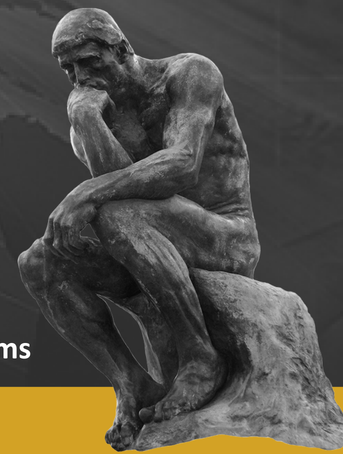
MAULDIN ECONOMICS

THINGS THAT MAKE YOU GO

Hmmm...

A walk around the fringes of finance

By Grant Williams



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1 OCTOBER 2012

Jeopardy

Jeop·ard·y/'jeperdē/

Noun: Danger of loss, harm, or failure

"Final Jeopardy! questions seem to be, by design, things you can't know. And so it's not about who knows them, but who can figure them out in thirty seconds."

— Ken Jennings

"We need a new format. We should shut down and retool."

— Kramer, Seinfeld: The Merv Griffin Show

"It's a strange thing, but when you are dreading something, and would give anything to slow down time, it has a disobliging habit of speeding up."

— J.K. Rowling, Harry Potter and The Goblet of Fire

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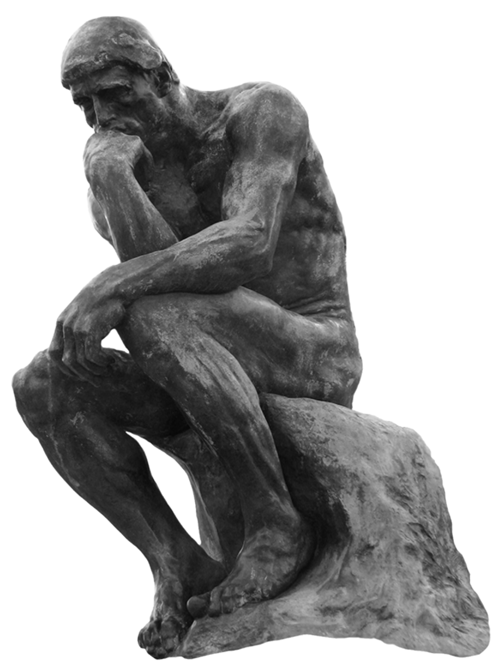


Things That Make You Go *Hmmm...*

Julann Griffin is hardly a household name. However, her husband, Merv, most certainly is.

Griffin, a talk show host, actor and musician, was also the host of a game show called "Play Your Hunch"—a role that he enjoyed for four years in the late '50s/ early '60s. During one famous episode of the show (which, like most shows of the era, was broadcast live) Johnny Carson's predecessor as host of *The Tonight Show*, Jack Parr, somehow accidentally wandered onto the set. Griffin pigeonholed the talk show host for an impromptu interview, which led to a guest hosting job on *The Tonight Show*.

Griffin was so uncomfortable in front of the cameras of a live talkshow broadcast that he attempted to resign after only a few minutes. Despite being persuaded to continue, Griffin was never really comfortable with the format, but he managed to overcome that discomfort and later establish his own talk show as one of the most successful of all time. In all, it ran for 21 years and, during that run, won 11 Emmys. The show produced many entertainment milestones, the debut of Arnold Schwarzenegger and famous interviews with controversial figures George Carlin and Richard Pryor among them.

In the early 1960s, on a plane ride from Duluth to New York, Julann Griffin had a brainwave that would set her husband on the way to wealth beyond the couple's wildest dreams.

Griffin takes up the story:

> *(AP): My wife Julann just came up with the idea one day when we were in a plane bringing us back to New York from Duluth. I was mulling over game show ideas, when she noted that there had not been a successful "question and answer" game on the air since the quiz show scandals. Why not do a switch, and give the answers to the contestant and let them come up with the question.*
>
> *She fired a couple of answers to me: "5,280," and the question of course was how many feet in a mile. Another was "79 Wistful Vista." That was Fibber and Mollie McGee's address. I loved the idea, went straight to NBC with the idea, and they bought it without even looking at a pilot show.*

Julann Griffin had invented *Jeopardy*.

The premise of the show is as simple as it sounds in Griffin's description above, but it is precisely that simplicity that has ensured its longevity.

Like most game shows, most of the answers are pitched at a level that the vast majority of the contestants (as well as the audience) will comfortably know the answers to, with the degree of difficulty only increasing once there is a more significant amount at risk (in this case, the top-priced answer is worth $2,000).

Since late 2009, the world has been engaged in its own round of *Jeopardy* as, after being introduced to the crowd, the answers given to it were, at first, predictably simple:

"I'll take 'GREECE' for $1,200, please."

"OK, here we go: The REAL figure for this was 15.4%, not 3.7%."

"What is Greece's budget deficit?"

"Correct!"

Remember way back when all this started, folks?

At the end of 2009, the incoming Greek government revised their deficit from what had been 3.7% of GDP at the beginning of the year under the (New Democracy government) to 12.7% after taking a look at the books. By November 2010, however, Eurostat had placed the true figure at 15.4%.

Hey, it's an easy mistake to make—and one that will no doubt be made again. In fact, it likely IS being made again, right now, in another European nation—but more about Spain later.

This past week or so, a couple of interesting developments have been taking place in the ongoing saga that is Greece.

Firstly, Angela Merkel has gone out of her way to demonstrate that beneath that cold, soulless exterior beats the cold, calculating heart of a politician:

> *(UK Daily Telegraph): Angela Merkel said her "heart bleeds" for Greeks facing hardship during the eurozone crisis as the German chancellor stressed that she was trying to help Europe, not anger people.*

Of course, Merkel being Merkel, the velvet glove contained a decidedly iron fist:

> *Speaking at her annual press conference in Berlin, the German chancellor said that it was important that richer Greeks paid their fair share to support the country...*

Nonetheless, Mrs. Merkel said that the country must press ahead with reforms, saying it does not help Greece to delay and that the government must now focus on collecting taxes...

Mrs. Merkel said that countries must cut debt levels in order to reduce their dependency on the markets. Reform is the best medicine to address the "massive disparities" in European competitiveness, she added.

But a couple of days earlier, the first signs of a shift on the part of the Troika were evident as Christine Lagarde hinted that there may be room to manoeuver for Greece, though it won't be on money but rather on the one commodity that the Eurocrats *seem* to think they have unlimited amounts of: time.

(Reuters); Greece may get more time to reach financial targets under its 130 billion euro rescue package but probably not more money, its international lenders signalled on Friday, saying a decision had to come by the end of October.

Greek Prime Minister Antonis Samaras, leading a country in its fifth year of recession at a time of rising discontent at home, wants two more years to implement economic reforms tied to the bailout to soften their impact.

International Monetary Fund Managing Director Christine Lagarde said lenders may now agree to some sort of extension.

"There are various ways to adjust: time is one and that needs to be considered as an option," Lagarde told a news conference following a meeting of euro zone finance ministers in Cyprus.

Greece's second bailout envisages Athens returning to international markets by 2015, but with two consecutive parliamentary elections in May and June after political parties struggled to form a coalition, the country has lost ground on its reform agenda. Deepening recession has also made the debt targets less attainable.

Although the extent of the shortfall will not be known until a report by lenders in October, Greece is unlikely to win back investor confidence quickly and meet its targets, which include a primary surplus of 4.5 percent of economic output in 2014.

Now, the extent of the shortfall may not be known until the Troika report is released in November, but I'd be more than happy to go out on a limb and say it will be TERRIBLE.

In fact, a couple of days after I wrote that last paragraph, Germany's *Der Spiegel* reported in its German-language edition that there may be a *tiny* problem:

(FT): Meanwhile in Greece the Troika decided to take a "brief pause" which is expected to last about a week and probably has something to do with the speculation in at least one German paper that the budget gap is close to double that previously expected. €20bn rather than €10bn.

The *Independent* has this:

> *The magazine said it based its figure on a preliminary report from the so-called Troika of experts from the International Monetary Fund, the European Commission and the European Central Bank who are assessing Greek progress in implementing reforms.*
>
> *Der Spiegel said Athens would qualify for its next tranche of eurozone bailout funding only if the deficit gap were closed. It said Mr. Samaras had been asking creditors whether they would be prepared to write off Greece's debts in order to make up the shortfall.*

Double the previous expectations, people. ***Double***.

Just one day later, an *FT* reporter reported on the report and, Hey Presto!, the big number that had gotten bigger had gotten bigger still (though, in fairness to the Greeks, this time only by 50%):

> *(FT): Apparently that Greek shortfall is even bigger than the even bigger figure reported in the German press on Monday.*

From *Eurointelligence*:

> *Spiegel Online and Suddeutsche Zeitung have updates on the Greek budget gap, which is even bigger than previously assumed – around €30bn. This is the accumulated short-fall the troika is expected to identify in its forthcoming report – the amount Greece has to raise, save, restructure, default on, if it wants to make it through the second loan programme. Spiegel writes that the troika will say that the recession has totally counteracted the budgetary savings, while the government has failed to introduce structural reforms.*

Spiegel says this leaves three scenarios: getting the €30 billion tranche anyway with more leeway for reforms, a new debt restructuring or… a forced exit. Which, it says, is not an option, politically.

More from *Eurointelligence*:

> *The troika will also state that Greece will not meet the long-term goals of funding the budget without external help from 2015 and a complete return to financial markets in 2020. Suddeutsche says the EU does not want Greece to fail, but it does not want to pay the €30bn either. There was thus a danger that they would shift the responsibility to the ECB.*

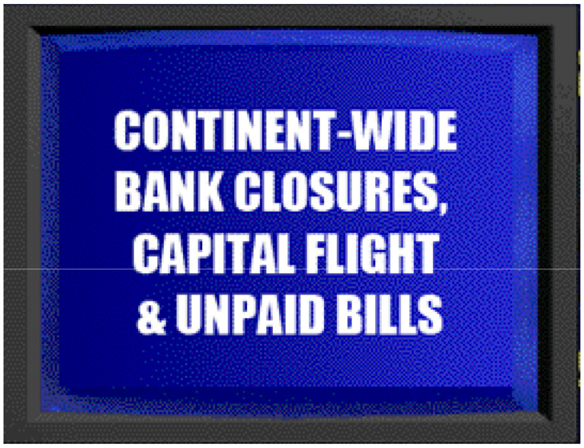
Let's be clear about Greece: It can't be fixed whilst within the confines of the EU. Not only that, but even now, the fact that the numbers coming out of Greece still have the capacity to catch inspectors off-guard to the tune of 200% tells you that one of three things is going on here:

a) The Troika inspectors are the most incompetent to hold that rank since Clouseau

b) Greece's bookkeepers are the German firm of Jacob & Wilhelm Grimm

c) All of the above

Greece needs to leave the EU as much as the EU needs Greece to leave. You'd think that would make things easy for everybody, wouldn't you? The truth, though, is somewhat trickier.



