

THINGS THAT MAKE YOU GO *Hmmm...*

A walk around the fringes of finance



“Formula for success: rise early, work hard, strike oil”

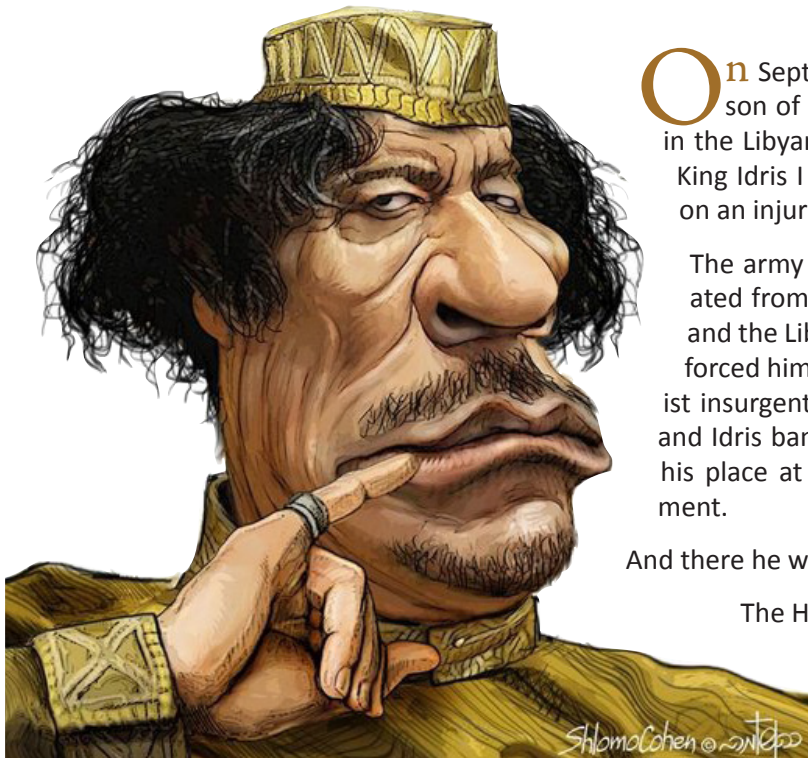
– J. PAUL GETTY

“China gets their oil from Libya. Why isn't China involved? They're going out spending billions of dollars a day on trying to take over the world economically. And we're spending billions and billions and billions of dollars on policing the world. Why isn't China involved with Libya?...we don't get oil from Libya, China does.”

– Donald Trump

Pythagorean theorem:	24 words
Lord's prayer:	66 words
Archimedes' Principle:	67 words
Ten Commandments:	179 words
Gettysburg address:	286 words
US Declaration of Independence:	1,300 words
US Constitution with all 27 Amendments:	7,818 words
EU regulations on the sale of cabbage:	26,911 words

– Europe's Problems Summed Up
(Thanks Cyril)



On September 1st, 1969, a 27 year-old army captain and son of a Bedouin farmer who had been born in a tent in the Libyan desert in 1942 staged a bloodless coup when King Idris I travelled to a Turkish Spa to receive treatment on an injured leg.

The army captain, one Muammar al-Qaddafi, had graduated from the University of Libya a mere six years earlier and the Libyan military academy in 1965, but somehow he forced himself to the forefront of a group of Arab nationalist insurgents and, once the monarchy had been abolished and Idris banished to first Greece and finally Egypt, he took his place at the head of the newly-formed Libyan government.

And there he would stay – for almost exactly forty two years.

The History Channel takes up the story:

Blending Islamic orthodoxy, revolutionary socialism, and Arab nationalism, Qaddafi established a fervently anti-Western dictatorship in Libya. In 1970, he removed U.S.

and British military bases and expelled Italian and Jewish Libyans. In 1973, he took control of foreign-owned oil fields. He reinstated traditional Islamic laws, such as prohibition of alcoholic beverages and gambling, but liberated women and launched social programs that improved the standard of living in Libya. As part of his stated ambition to unite the Arab world, he sought closer relations with his Arab neighbors, especially Egypt. However, when Egypt and then other Arab nations began a peace process with Israel, Libya became increasingly isolated.

It all sounds rather idyllic, doesn't it? Liberating women, improving the standard of living and attempting to unite the Arab world. Let's see Wikipedia's take on the aftermath of Gaddafi's arrival at the helm of the world's 17th-largest oil producer:

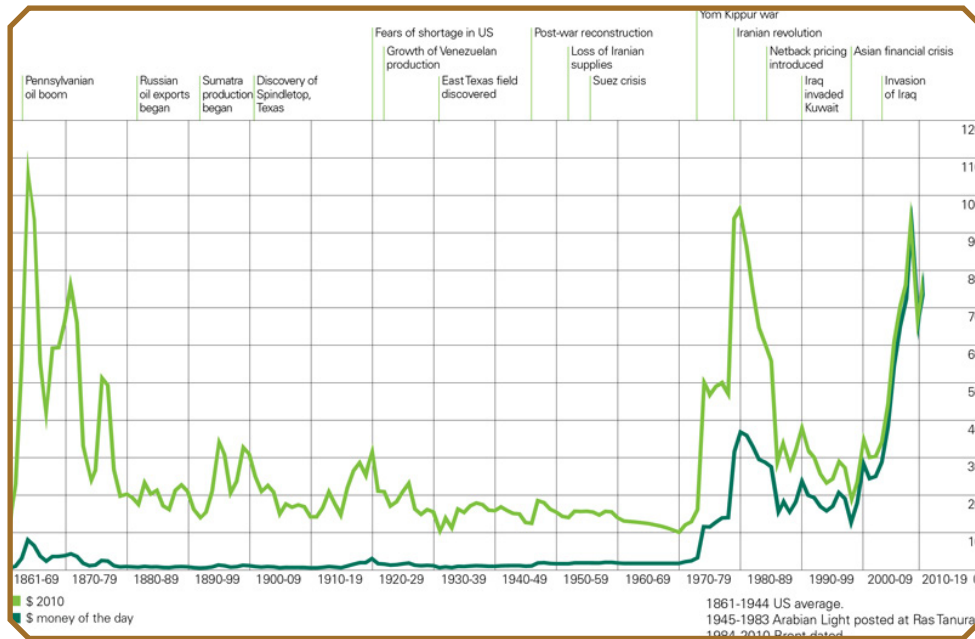
After seizing power, Gaddafi proceeded to eliminate any opposition and severely restricted lives of ordinary Libyans. Gaddafi's ideology was termed the Third International Theory and it was described in the Green Book. Gaddafi and his relatives took over much of the economy. Gaddafi started several wars, had a role in others, and spent on acquiring both chemical and nuclear weapons. More covertly, he directed the country's revenues to sponsor terror and other political activities around the world. The United Nations called Libya under Gaddafi a pariah state.

Gaddafi was unpredictable, radical and a force to be reckoned with by the West and his combative stance towards Western oil companies was rewarded with the kind of concessions that would alter the balance of power between OPEC and its biggest customers:

(Wikipedia): In The Age of Oil, historians considered Gaddafi's success in 1970 to be the "decisive spark that set off an unprecedented chain reaction" in oil-producing nations. Libya continued a winning streak against the oil companies throughout the 1970s energy crisis; Later that year, the Shah of Iran raised his demands to match those of Gaddafi. OPEC nations began a game of "leap frogging" to win further concessions from the oil companies after following Gaddafi's lead.

Gaddafi and the Shah of Iran both argued for quadrupling the cost of oil in 1975.

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CLICK TO ENLARGE

SOURCE: BP

‘The oil price’ is something of an interesting animal.

Since 1970, the oil price, which had nominally traded in the tightest of ranges since the late 1800s, has experienced enormous volatility with twin inflation-adjusted spikes almost 30 years apart finally being breached earlier this year when Brent hit a high of \$126.65 on April 8th of this year.

Back in 2008, when ‘the oil price’ was hitting record high after record high – peaking at \$145.29 in July of that fateful year – ‘the oil price’ being referred to was West Texas Intermediate, the light, sweet crude delivered into the facility at Cushing, Oklahoma which holds, at various times, between 5 and 10% of US crude inventory. That same ‘oil price’ now trades almost 40% lower at \$88. Except...

The rumblings began in earnest in 2007 with the release of a Lehman Brothers report which argued that WTI was no longer the benchmark for ‘the oil price’ due to the fact that it was highly localized and, with the tendency for inventory spikes in what is, with all due respect to any Cushing-based readers, well..... before I get myself into any trouble, I will let an aerial map of Cushing, OK (left) do all the heavy lifting for me.



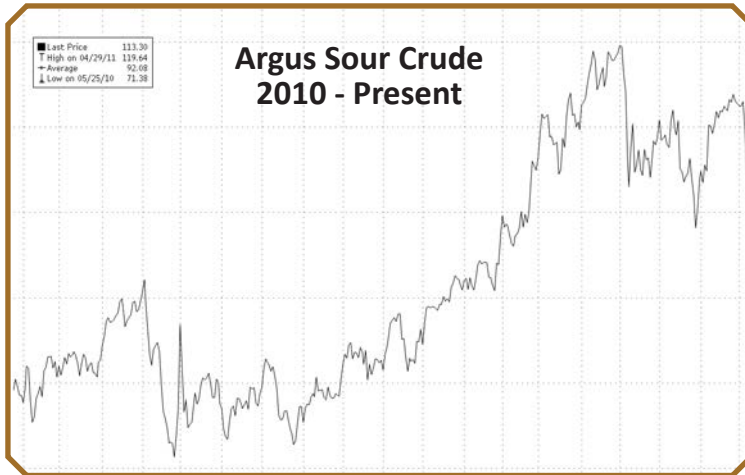
CLICK TO ENLARGE

SOURCE: GOOGLE MAPS

Any questions? Good. Let’s press on. In October of 2009, WTI was dealt another hammer blow by Saudi Arabia:

(FT): Saudi Arabia yesterday decided to drop the widely used West Texas Intermediate oil contract as the benchmark for pricing its oil, dealing a serious blow to the New York Mercantile Exchange.

