Exit, Schmexit

John Mauldin | August 27, 2013

In last week's *Outside the Box*, which included a paper from the San Francisco Federal Reserve on the effectiveness of quantitative easing, I wrote, "What [authors] Cúrdia and Ferrero are really saying is that the latest round of QE, massive as it has been, has not had all that much effect on the economy, and that other factors should be taken into account. I'm sure this thesis is somewhat controversial, and I look forward to seeing what QE proponents like David Zervos over at Jefferies have to say about it."

And David thundered back with an answer the next day, more or less along the lines that I expected but with an interesting twist. He thinks the San Francisco paper is basically a fig leaf, intellectual covering for a policy the Fed must pursue no matter what. Quoting from his work, which is the lead story for this week's *Outside the Box*:

> There is no doubt these folks are trying to delicately pop a fixed-income leverage bubble. They are deathly afraid of a souped-up version of the 1994 rout! They know that balance sheet expansion comes with the parasitic side effect of excessive private sector leverage. And as of now they feel the potential costs of further expansion are beginning to outweigh the benefits. The economy is recovering; QE has been working like a charm; but it's time to nip the side effects in the bud. That's the current Committee view!
>
> As a consequence, there is a campaign underway by the FOMC to somehow convince us all that "soothing language" will be better than QE injections. That, of course, is like trying to tell Charlie Sheen that a warm cozy snuggle by the fireplace with a good book will be better than an eight ball. The market is not stupid, and neither is Charlie — both will freak out when u try to take their drugs away! And to be sure, we are 130bps into this freak-out session on 10yr rates. The bubble has been popped. And the question we should all be asking ourselves is, will the Fed lose control of the situation? My answer to that (for now) is NO! But I must say, there is quite a bit more room for a policy mistake than at any other time in the past few years."

We follow David's brief but pointed analysis with two related pieces, the first from Stephen Roach, who talks about the potential consequences for emerging markets when central banks have to reduce their easing. As we have all seen, even the run-up to tapering has not been pretty, and emerging-market central banks everywhere are complaining; but as James Bullard, president of the St. Louis Fed, noted in an interview with Bloomberg Radio, the domestic economy is the primary objective of Fed policy. "We're not going to make policy based on emerging-market volatility alone," he said. "They were complaining about us easing too much. Now when we start to talk about taper they're complaining about too tight of a policy. They have an independent monetary policy, and they have to use that to manage their own economies."

And so it goes without saying that, since we have an independent policy, too, what happens in foreign economic climates can't have much of an effect on us, can it? Au contraire, says the ever-colorful Joan McCullough. In our final piece, she rewinds the historical videotape to show that the US Treasury and Federal Reserve have ganged up more than once to bail out foreign countries before they could create big problems here.

But let's hear Joan say it:

> So what's the difference if we send money to foreign shores to stop the hemorrhaging so that it doesn't reach us? Or if we acknowledge that having printed money and caused those foreign countries to be at the whim of fast, free do-re-mi ... we now put them in jeopardy by our withdrawing same? We did it in Mexico. We did it in Asia. We saw them nearly implode once the hot money started to leave big time and saw that this would cause us problems. So we took action to defend ourselves.
>
> Why now, are they denying this reality? Just plain stupid? Or is there a method to the madness? Such as they see that they have created such a horrific, no exit mess as the result of QE Infinity and ZIRP, that they must now pretend that US policy has always been "every man for himself"? When we know that this is blatantly false?

As you read these three pieces, recognize that the problems described are all part of the same set of unintended consequences of massive central bank monetary easing and related unorthodox policies, and that the time is rapidly approaching when the world is simply going to have to live within its means.

> "AND what is so rare as a day in June?
> Then, if ever, come perfect days;
> Then Heaven tries earth if it be in tune,
> And over it softly her warm ear lays;
> Whether we look, or whether we listen,
> We hear life murmur, or see it glisten…"
> — James Russell Lowell

With apologies to Mr. Lowell, far more rare is a pleasant day in Texas in August. But this year, while temperatures are still in the 90s during the day, the evenings cool down enough to allow one to comfortably sit outdoors at a restaurant or on the deck. I remember one span of two weeks in the 1980s when temperatures soared into the 110s every day. Generally, Texas is miserably hot in August, but this has been the best weather in August I can remember in my entire 63 years. I am sure that global warming is responsible somehow. This paean to the weather is occasioned by the wonderful evening I spent last night with my friend from the first grade Randy Scroggins, over chili rellenos and salsa at Gloria's, sharing life memories and updates on our kids. It is a special relationship that can survive youth, business successes and failures, and 13 kids between us. We've lived each other's ups and downs but have always been there for each other.

