ECB will find itself. Because, starting in November, it will be in charge of supervising 120 of the main banks in the European Union. It will have deep access to the banks' records and will be able to assess their financial stability and have a look at all of their assets. And, at the same time, it will be able to buy those same assets that it will know more about than anybody else in the market. The ECB will be judge and jury and will not have to report to any higher authority; it will decide on its own which bank to save or not to save. If we are to rely on Mario Draghi's penchant for lax policies, we can predict he will have a tendency to pour liquidity ad infinitum into banks that would need re-structuring, which would result in degrading the ECB's balance sheet even more...

Wolfgang Schäuble is thus pushing for the separation of monetary policy and missions of banking supervision... which is great, but someone should have thought about this beforehand and give this mandate to another structure! But, seriously, if Mario Draghi concedes to such a separation, what value would it have? Large banks have been selling us this 'Great Wall of China' between their credit department (privy to insider information on some companies) and their merger-and-acquisitions department, but experience has shown us that we cannot put too much value in that assertion.

Adding to the warnings of Germany's finance minister, other sources of conflict exist. The Constitutional Court of Karlsruhe could very well block an eventual QE plan to come to the aid of a struggling country (the OMT plan announced by Draghi in September 2012). And, from a different angle, electoral gains for the new AfD party, Alternative fur Deutschland (anti-euro), making inways on Angela Merkel's CDU electorate, could push Berlin to harden its position against the ECB.

When the euro was created, it was sold to the markets as a 'super deutschmark'. And now successive crises in Greece, Cyprus, and in sovereign debt in 2011 (rates burning up in Italy and Spain) have already taken a large toll on the European Central Bank, much more than Germany would have wished for. And the fact that this lax and opaque policy is continuing at the time the Fed is tapering its own QE and is even talking about raising interest rates just makes divergences more profound. The euro has already lost 10% to the dollar in four months... such a plunge would not have occurred with deutschmarks! This whole thing cannot please the Germans... It is difficult to predict how a clash could materialise, but we're quickly getting there.

Is the Foreign Exchange Market the New Playground for Central Banks?

Oct 9, 2014

Central banks have kept silent about this but it's hard to believe that manipulating the foreign exchange market isn't part of their policies; it's probably also part of their new strategy.
Neither injecting liquidity nor keeping interest rates near zero have worked. All hopes for any economic recovery have vanished and growth is desperately at a standstill. Furthermore, there looms the threat of deflation, which would make the weight of debt totally unbearable. What to do? There is one instrument left: currency devaluation! It

could have several advantages, expectedly: boosting exports, thus growth, importing inflation (through higher commodity prices) and, hopefully, keeping at bay the spectre of deflation... an ideal solution!

The Bank of Japan (BoJ), always ahead of the others, has been doing just that for quite a long time. The yen lost 20% of its value in comparison to the dollar in 2013, and 15% since January 2014. On Wednesday, October 1st, the dollar reached the symbolic number of 110 yens for the first time since the 2008 financial crisis. At the start of 2012, it was worth 76 yens... which gives a little perspective on the Japanese currency's tumble. As regards the euro, the devaluation is more recent but as important, as it has already lost 10% to the dollar in the last four months, which is quite significant in those very large and usually very quiet markets. This movement can be explained by the statements from Mario Draghi and Janet Yellen regarding asset buybacks for the former and the end of QE for the latter.

But, as a matter of fact, does it work? Has growth picked up in Japan? Has the threat of deflation disappeared? Of course not, as everyone knows, but this won't keep the BoJ from persevering... In reality, the "expected" benefits from currency devaluation are the result of (Keynesian) mirages that are just as much an illusion as the benefits expected from monetary printing (boosting growth) or zero interest rates (enticing businesses to invest). On some occasions, and on the short term, there could be some benefits, but if devaluating one's currency were such a sure recipe for instantly bringing back productivity and growth, it would have been known for a long time!

On the other hand, this little sterile game could degenerate. A devaluated currency means losses for foreign investors holding assets denominated in such a currency, whether it be stocks or sovereign bonds, who are tempted to get rid of them. Things may get rocky! Japan is protected, as far as its public debt goes (held at 95% in Japan), but Europe is not.

Above all, the high risk may come from the United States, not used to having a strong dollar. Let's just recall their tantrum against an under-valued Chinese Yuan... Japan is back at it, since the 2008 crisis, and now the ECB is joining the fun! The Fed cannot not react to a too strong dollar – which would be an excellent argument for Janet Yellen to prolong QE or keeping rates at zero. And if the Fed starts playing this game, emerging countries will have to do something, since most of them are relying on the US dollar. We may see a period of "competitive devaluations", troubles, even currency wars, which would cause havoc in all other financial assets.