The decision by the world’s big-



gest oil exporter could encourage other producers to abandon the benchmark and threatens the dominance of the world's most heavily traded oil futures contract...The move reveals the growing discontent of Riyadh and its US refinery customers with WTI after the price of the benchmark became separated from the global oil market this year.

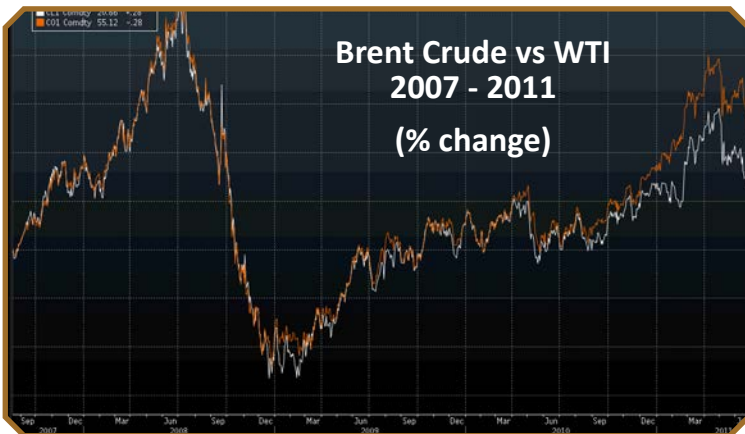
The surge in oil inventories in Cushing, Oklahoma, where WTI is delivered into America's pipeline system, depressed the value of the WTI against other global benchmarks, throwing the global oil market into disarray.



Saudi Arabia moved to a new index developed by Argus in London; the Argus Sour Crude Index. This was assembled to track the price in the physical market of a basket of US Gulf Coast crudes, including Mars, Poseidon and Southern Green Canyon:

(FT): ...Argus said the change in policy reflected the "increased importance of the US Gulf coast sour crude market, in which both production and trading activity was rising sharply".

Paul Horsnell, head of commodities research at Barclays Capital in London, said Saudi Arabia's decision was likely to reflect a "wider discontent" from its customers in the US about WTI performance.



Edward Morse, chief economist at LCM Commodities in New York, said: "It is a recognition by large players that WTI sometimes does not reflect the true value of crude oil in the waterborne market."

Saudi Arabia has priced its oil using WTI since 1994.

And so it was that 'the oil price' gradually became less about the little town in Oklahoma with a population of 9,596 and more about the real world price: and that meant Brent.

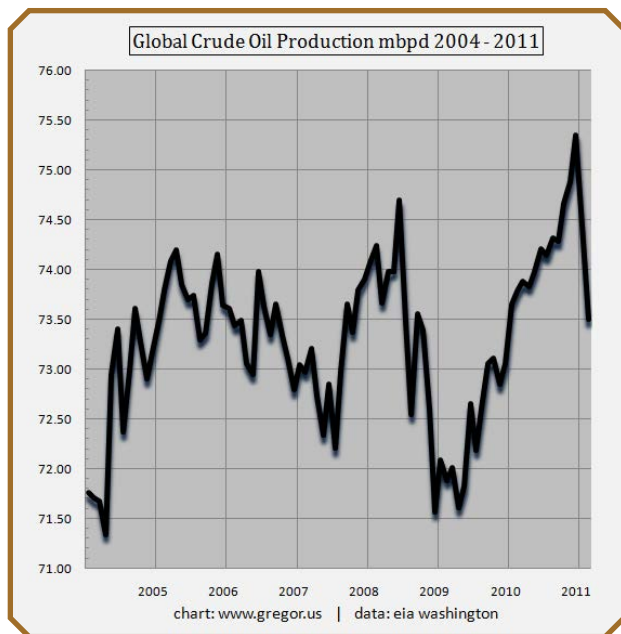
SOURCE: BLOOMBERG

It is notable that when people talk about oil having hit its 'high' of \$140 back in 2008 and now trading almost 40% lower they are referring to the price of WTI, which has tumbled back into the \$80s, but both Argus Sour Crude (left, top) and the more ubiquitous Brent Crude (left, middle) contracts are still trading within shouting distance of their lifetime highs. The bottom chart shows how Brent and WTI have disconnected from an almost perfect correlation EXACTLY at the time QE2 was announced back in August of 2010 - not that Quantitative Easing is in ANY way responsible for an increase in the price of commodities of course. I want to make that QUITE clear...

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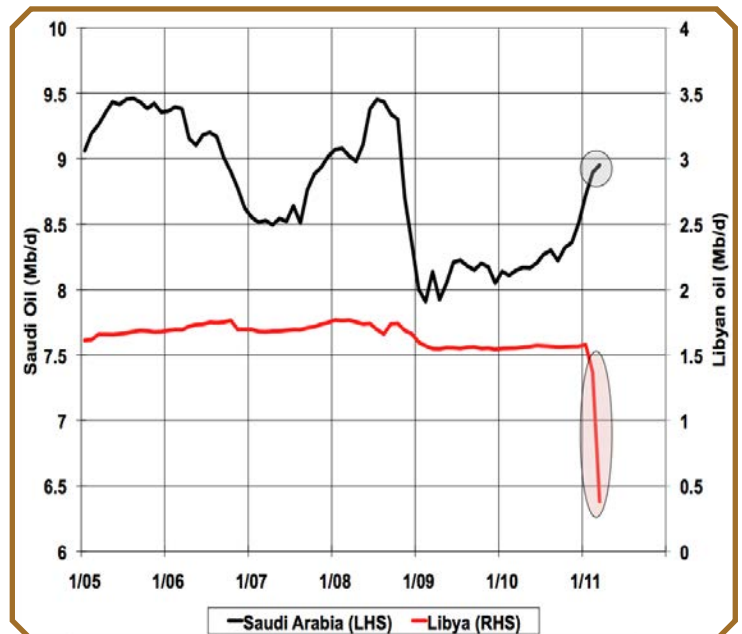
Naturally, it is useful when one is in the business of managing an economy and attempting to control inflation while simultaneously printing as much money as one can get away with, to be able to point to a falling oil price as evidence that the dreaded spectre of inflation is not an immediate concern and the weakness in WTI has afforded the US government and their Central Bank sidekicks the luxury of being able to do that, but the stubbornly high price of Brent is becoming something of an irritant.

Back in June when the IEA announced they were releasing 60 million barrels of oil from OECD inventories due to the high price of crude, it was suggested that the main reason for such an action was the loss of oil production that accompanied the beginning of the popular uprising against Colonel Gaddafi and a look at a chart of world oil production (left) shows just how severe a drop-off in price the unrest in Libya caused. What is even more interesting, however, is the chart on the right which shows Saudi oil production levels at the time of the virtual shutdown of Libyan oilfields with the March data for both countries' output circled. Clearly, Saudi Arabia was either unwilling or unable to plug the Libyan output gap:



[CLICK TO ENLARGE](#)

SOURCE: GREGOR/EIA



[CLICK TO ENLARGE](#)

SOURCE: THE OIL DRUM

At the time, Reuters reported on the Saudi response to the supply disruption and it appeared as though they were opening up the spigots:

Saudi Arabia has increased its oil production to more than 9 million barrels per day (bpd) to compensate for disruption to Libyan output, an industry source familiar with the kingdom's production told Reuters on Friday.

"We have started producing over 9 million barrels per day (bpd). We have a lot of production capacity," the source said, but said he could not say when the change had taken place.

But clearly, from the graph (above, right), the 'change' had taken place gradually over the preceding six months - the Saudi response to Libyan production dropping off the proverbial cliff could hardly be labelled 'shock and awe'.

The Oildrum leaned distinctly in the direction of ‘unwilling’ as the reason for the less-than-dramatic response:

Back in 2006, when [Saudi] production started to gradually decline from 9.5mbd even as global oil prices were in the worst spike since the 1970s, I was an advocate of the view that the decline was largely involuntary: they’d never produced more than 9.5mbd, they’d underinvested for decades, and some of their big fields were getting very tired (particular northern Ghawar and Abqaiq) and they were starting a big rash of new projects and ramping up their rig counts at the same time.

I see current events differently. The reduction in late 2008 was clearly voluntary to support prices in the face of the great recession. There’s no new projects announced, and the rig count hasn’t taken off. So my take is that the failure to increase production to compensate for Libya is deliberate. We can only speculate, but my guess is that, having watched how the west has helped to ease Mubarak and Ben-Ali out of power and is intervening in Libya to the same end, the Saudi regime is in no mood to care about our desire for more oil. Instead, they are very much in the mood to build as large a war chest as possible with which to appease their own population, strengthen their defense measures, etc.

So, instead of Saudi production increasing to compensate for Libya, total world production decreased, and oil prices went up sharply to enforce the necessary conservation on the world’s oil consumers.

The debate about Peak Oil has been raging since the fateful day in 1956 when M. King Hubbert presented to the American Petroleum Institute his theory that oil production would follow a bell curve and, at an unspecified stage in the future, enter a terminal decline, but that debate is too multi-faceted for these pages so we will simply use a couple of charts (which would coincidentally appear to support Dr. Hubbert’s thesis) in order to flesh out the remainder of our discussion for today.

First up, a list of the world’s biggest oilfields (right):

The list of the 18 largest ‘supergiant’ oilfields (left) highlights one of the biggest challenges facing the oil industry to date in that the average age of these fields is exactly 60 years old. Moreover, the most recent discovery was made 35 years ago when the Cantarell Complex (highlighted) was found by a fisherman named Rudesindo Cantarell 80 km off the coast of Mexico in the Bay of Campeche.