In two weeks I fly to Bismarck, where I will spend the day with Loren Kopseng, flying first to South Dakota and Mount Rushmore to play tourist (and to finally be able to say I have visited all 50 states) and then north to the Bakken for an update and tour of that fabulous oil play. Last year I flew around the block in a helicopter with Loren as he introduced me to the region. He asked me if I knew anything about oil, and I said I grew up in the oil patch but that my best friend (which would've been Randy) wouldn't let me invest in his oil company in 1981, when he was on one of his really big rolls.

"Wow!" said Loren. "He was a really good friend to you. 1981 was the first time I went bankrupt in the oil business." There's something special about oil wildcatters in general and Texas wildcatters in particular. I recognize that passion when I talk to Loren. Slightly mad, just about a half bubble off dead center, as my dad would say. But damn, you've got to love 'em.

Your wishing I had a few oil wells now analyst,

John Mauldin, Editor
Outside the Box

Guidance Schmidance ... Show Me the Money

By David Zervos, Jefferies & Co.

> "Actions speak louder than words."
>
> "Talk is cheap."
>
> "Speak softly and carry a big stick."

These are common aphorisms which have been used historically to admonish those with loquacious tendencies to pipe down. They are words of wisdom — and something our central bankers should think about long and hard. The release of the minutes yesterday confirms that there is a campaign within the core of the Committee to wean our economy off of an ever-increasing central bank balance sheet and to rely instead on "words" for the necessary accommodation. The recent work from the SF Fed, along with some tortured paragraphs on forward guidance in the minutes, indicates that "the power of mental persuasion" is fast becoming the central monetary policy tool for the FOMC. To make the concept simple, they are replacing the big stick of money printing with the cheap talk of forward guidance.

Why are they doing this? Well, reading between the lines, it appears that many on the Committee are nervous about the size of the USD 4 trillion balance sheet. It is a BIG stick — and frankly it has worked pretty darn well at creating a reflationary recovery. But as we in the market and those on the Committee know all too well, there are some nasty long term negative side effects from excessive QE usage — the difficulty in draining excess reserves effectively down the road, the potential for creating politically sensitive mark-to-market losses, and of course the big kahuna: the systemic risks arising from excessive leveraged risk taking in fixed-income markets. On this last point I found this passage in the minutes quite revealing:

> Some participants also stated that financial developments during the intermeeting period might have helped put the financial system on a more sustainable footing, insofar as those developments were associated with an unwinding of unsustainable speculative positions or an increase in term premiums from extraordinarily low levels.

There is no doubt these folks are trying to delicately pop a fixed-income leverage bubble. They are deathly afraid of a souped-up version of the 1994 rout! They know that balance sheet expansion comes with the parasitic side effect of excessive private sector leverage. And as of now they feel the potential costs of further expansion are beginning to outweigh the benefits. The economy is recovering; QE has been working like a charm; but it's time to nip the side effects in the bud. That's the current Committee view!

As a consequence, there is a campaign underway by the FOMC to somehow convince us all that "soothing language" will be better than QE injections. That, of course, is like trying to tell Charlie Sheen that a warm cozy snuggle by the fireplace with a good book will be better than an eight ball. The market is not stupid, and neither is Charlie — both will freak out when u try to take their drugs away! And to be sure, we are 130bps into this freak-out session on 10yr rates. The bubble has been popped. And the question we should all be asking ourselves is, will the Fed lose control of the situation? My answer to that (for now) is NO! But I must say, there is quite a bit more room for a policy mistake than at any other time in the past few years.

Why? Because the idea that forward guidance is somehow going to ease the pain of exiting from QE is a pipe dream. In fact, it takes enormous hubris on the part of our central bankers to believe their words are so powerful. I thought we had rid the central banking community of such ridiculous delusions of grandeur in 2008/09 — but no such luck, they are back to their old ways. The really sad part about all of this is that the Fed is trying to convince us forward guidance will work precisely when the Board of Governors is going to lose between three and five of its voting members. Ben, Betsy, and Susan are all gone next year. And Jerome and Janet could easily leave as well. Oh yeah, and the Cleveland Fed will get a new president in 2014. Honestly, it's hard to remember a time in the past when the POTUS had so much potential control of the FOMC. So the idea that time-consistent forward guidance has any value at this stage is basically insane.