"I'll take 'CONSEQUENCES' for $1,600, please."

"OK, here we go: Continent-wide bank closures, capital flight and unpaid bills."

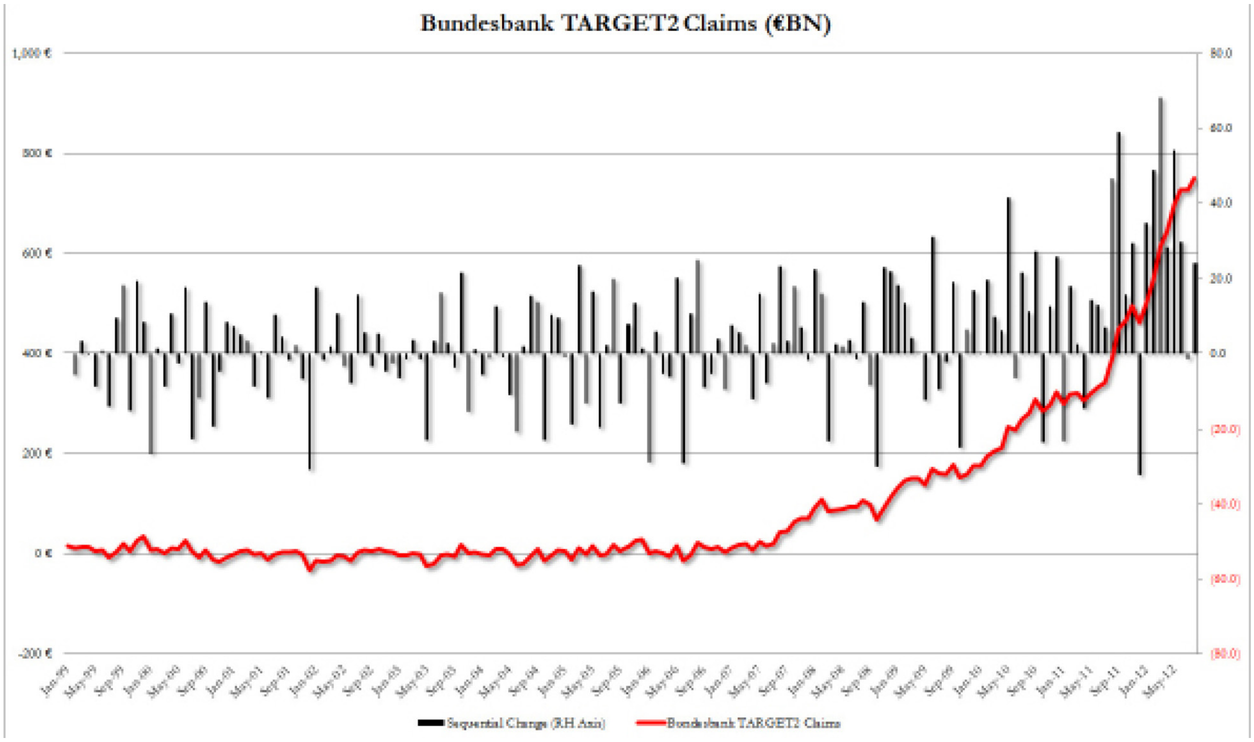
"What are the consequences of a Grexit?"

"Correct!"

Greece doesn't want to leave whilst there is still even a *remote* chance of being given billions more in loans that they have zero intention of paying back (after all, why would you walk away from the guy throwing money at you until his bag was empty?), whilst it appears to have finally dawned on Europe that Greece has them over a barrel in the sense that if they were to leave, not only would billions in loans disappear faster than my friend The Grey Dot when the check arrives, but it would precipitate a Europe-wide bank holiday and escalate the bank run that has been in progress for over a year now.

If Greece *were* to leave the EU, then all Greek banks would need to be shut in order to return to the Drachma, and if you closed all the *Greek* banks, it would make it apparent to those last few blissfully ignorant savers still keeping their savings in Spanish banks (to pick but one imperiled European country completely at random) that the exit of a weak country from the euro—an outcome Greek PM Antonis Samaras described as "not an option" as recently as this week—was *decidedly* an option, and that would necessitate either closing Spanish banks too in order to stop capital flight to the safety of German deposit accounts accelerating further or imposing strict capital controls Europe-wide (which is hardly in keeping with the spirit of the union). Of course, if you then close *Spanish* banks...

Perhaps the sudden flexibility surrounding Greece is a sign of realization about the true possibility of an exit being "manageable." Perhaps it is the result of a quick tot-up of who would owe what to whom. It's hard to say, but I suspect that at the heart of the flexibility somewhere lies our old friend, TARGET2.



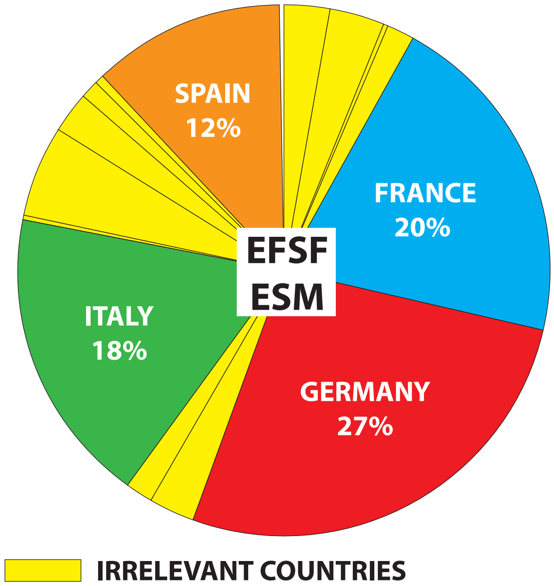
Source: Zerohedge

We have spoken at length about the TARGET2 system in these pages previously, but I think it's important enough to make it worth belaboring the point. Here's a quick recap on how it works (emphasis mine):

> (Marc to Market): Target2 *facilities cross-border movement of capital Europe. Local banks go through their central bank, while the central bank itself has an account at the ECB that is credited or debited.*
>
> *The problem arises because the imbalances are getting larger and the risk of that a country leaves, or the entire union disintegrates, has risen.*
>
> *If a woman in Greece takes her savings out [sic] a Greek bank and deposits them in a German bank, for example. The German bank's account at the Bundesbank is credited with the savings and the BBK account at the ECB credited. The Greek bank's account at the Greece central bank is debited and the central bank's account at the ECB is debited.*

> ***There is not [sic] limit to the imbalances. Nor is there a mechanism for final settlement. The imbalances do not seem to really matter provided the system stays together.*** *If the system falls apart, the problems are going to be on such a magnitude that the Target2 imbalances will not be the first concern.*

What this means is that Germany is "owed" three-quarters of a trillion euros by (mainly) Greece, Italy, Spain, Portugal and Ireland (chart, previous page). (You know, as often as we group those countries together, you'd think someone would have come up with a snappy acronym for them by now in the interests of simplification. Oh well...) What it *also* means is that the exit of any countries to whom Germany is a creditor would mean the Bundesbank kissing goodbye to their portion of the outstanding amount owed to TARGET2 by that country.



In the case of Spain (to pick but one imperiled European country completely at random), that outstanding amount would total €409 billion, and based on Germany's proportional commitment of 27% to the EFSF/ESM, that would mean the exit of our randomly selected country (in this case, Spain) would cost Germany roughly €110 billion. Incidentally, it's worth pointing out that should that randomly selected country exit the euro, it would also cost Italy €73.6 billion and Spain itself a cool €49 billion, so by staying in the euro, Spain is actually saving itself almost €50 billion.

Isn't the Eurozone clever?

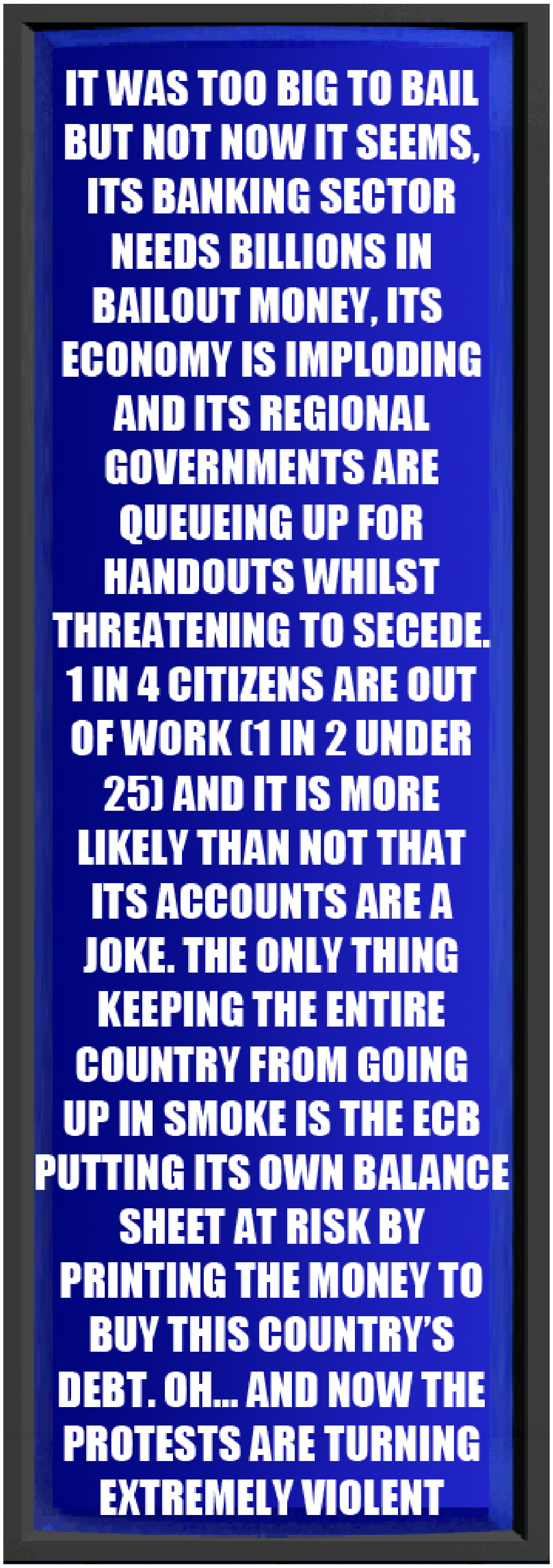
Perhaps too clever for its own good.

There really is no such thing as a "manageable" exit for anybody right now, I'm afraid. European countries are lashed together on board a sinking ship, and that fact is slowly dawning on them, which accounts for the softening in tone surrounding Greece as well as the increased understanding that, as I pointed out earlier in this piece, of the two variables available to the Eurocrats, they are out of money. Their BIG problem is that they seem to think that they can print the money to buy them time.