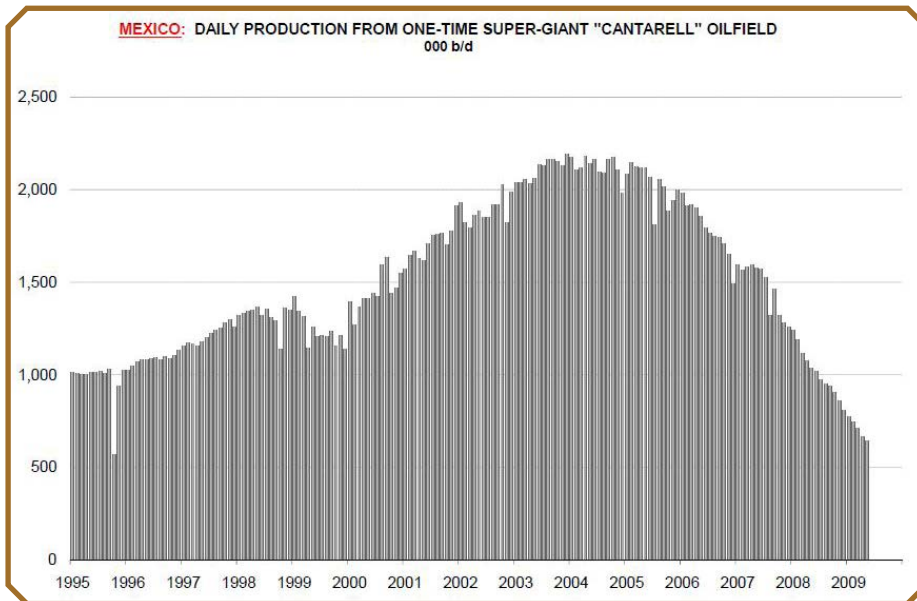
Cantarell complained that oil seepage was ruining his fishing nets and the good folks at PEMEX (Mexico’s national oil company) kindly investigated the problem for him - only to find the motherlode.

In 2004, however, PEMEX suddenly announced that production from Cantarell was forecast to steeply decline from 2006 - at a rate of 14% per year.

By 2008, the annual rate of decline had reached 36% and by 2009 it hit 38%.

Field Name	Country	Discovery year	Range of URR [GB]
Ghawar	Saudi Arabia	1948	66-100
Burgan Greater	Kuwait	1938	32-60
Safaniya	Saudi Arabia	1951	21-36
Bolivar Coastal	Venezuela	1917	14-36
Berri	Saudi Arabia	1964	10-25
Rumalia N&S	Iraq	1953	22
Zakum	Abu Dhabi	1964	17-21
Cantarell Complex	Mexico	1976	11-20
Manifa	Saudi Arabia	1957	17
Kirkuk	Iraq	1927	16
Gashsaran	Iran	1928	12-15
Abqaiq	Saudi Arabia	1941	10-15
Ahwaz	Iran	1958	13-15
Marun	Iran	1963	12-14
Samotlor	Russia	1961	6-14
Agha Jari	Iran	1937	6-14
Zuluf	Saudi Arabia	1965	12-14
Rudhoe Bay	Alaska	1969	13

SOURCE: AAPG/OGJ/EIA



[CLICK TO ENLARGE](#)

SOURCE: FEDERAL GOVT OF MEXICO

In graphical form, the fall from grace of the Cantarell supergiant is even more amazing (chart, left).

Clearly, in oil we have a commodity the world cannot live without which is the subject of great debate as to whether its future supply is sustainable. The largest concentration of this commodity resides underneath the most combustible region on the planet, the guardians of that oil are very secretive about their production rates and have a vested interest in maximising profits from the sale of their only asset, the evidence that is in the public domain (such as that surrounding Cantarell along with Great Britain's experience with North Sea Oil)

would seem to suggest that once the decline stage is reached it will be rapid and.... what was the other thing?

Oh yes, the institution in charge of producing the colourful pieces of paper which can be swapped for that commodity are committed to producing as many of them as they can get away with before anybody notices.

As stock markets plummeted in August, one thing that was noticeable was the resilience of both 'the oil price' (in the shape of Brent Crude, of course) and that of copper - two bellwether indicators of any slowdown in growth that can be relied upon to flash signals when a recession is nigh.

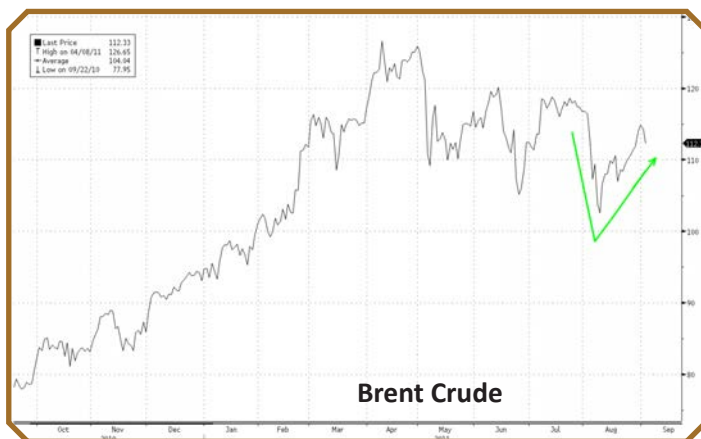
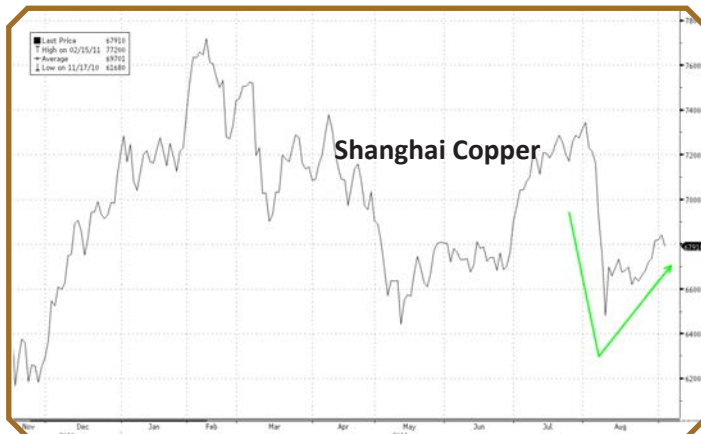
To be sure, the data reported in August was dreadful. In the US we saw a slew of appalling regional manufacturing reports, (the Philly Fed and Empire numbers could genuinely be described as 'shockers'), shattered consumer confidence numbers and rising inflation all topped off with a big fat goose egg in the NFP report last Friday, while in Europe, as the periphery continued to confirm just how weak their economies continue to be, the real shocks came from the region's perennial powerhouse economy, Germany.

German private investment and consumption were down, government spending rose, GDP was below forecast and the PPI number was alarmingly elevated on both a month-on-month and year-on-year basis and the ZEW survey (Germany's barometer for economic growth expectations) had its biggest fall since July 2006. On balance, it looks for all the world as though the two largest and most powerful regions on Earth are about to head into synchronised recessions - the only possibility that this turns out NOT to be the case would seem to be that they are both already IN recessions.

So why doesn't 'the oil price' reflect this likelihood? Simple:

1. China has a LOT of paper money and is happy to swap it for hard assets that it knows will ultimately be far more beneficial in the long run as Western governments continue to debase their currencies.
2. Western governments continue to debase their currencies.

THINGS THAT MAKE YOU GO *Hmmm...*



SOURCE: BLOOMBERG

But it isn't just 'the oil price' that has shown remarkable resilience into the teeth of what looks like another severe recession. Throughout August, sitting out here in Asia, it was plain to see that there was a firm hand bidding for copper in the Shanghai market and, realistically, nobody in the region was in any doubt as to exactly who that firm hand belonged to. Consequently, copper - that great barometer of both economic activity and inflationary pressure - held up surprisingly well given the poor economic backdrop and the 'risk off' episodes that littered the first half of the month.

The signs are clear: Inflation is not only the preferred option to soothe the pain of a world drowning in debt, but (semantics about which 'oil price' to use aside) pretty much the only bullet left in the guns of central bankers and, until somebody stamps a 'sell-by date' on such things as copper, oil or our old friends gold and silver, the Chinese will continue to swap their paper for hard assets and, realistically, the price is of secondary importance to them.

Ben Bernanke's 'disappointing' speech at Jackson Hole was received poorly by markets that have become used to a generous helping of stimulus from the Fed Head whenever things looked bleak but subsequently, with a non-farm payrolls report that showed the US economy produced precisely zero jobs last month, further wobbles in stock markets that are focusing ever-more intently on the debacle that is Europe and the remarkably pro-stimulus words of two Fed officials, it has become even clearer that, come the Fed's extended two-day meeting in late September, QE3 (or whatever it ends up euphemistically being labelled) is pretty much a done deal.

Add to that the increasing likelihood that the ECB begin to monetize their own problems via Eurobonds and rate cuts (ECB mandates and approval by the citizens of Europe be damned at this point in the game) and the odds on seeing a meaningful retreat in 'the oil price' - even in the face of a global recession - are becoming thinner by the day.

The surprising relative strength in 'the oil price' is signaling that the familiar paradigm of slowing growth being accompanied by a falling oil price to help equilibrium be reached at which point growth can begin again is just another casualty of central bank interference in markets via unprecedented monetary printing experiments. The inevitable inflation that results from massive money-printing operations is a concern to many, and, while it is seemingly not apparent in Western government numbers, it is out there. Believe me. It is out there in the price of oil, and copper it can be seen in the price of gold and silver and it is in the price of such vital things as Thai Hom Mali rice which has risen 26% this year and looks set to rise a further 25% NEXT MONTH ALONE [according to the Bangkok Post](#). If you want to see what problems inflation can cause, keep an eye on the price of rice here in Asia. The fact that the US CPI appears benign, means very little. The less obvious signs are far more important.

Of course, the other thing to consider is the new man at the head of the Libyan government when it is finally established. We don't know who he is. We don't know how he thinks. But surely, the new leader of the world's 17th-largest oil producer HAS to offer more stability to both the world in general and 'the oil price' in particular than Muammar al-Qaddafi.

Surely?