But that will not stop the Fed propaganda machine from trying. Remember, we have that excellent bit of research from some leading SF Fed economists to fall back upon. They have a "model" — yes, one of those wondrous Fed concoctions that were so effective at forecasting economic activity for the past few decades (insert more sarcasm). Let's take an excerpt on "model assumptions" from the Economic Letter authored by those SF Fed economists:

> We consider an economy with two types of investors. The first can invest in both short- and long-term assets. For them, a lower risk premium prompts them to reallocate their portfolios, but doesn't change their spending behavior. If all investors behaved this way, a change in the risk premium would not affect the economy. The second type of investor buys only long-term bonds, for example to match asset duration with life events, such as retirement date. If long-term yields fall, these investors have less incentive to save and may allocate more money to consumption or investment in nonfinancial assets. This boosts aggregate demand and puts upward pressure on inflation.

Really? A model with 2 types of investors in some highly stylized metaphor of an economic system is going detect that markets reacted more to guidance on rates than large scale purchases? Where are the mortgage REITS, where are the hedge funds, where are the dealers, where are the sovereign wealth funds??? PUUULLLEASE!! This might be an interesting exercise for some PhD students, but in the real world it has NO use! This reminds me of the joke about the three econometricians applying for a job on Wall Street — one from Harvard, one from Princeton, and one from Faber College. The joke goes something like this:

Three econometricians head in for an interview with a large investment bank on Wall Street. The first one is from Harvard — Dr Smith. He steps in to meet the head of trading and on the white board in the room are two jagged lines pointing upwards that look awfully similar. The head of trading says to Dr Smith — what do you think the correlation is between those two time series on the white board? Dr Smith answers — at least .95 maybe .99. The head of trading says thanks and sends him out. Dr Jones from Princeton then steps in and the same thing happens. Finally, Dr Blutarsky from Faber College (and a Delta house alum) strolls in looking hung over and a bit dazed. The head of trading asks the same question, and Dr Blutarsky responds — what would you like it to be? Instantly, the head of trading says — YOUR HIRED!

Seriously though, after seeing this paper and reading the minutes, I had an instant memory of being at a St Louis Fed conference in 2009. It was the 30th-anniversary celebration of the great money-targeting experiment of '79-'82. Oddly enough, Volcker wouldn't come. But in the audience was Steve Axilrod, who basically ran the entire staff at the Fed during that time. He told a story about Volcker calling him and a few of the other senior economists into a room in early 1979 to discuss raising rates aggressively. He needed "an academic rationale" for driving rates much higher and thereby squashing inflation. But he couldn't just say "I'm raising rates," as that would be too politically controversial. Et voila, the staff came up with a new study suggesting that targeting the money supply rather than interest rates was a more appropriate and effective way to stop inflation. In short order the funds rate target was abandoned, and the era of money supply targeting began. Oh yeah, and after the changeover, the first print on short rates in October 1979 was 300bps higher!

That would not be the first time the Fed manufactured research to support a policy stance, and it clearly was not the last. The reality is, they are trying to cleanly get out of a VERY tricky situation. The good times from QE are in the here and now (i.e. housing up, spoos up, u-rate down etc etc). The bad times are lurking on the horizon (i.e. difficult balance sheet unwinding, higher inflation, emerging market stress, systemic financial asset deleveraging, etc., etc.). That said, so far they have done a fabulous job of extinguishing a bunch of the excessive fixed-income leverage from the system. But they need to be careful. The markets and the economy are still fragile. They have made the mistake many times before of declaring victory too early. We needed the QE, and we may need it a lot longer. The last thing we need now is a bunch of sanctimonious central bankers telling us their words matter more than their actions. Their actions are what saved us, their words have been an annoyance! The only way words would really matter is if Ben (or Larry/Janet) followed Mario and said: "Our policy is to do whatever it takes to generate asset price reflation and an economic recovery." Now that's the kind of speaking softly and carrying a big stick that Teddy Roosevelt would be proud of!