I hate to be the one to break it to the Eurocrats, but time ain't for sale, and if it were, it would probably want payment in gold as opposed to freshly minted fiat currency.

Which leaves us with just one square left on the board, so let's get to it, shall we?

"I'll take 'COUNTRIES THAT ARE TOO BIG TO BAIL' for $2,000, please."



"OK, here we go: It was universally acknowledged as 'too big to bail' a mere 18 months ago but is now haggling over terms of a full bailout after being granted a €100 billion handout for its banking sector. Its economy is on the verge of implosion, its regional governments are queuing up for bailouts of their own and—in the case of Catalonia, its wealthiest province—are openly threatening to secede. Its property market is plummeting at terminal velocity, 1 in 4 of its citizens are unemployed (1 in 2 below the age of 25), there are widespread rumors that the books are being cooked at both a regional and national level, and the ECB is keeping it afloat by buying unlimited amounts of its short-term debt, putting its very solvency at risk."

"What is Spain?"

"Correct!"

The realization that Spain is the key to the entire European house of cards is slowly dawning on the denizens of Europe, and it's a sobering thought indeed, but all we are really doing is going back to where we were last year, before interference in the markets made us forget the truth:

*(Satyajit Das, **Jan 5, 2011**): Spain has low productivity, high unemployment, an inflexible labour market and a banking system with large exposures to property and European sovereigns... If Portugal (debt about €180 billion) were to require help, then it would reduce available funds in the existing EU's bailout mechanism. Spain (with more than €950 billion debt) is simply too big to bail out using the present facilities.*

Despite Mario Draghi's unlimited bond buying and ~~spontaneous~~ carefully considered promise to do "whatever it takes" to preserve the euro, reality has a nasty habit of making fools of the most confident of men or, in the words of Mike Tyson:

> *"Everybody has a plan until they get punched in the face."*

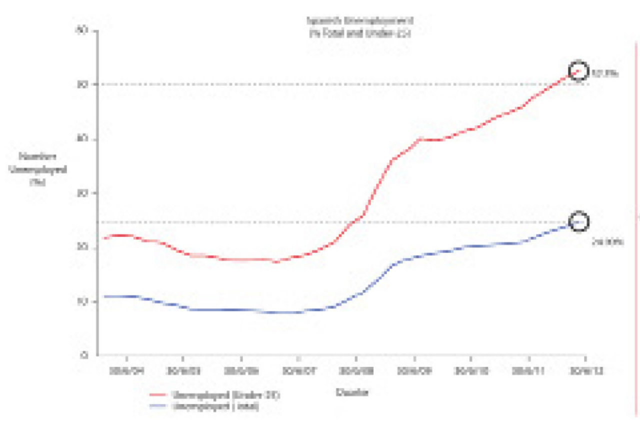
In an extremely insightful piece recently, Frank Veneroso highlighted the myriad problems facing Spain as it battles to pull off what, let's be realistic about it, is an impossible trick:

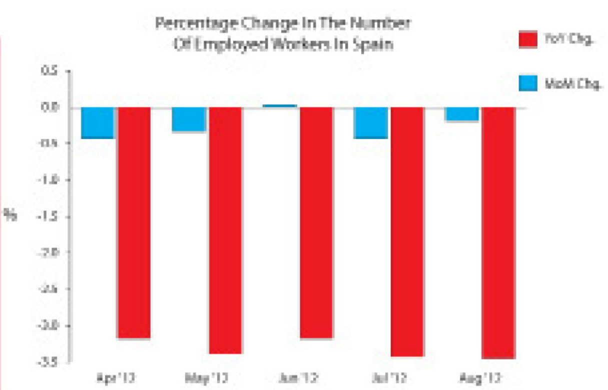
> *(Frank Veneroso): This week Bloomberg reported Spanish bank deposits declined by 224 billion euros or 10% in the twelve months ending July 31st. That is equal to more than 20% of Spanish GDP. When I started to warn about Spain as "the domino too big to fall" in May of 2011, I could not have imagined a deposit contraction of this magnitude.*
>
> *Spanish banking system borrowings from the ECB rose from 82 billion euros to 412 billion euros in the twelve months through August of this year, according to the Bank of Spain. Once again this amounts to lender-of-last-resort financing equal to over 30% of GDP in a mere year. This is also unimaginable.*
>
> *There can be no doubt that the run on Spanish banks has been ongoing, massive, and most likely devastating.*

That is Spain's first problem. With the full mobility allowed by the Maastricht Treaty, how is it possible to keep capital parked inside a weak country such as Spain when it can sit in the same currency in a far safer institution a few hundred kilometres to the north and still be accessed with a few clicks of a mouse? Simple. It isn't.

Ah, but if only that were Spain's lone problem.

The dreadful unemployment situation in Spain has been talked about in abstract terms for almost 18 months now, but things are decidedly not improving as you can see from the graph below (left). A look at the second chart (below, right), which shows the change in the number of employed workers, is perhaps even more illustrative of the problems facing Spain:





Source: Bloomberg/TTMYGH

The number of employed workers in Spain is falling by an average of just over 3% per *month*. To put that in perspective, that is the equivalent of roughly 600,000 workers dropping out of the US workforce every thirty days.

Numbers like that would make a big difference to little things like, oh... central bank policy... and elections.

But let's get back to the unmitigated disaster that is Spain and take a look at the underpinnings of Spain's once-booming economy and now-busting banking sector; the property market. It's a familiar tale, I'm afraid.

The news in August was shocking:

> *(UK Guardian): House prices in Spain fell by 11.2% in July, the biggest monthly fall since March last year. Overall prices have fallen by 31% since the financial crisis hit in 2008. Spain has an estimated 2 million unsold homes.*
>
> *Prices have slumped across the board and even in the big cities they are down 11.8% and 11% on the Mediterranean coast. The biggest falls have been in the Balearics and Canary Islands where prices declined in July by 14%. The government's decision to raise VAT from 4% to 10% on house purchases as of next year is expected to depress the market still further.*

A market that started falling along with everything else in March 2008 somehow managed to fall over 11% in a single month four *years* later.

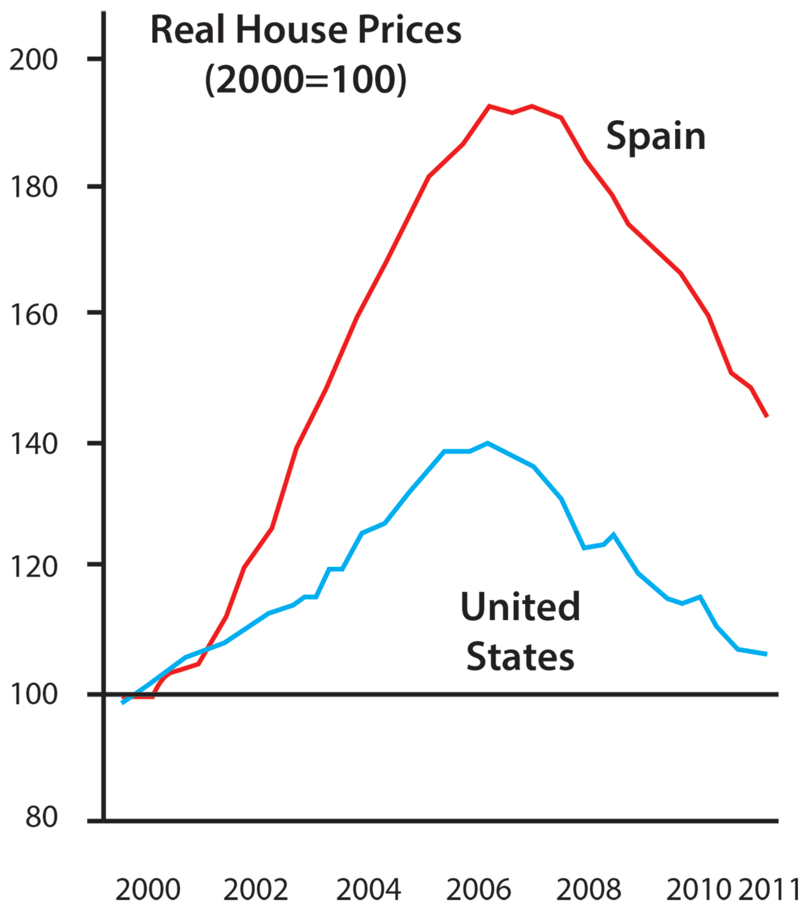
Somehow? I'll tell you how.

Spanish banks have been carrying massive property portfolios at completely unrealistic levels on their balance sheets to promote the illusion that they are sound institutions, but now, with stark headlines about the precipitous fall in real estate values on every front page in Spain and the prospect of a €100 billion bailout on the horizon, they are finding a little religion—even though that can be somewhat painful to face up to:

> *(Chicago Tribune, July 26): The euro zone's biggest bank, Santander, said on Thursday first-half profit halved after it took writedowns on deteriorating Spanish real estate assets while deposits in Spain jumped during the quarter.*
>
> *Santander said it had now completed 70 percent of required writedowns against repossessed housing and unrecoverable loans to developers demanded by regulators in an attempt to belatedly recognise losses from a 2008 property crash.*
>
> *Although in line with the provisions ordered by the Spanish government, traders were surprised the bank was willing to take such a slice of these losses so early in the year.*

Spain's property bubble was truly something to be admired. It made that of the United States look like no big deal, as can be seen from the graph below, and the fallout amidst the Spanish banking sector remains anything but finished. Back to Frank again:

(Frank Veneroso): Spanish real estate prices have been falling for years. According to official data released this past Friday, the decline in house prices has accelerated. They fell 14.4% year on year in the second quarter – the fastest rate since the real estate bubble burst in 2007. This is what one should expect given the unimaginable "run" on the Spanish banks. Real estate is the principal collateral behind Spain's untenably high ratio of private non-financial debt to GDP, and it is collapsing.



Source: Edward Harrison

As if on cue, the results of the Spanish bank stress tests were released on Friday and, predictably, they told a sorry tale (though, even more predictably, they were spun as positive by the authorities):

(UK Daily Telegraph): Spanish banks need a combined capital injection of almost €60bn, according to a report that Madrid claimed showed the nation's finances were more sound than the market fears.

Despite scepticism from analysts, the results are a rare boost for Mariano Rajoy, Spain's embattled prime minister who is struggling to contain regional rebellions as well as the financial crisis. He had promised the figure would be "far below the €100bn" Brussels has provided for.

Seven out of 14 of Spain's biggest banks failed stress-tests conducted by consultants at Oliver Wyman, who assessed the strength of 115,000 loans.

Not bad, huh? Only 50% of Spain's banks need shoring up. But...