Today's Things That Make You Go Hmmm..... contains a veritable kaleidoscope of information on such diverse subjects as Hurricane Irene, the inhabitants of long-stay motels and the Japanese mafia.

We kick things off with a look at the science of jawboning as Bruce Krasting lays bare the Fed's cunning plan to change the world with nothing but hot air, Michael Pettis weighs in with some predictions for the coming decade and we hear how, in Japan, the Yakuza are having to alter their business model.

Europe continues to head towards a defining moment as the Bundesbank growls about the bailouts, we see sovereign debt concerns escalating again, a senior member of the IMF voices his opinion on the likelihood of a hard Greek default by the end of this year and, talking of Greece, we head to Athens to find out about a growing tax revolt (an interesting concept in a country where tax avoidance is a national sport).

CNBC's Bob Pisani enters the GLD vault and unwittingly succeeds in opening up yet another can of conspiracy worms, Wikileaks sheds some light on Chinese gold-buying, Central Banks are fleeing to the safety of the Federal Reserve in record-setting fashion and we take a look at the ad plight of the ever-growing number of long-term residents at US motels as well as a deliciously ironic look at the media coverage of Hurricane Irene by a fellow sardonic Brit.

Our charts contain a wealth of information around Friday's jobs number courtesy of Bill McBride's wonderful Calculated Risk site, a look at the average gold holding of a pension fund as well as the strangely coincidental average intraday move of the gold price and we check out Libyan oil production as well as a handy reference guide to the EFSF (which you'd probably be advised to laminate and keep in your wallets this month - you're gonna need it).

The urbane Jim Grant gets to debate Steve Liesman and the CNBC gang on the subject of the Gold Standard (hardly a fair contest), we see what can only be described as a 'Farage Montage' and there's even time for a brief chat about the gold market that I had with Mr. Al Korelin last week.

Oil be going now....

I have recently joined Vulpes Investment Management here in Singapore where I will act as advisor to the Vulpes Testudo fund:

www.vulpesinvest.com

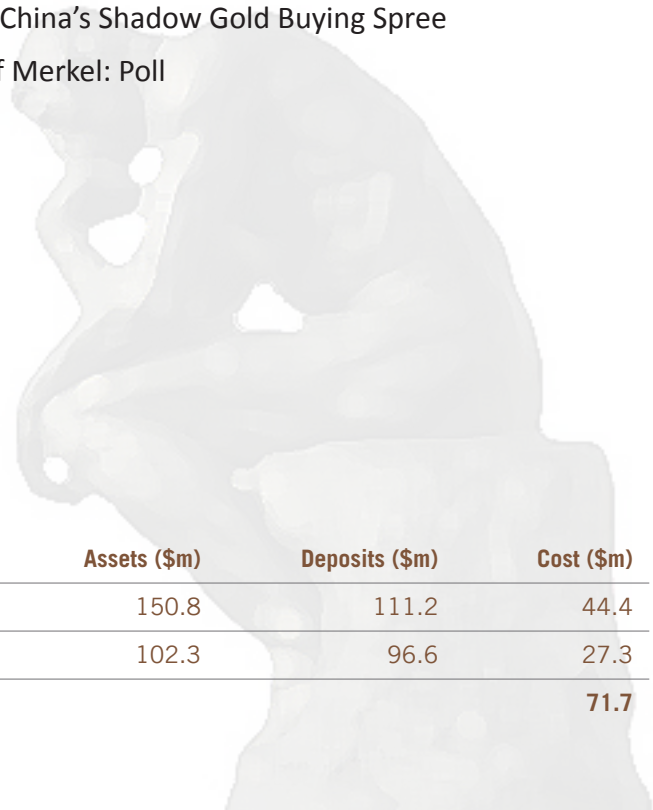
As a result of my role at Vulpes, it falls upon me to disclose that, from time-to-time, the views I express and/or the commentary I write in the pages of *Things That Make You Go Hmmm.....* may reflect the positioning of one or all of the Vulpes funds - though I will not be making any specific recommendations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

Grant

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04 September 2011

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 Charts That Make You Go Hmmm.....
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 And Finally.....



The Ginnie, Ginnie Banks

#	Bank	Assets (\$m)	Deposits (\$m)	Cost (\$m)
69	Patriot Bank of Georgia, GA	150.8	111.2	44.4
70	CreekSide Bank, GA	102.3	96.6	27.3
Total Cost to FDIC Deposit Insurance Fund				71.7

Go back a week to an article in the NY Times (Link). The guts of this story is that the Administration is working on a plan to Re-Fi residential mortgages on a massive scale.

The New York Times

U.S. May Back Refinance Plan for Mortgages

By SHAILA DEWAN and LOUISE STORY
Published: August 24, 2011

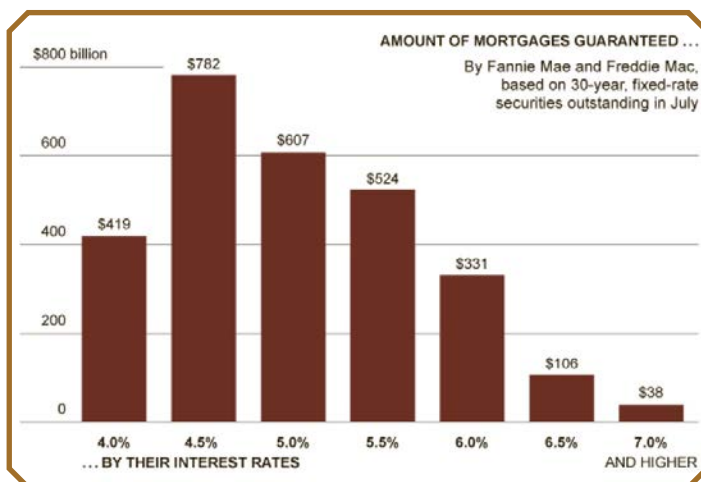
SOURCE: NYTIMES

those who owe F/F big bucks get a break? Where is the fairness in that result?

But every day since the NYT story, I have heard the rumblings about some deal being done. It has already impacted MBS spreads. It's back in the news today with an article in the WSJ. (Link) I have to believe that where there is smoke, there is probably some fire.

I went back to the NYT piece. There are some clues. First is that Louise Story wrote the article. She is a fine reporter. Anything that she says has been supported by "real" sources. "Who were these sources?" is a question to ask. Some words from the piece:

Administration officials said on Wednesday that they were weighing a range of proposals.



CLICK TO ENLARGE

SOURCE: NYTIMES

Read this to mean that people in the Administration deliberately planted this story. This was a "trail balloon" approach. This is very typical for this administration. They leak their intentions in advance. More from the NYT:

But refinancing could have far greater breadth, saving homeowners, by one estimate, \$85 billion a year.

The following chart [left] was included in the NYT's article.

The information in the chart and the very precise estimate of "85 billion a year" can only have come from one source. It has to be the FHFA that is doing the talking to the NYT. It had to come from the most senior level. That HAS to mean that it came from the Acting Director, Edward DeMarco...

*** BRUCE KRASTING / LINK

Markets have been crazy this month, but rather than try to wade through all the news, much of which doesn't seem to have much informational content, I thought I would duck out altogether and instead make a list of things I expect will happen over the next several years. We are so caught up in noise and market volatility – as the market swings first in one direction and then, as regulators react, in the other direction – that it is easy to lose sight of the bigger picture.

My basic sense is that we are at the end of one of the six or so major globalization cycles that have occurred in the past two centuries. If I am right, this means that there still is a pretty significant set

of major adjustments globally that have to take place before we will have reversed the most important of the many global debt and payments imbalances that have been created during the last two decades. These will be driven overall by a contraction in global liquidity, a sharply rising risk premium, substantial deleveraging, and a sharp contraction in international trade and capital imbalances.

To summarize, my predictions are:

- *BRICS and other developing countries have not decoupled in any meaningful sense, and once the current liquidity-driven investment boom subsides the developing world will be hit hard by the global crisis.*
- *Over the next two years Chinese household consumption will continue declining as a share of GDP.*
- *Chinese debt levels will continue to rise quickly over the rest of this year and next.*
- *Chinese growth will begin to slow sharply by 2013-14 and will hit an average of 3% well before the end of the decade.*
- *Any decline in GDP growth will disproportionately affect investment and so the demand for non-food commodities.*
- *If the PBoC resists interest rate cuts as inflation declines, China may even begin slowing in 2012.*
- *Much slower growth in China will not lead to social unrest if China meaningfully rebalances.*
- *Within three years Beijing will be seriously examining large-scale privatization as part of its adjustment policy.*
- *European politics will continue to deteriorate rapidly and the major political parties will either become increasingly radicalized or marginalized.*
- *Spain and several countries, perhaps even Italy (but probably not France) will be forced to leave the euro and restructure their debt with significant debt forgiveness.*
- *Germany will stubbornly (and foolishly) refuse to bear its share of the burden of the European adjustment, and the subsequent retaliation by the deficit countries will cause German growth to drop to zero or negative for many years.*
- *Trade protection sentiment in the US will rise inexorably and unemployment stays high for a few more years.*

*** MICHAEL PETTIS / [LINK](#)

Germany's Bundesbank has issued a thundering denunciation of Europe's rescue policies and actions by the European Central Bank, alleging that EU treaty law has been "completely gutted".

Jens Weidmann, the bank's president, said monetary union risks losing its democratic legitimacy as EU leaders take a "large step" towards a debt union without legal authority, and sever the crucial link between budget policy and elected parliaments.

He said mass bond purchases by the European Central Bank had "strained the existing framework of the currency union and blurred the boundaries between monetary policy and fiscal policy. Decisions

on further risk-taking should be made by governments and parliaments, as only they have democratic legitimacy.”

Mr Weidmann said that if Europe is unwilling to accept a genuine fiscal union backed by a European tax system, it must strengthen the existing ‘no bail-out’ clause in the EU Treaties “instead of letting it be completely gutted.”