I suspect, when all is said and done, the FOMC will actually follow that simple rule (as it largely has done up until now). But for the moment, they are trying to be cute and rid us of some nasty leverage based side effects of QE. So far so good, but if their strategy backfires and side effect management contaminates the seeds of recovery, the stick will come out VERY quickly just like it has in the past. And once again actions will speak louder than words! Good luck trading.

The Global QE Exit Crisis

By Stephen Roach, Yale University Jackson Institute of Global Affairs

The global economy could be in the early stages of another crisis. Once again, the US Federal Reserve is in the eye of the storm.

As the Fed attempts to exit from so-called quantitative easing (QE) — its unprecedented policy of massive purchases of long-term assets — many high-flying emerging economies suddenly find themselves in a vise. Currency and stock markets in India and Indonesia are plunging, with collateral damage evident in Brazil, South Africa, and Turkey.

The Fed insists that it is blameless — the same absurd position that it took in the aftermath of the Great Crisis of 2008-2009, when it maintained that its excessive monetary accommodation had nothing to do with the property and credit bubbles that nearly pushed the world into the abyss. It remains steeped in denial: Were it not for the interest-rate suppression that QE has imposed on developed countries since 2009, the search for yield would not have flooded emerging economies with short-term "hot" money.

As in the mid-2000's, there is plenty of blame to go around this time as well. The Fed is hardly alone in embracing unconventional monetary easing. Moreover, the aforementioned developing economies all have one thing in common: large current-account deficits.

According to the International Monetary Fund, India's external deficit, for example, is likely to average 5% of GDP in 2012-2013, compared to 2.8% in 2008-2011. Similarly, Indonesia's current-account deficit, at 3% of GDP in 2012-2013, represents an even sharper deterioration from surpluses that averaged 0.7% of GDP in 2008-2011. Comparable patterns are evident in Brazil, South Africa, and Turkey.

A large current-account deficit is a classic symptom of a pre-crisis economy living beyond its means — in effect, investing more than it is saving. The only way to sustain economic growth in the face of such an imbalance is to borrow surplus savings from abroad.

That is where QE came into play. It provided a surplus of yield-seeking capital from investors in developed countries, thereby allowing emerging economies to remain on high-growth trajectories. IMF research puts emerging markets' cumulative capital inflows at close to $4 trillion since the onset of QE in 2009. Enticed by the siren song of a shortcut to rapid economic growth, these inflows lulled emerging-market countries into believing that their imbalances were sustainable, enabling them to avoid the discipline needed to put their economies on more stable and viable paths.

This is an endemic feature of the modern global economy. Rather than owning up to the economic slowdown that current-account deficits signal — accepting a little less growth today for more sustainable growth in the future — politicians and policymakers opt for risky growth gambits that ultimately backfire.

That has been the case in developing Asia, not just in India and Indonesia today, but also in the 1990's, when sharply widening current-account deficits were a harbinger of the wrenching financial crisis of 1997-1998. But it has been equally true of the developed world.

America's gaping current-account deficit of the mid-2000's was, in fact, a glaring warning of the distortions created by a shift to asset-dependent saving at a time when dangerous bubbles were forming in asset and credit markets. Europe's sovereign-debt crisis is an outgrowth of sharp disparities between the peripheral economies with outsize current-account deficits — especially Greece, Portugal, and Spain — and core countries like Germany, with large surpluses.

Central bankers have done everything in their power to finesse these problems. Under the leadership of Ben Bernanke and his predecessor, Alan Greenspan, the Fed condoned asset and credit bubbles, treating them as new sources of economic growth. Bernanke has gone even further, arguing that the growth windfall from QE would be more than sufficient to compensate for any destabilizing hot-money flows in and out of emerging economies. Yet the absence of any such growth windfall in a still-sluggish US economy has unmasked QE as little more than a yield-seeking liquidity foil.

The QE exit strategy, if the Fed ever summons the courage to pull it off, would do little more than redirect surplus liquidity from higher-yielding developing markets back to home markets. At present, with the Fed hinting at the first phase of the exit — the so-called QE taper — financial markets are already responding to expectations of reduced money creation and eventual increases in interest rates in the developed world.

Never mind the Fed's promises that any such moves will be glacial — that it is unlikely to trigger any meaningful increases in policy rates until 2014 or 2015. As the more than 1.1 percentage-point increase in 10-year Treasury yields over the past year indicates, markets have an uncanny knack for discounting glacial events in a short period of time.