...Bankia Group, the lender that requested €19bn of state aid in May, now had a capital shortfall of €24.7bn.

Banco Popular, Spain's sixth biggest bank by assets, has a shortfall of €3.2bn - almost as much as its €3.58bn market value - suggesting that it will almost certainly need state aid.

Based on the accuracy of previous stress tests, I think it's safe to assume that the original €100 billion is nowhere near enough.

But perhaps the single biggest problem with Spain is not the housing market, nor the busted banking sector, nor even the chronic unemployment. No. The biggest problem Spain presents to the world is the lack of credibility in the official statistics it releases amidst rumours of massive unpaid bills and insolvency in many of its regional governments.

With the specter of Greece's revelatory restatements just a couple of years old, this lack of confidence in the veracity of Spanish figures will weigh heavily indeed, and it is something that has been a very real problem since before markets obligingly decided to pull the wool over their own eyes:

*(GMI, **July 2011**): Back here on the Costa Blanca, things are equally awful. Sitting down with a friend here, he told me the story of a local landscape gardener who won the contract to supply a local town with a hundred or so fully mature palm trees and to plant them along a boulevard. Only after having undertaken the work, he was told that the town hall could only pay him in three years' time!*

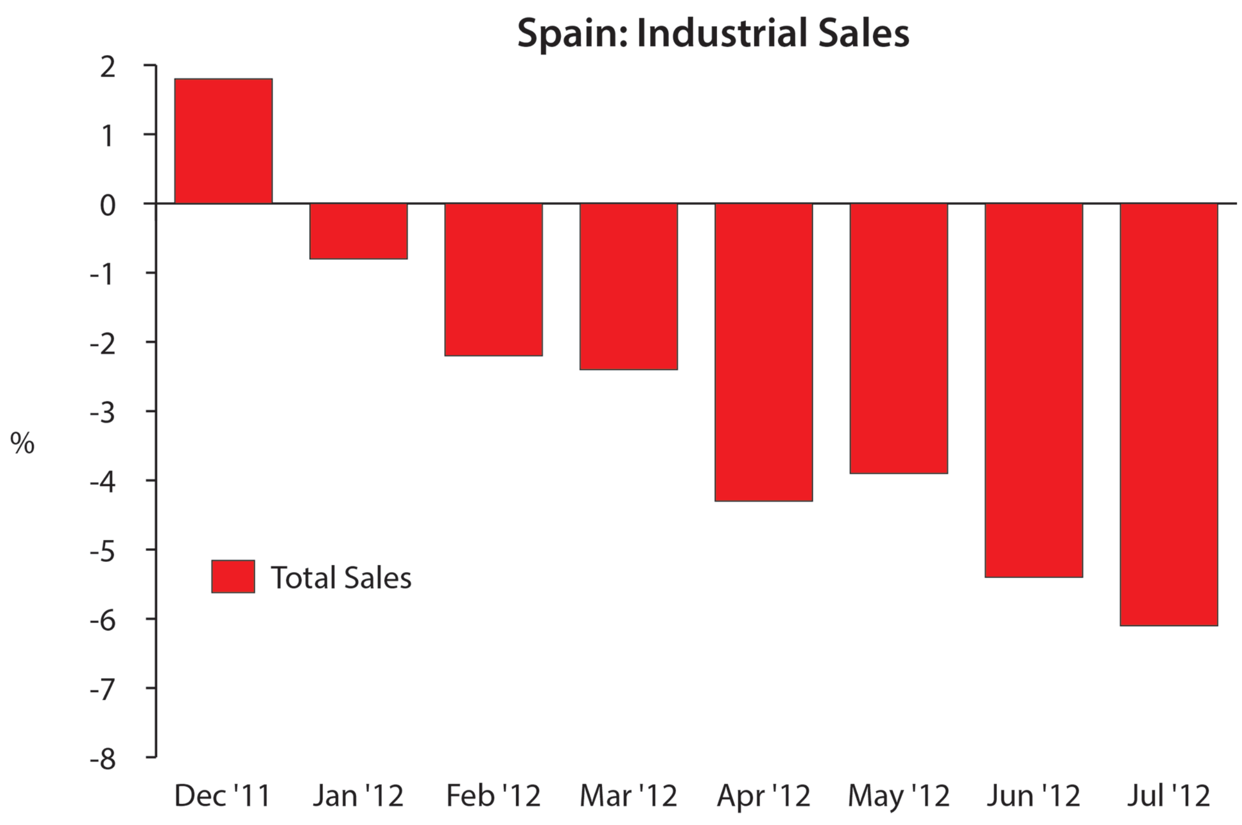
There are stories like this all over the Valencia region. Town halls are still spending money but changing their payment terms so it won't hit their accounts for a few years, by which time they hope things are better. Not good at all. This alone is forcing many small businesses to go under, and local town halls have stopped paying for virtually anything in which they don't have a financial 'interest' themselves.

Local newspapers have reported on local hospitals not paying for basic medical supplies such as bandages, and also many have cut paramedics from the ambulances to cut costs. This is really troubling.

These stories were over a year old. Think things have gotten any better since then?

As soon as the true depth of the problem is revealed, the world can begin to move past it, but, I strongly suspect, that true depth is truly horrifying:

> *(Frank Veneroso): Amidst all this, the Spanish government reports that its economy is almost stable. It claims its GDP has fallen only 1% over the last four quarters. That is one-third the rate of decline of Italy where the private debt-to-GDP ratio is half that of Spain.*
>
> *Again, Spain reports a mere 2.8% year-on-year decline in industrial orders through July.*
>
> *I am extremely skeptical of this benign Spanish economic data... The monthly industrial production data shows a decline since the economic peak in 2007 that is three times that reflected in the GDP accounts. Spain's GDP numbers stink like rotten fish.*
>
> *I pour through the lesser items in the Spanish economic data. They tell me the Spanish economy is falling hard. Here is a chart on nominal Spanish industrial sales. In real terms, these sales have probably fallen by 8% year on year.*



Source: Veneroso/Bloomberg

As I have been snatching time to write this piece on airplanes and in various hotel rooms at stupid o'clock in the morning this past week, the problems in Spain have rapidly escalated, with a series of violent protests this past week against Mariano Rajoy's proposals for increased austerity:

> *(UK Daily Telegraph): Spain's government was hit by the country's financial crisis on two fronts on Tuesday as protestors enraged with austerity cutbacks and tax hikes clashed with police near Parliament while the nation's borrowing costs increased in an auction of its debt.*
>
> *More than 1,000 riot police blocked off access to the Parliament building in the heart of Madrid, forcing most protesters to crowd nearby avenues and shutting down traffic at the height of the evening rush hour.*
>
> *Police used batons to push back some protesters at the front of the march attended by an estimated 6,000 people as tempers flared, and some demonstrators broke down barricades and threw rocks and bottles toward authorities.*
>
> *Television images showed officers beating protesters in response, and an Associated Press television producer saw several people dragged away by police and one protester with his head bloodied. Spain's state TV said at least nine people were injured, including one officer, and that 15 were detained.*
>
> *The demonstration, organized with an "Occupy Congress" slogan, drew protesters from all walks of life weary of nine straight months of painful economic austerity measures imposed by Prime Minister Mariano Rajoy and his solid majority of lawmakers. Smaller demonstrations Tuesday attracted hundreds of protesters in Barcelona and Seville.*

...and an oh-so-familiar backtrack from Northern European finance ministers over the proposed Spanish banking system bailout:

> *(Ambrose Evans-Pritchard): Spain's debt crisis has returned with a vengeance after Germany, Holland and Finland reneged on a crucial summit deal and scuppered hopes of direct eurozone help for Spanish banks.*
>
> *Yields on 10-year Spanish bonds punched back above the danger line of 6pc and spreads over German Bunds reached 450 basis points, intensifying pressure on Madrid as it continues to resist a sovereign bail-out.*
>
> *The alliance of hardline creditors said the European Stability Mechanism (ESM) – or bail-out fund – could not be used to cover "legacy assets" from past banking crises, even after the eurozone's banking supervisor starts work next year.*
>
> *This prevents the ESM from recapitalising Spain's crippled banks directly under a €100bn (£79bn) loan package agreed with Madrid in June. The burden will fall entirely on the Spanish state.*

The Spanish newspaper Expansion said the AAA trio had "dynamited" the EU accord. The extra debt burden is likely to be around €60bn or 6pc of GDP, depending on bank stress tests to be unveiled on Friday. Pessimists fear it could rise to 15pc of GDP once full losses from the property crash are crystallised.

The European Commission appeared shocked by the German-led volte-face, saying the original summit deal was "quite clear". All EMU leaders signed a pledge to break the "vicious cycle" between banks and states. The document said the ESM must be allowed to "recapitalise banks directly", clearly referring to Spain.

Amazingly enough, markets rendered soporific by Mario Draghi's morphine injections into sovereign bond markets seemed to suddenly awaken to the fact that Spain ***IS*** still a problem, the underlying issues ***HAVEN'T*** gone away and things are likely to get a lot worse ***BEFORE*** they get better. Who knew?

Damian Reece hit the nail on the head when he eloquently stated the case I have been making for quite some time now; Spain is no better than Greece—just bigger:

(Damian Reece): Spain has taken another confident stride to becoming the next Greece, a status long predicted for the country in some quarters.

When the economic situation is bad (the country's GDP estimates fell again on Wednesday) there's nothing like a dose of political mismanagement to give things a good hard shove towards the same abyss that Athens disappeared into sometime in the middle of last year.

It's only September, but the scenes from Madrid in recent days prompted me to revisit the annual predictions in which we indulge every January. At the start of the year, as we looked forward to another 12 months of experimental eurozone economics, not to mention politics, with renewed austerity measures and another euro treaty, this column said: "None of this has been tested at the ballot box, and I predict a year of popular political protest across the eurozone, some of which will turn violent, prompting shocking scenes as governments use force to regain order."

You can't let a gun off slowly, but Spanish prime minister Mariano Rajoy has been openly flirting with the idea of seeking a bail-out from the European Central Bank in recent days, but only if capital market investors forced Spain into it by sending yields on Spanish government debt higher.

In the land of bull fighting, he has waved the proverbial red rag. Lo and behold, Spanish bond yields duly shot up again on Wednesday to 6pc, pricing Spain out of the markets and forcing him closer to going cap in hand to Frankfurt, assuming the ECB bail-out is actually real as opposed to an empty promise. This, in turn, will undermine his political credibility at home which the riots in Madrid and secession fever in Catalonia reveal is already suffering. (full article below)

Here's the simple truth:

Spain, like Greece, cannot be trusted to publish accurate economic statistics because the stakes are way too high and the true numbers likely far too shocking. For the time being, however, the market is happy to turn a blind eye to that fact because there is still money to be made from gaming the largesse of Mario Draghi's "unlimited" backstop. But mark my words, the time will come when Mr. Market decides there is more money to be made from testing the resolve of Signor Draghi and the veracity of Spanish economic statistics, and when that day comes, there will be nothing that Mariano Rajoy, Mario Draghi, the ECB or the combined might of the Eurocrats can do to alter the outcome.