The escalating protest from the Bundesbank leaves the ECB in an invidious situation as it tries to shore up Italy and Spain, holding yields on their 10-year bonds at 5pc by intervening on the secondary market.

“... The escalating protest from the Bundesbank leaves the ECB in an invidious situation as it tries to shore up Italy and Spain

Julian Callow said Italy must redeem a record €62bn (£55bn) of debt by the end of September yet the government of Silvio Berlusconi is blacksliding on its austerity package and cavilling over details.

“This is a very large sum of money. The situation is extremely serious, and this is no time to be rearranging deck chairs,” Mr Callow said, suggesting that ECB chief Jean-Claude Trichet may have to go to Rome to read the riot act.

The government has agreed on tougher measures to curb tax evasions but a wealth tax was dropped on the insistence of Mr Berlusconi. The deal after three weeks of wrangling is so thin that the ECB may find it hard to justify further purchases of Italian debt. The bank has used intervention as a pressure tool to force states to deliver austerity.

Mr Callow said the eurozone is already in an industrial recession and needs stimulus to head off a possible credit crunch and stabilise the debt crisis. He said the ECB should cut interest rates to cushion the effect of fiscal tightening in a string of EMU states and halt accelerating capital flight from the eurozone.

Holger Schmieding from Berenberg Bank said there is a “significant risk” of recession across Europe and the UK but insisted it would be a mistake for the authorities to relax on either the fiscal or monetary front. “They must tough it out,” he said.

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

Concerns about the euro zone’s ability to cohesively respond to its debt crisis resurfaced Friday after talks between Greece and its foreign creditors were interrupted and the head of the European Central Bank warned Italy to stick to its austerity program.

European stocks were sagging even before a disappointing U.S. jobs report added to concerns about the global economy, dragged lower by those companies most tied to growth like car makers, banks and insurers.

Yields on 10-year Italian bonds rose almost a tenth of a percentage point to 5.21 percent — well above the 5 percent level that is considered to be the top rate desired by policy makers.

The yield on Spain’s 10-year securities climbed slightly to 5.06 percent, despite passage in the lower house of the Spanish Parliament on Friday of an amendment that will enshrine stricter budgetary discipline in the Constitution.

The ECB on Aug. 8 began the extraordinary step of buying Italian and Spanish debt to help calm markets after 10-year rates had spiked to around the 6 percent level.

David Schnautz, interest rate strategist at Commerzbank in London, said many investors had chosen to use the E.C.B.'s recent bond buying program to offload those bonds, and that was causing yields to drift up now.

"There's still no genuine investor demand for Spanish and Italian government bonds," he said.

Sentiment was hit after the team of European and International Monetary Fund officials pulled out of Athens early as they apparently disagreed over the country's deficit figures and how to make up for a growing budget shortfall.

The mission had been sent to determine whether Greece would meet the conditions for the next tranche of emergency loans, due in September.

The representatives of the European Commission, the European Central Bank and the I.M.F. said in a statement that "good progress" had been made, but that they wanted to allow time for the Greek government to complete technical work on the 2012 budget and reforms.

The delegates, who had been scheduled to leave next week, said they would return to Athens by mid-September, "when we expect the Greek authorities to have completed the technical work, to continue discussions on policies needed to complete the review."

*** NYTIMES / [LINK](#)

For the television reporter, clad in his red cagoule emblazoned with the CNN logo, it was a dramatic on-air moment, broadcasting live from Long Island, New York during a hurricane that also threatened Manhattan.

"...In New York city, CNN's silver-haired Anderson Cooper, more usually seen in a tight t-shirt in a famine or war zone, was clad in what one wag dubbed "disaster casual".

"We are in, right, now...the right eye wall, no doubt about that... there you see the surf," he said breathlessly. "That tells a story right there."

Stumbling and apparently buffeted by ferocious gusts, he took shelter next to a building. "This is our protection from the wind," he explained. "It's been truly remarkable to watch the power of the ocean here."

The surf may have told a story but so too did the sight behind the reporter of people chatting and ambling along the sea front and just goofing around. There was a man in a t-shirt, a woman waving her arms and then walking backwards. Then someone on a bicycle glided past.

Across the screen, the "Breaking News: Irene Batters Long Island" caption was replaced by stern advice from the Federal Emergency Management Agency (FEMA): "Stay inside, stay safe."

The images summed up Hurricane Irene – the media and the United States federal government trying to live up to their own doom-laden warnings and predictions while a sizeable number of ordinary Americans just carried on as normal and even made gentle fun of all the fuss.

There was almost palpable disappointment among the TV big guns rolled out for the occasion when Irene was downgraded to a mere 'tropical storm'. In New York city, CNN's silver-haired Anderson Cooper, more usually seen in a tight t-shirt in a famine or war zone, was clad in what one wag dubbed "disaster casual".

He looked crestfallen and fell briefly silent when a weatherwoman told him that the rain was not go-

ing to get any worse. “Wow, because this isn’t so bad,” he said. “It’s an annoying rain but it isn’t even a sideways rain.”

Then came the press conferences from the politicians, with Governor Chris Christie of New Jersey insisting that his evacuation of the Jersey Shore was “a pre-emptive measure that I am confident saved lives” and there could still be damage worth “tens of billions” of dollars.

Janet Napolitano, the Homeland Security chief, declared that there was “a ways to go with Irene” but “with the evacuations and other precautions taken we have dramatically decreased the risk to life”. Mayor Michael Bloomberg of New York seemed thoroughly delighted with himself, as if he personally had calmed the waters and stifled the winds.

The truth is that the dire warning beforehand suited both politicians and journalists. Just as with the minor earthquake that shook the east coast last week causing no loss of life and virtually no damage, Irene became a huge story because it was where the media lived.

For politicians, Irene was a chance to either make amends or appear in control. The White House sent out 25 Irene emails to the press on Saturday alone.

★ ★ ★ UK DAILY TELEGRAPH / [LINK](#)

We have to evolve our business model,” said Masatoshi Kumagai, one of the bosses of the Inagawa-kai syndicate of the Japanese yakuza, in an interview with reporters of the French magazine L’Expansion. In the media, yakuza are portrayed as getting stronger and richer, but the opposite is actually true, he said. They’re on decline, and if they don’t change their business model, they might cease to exist.

Yakuza are an economic force in Japan with over 100,000 members in 22 syndicates, grouped into three families. An ambiguous relationship between them and the government contributed to their prosperity. After World War II, the government used the yakuza to fight Chinese and Korean gangs rampaging in the country. In the 60s, with the encouragement of the Liberal Democratic Party (LDP)

“... everybody engages in insider trading, and yakuza have lost their edge. In fact...there is no longer any dividing line between the legal financial world and yakuza

that ran Japan essentially from 1955 to 2009, yakuza broke up massive strikes. As the relationship solidified, their influence spread: Rackets, pachinko, drug trafficking, consumer loans, prostitution—and they got rich. They showed up at parties of the jet-set and threw around money and had so much power that even the anti-gang law, passed in 1992 to control their influence and visibility, wasn’t put into effect until six years later.

The slow and lacking response by the government to the horrible earthquake in Kobe in 1995 didn’t help. Yakuza swooped in, even using a helicopter, and provided disaster relief while the authorities were dillydallying around. This was played up in the media and added to their aura of semi-legitimacy.

But when a yakuza assassinated the Mayor of Nagasaki, Iccho Ito, in 2007 outside his campaign office, everything changed. Considered an attack against democracy, the assassination caused the government to declare war on the yakuza. And crackdowns began. Then the financial crisis hit, and the LDP was losing its grip on power. In a desperate effort to prop up its popularity, it cracked down even harder.

As a consequence, said Masatoshi Kumagai, yakuza are weakened by repression and can no longer run their businesses as they see fit. The protection racket, for example. If caught by police, a shopkeeper

can get in trouble for cooperation with a criminal enterprise. Same thing in construction, which used to be dominated by yakuza. Their influence is diminishing, and they have to make themselves more and more invisible. While there remain some big business opportunities, like drug trafficking, they don't make as much money as before. And what you read in the media about their profits, he said, is exaggerated.

Even in finance, they're weakened. For a long time, they flourished with insider trading because they got the information before anyone else. That's no longer the case. As the recent scandals have shown, everybody engages in insider trading, and yakuza have lost their edge. In fact, he says, there is no longer any dividing line between the legal financial world and yakuza.

★ ★ ★ [ZEROHEDGE](#) / [LINK](#)

A long way down the US housing ladder, beneath the grisly 'projects' of *The Wire* and the trailer parks hymned by Eminem, beneath the slums of New Orleans and the ghettos of Detroit, you'll find the long-stay hotel. Cheap, not very cheerful, and pretty much a last resort, these institutions provide four walls and a roof, for a few hundred bucks a month. It's some of the cheapest accommodation you'll find anywhere in the US, aside from a cardboard box.

“... Long-stay hotels can be found in almost every major American city. They offer none of the privacy of trailer parks, and even less of the permanency.” Long-stay hotels can be found in almost every major American city. They offer none of the privacy of trailer parks, and even less of the permanency. Guests make do with postage stamp-sized rooms, paper-thin walls, and nylon sheets. You'll rarely find them listed in tourist guides, even the section of a *Lonely Planet* devoted to 'rock-bottom dives'. Staying in one isn't exactly what you might call a holiday. It is, however, an experience. So says Kalpesh Lathigra, whose compelling photo-essay on the Wilmington Hotel in Long Beach, Southern California, is published on these pages.

A British documentary photographer, he stumbled upon the place while looking up relatives during a family holiday to Los Angeles (it is owned by his uncle, Bachu), and has since re-visited for extended periods, building close relationships with its most colourful and well-established residents.

“The hotel is one of those places with a feel that you know just has to be recorded,” he says. “There's something in the ether. I remember walking in for the first time, and straight away realising that it had this weird character that cried out to be photographed.”

“The carpet looked like it was bought in the 1970s. The doors are this ugly blue. My idea of American hotels and motels was of a place where you came and stayed for a night or two. But here, every room was occupied by someone who had been living there long-term. It felt like one of those places that has a real story to tell.”