Courtesy of that discounting mechanism, the risk-adjusted yield arbitrage has now started to move against emerging-market securities. Not surprisingly, those economies with current-account deficits are feeling the heat first. Suddenly, their saving-investment imbalances are harder to fund in a post-QE regime, an outcome that has taken a wrenching toll on currencies in India, Indonesia, Brazil, and Turkey.

As a result, these countries have been left ensnared in policy traps: Orthodox defense strategies for plunging currencies usually entail higher interest rates — an unpalatable option for emerging economies that are also experiencing downward pressure on economic growth.

Where this stops, nobody knows. That was the case in Asia in the late 1990's, as well as in the US in 2009. But, with more than a dozen major crises hitting the world economy since the early 1980's, there is no mistaking the message: imbalances are not sustainable, regardless of how hard central banks try to duck the consequences.

Developing economies are now feeling the full force of the Fed's moment of reckoning. They are guilty of failing to face up to their own rebalancing during the heady days of the QE sugar high. And the Fed is just as guilty, if not more so, for orchestrating this failed policy experiment in the first place.

They *So* Stink

By Joan McCullough, East Shore Partners

Let's just cut to the chase. They *so* stink, it's beyond the pale.

It was the middle of last night. I'm diggin' around, readin' here and there. When I come across this B'berg article: "FED Officials Rebuff Coordination Calls As QE Taper Looms". By Simon Kennedy, Joshua Zumbrun and Jeff Kearns.

http://www.businessweek.com/news/2013-08-25/fed-officials-rebuff-coordination-calls-as-stimulus-taper-looms

This is a must read. Meanwhile, here's the gist: At Jackson Hole, more than one emerging market honcho expressed concern regarding the possibility of his respective country's demise as the FED hints about **cuttin' off the loose juice**. All the reasons we have cited previously in this space, i.e., the spectrum of nasty fall-out to these emerging economies (formerly known as "Third World" was expressed; I said "formerly" ... for the time being anyhow) ... not the least of which is the aptly-named "fast money' doin' what it always does: exit in a hurry. Leaving these poor slobs in the lurch on many levels, big time.

The response from the FED geeks cited in the piece: **Tough noogies. Every man for himself. Our mandate is only applicable to maintain the health of the US. Go fish.**

Best response to that baloney cited in the piece: From Christine Lagarde, head of the IMF. "Watch out that your arrogant response doesn't go full circle ... and come back to *ite you on the bass."*

Like I said, that's the nutshell. It is definitely a must read.

By the time I got done with the article, I was jumpin' furious.

So now it's time to **Go to the Video**, for those who either weren't here yet (whippersnappers) or those who may need a reminder (aging dinosaurs). As to show how this infernal game has rolled and keeps rollin'. Much to my enragement.

The bottomline is that these sunzabees are ruthless. Bullschmitt rolls off their tongues way too effortlessly. And I for one, have had enough enzyme free donkey fazoo shoveled my way to last two lifetimes. Their arrogance is unexampled. And it is clear that they labor under the delusion that we all have amnesia. And are way too stupid to see thru their crap.

Tough noogies indeed. Every man for himself, eh?

Do you get the picture? Great. Now let's take these bums apart, inch by inch. I'm writin' most of this off the top of my head. My memory gets real sharp when I get berserk.

Here it is:

It is the Mexican peso crisis of 1994.

What really happened is that the Mexicans lied about how much they had left in dollar reserves; they had been defending the peso. As it was under siege.

And although they swore up that they would not devalue, bang, they did it.

Their Treasury market (Tesobonos and Cetes) as I recall, seized up. Who was trapped, holdin' Herman and a lot of Mexican paper? Some of the biggest US institutional accounts.

What did we do?

Trader Bob Rubin, then Secretary of the Treasury, conspired with the head of the FED, Alan Greenspan, to raid the Exchange Stabilization Fund. Which had been established under Roosevelt to stabilize the buck. Under so many guises, not the least preposterous one being Rubin's claim that stabilizing the Peso would stop illegal border crossings, we sent taxpayer do-re-mi into Mexico. Which provided a much-needed exit for those US institutional investors who needed it.