As always, forget the talk, ignore the rhetoric and discount words like "manageable," "impossible," "not an option" and "believe me." Beneath all this lies a set of fundamental mathematical equations, and last time I checked, the laws of mathematics weren't something that could be subverted.

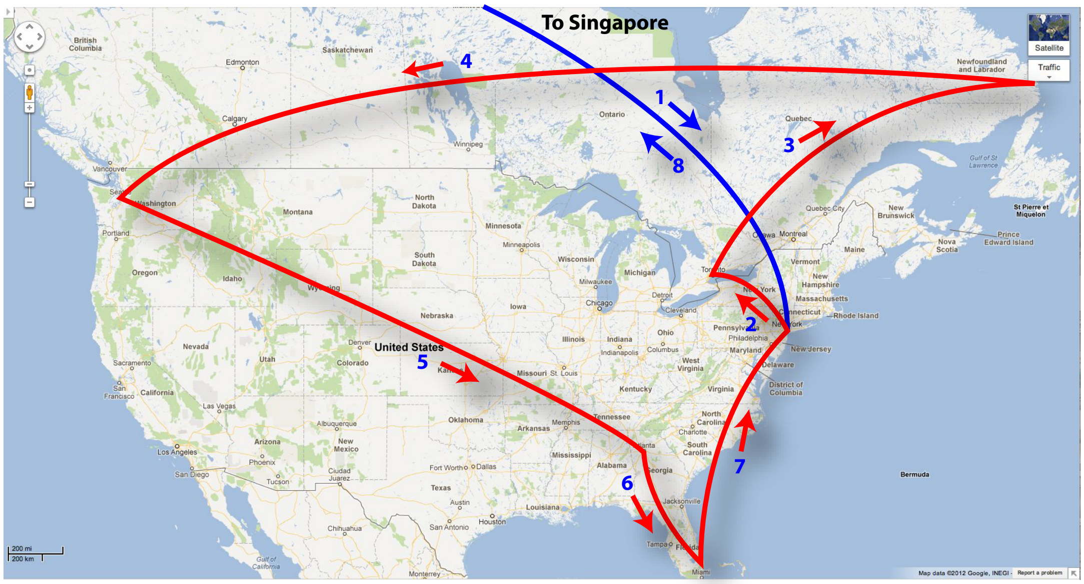
Whether it's Greece or Spain is irrelevant. Something has to give here, and when it does, the genie will be out of the bottle for good. That day is approaching much faster than many realize—a fact Jeremy Warner elaborated upon in an article titled simply, "Spain Must Leave the Euro":

> *(Jeremy Warner): Mariano Rajoy, the Spanish prime minister, has been digging his heels in over requesting any form of bail-out, despite the evident need for one as the Spanish economy slips ever deeper into recession and the budget deficit widens back into double digits. There is now no chance whatsoever of Spain meeting its fiscal targets.*
>
> *Less than a year after sweeping to power in a landslide victory, Mr Rajoy is already fatally wounded. He promised never to apply taxpayers' money to bailing out the banks. He already has. He promised not to follow Greece, Ireland and Portugal into a sovereign bail-out. Now, other than leaving the euro, he's got no choice. Even on gay marriage, Mr Rajoy has failed to deliver as promised.*
>
> *A further €40bn package of austerity measures has been announced in a desperate bid to get ahead of what Brussels wants of Spain and, we must suppose, thereby obtain a somehow unconditional bail-out, allowing national pride to be salvaged. These measures are almost bound to be self-defeating, for they threaten further to shrink the economy, thereby making deficit reduction tougher still. Spain is chasing its tail into austerity-induced fiscal and economic meltdown. Mr Rajoy is a dead man walking.*
>
> *Other than leaving monetary union and defaulting on its euro debts, which for the moment even the rebellious Catalans don't seem to want, is there any way out for Spain? The answer looks ever more likely to be no.*
>
> *Membership of monetary union is preventing the application of appropriate monetary policy to the periphery sovereigns. The single currency has also denied Europe the natural market mechanism of free floating exchange rates to correct deficiencies in competitiveness and reduce external indebtedness.*

> *There is only one conclusion to be drawn from all this; though the short-term costs would be profound, Spain must leave the single currency.*
>
> *Spain is damned if it leaves, but damned for eternity if it stays. Eurozone policy as it stands offers no plausible way back to prosperity.*

Hear, hear Jeremy. Hear, hear.

This past week has been something of an odyssey as you can see from the map of my movements below. Consequently, this week's edition of *Things That Make You Go Hmmm...* may seem a little more disjointed than usual, for which I apologize.



I would just like to take this opportunity to offer my heartfelt thanks to Pauline, Gerry and Gerri at the Resource Investors Forum in St. John's, Newfoundland, for inviting me to speak, and for their hospitality this past week. It was a long way to travel from Singapore, but they put on a great conference, and the scenery was spectacular. I made some wonderful new friends and will definitely be back next year.

In response to several requests, I will be posting the presentation I gave online shortly.

I will also be speaking at the *Mines & Money conference* in Sydney on October 16.

For now, though, I'll leave you to dive into *Things That Make You Go Hmmm...*

Until next time...

Mario Draghi's promise to do “whatever it takes” to save the euro never did look like inducing any more than a temporary lull in the storm; still less did the German Constitutional Court’s thumbs up to the European bail-out fund and the trouncing that eurosceptic parties received in the Dutch election.

Yet the eurozone crisis has sparked back into life more swiftly than even I would have anticipated, with the epicentre returning to a fast-shrinking Spanish economy. Political and economic developments are once more threatening to combine into an uncontrollable firestorm.

To understand why, it is first necessary to explode some myths about the nature of the eurozone debt crisis. This is not at root either an isolated banking crisis or indeed a fiscal one, though that’s how public policy in Europe attempts to define it.

As many of us have long argued, both these phenomena are but symptoms of what in essence is just a good old fashioned balance-of-payments crisis. This has been greatly exaggerated by monetary union, which is also preventing the application of time-honoured solutions. Utopian pursuit of the single currency is damning Europe to economic oblivion. Political hubris has eclipsed economic common sense.

After monetary union, capital flowed in ever-increasing quantities from Europe’s surplus to its deficit nations; Germany and others were in essence lending the periphery the money to buy German goods and services. Monetary union precluded the sort of interest and exchange rate discipline that would normally serve to keep things in check.

Cheap money fuelled unsustainable construction and credit booms in the periphery and encouraged governments to spend more than they should. Relative to the core, wages and prices rose, rendering these countries progressively less competitive and deepening the problem of trade imbalances. The deficit countries borrowed to spend, rather than earning it.

Since the onset of the financial crisis, the process has gone violently into reverse. Money has fled the periphery, starving it of credit and exacerbating the economic downturn. Tax revenues have collapsed, causing budget deficits to soar and fiscal crisis to take root.

With a shrinking economy has come a mounting bad debt problem, which Spain and others have yet fully to recognise. Confidence in the banking system is at rock bottom, leaving Spanish banks progressively more dependent on the European Central Bank printing presses to fund their lending.

Spain is looking for some €60bn to recapitalise its banks but this is widely thought a gross underestimate of the true size of the problem. City analysis puts the amount needed to restore credibility at nearer €150bn, or 15pc of GDP. Touchingly, the Spanish government still seems to think that much of this new capital can be raised in markets. In truth, the only two banks thought remotely capable of tapping the capital markets, Santander and BBVA, are also the only two likely to be judged in forthcoming stress tests not to need it. If even British banks are thought "uninvestable", what hope Spanish banks? [sic]

*** JEREMY WARNER / LINK

A small fish like Taiwan, diplomatically isolated as it is, does not often pick a fight with both of Asia's largest economies at the same time. But this disputed island chain, known to Japan as the Senkaku islands and to China as the Diaoyus, is casting its strange spell across the whole of the East China Sea.

A fierce shootout with water-cannon broke out between Japan's coast guard and Taiwan's on the morning of September 25th. The Japanese side was trying to repel an armada of almost 60 Taiwanese fishing vessels, which had sailed irritatingly near the islets, by blasting some of them with deck-mounted water cannon. Taiwan's patrol boats retaliated by firing back with their own high-pressure hoses at the Japanese coastguard ships, all the while booming over loudspeakers that these rocks are the sovereign territory of the Republic of China (Taiwan's official name) and that the Japanese vessels must leave Taiwan's territory immediately.

The fishing fleet managed to sail within three nautical miles (5.5km) of the disputed islands, before being turned back by the Japanese side. Meanwhile Taiwan's navy dispatched frigates to the country's north-eastern coast and scrambled warplanes, such as F-16s and Mirages, to monitor the civilian armada, according to a statement issued by the defence ministry on September 26th. The point, they say, was to be prepared for any eventuality. The president, Ma Ying-jeou, lent his support too, not missing a chance to add that the waters around the contested islands have been fishing grounds for Taiwan's fishermen for more than 100 years.

This marked Taiwan's first foray into the waters that surround the uninhabited Diaoyus since the Japanese government first nationalised a few of them, two weeks ago. The Japanese government is said to have protested to Taiwan through Japan's de facto embassy. The incident complicates the ongoing row between Japan and the People's Republic of China, over the archipelago's sovereignty. Even without Taiwan's interference, the affair has triggered huge protests on the mainland, some of them violent, and calls to boycott Japanese business.

Chinese boats have briefly entered into waters surrounding the contested islets in recent weeks (and a vessel from Hong Kong even landed), but they were never made the target of Japanese water-cannon. This could be because, unlike the Taiwanese fishing fleet, they tend to leave quickly after verbal warnings.

China put its first aircraft-carrier into service on September 25th, in a show of defiance towards Japan. But China and Japan appear to also want to show the public they are working to soothe tensions. They symbolised their good intentions with a four-hour meeting on the same day as the carrier's launch, bringing together China's vice foreign minister, Zhang Zhijun, and his Japanese counterpart, Chikao Kawai. The two were flanked by their aides for a photo-op at China's foreign ministry, though the talks themselves seem not to have produced much progress.

The question then is, with Japan and China each doing their bit to calm things down, why has Taiwan suddenly taken up the sabre-rattling? No doubt many Taiwanese patriotically believe the islets belong to Taiwan. These would include both pro-China elements in Mr Ma's Kuomintang (KMT) and members of the pro-independence Democratic Progressive Party, who like to annoy China by asserting Taiwan's sovereignty. Mr Ma is suffering from dismal popularity ratings, as low as 15% in some polls, and tough-talking over the islets could boost his standing. On the other hand, his ratings have been hurting for a while now and yet until this incident, Mr Ma had appeared to respond to public pressure by favouring a low-key and rational approach. In early August he announced something called the East China Sea Peace Initiative, which called on the archipelago's three claimants—Taiwan, China and Japan—to put aside their disputes, start up a dialogue and develop the area's resources in harmony. So what happened?