Lathigra's images capture some of the unlovely realities of life at the \$150-a-week Wilmington, which is situated a stone's throw from the industrial fug of Long Beach port, and a half-hour's drive from the mansions of Beverly Hills and the Hollywood sign. They show peeling paint, filthy curtains, and nicotine-stained walls – not to mention the battle-scarred men and women who have ended up inhabiting the building's 30-odd rooms.

★ ★ ★ [THE GUARDIAN](#) / [LINK](#)

The SPDR Gold Trust (GLD) may have sought to defuse conspiracy theorists by opening up its massive London gold vault to CNBC, but instead it opened up a new line of inquiry.

In the [segment](#) reporter Bob Pisani was forced to surrender his cell phone before being driven, not unlike a hostage, in what appears to be a cargo van with its windows sealed by black tarp. “We have no idea where we’re going,” he says over background music reminiscent of the “Mission Impossible” theme.

Once inside, Pisani holds up a random gold bar, its refiner’s stamp clearly legible. (This occurs about 2:10 into the video segment.) As Zero Hedge points out in [a blog post today](#) the serial number on that bar, ZJ6752, does not appear on GLD’s most recent bar list, dated August 31. Given that GLD tonnage stayed relatively flat over the previous week, when Mr Pisani’s visit presumably occurred, few if any bars are likely to have been removed from the vault in the interim, Zero Hedge notes.

There must be an explanation, but the plot thickens.

“Of course, Pisani may have well shot the documentary some three weeks ago, when gold peaked at 1310 [metric] tons, although we assume he would have then said 1,300 tons held by the warehouse, not 1,200 as he did,” Zero Hedge says. “If that is the case, there is a small chance based purely on statistics that ZJ6752 was promptly moved out of the warehouse upon a redemption event. The chance is about 1 in 10,000 or so, but still. ...”

The question, or at least one question, is: When did Mr Pisani pay his visit?

Phantom gold conspiracies haven’t seemed to dent demand for GLD, despite BlackRock’s attempt a year ago to distinguish itself as the only US-listed gold ETF to be fully allocated daily. (Jeremy Charles, global head of precious metals at HSBC, which houses the vault, tells Pisani: “At no point in time is there a risk to the trust.” But GLD’s prospectus states that up to 430 ounces of gold can be held in the trust’s unallocated account overnight, which would seem to constitute a type of risk.)

Still, the CNBC invite suggests GLD is at least somewhat bothered by the whispers. We could see this episode proving a PR tipping point, ushering in either a new era of openness and access or, alternately, even more secrecy.

★ ★ ★ FT (VIA GATA) / [LINK](#)

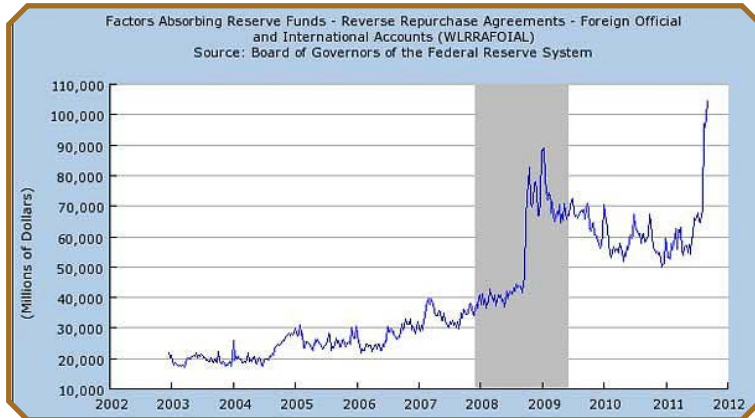
A key warning signal of global financial stress has shot above the extreme levels seen at the height of the Lehman crisis in 2008.

Central banks and official bodies have parked record sums of dollars at the US Federal Reserve for safe-keeping, indicating a clear loss of trust in commercial banks.

“... The Bank for International Settlements says European and British banks have a dollar “funding gap” of up to \$1.8 trillion Data from the St Louis Fed shows that reserve funds from “official foreign accounts” have doubled since the start of the year, with a dramatic surge since the end of July when the eurozone debt crisis spread to Italy and Spain. “This shows a pervasive loss of confidence in the European banking system,” said Simon Ward from Henderson Global Investors. “Central banks are worried about the security of their deposits so they are placing the money with the Fed.”

These dollar accounts are just over \$100bn (£62bn) and are small beer compared to the vast sums invested in bonds as foreign reserve holdings. Yet they serve as stress indicator, reflecting the operating decisions of the world’s top insiders.

The dollar data refers specifically to reverse repurchase agreements.



SOURCE: ST LOUIS FED

Lars Tranberg from Danske Bank said European banks are reduced to borrowing dollar funds for “a week at a time” rather than the usual six to 12 months. “This closely resembles what happened in late 2008, though the difference this time is that the major central banks have dollar swap lines in place. If the dollar funding markets completely freeze up, the European Central Bank can act as a backstop.”

Mr Tranberg said dollar deposits of US banks have increased by \$400bn since mid-June, mostly offset by dollar reductions in Europe. “It is clear that the problem lies with the European banks. The

credit default swaps on these banks are very high and provide a risk gauge.”

The Bank for International Settlements says European and British banks have a dollar “funding gap” of up to \$1.8 trillion stemming from global expansion during the boom that relies on dollar financing and has to be rolled over. This is not normally a problem but funding can seize up in a crisis.

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

Tax evasion in Greece threatened to take organised form on Thursday when café and restaurant owners refused to pay a 10-point VAT rise, as a deep recession clashes with the government’s increasingly desperate search for revenue.

The steep rise in value added tax on the hospitality sector from 13 per cent to 23 per cent is part of a package of fiscal measures agreed in return for the country’s second financial rescue by European Union partners.

But for many of Greece’s ubiquitous cafés and souvlaki stands, which have already seen a 20-40 per cent decline in business in the past year as customers rein in spending, the VAT rise is the final straw.

“Our members voted at an extraordinary general assembly not to pay the increase because it will drive many establishments out of business,” said the PanHellenic Federation of Restaurants and Related Professions, representing more than 15,000 hospitality businesses.

Sete, an association of Greek hoteliers and tour operators, said the tax rise was “inappropriate, unjust and will not produce the revenues it targets”.

The measure is projected to raise €750m (\$1,072m) over the next year, according to the finance ministry, which says owners will be fined for tax evasion if they fail to pay VAT at the increased rate.

The restaurateurs’ reaction highlights the desperation of Greece’s small business community amid the worst recession in memory. The economy is set to shrink this year by more than 5 per cent and by another 2 per cent in 2012, according to finance ministry projections.

Grigoris Dimitropoulos, owner of a café on Adrianou, a pedestrian street close to the Acropolis, called the increase “totally unfair”, given that VAT was raised from 9 per cent to 13 per cent less than a year ago.

★ ★ ★ FT / [LINK](#)

Talks over new bailout funds for Greece were suspended Friday amid disagreements over how to fill a government-deficit gap that once again is veering off track, raising doubts about the country's future access to finance and triggering renewed nervousness in financial markets across Europe.

The suspension pushed yields on Greek government debt to levels indicating that investors see a default by Athens soon as a near certainty: Interest rates on one-year paper blew out past 70% and two-year yields rose close to 50%.

“... I expect a hard default definitely before March, maybe this year, and it could come with this program review

More disturbingly for euro-zone governments—given Greek bonds are barely traded and wild swings in yields are therefore likely—financial markets also pushed up borrowing costs for Italy, reflecting anxieties about Italian austerity measures being watered down, and for Spain.

The continent's stock markets also retreated, with the French market down 3.6% and the German market down 3.4%.

The suspension of the talks in Athens between the government and a group of officials representing the providers of Greece's bailout cash came, officials said, amid a dispute about how to address new gaps opening up in the government budget deficit.

“The Greek side insisted the missed targets are the result of the recession. The troika said recession played a part, but Greece basically didn't keep up with its commitments, so more measures will be needed to make up for the lost ground,” said a person with direct knowledge of the talks.

“There is a clear disagreement that can't be bridged today,” the person added.

The talks with the so-called troika—representatives of the International Monetary Fund, European Central Bank and European Commission—began earlier this week and were expected to be concluded by Sept. 5. According to a Greek government official, the delegation is now expected to return in about 10 days, after the government has prepared a draft of its 2012 budget.

On the talks hangs a payout of €8 billion (\$11.5 billion) of rescue funds under the €110 billion package arranged last year, needed to ensure the government pays its way.

Greece has negotiated a further official rescue package of more than €100 billion, meant to tide it through 2014, which has yet to be formally agreed by lenders.

“I expect a hard default definitely before March, maybe this year, and it could come with this program review,” said a senior IMF economist who is keeping close tabs on the situation. “The chances for a second program are slim.”

*** WSJ / [LINK](#)

Wondering why gold at \$1850 is cheap, or why gold at double that price will also be cheap, or frankly at any price? Because, as the following leaked cable explains, gold is, to China at least, nothing but the opportunity cost of destroying the dollar's reserve status. Putting that into dollar terms is, therefore, impractical at best, and illogical at worst. We have a suspicion that the following cable from the US embassy in China is about to go not viral but very much global, and prompt all those mutual fund managers who are on the golden sidelines to dip a toe in the 24 karat pool. The only thing that matters from China's perspective is that “suppressing the price of gold is very beneficial for the U.S. in maintaining the U.S. dollar's role as the international reserve currency.

China's increased gold reserves will thus act as a model and lead other countries towards reserving more gold. Large gold reserves are also beneficial in promoting the internationalization of the RMB." Now, what would happen if mutual and pension funds finally comprehend they are massively underinvested in the one asset which China is without a trace of doubt massively accumulating behind the scenes is nothing short of a worldwide scramble, not so much for paper, but every last ounce of physical gold...