Greenspan testified before Congress, the day I threw my shoe at the TV screen in the trading room, that he had "no record of the route the US funds took once delivered locally". This was the truth. It was what this bamboozler *didn't say*, that was critical. And since Congress was too ignorant to ask the next logical question once he said "I have no record", a good leather pump went flyin'.

What was that next, logical question? "If you don't have the records, who does?" And the answer, natch, would have been, of course "THE FREAKIN' MEXICAN CENTRAL BANK."

Of course, we never got to that point. The dopes in Congress were satisfied that Magoo didn't have the records. And gave this fibber a pass.

And so went the taxpayer money, down south. Then back up north. And the illegals kept swarmin' the borders. But Rubin was nowhere to be questioned about his baloney. SOS.

Nevertheless, we knew what the excuse was for raiding the ESF right off the get-go because Rubin had repeated it so often: **In stabilizing the Peso, we stabilize the buck. Due to the cross-border investing, this is a given, i.e., it is in our best interests to prevent a crack-up over there ... in order to prevent reverberations being felt over here.**

What you probably don't recall as vividly is that back then, there were in effect some regs regarding the amounts that could be released from the ESF before Congress had to give its approval. I believe the magic line in the sand was a cool billion $. And that's part of the reason why we had all the hearings at the time. Because Congress, as you know, is supposed to control our purse strings. As part of the system of checks and balances. I know. That became a joke under Obama. Nevertheless, it's still on the books. So plod on we must with this tale.

We are January of 1995 now. Clinton is in the WH. Monica is still under the desk, so Bubba still has clout. Greenspan/Rubin told him to ask Congress for $40 bil in loan guarantees for the Mexican government. Get it? They issued the cetes that these big US institutions were trapped with. So why not give them loan guarantees, eh? Smart.

Congress said no.

Which should have put an end to the whole thing. But Clinton defied them and gave Mexico $20 bil. Now remember, $20 bil was a lotta' do-re-mi back then. And for the record, was the largest slug the ESF had ever even thought about dolin' out.

So tempers were flaring in Congress. Not only because Clinton et al had flipped them the bird, but because of the size of the guarantee. As I recall, $20 bil was roughly half of the whole stash in the ESF.

To shut Congress up, Clinton cited Roosevelt or some baloney. Because apparently under the Gold Act of 1934 ... yeah, that abomination ... Clinton claimed he had discretion. (So why didn't he just use it instead of going thru the motions? Right.)

Okay, where's this goin'? **To make the point that back during the Mexican crisis, we made it plain to all, that taking steps necessary to stabilize other countries where US investors are heavily exposed ... is in the best interest of the US.**

So, okay, that is the job of Treasury, right? What has it got to do with the FED? Greenspan and Rubin sat shoulder to shoulder at those hearings. The sight was much written about at the time. I clearly remember it and was taken aback myself. As they did nothing to dispel rumors that they had put their heads together on the Mexican bailout. And why would Treasury act without the FED's counsel anyhow, right? It is the FED which does the transfers and oversees the financial system. So the FED gets no pass on this one. Ever. Cahoots 24:7? You bet. Keep readin'.

What was happening before our very eyes was the resurrection of the ESF. Where many that day in the trading room where I sat, had never even heard of it. Some guys sittin' upstairs, too, were equally givin' it the *"ES... what?".* So you get the picture.

Thus, the ESF was resurrected and then stood on its ear.

As follows: We morphed from promoting, starting in the 1930s, occasional, quiet, clandestine efforts to maintain the stability of the buck. Period.   To a new, broader mandate which required us to keep orderly exchange agreements with our counterparties by stabilizing any and all foreign exchange rates. See the difference? The original intent was to keep the buck on an even keel.   The New Age of Rubin expanded that to mean that we had an obligation to keep other country's money balanced. So that ours would not be rocked and thus go haywire. Which would upset the US economic applecart.

And that's how they got away with all that carry-on almost 20 years ago. By disguising a bail-out of some big institutions as "Mexico's interest is our interest." And we never objected.

So Rubin took it further.

We are now in late 1997. Around Christmas.

S. Korea was blowin' up. So Rubin had dinner with Greenspan. Again. And the various aides. In order to figure out a way to solve this latest crisis.

What had been happening *in the lead up to this dinner*? Asia was goin' down the rathole. But Rubin, still chafing from criticism over the use of the ESF in the Mexican caper, kept a distance from these countries, opting to deem them as local annoyances and not critical to the US economic miracle.