*** ECONOMIST / LINK

Japanese tourists are canceling trips to China, and hard-hit Panasonic is, not surprisingly, reducing business trips from Japan to the country. As a result, Japan Airlines reduced flights to and from Chinese destinations. It halved Tokyo-Beijing and Osaka-Shanghai flights, for example. All Nippon Airways reported an increase in cancellations on its flights from China to Japan. And it is not only Japanese carriers that have been hurt. China Eastern, China's second-biggest airline, is delaying the October 18 start of its Shanghai-Sendai route due to insufficient bookings.

With the streets calm for the time being, Japanese businesses are getting back to work. Toyota, for instance, restarted its China operations today. Most Japanese stores have reopened by now. Aeon has resumed selling at all but two China locations.

The short-term effect of the rioting, therefore, should be limited. Moody's says the longer-term consequences will be "difficult to determine," but they could prove to be detrimental to China's economy for three principal reasons.

First, China today is no longer in its upward supercycle. When it was in that phase, demonstrations did not noticeably affect growth. Even the disruptions in the nearly 190 cities during the Beijing Spring of 1989, which ended in the horrific massacre in the Chinese capital in early June of that year, did not result in a downturn. A few foreign businesses built backup manufacturing facilities in nearby countries, but they quickly transferred all production back to China when Deng Xiaoping restored order.

Then, almost nothing could derail momentum. And that remained true even as the number of protests increased last decade. The 2005 demonstrations, for example, had no apparent long-term effect on Japanese business interests.

Today, however, the Chinese economy is in obvious distress, with fewer analysts buying Beijing's claims that the country is growing in the high single digits. Charles Dumas of Lombard Street Research, for example, thinks China's growth rate is only 1.6%, and it could even be lower than that. In this environment, even minor disruptions could have a "tipping point" effect.

Japanese companies were, even before the recent disturbances, thinking of reducing their China exposure. As Kyohei Morita of Barclays told the Wall Street Journal, "Growing anti-Japan sentiment could become a catalyst for Japanese companies' further shift of focus toward Southeast Asia from China."

Economic fundamentals are already driving companies to look south. Quickly rising wage rates makes the Chinese export belt increasingly uncompetitive for low-end manufacturing as does the stricter enforcement of environmental rules demanded by the Chinese public. China's interior is benefiting from migration away from coastal export areas, but so are Vietnam and even the U.S.

*** FORBES / LINK

The latest Foxconn incident is raising more questions about China's manufacturing sector's ability to grow. It is becoming difficult to see how China's overall economy can expand at projected rates with such uncertainties around manufacturing.

WSJ: - The riot raises questions about the sustainability of China's vaunted manufacturing machine. And it poses a challenge to the government that is struggling to satisfy the soaring expectations of a new generation of Chinese workers who came of age in an era of double-digit economic growth and are less willing than their parents to make personal sacrifices for their country...

We are now seeing clear signs of strain faced by China's high tech factories as they attempt to squeeze more production out of their thin margins (discussed here) - and hitting bottlenecks in the process.

> *FT: - [Foxconn] is the sole assembler for the iPhone 5 this year, with 80-85 per cent of shipments next year as well, according to analysts at Barclays. At an estimated $8 a phone, that workload brings in revenue, but has also put the company under strain. To handle Apple's demands, Citi analysts estimate, Hon Hai must increase headcount at its Zhengzhou iPhone factory from 150,000 workers in June to 250,000 in October.*

The relentless selloff in China's domestic stock market is reflecting this uncertainty in manufacturing growth (as well as the renewed volatility in Europe). The Shanghai Composite Index hit a new multi-year low this morning.

China's official news has little on the incident in Taiyuan, but the authorities are clearly preparing the population for weaker growth ahead. As discussed about a year ago (see post), the impending slowdown will increase risks of social unrest and possibly additional production disruptions. That in turn will hurt confidence and investment, as the economy will become increasingly dependent on government stimulus.

> China Daily: - China's economic growth is likely to slow for its ninth consecutive quarter in the period from July to September, top policy advisers said on Tuesday.
>
> If their predictions prove true, the government may find itself taking "remarkable measures" to combat the slump, they said.
>
> Zheng Xinli, deputy head of the China Center for International Economic Exchanges, a government think tank, said China's economic data for August has turned out worse than expected and the economy's prospects remain gloomy. Amid those circumstances,the country's GDP is unlikely to grow at a faster pace in the fourth quarter.
>
> "The urgent need right now is to clarify what are the most effective ways to boost domestic demand," Zheng said.

*** SOBER LOOK / LINK

The European Stability Mechanism row damages the notion that the eurozone countries are capable of acting quickly.

The plan to recapitalise banks was meant to be the easy part of the latest scheme to save the euro. Didn't everybody agree that breaking the link between weak sovereigns and weak banks was a vital and urgent step? Wasn't the central European Stability Mechanism (ESM) deemed the perfect vehicle to strengthen the balance sheets of teetering banks and thus offer a helping hand to the governments of the likes of Spain and Ireland?

Yes and yes. But now comes a powerful "no" in the form of a joint statement from the German, Dutch and Finnish finance ministries. The critical paragraph began with the words "regarding longer-term issues", a giveaway that a classic piece of foot-dragging was on the way.

The ESM, declared the trio, can only go to work on bank recapitalisations "once the single [bank] supervisory mechanism is established and its effectiveness has been determined". That latter could take years. Further, "legacy assets" should remain the responsibility of national governments. So are saying there should be no central hand-outs to cover past government-funded bailouts of banks.

The statement is a shocker. Even if there had not been riots in euroland yesterday, stock markets would have slumped on the news and bond yields in the periphery would have soared. If the will of the trio of northern objectors prevails, the €60bn (£47.8bn) needed to save the Spanish banking system will go directly on the Spanish government's books, thereby making the arithmetic of the inevitable bailout of Madrid bigger and uglier. And poor old Ireland – the one country that the austerity disciplinarians could promote as a story of recovery – would get a slap in the face.

More fundamentally, the row over the role of the ESM damages the already-fragile notion that the eurozone countries are capable of acting quickly. Germany and the others seem guilty of sharp practice here – they are attempting to re-write an agreement whose general meaning had seemed clear. The time to argue these points was when use of the ESM was being debated by all.

But, if that's the true picture of the state of eurozone relations, you can't blame investors for wondering what other agreements could be challenged in future. It is a terrible climate in which to negotiate the conditions of the Spanish bailout. The backdrop to those delicate talks will now be poisonous.

*** UK GUARDIAN / LINK

"My allegations in *silver are incredibly specific. I believe that JPMorgan, by virtue of a massive concentrated short position in COMEX silver futures, is manipulating the price of silver lower than it would be otherwise. If JPMorgan's concentrated short position did not exist, the price of silver would be substantially higher. It does not matter if the bank is hedging or engaged in market-making; the mere existence of such an unprecedented large and concentrated short position proves manipulation. That's a key feature of commodity law and is why the CFTC monitors concentration closely.*

For some reason, however, the Commission treats silver differently than other commodities. In addition to ignoring the concentrated short position, it glosses over the results of the concentration on price. Silver witnessed, among other large and uneconomic sell-offs, two distinct sell-offs in 2011, in which the price fell 30% and 35% within a few days. Not one word was heard from the Commission on the two most pronounced sell-offs in modern commodity history. Yet, this week Commissioner O'Malia promised that the Commission was looking into the 4% price decline in oil. A decline in oil of 4% gets same day comment; 35% down in silver is not worthy of any comment. This amounts to a level of discrimination that is not tolerated in society or in regulatory matters.

In addition to being specific, my allegations around JPMorgan manipulating the silver market are consistent and continuous. Four years ago, instead of responding directly to public complaints about JPMorgan's concentrated short position, the Commission chose to investigate as a way of kicking the can down the road. After four years, the issue remains because JPMorgan's concentrated short position remains. No one in authority wants to make the issues around this short concentration more transparent; not the CFTC, not the CME, not JPMorgan itself. Transparency is good in principle and for the other guy; but when it comes to silver, not so much..."

Ted Butler, 25 September 2012

As you know I think the CFTC may be caught in a credibility trap with respect to the silver and gold markets. And if so, at some point this is going to break, as a scandal of major proportions.

All the CFTC has to do is to release its findings, and satisfy analysts like Ted Butler with proof that the big short in silver is a genuine hedge. That is their responsibility as the representatives of the public in overseeing the markets.

That they will not do so, that they will not even speak to the issue but continue to be evasive, makes one wonder just what sort of people these are, and what they have to hide.

*** JESSE'S CAFE AMERICAIN / LINK

Greece's budget shortfall now totals 20 billion euros, according to preliminary estimates by international lenders, SPIEGEL has learned. Prime Minister Antonis Samaras has asked public-sector creditors to forgive some debt. Meanwhile, Berlin and the European Commission are divided over when the decision on Greece's fate should be taken.

The Greek government's budget deficit is bigger than expected and currently amounts to some €20 billion ($26 billion), according to preliminary estimates by the so-called troika made up of the European Commission, European Central Bank and International Monetary Fund, SPIEGEL has learned. The figure is almost double previous estimates.

The next tranche of EU aid can only be paid out to Greece when that budget gap has been closed. The government of Prime Minister Antonis Samaras is believed to have made several requests for government creditors to forgo debt repayments. He is also hoping that lenders will give his government two years longer to fulfill his austerity program. In that case, Greece would probably require an additional €20 billion in aid.

Meanwhile a row has erupted between the German government and the European Commission over when the decision will be taken on whether Greece will get any fresh money at all.

The Commission wants a decision to be reached at the next EU summit on Oct. 18-19. But Berlin says there won't be reliable figures available until November at the earliest.

Officials said on Friday that Greece and the troika had made progress in negotiations on an austerity package, but had failed to reach a deal at the last meeting before visiting inspectors from the troika left Athens last weekend.

The talks are due to resume in a week when the troika inspectors return to Athens. So far, Greek officials have said agreement on €9.5 billion of the €11.5 billion package of spending cuts had been reached. That includes cuts to wages, pensions and benefit payments and savings planned from an increase in the retirement age.

Greece, which is almost bankrupt, needs the troika's approval on the spending cuts to ensure the release of the next tranche of aid. Without that money, it will have to default and may have to leave the euro zone."

*** DER SPIEGEL / LINK

Last Monday, he was in Rome. A week earlier, he ploughed through northern Italy. In just two days, he made stops in 20 cities — from Mantua and Monza to Bergamo and Brescia — logging 3,250 kilometers (over 2,000 miles) in the process. Everywhere he went, the rooms were packed and the crowds were enthusiastic. Now his journey is taking him to southern Italy, starting with Naples.