From Wikileaks:

3. CHINA'S GOLD RESERVES

"China increases its gold reserves in order to kill two birds with one stone"

“... what would happen if mutual and pension funds finally comprehend they are massively underinvested in the one asset which China is without a trace of doubt massively accumulating behind the scenes...”

"The China Radio International sponsored newspaper World News Journal (Shijie Xinwenbao) (04/28): "According to China's National Foreign Exchanges Administration China's gold reserves have recently increased. Currently, the majority of its gold reserves have been located in the U.S. and European countries. The U.S. and Europe have always suppressed the rising price of gold. They intend to weaken gold's function as an international reserve currency. They don't want to see other countries turning to gold reserves instead of the U.S. dollar or Euro. Therefore, suppressing the price of gold is very beneficial for the U.S. in maintaining the U.S. dollar's role as the international reserve currency. China's increased gold reserves will thus act as a model and lead other countries towards reserving more gold. Large gold reserves are also beneficial in promoting the internationalization of the RMB."

*** ZEROHEDGE / [LINK](#)

Two thirds of Germans surveyed in a poll think their parliament should not ratify more money for the euro-zone bailout fund and agree with former chancellor Helmut Kohl that Angela Merkel's government is undermining Germany's influence abroad.

Center-right Chancellor Merkel is trying to face down a threatened revolt in her own bloc in parliament over a September 29 vote to ratify more money and powers for the euro rescue fund.

She was also publicly criticized by her ex-mentor Kohl, Germany's longest-serving post-war chancellor and architect of German reunification, over policy on Europe, the United States and Libya, saying Berlin had "no view or idea" about where it was going.

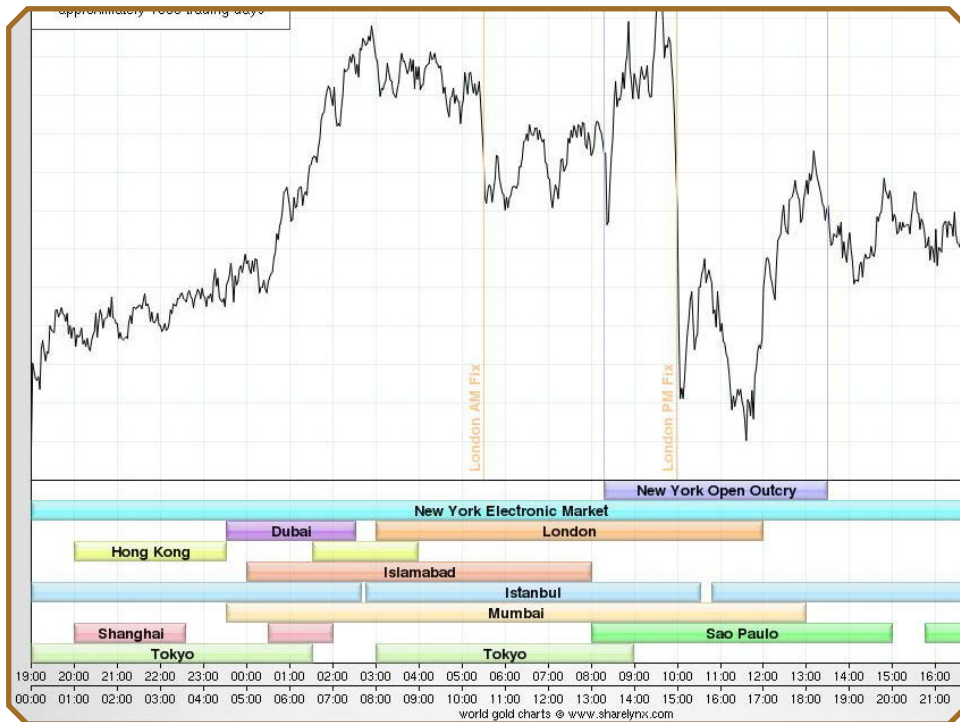
An opinion poll by Infratest dimap for public broadcaster ARD suggested 68 percent of Germans agree with Kohl's comments published in a magazine last week, while 66 percent think the Merkel government has "lost its grip" on the euro crisis.

Two thirds said they were opposed to giving more funds for the European Financial Stability Facility (EFSF) and over half were against introducing common euro-zone bonds -- a proposal the German government has energetically rejected so far.

At the same time, 64 percent believed European countries should coordinate policy more closely, suggesting most Germans are reluctant to fund more bailouts but are not "eurosceptic" in the broader sense.

*** REUTERS / [LINK](#)

CHARTS THAT MAKE YOU GO *Hmmm...*



CLICK TO ENLARGE

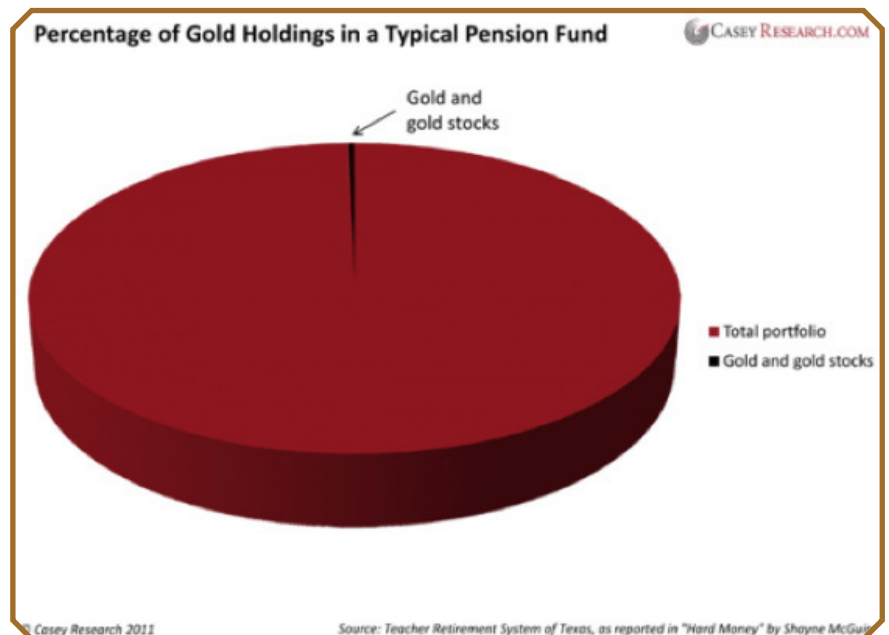
SOURCE: SHARELYNX/CASEY RESEARCH

I have posted this chart before - a long time and many dollars in price ago - but it bears another look just to get some sense of the daily machinations in the gold market.

The chart shows the aggregate intraday move of gold over a 4-year period and demonstrates beyond any doubt whatsoever that the price of gold tends to drop precipitously ahead of the two major price 'fixes' of the day.

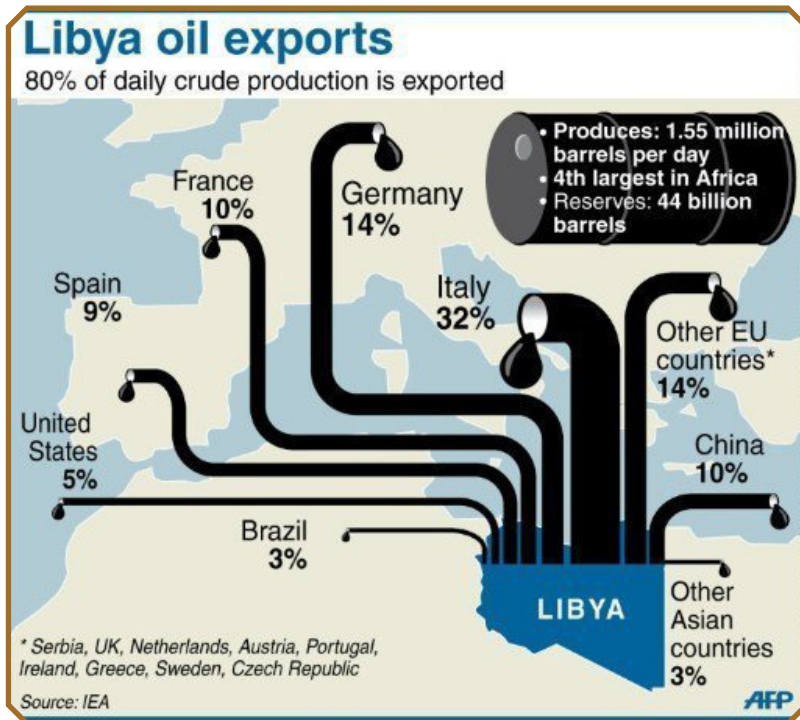
That's the information - what you choose to read into it is entirely up to you...

The holdings of gold and mining stocks in the average pension fund suggest that, once the incorrect assumptions about the continuing upward trajectory of the barbarous relic are altered, the scramble for physical gold as well as mining shares will be quite something...



CLICK TO ENLARGE

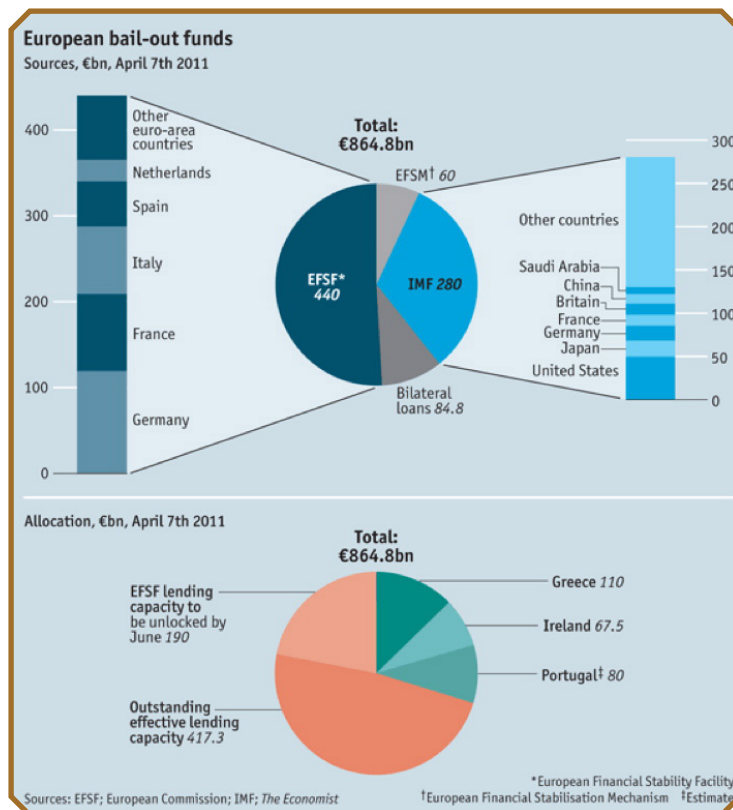
SOURCE: CASEY RESEARCH



A timely reminder, courtesy of Barry Ritholtz, of just how important Libyan oil is to various parts of the world...