Unfortunately, it just kept gettin' worse until it threatened to [de]stabilize the whole area.

Let's be more specific about that. Thailand and Malaysia aside, S. Korea had paper all over the globe. And they were on the brink. And Japan ... was one of their biggest investors, holdin' huge S Korean debt. For the record, at the time, they were high on our list of trading partners, too, about #5 or 6. And as you know, we have thousands of US troops stationed there as well.

So he could no longer ignore this stuff.

Because by now, the world of derivatives was starting to unfold to where it was a word heard on the 6 o'clock news by most of America.

What was the deal, then?

It would have been hard to find a country, large or small, who didn't hold S Korean investments. So the US would have gotten banged by a S Korean implosion ... either directly or indirectly.

And since Japan ... a major world economy ... had the biggest exposure, it didn't take too much of a stretch of the imagination to see how once the derivatives and interest rate and currency swaps and forex contracts and other sundry hedges got dragged into the vortex, that it would only be a NY minute before their crap landed on our sunny shores.

The US was not quick to figure this out. I remind you who was Deputy Treasury Secretary at the time: Larry Summers. Yes. One and the same.

He was dispatched to find out how much reserves S Korea had left. The old story, right? How many bucks do you have in the vault, eh?

Apparently, it wasn't much. So behind the scenes ... and using the IMF as the beard, the US cobbled together a $75 bil bailout package in the form of loans to S. Korea. Attached to these loans was a message from Trader Bob delivered by the IMF to S Korea: drop your trade barriers and rebuild your financial system. Which was a joke. Because a handful of families/titans controlled the whole magilla, employing a huge chunk of the population to boot.

That was in early December when the IMF cut the package for S. Korea with us pushing behind the scenes. Early December of 1997.

But it didn't work, no sir. As much as Clinton tried to downplay it, it didn't work. And S Korea kept hemorrhaging reserves as the foreign money couldn't get out fast enough.

And that, ladies and germs, is what precipitated that Christmas-time dinner between Rubin and Greenspan.

It is noteworthy that by this point, **the Japanese stock market was gettin' drubbed mercilessly. And fingers were being pointed. And the DJIA then started to lose ground**. The rumors were ceaseless and went something like this: If the US doesn't stop the mess unfolding in S Korea, then directly and indirectly, they are gonna' take the US economy to its knees. As Asia in general was a total mess; **US earnings in the area were in jeopardy**. Got that? US earnings in the area were in jeopardy. And S Korea's reserves by then were estimated to be under $10 bil; Mexico had about $6 bil left when they pulled the trigger. So it was a matter of days before S Korea did the same.

The IMF kicked into gear and demanded more funds from the US. Which we kicked in. Disguised by further commitments at the time from Germany, Japan and the UK and probably others who had exposure, too.

How did this work out?

McDonough was Chairman of the NY FED at the time. He got on the blower and asked all the big banks to roll over their loans to S Korea.

And very importantly, asked them **not** to execute margin calls on any derivatives and such with S Korean entities that had gone south.

Having no choice in the matter, apparently they complied.

That's the gist of what happened. After that stuff, there was a load of political carry-on as the S Korean unions got involved and there was a power struggle at the top of their country's leadership.

But you get the point. You see the extremes that we went to ... and the taxpayer money that was put at risk to becalm a financial crisis ... away from these shores. In the process, we ended up financing the government/ large business entities of a foreign country which the US said was strategic to the continued success of the US economic miracle.

So what's the difference if we send money to foreign shores to stop the hemorrhaging so that it doesn't reach us? Or if we acknowledge that having printed money and caused those foreign countries to be at the whim of fast, free do-re-mi ... we now put them in jeopardy by our withdrawing same?

We did it in Mexico. We did it in Asia. We saw them nearly implode once the hot money started to leave big time and saw that this would cause us problems. So we took action to defend ourselves.

Why now, are they denying this reality?

Just plain stupid? Or is there a method to the madness? Such as they see that they have created such a horrific, no exit mess as the result of QE Infinity and ZIRP, that they must now pretend that US policy has always been "every man for himself"? When we know that this is blatantly false?

I'll be giving this poser some more thought including how the Nikkei and then the DJIA followed suit and why. Way back then. Suggest you do the same.

Like I said, they *so* stink.

Geez.

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