Because of their lax policies, central banks have already caused bubbles everywhere and crashed risk premiums, which has totally blinded the markets. The foreign exchange market was the last one remaining relatively calm, away from those turbulences... but this is about to change soon.

Regulators and Banks Settle on the Backs of Depositors

Oct 16, 2014

In the world of finance, important things often occur during the weekend, when markets are closed, when negotiations and inside rumours cannot have any repercussions or profit to any insiders, as the media is busy with trivial news and the weather. An important agreement was signed on Saturday, October 11, between the large global banks "under pressure from regulators", as stated in the AFP news release, and it relates to derivatives and, more specifically, the CDSs, or credit default swaps. These CDSs are like insurance against a country defaulting on its debt or a company going bankrupt.

The idea looks good at first glance, since it constitutes protection against the failure of an asset one owns, so what's wrong with it? Well, the problem is that these derivatives have been sold in large quantities by the banks and that they might not necessarily have the required funds in case of a default, which would in turn bankrupt them, thus giving rise to a catastrophic domino effect. We've seen it already in September 2008 when Lehman Brothers, a large derivatives market trader, went bankrupt, creating chaos in the financial markets.

Regulators in large countries assert that a delay, however short, could give a failing bank time to re-capitalise itself and thusly avoid a panic effect on the financial markets. The International Swaps and Derivatives Association (ISDA), representing the banking sector, has also accepted to abandon the principle of automatic unwinding, or close-outs, of contracts, should a financial institution find itself in trouble. If a "too big to fail" bank is about to fail, regulators will have some time to find a solution in order to avoid an "inordinate" bankruptcy with potentially explosive consequences.
It is not too reassuring to think that this agreement underlines the real risk of big banks going bankrupt. Nevertheless, this agreement is objectively a good thing, since it delays a potential domino effect. But let's be careful, since we now know how regulators go about solving banking crises: Their new method was inaugurated in Cyprus, in the Spring of 2013, and written in a European guideline that will soon go into effect (January 1st, 2016). Depositors' accounts are used to make up for the bank's losses; money is taken directly from their savings in order to restore the bank's solvability. As happened in Cyprus and is written in the guideline, only accounts over 100,000 euros will be affected, but this won't certainly be enough should a grave crisis occur, in which case one can be certain that all accounts will be involved.

Are Sovereign Bonds the Last Rampart Before the Collapse?

Oct 23, 2014

Last week was a rocky one on the stock markets, with London, Frankfurt, Paris and New York sliding heavily. Sort of a mini-crash, but not too serious... a simple warning showing some nervousness among investors: has the time of disillusion come? In Europe and Japan, stock market indices are below their January 1st, 2014, level, and in the United States, they're just slightly above it.

The basic problem is that global liquidity is growing at a much higher pace than real economic growth. Even with the Fed stopping its QE, there is Japan accelerating its own QE and the European Central Bank is restarting its own plan, notably by buying banking assets. And all those central banks are maintaining rates at zero, which facilitates monetary expansion. The result being that all this excess money, which is not going into the real economy (loans to businesses haven't picked up), finds its way on the markets and pushes asset prices higher. Hence the stock market performance since 2009 (March 2009 exactly, date of the first Fed QE).

But, at a certain level of appreciation, the prices of risky assets (stocks, corporate bonds) stop going up because investors realise that, obviously, the risk premiums are not enough to cover the risk anymore. And the fear is being reinforced by the fact that hopes for a real economic recovery are vanishing (the IMF lowered its previsions, a series of poor numbers were recently published in the United States and Germany).

How are investors reacting? They're fleeing into the last assets still considered safe, namely risk-free sovereign bonds, i.e. those of the United States and Germany, mainly.

Because, at the same time, there is more differentiation taking place between sovereign bonds: Greece is being abandoned and its rates are rising dangerously; Spain and Italy are being shunned and are not profiting from this influx; France is getting some of the action, but not as much as Germany, which is reflected in the growing spreads between the different rates. The whole bonds sector is becoming more differentiated, more volatile, thusly more dangerous. But debts that are considered safe are profiting and, as we've seen, their rates turned lower last week amidst the stock market storm.

The United States' public debt represents a large volume but, however, its absorption capacity is not infinite. And neither is its credibility. Even though the Fed is backing the whole thing and stands ready to print anything to meet payments, at one point defiance will be on the rise. We may not be there quite yet, but this is clearly the last rampart holding together the monetary and financial systems. If this starts to fail there will be a general panic.
Well, yes, there is another rampart, but the monetary authorities, the large investors and the banks do not believe in it: I'm talking about gold, of course. In the course of History, gold has never failed, but be warned: there might not be enough of it to go around!