The journey is being made in a white camper with the word "Adesso!", or "Now!", written in big letters on the exterior. Inside sits Matteo Renzi, the 37-year-old mayor of Florence. He is confident, relatively young for an Italian politician — and sparking fear within the establishment. He is determined to win this spring's parliamentary election on his own, to become prime minister and to lead Italy for the next five years.

The resonance has been massive. More than anyone, young, Internet-savvy Italians are excited that someone is finally sounding the call to the barricades. After all, the older generation has yoked them with unemployment and debts. Even older conservatives who used to vote for former Prime Minister Silvio Berlusconi are jumping on the bandwagon. Fausto, for example, a self-employed construction engineer in his mid-50s, says: "If Renzi runs, he'll get my vote!"

Many of Renzi's supporters are former left-wing voters who had stopped voting because they were disappointed by their parties. But now they are suddenly enthusiastic again. Many have donated to his online "Fai il pieno al camper" ("Fill Up the Camper") campaign, which collects small donations in small increments starting at €5 ($6.50) to help bankroll his tour through Italy. By mid-Wednesday, the campaign had already collected almost €33,000 in donations.

Although Renzi's campaign website already makes it seem like he's on a triumphal procession, his race to the top has actually just begun. Before this stylish Florence native can prepare to conquer Italy, he must first win the battle to become his party's leading candidate. To do that, he still has to win the primaries of the center-left Democratic Party (PD), an unhappy marriage of former communists and erstwhile supporters of the Christian Democracy party, which dominated Italian postwar politics until it was destroyed by corruption trials in the early 1990s.

This first step will perhaps be the hardest — particularly because not everyone in the PD is celebrating this political dynamo out of Florence. Many find him "abnormal" and "populist," and some even detest him. The reason for this is clear: Renzi doesn't just want to chase Berlusconi and his followers from the halls of power. He also wants to dethrone the leaders of his own party. "People who have hunkered down in parliament for 25 to 30 years cannot make decisions about our future!" he shouted at a recent political event in a marketplace. Italy needs "new faces," he added, including in the PD. For that reason, he urges people to "consign to the garbage heap" veteran party bigwigs, including ex-Family Minister Rosy Bindi, ex-Prime Minister Massimo D'Alema, ex-party secretary Walter Veltroni — and anyone else who comes to mind. In his eyes, they all need to go. Italians need to banish the generation of politicians that arose out of the student protest movement of the late 1960s to the history books, he says.

But the people he is referring to are determined to avoid this fate. Senior PD officials and the numerous factions within the party have worked to hammer out a deal that will see Pier Luigi Bersani, the party's current leader, nominated as the party's leading candidate and given the party's blessing through a series of intraparty elections similar to presidential primaries in the United States.

For the first time in a long time, the party has a chance to become the strongest political force in the country after elections in the spring. Polls currently give the PD some 27 percent of the vote. Berlusconi's right-wing People of Freedom (PdL) party, on the other hand, is languishing below the 20 percent mark. The Northern League, the PdL's former coalition partner, polls at between 5 and 6 percent. And even the star of Beppo Grillo, the populist comedian turned political upstart, isn't shining so bright anymore: The polls say he would hardly win more than 15 percent of the vote.

Given these circumstances, it is entirely possible that the PD could lead the next coalition government in Rome. If that happened, Bersani would be the prime minister, but there would of course also be choice political appointments for D'Alema, Bindi and the other members of the party brass.

*** DER SPIEGEL / LINK

China's rulers have put on a forceful show of unity after the country's biggest political scandal in decades, kicking Bo Xilai out of the Communist party and making myriad accusations that could lead to the death penalty for the disgraced one-time high-flying politician.

The announcement that the former party secretary of Chongqing has been accused of taking bribes, improper sexual relations with multiple women and other unspecified crimes comes six months after he was purged following revelations that his wife had murdered a British businessman.

Ths list was unexpectedly extensive. Some observers had thought that the government might hand Mr Bo only a light punishment because he was one of the country's most popular politicians and his father was a revered revolutionary leader.

The Communist party is now expected to close its most damaging crisis since the 1989 Tiananmen Square massacre before the critical congress at which power will be transferred to China's next generation of leaders. The Xinhua news agency announced on Friday that this would be held on November 8.

Mr Bo's populist streak and penchant for Maoist nostalgia had made him a threat to the cautious, technocratic, consensus-driven style of leadership that has been at the heart of China's political model since the 1990s.

His open challenge for a top national position came undone in a dramatic blaze this year when his Chongqing police chief fled to a US consulate alleging that Mr Bo had covered up the murder of Neil Heywood orchestrated by his wife Gu Kailai.

Xinhua said the congress would start on November 8, just two days after the US presidential election. Xi Jinping and Li Keqiang are all but certain to take over from Hu Jintao, president, and Wen Jiabao, premier, who have governed since 2002.

Cheng Li, an expert on Chinese politics at the Brookings Institute in Washington, said the accusations against Mr Bo were "very, very serious" and that Mr Bo might receive the same punishment as his wife: a death sentence commuted to life in prison.

The Bo case has cast a long shadow over the succession plans. Party insiders said officials wanted to reach a consensus about how to deal with Mr Bo before proceeding with the congress, hence the delay in announcing a date.

Gu has already been found guilty of murdering Neil Heywood, the UK businessman. But Mr Bo has not been seen or heard from since April when he was accused of violating party discipline.

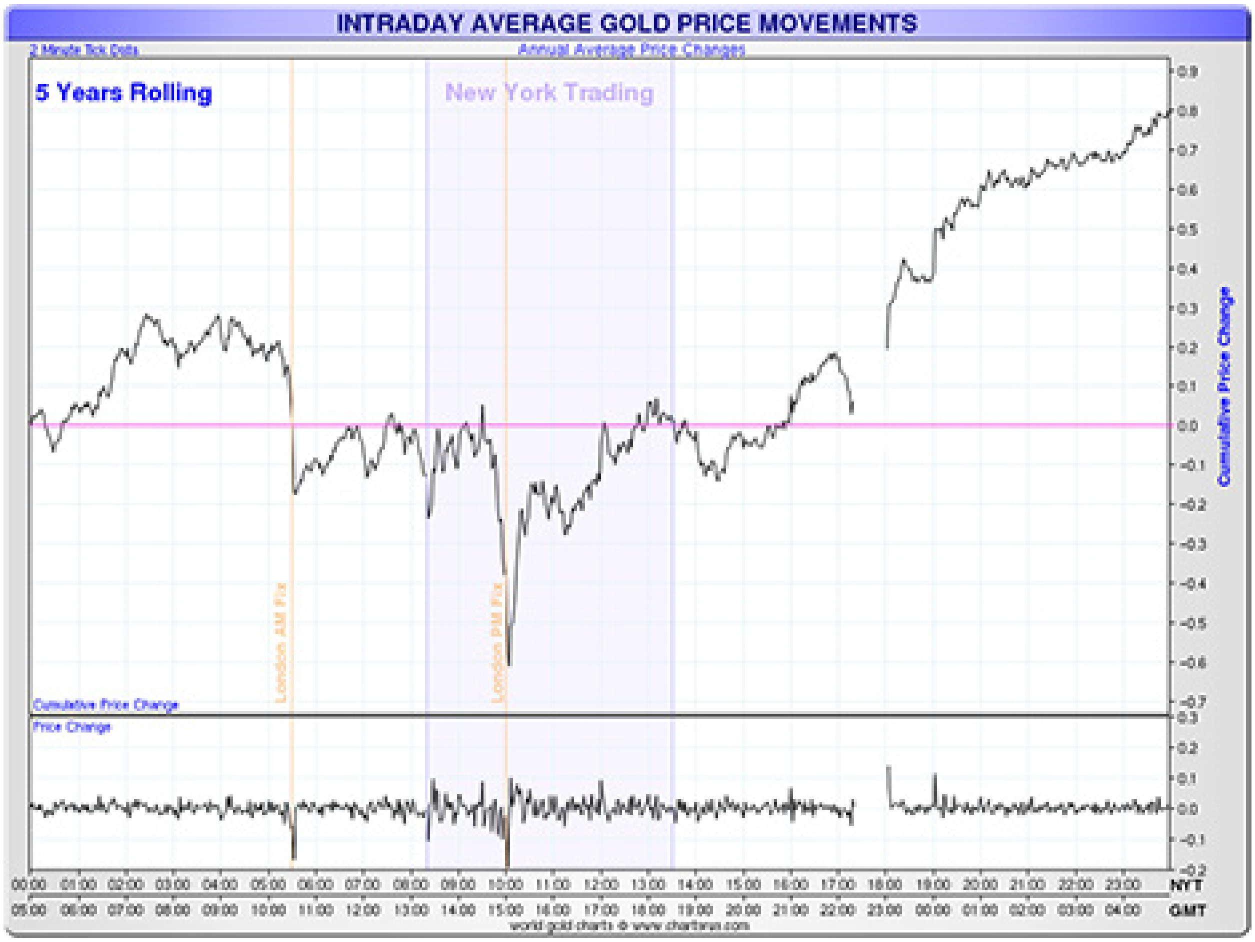
Xinhua said that in the aftermath of the Heywood murder, Mr Bo had “abused his powers of office and committed serious errors and bears a major responsibility”.

Beyond that case, Xinhua said there was evidence that Mr Bo had consistently violated party discipline over the years, extending back to his time as chief of the north-eastern city of Dalian and as the country’s commerce minister.

“Bo Xilai’s actions had grave repercussions, and massively damaged the reputation of the party and the state,” it said.