CLICK TO ENLARGE

SOURCE: LIBYA OIL EXPORTS (VIA BIG PICTURE)

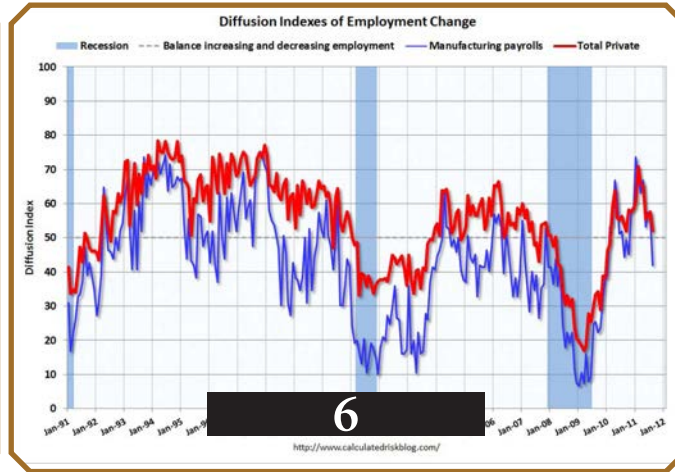
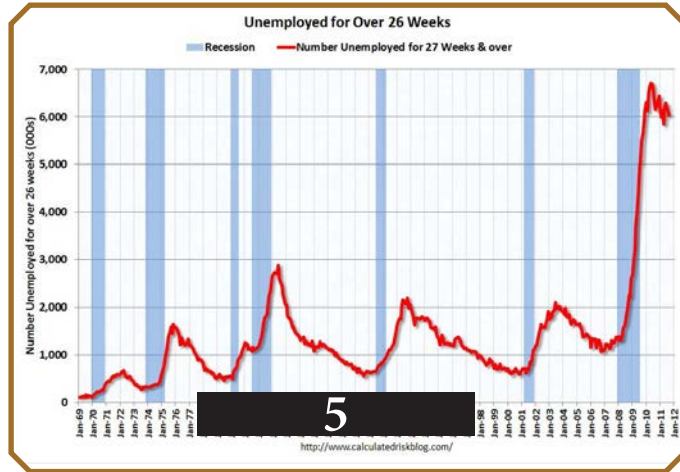
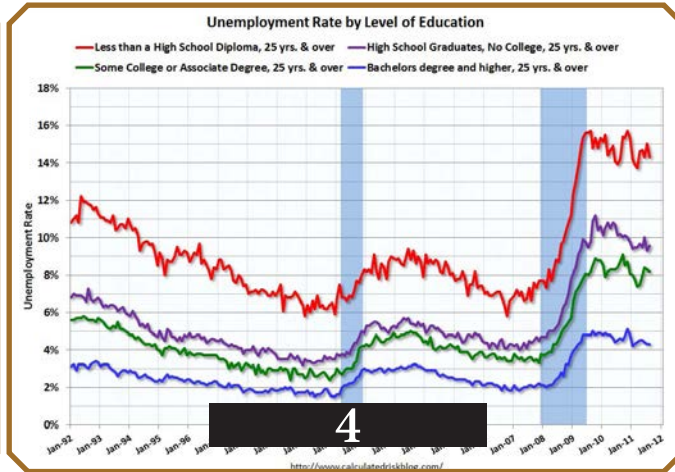
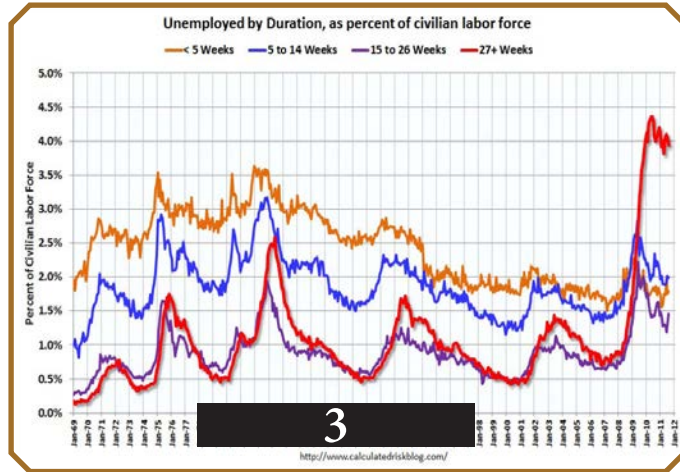
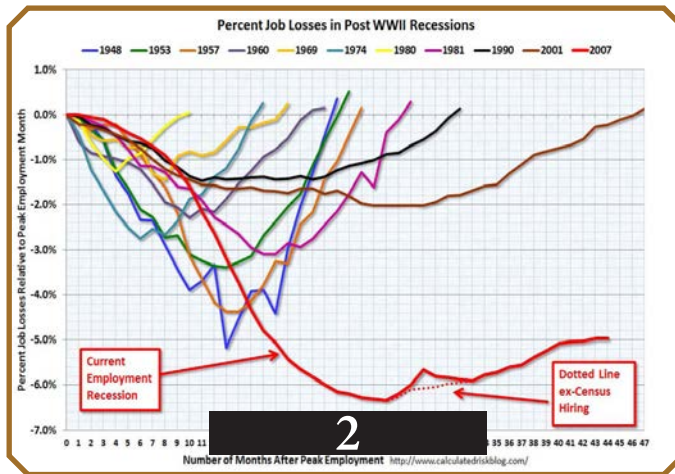
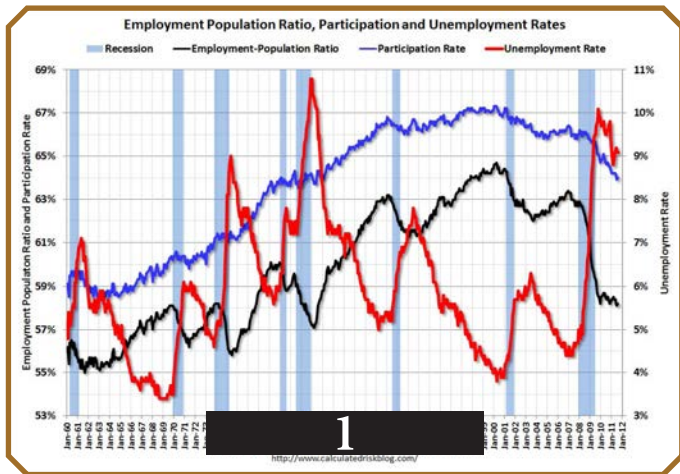


This graphic on the various European bail-outs (including the EFSF) is something you'll want to keep to hand through the month of September as Europ continues to unravel. The chart was produced earlier this year at which time the Economist had this to say about the EFSF:

...[b]ut the EFSF's effective lending capacity is only €250 billion, because only six of its 17 members have a AAA credit rating. European leaders have pledged to bring the fund's actual firepower up to €440 billion by the summer but in the meantime the IMF has more cash on hand, at €280 billion. If all that money were used (a very big if), America would end up lending indebted euro-zone nations €50 billion.

SOURCE: ECONOMIST

CHARTS THAT MAKE YOU GO *Hmmm...*



- | | | | |
|----|--------------------------------------|----|--|
| 1. | Employment Population Ratio | 4. | Unemployment Rate By Education Level |
| 2. | % Job Losses In Post WWII Recessions | 5. | Unemployed Over 26 Weeks |
| 3. | Unemployed By Duration (%) | 6. | Diffusion Indexes Of Employment Change |

SOURCE: CALCULATED RISK

WORDS THAT MAKE YOU GO *Hmmm...*



CLICK TO WATCH

As well as being a regular visitor to the pages of Things That Make You Go Hmmm....., former commodity trader, Member of the European Parliament and leader of the UK Independence Party, Nigel Farage, is something of a polarising figure in Europe.

His outspoken views are often a source of amusement due to his bombastic and confrontational approach, but, as this video shows, history is already showing that his passionate diatribes have turned out to be - for the European establishment at least - alarmingly accurate.

The demeanour of his fellow MEPs speaks a thousand words.

Like him or loathe him, this video is well worth 14 minutes of your day.

Despite an introduction to a discussion about the gold standard that looks like a cartoon (complete with music seemingly designed to imply insignificance), CNBC at least has the good grace to let Jim Grant put forth the case for a gold standard.

There is no better, no more erudite champion.



CLICK TO WATCH



CLICK TO LISTEN

The handsome gentleman on the left is Al Korelin, host of the [Korelin Economics Report](#), while the mugshot on the right is that of your humble scribe. I was fortunate enough to get the chance to chat with Al earlier this week about the recent gyrations in the gold market...

and finally...

This amazing video was sent to me by my good friend Michael. He knew, the second he hit the send button on his email, that he'd be seeing this in the pages of Things That Make You Go Hmmm.....

I hate being so damn predictable!

If you didn't believe a man could fly before you watched this incredible footage, you'll find your mind changed forever in the space of 3 minutes and 45 seconds...

Thanks Mike!



CLICK TO BE AMAZED

Hmmm...

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COMMENTS

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