ECB Stress Test Results Show Banks Struggling

Oct 30, 2014

Last Sunday, the European Central Bank announced its verdict on the stress tests it has been conducting for several months and, this time around, quite a few banks have failed them. The preceding stress tests in 2009 and 2011 had seriously diminished the ECB's credibility by not detecting anything at all (even though Irish banks had passed the tests, they went bankrupt a few months later, and so did Dexia). This time, 25 banks failed, on a total of 130 being tested, and I would submit that this number is significant.

Should these tests be taken seriously, then, as the mainstream media is doing? Not really. First, this list only comprises second-rate banks such as Cyprus's and Greece's (for which no stress test is needed to realise they are broke) and Italian banks. The only important banks are Dexia and Monte dei Paschi, the difficulties of which have been well known for a long time. No large European systemic bank is part of the ones that failed the tests, and for good reason, because the failure of any one of them would provoke a destructive crisis (remember Lehman Brothers?)! The ECB only bothered to focus on a few lame ducks in order to reassure the markets.

There is also nothing to be reassured about when we take a look at the "black" scenarios invoked by the ECB for some European countries: A 20% price decline in real estate and on the stock markets (only!) – A slightly higher rate of unemployment than today's (12.2% in France/today 10.9%, 27.1% in Spain/today 23.2%, 14.4% in Italy/today 12.2%) – Limited deflation (-0.3% in France, +0.6% in Italy) – A lower interest rate hike than what some countries have already experienced (5.8% for Italy while it had been at 7.4%, 5.6% for Spain while it had been at 7.6%) – And, finally, a very limited "recession" (-1.1% for France, -1.6% for Italy, -1.0% for Spain). This last number is more evocative of the ongoing slowdown than of a real crisis... those so-called "black" scenarios are lacking in stress!

Let's also note that the main risk, i.e. sovereign debt, has been side-stepped. As everyone knows, a country cannot go bankrupt (unless its name is Greece or Cyprus... for now). The ECB is well behaved... it knows it is better to leave the States and the large banks alone.
And then, two days later, almost inadvertently, the ECB published a number that should have caused quite a commotion but that was not mentioned in the media: European

banks hold 880 billion euros worth of bad or doubtful loans (e.g. at least 90 days late for payment), and this number represents 4% of their balance sheets. While 4% may not seem much, it does correspond to their mean leverage, or the ratio between their reserve funds and their liabilities, the "gross" leverage without any adjustment for risks (for example, for BNP Paribas: 1.8 trillion of assets for 72 billions of reserve funds – 72/1,800 = 0.04, or 4%); Deutsche Bank is at 3.1%, Société Générale is at 3.3%, ING Bank is at 4.6%).

4% represents the average leverage of European banks. So even if those loans are not totally lost (payments can start again, the bank may seize the debtor's assets and sell them), we discover anyhow that European banks bad loans are about equal to their reserve funds... In other words, they are virtually bankrupt. Thank you, ECB, for this news!

United States: Voters Know Better than Economists

Nov 6, 2014

What head of State would not dream of going into an election backed by 3.5% growth and 5.9% unemployment rate? That would surely insure victory over opponents... However, Barak Obama and the Democrats just lost the mid-term elections. They were already in minority in Congress and now they are sinking even deeper, losing their majority in the Senate in favour of the Republicans.

There is nothing unfair in these results. On the contrary, they simply show that manipulating statistics has its limits. The American people, unlike "economists", columnists and political leaders, know that unemployment is being grossly under-estimated, namely because millions of discouraged unemployed workers are not accounted for in the statistics. People also realise that the Fed's monetary printing experiment has created a "wealth effect" (QE is good for stocks and shareholders) generating a little growth, but that this growth remains fragile and bubble-like. The American people, in general, are not faring better since the 2008 crisis and there is no real economic recovery: they just let it be known to the politicians in place.

All this "quantitative easing", which purpose was to hide the misery, will have brought the Fed's balance sheet from $800Billion before the crisis to over $4.5Trillion today. All this debt, at the end, only generated a limited spike in GDP. The results are deplorable but all this free money, in truth, has been put to use in doping the stock market indices. Fed's chairwoman Janet Yellen has announced the end of QE but, in reality, it's a little more complex. The Fed has indicated it will continue to reinvest the proceeds of bonds as they mature and keep them on their balance sheet, which will not be reduced... it is akin to continuing a mini-QE of sorts. And, above all, the base rate, fixed at 0%, will stay there for a long time, which will allow the banking system to finance itself with real negative rates. Talk about an incredible bonanza!

Bottom line: these mid-term elections bring reality back to the forefront, and reality looks ugly. These voting results should be taken as an extra warning about the uselessness and danger of all those "quantitative easing" plans put in place all over the world.

INDEX

A

B

C

D

E

F

G

I

J

L

M

N

O

P

Q

R

S

U