*** FT / LINK

Charts That Make You Go *Hmmm...*



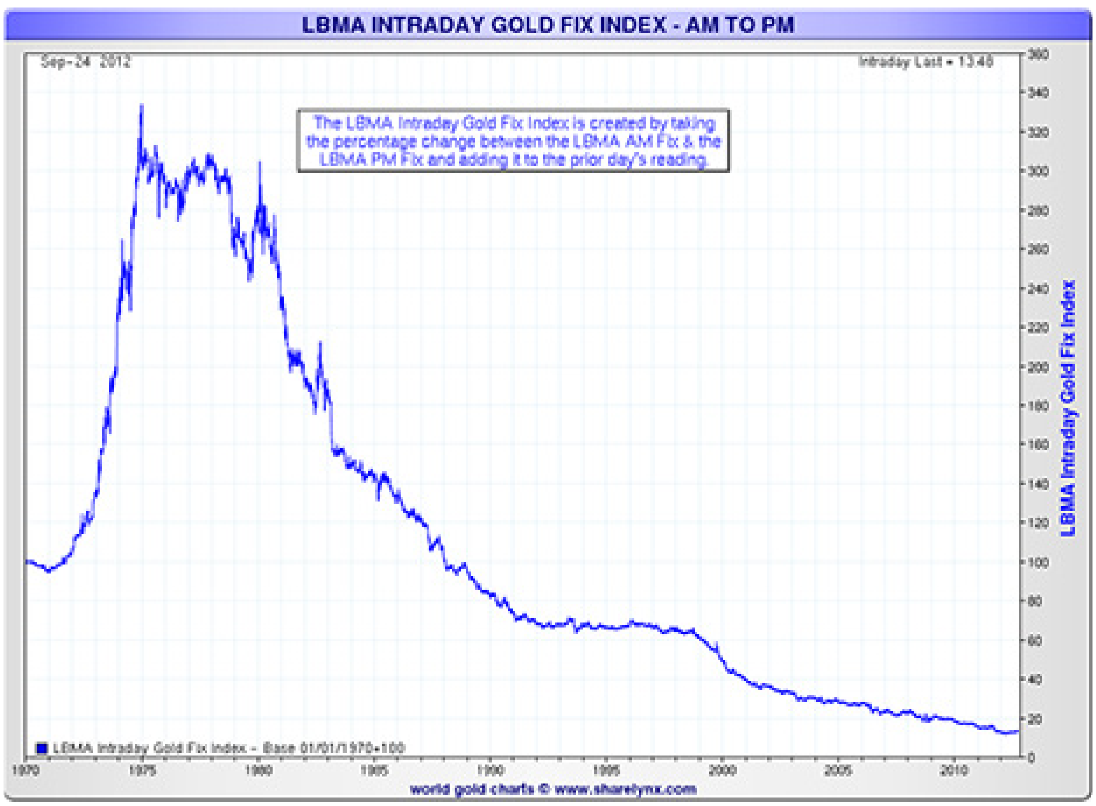
Source: Nick Laird www.sharelynx.com

Nick Laird has updated his intraday gold tick charts, and they are as extraordinary as ever. This first chart (above) shows a 5-year rolling average of the gold price intraday from August 2007-August 2012.

The conclusions are obvious.

Next up are two absolutely fascinating charts that detail the results of buying the LBMA morning fix every day and selling the afternoon fix versus buying the afternoon fix, holding overnight and then selling the following day.

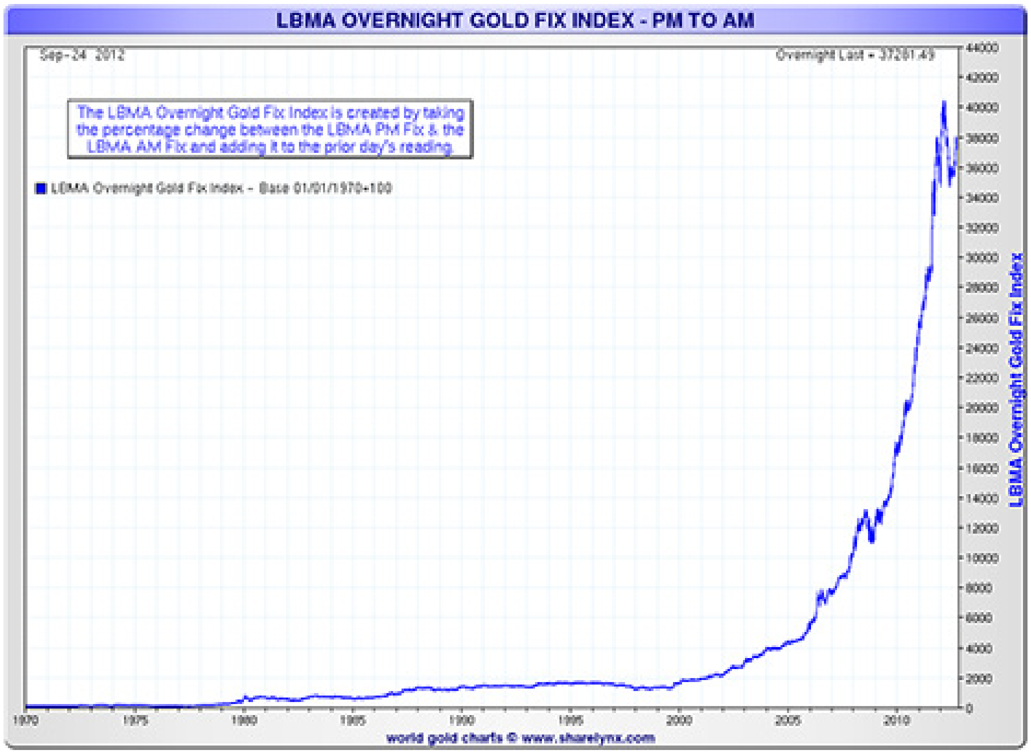
(Ed Steer): Theoretically speaking, if you bought the London a.m. fix on the first business day of 1970..and sold the London p.m. fix the same day...and did that for every business day for just about 43 years, your profit/loss profile would look like the chart below. Your initial $100 investment would be worth $13.48 at the close of trading on Monday, September 24, 2012. What the chart really shows is a negative London price bias. This began in January of 1975 and, with the odd exception, the general trend has been down every year since then. Even during the biggest bull market in gold the world has ever seen...the one going on right now...gold has been negative every single year between the London a.m. and the London p.m. fix, with no exception. One has to wonder how this is possible without price management. And the answer is...it isn't.



Source: Nick Laird www.sharelynx.com

However...also theoretically...if you bought the 4:00 p.m. GMT London p.m. gold fix...10:00 a.m. in New York...and held that position through Far East trading and sold just before the London p.m. fix [the London open would have been better, but that's another story]...every day for the same 43 years...your profit/loss profile would look like the chart below. Your original $100 investment would have been worth $37,281 at the close of trading this past Monday.

Please check out Nick's work at www.sharelynx.com. If you follow gold, you MUST follow Nick.

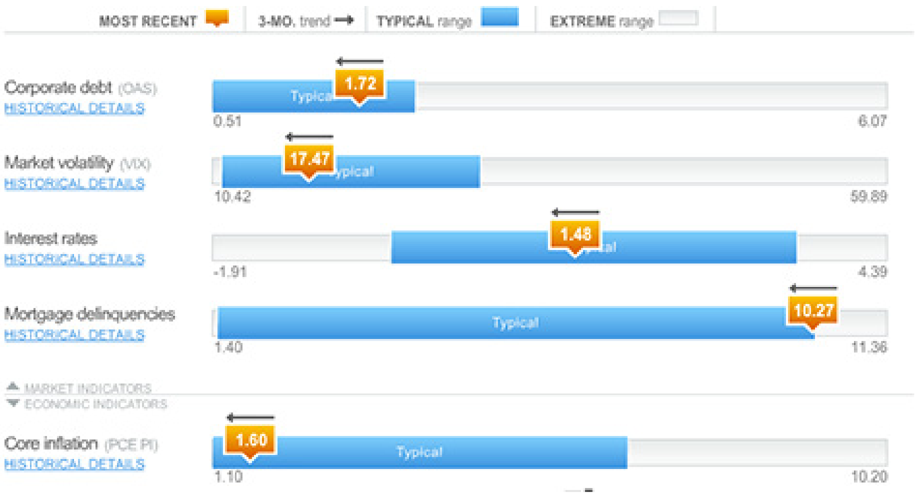


Source: Nick Laird www.sharelynx.com

From the folks at Russell, a look at various economic indicators:

Corporate debt spreads, the month-end VIX, and interest rates all remain within typical ranges. Mortgage delinquencies dropped slightly during 2nd quarter. U.S. equity markets ended August positively..

*** RITHOLTZ



Source: Ritholtz/Russell

The S&P 500 logged its fifth consecutive daily decline and seventh of the past eight sessions. The index closed the day with a moderate loss of 0.57%. What's particularly interesting is a snapshot of the index showing the twin rallies of September -- the first dating from September 6th after Mario Draghi unveiled the ECB plan to save the euro. The second, of course, was the announcement of QE3 on September 13th. The index peaked the following morning. We've since erased a bit over half the gains.

Here is a 5-minute snapshot of today's slump.

This 60-minute chart of September to date shows the ECB and QE3 rallies and the erasure of gains so far..

*** DOUG SHORT / LINK

Source: Doug Short

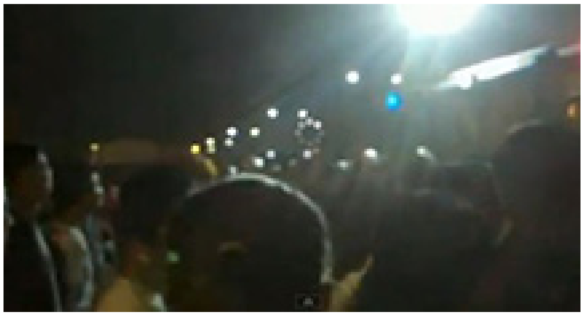
Words That Make You Go *Hmmm...*

It's not often we get to spend 25 minutes in the company of Jim Grant, but if we get offered the chance, it would be rude to turn it down.

Here, Jim talks to Lauren Lyster about QE to infinity and "The Great Levitation."

CLICK TO WATCH

The riots at the Foxconn plant in Taiyuan, China, are quite extraordinary, as can be seen in this video. 2,000 workers were involved at a factory complex that employs 79,000 people and is believed to be one of the main suppliers of parts for the Apple iPhone 5.



CLICK TO WATCH

Ahead of the Mines & Money Conference in Sydney on October 12, I recently spoke to the conference organizers about the value offered by gold mining stocks, the pain that comes with investing in the sector and the disproportionate influence that the likes of Mario Draghi exert on them.

The interview was conducted a couple of weeks ago before QE3 and before the breakout in gold mining stocks—unfortunately!

CLICK TO WATCH

and finally...

Meet Espen Fadnes.

Espen is a world champion wingsuit flyer and this short video will, as it says on the web page, leave you breathless... (Thanks, BL)

Hmmm...

Grant Williams

Grant Williams is a portfolio and strategy advisor to Vulpes Investment Management in Singapore—a hedge fund running over $250 million of largely partners' capital across multiple strategies.

The high level of capital committed by the Vulpes partners ensures the strongest possible alignment between us and our investors.

In Q4 2012, we will be launching the Vulpes Agricultural Land Investment Company (VALIC), a globally diversified agricultural land vehicle that will provide truly diversified exposure to the agricultural sector through a global portfolio of physical farmland assets.

Grant has 26 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.

Grant has been writing *Things That Make You Go Hmmm...* since 2009.

For more information on Vulpes, please visit www.vulpesinvest.com

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Follow me on Twitter: @TTMYGH

YouTube Video Channel: http://www.youtube.com/user/GWTTMYGH

California Investment Conference 2012 Presentation: "Simplicity": Part I : Part II

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

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