THINGS THAT MAKE YOU GO
Hmmm...

A walk around the fringes of finance

"I know why you're here, Neo. I know what you've been doing... why you hardly sleep, why you live alone, and why night after night, you sit by your computer. You're looking for him. I know because I was once looking for the same thing. And when he found me, he told me I wasn't really looking for him. I was looking for an answer. It's the question that drives us, Neo. It's the question that brought you here."

– TRINITY, *THE MATRIX*

"I know what you're thinking, 'cause right now I'm thinking the same thing. Actually, I've been thinking it ever since I got here: Why oh why didn't I take the BLUE pill?"

– Cypher, *The Matrix*

"Trinity: Neo... nobody has ever done this before.
Neo: That's why it's going to work. "

– The Matrix

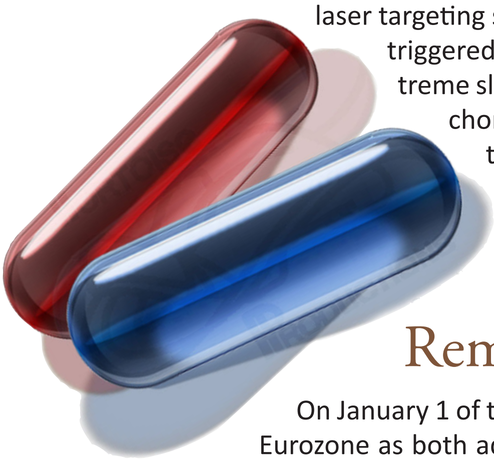
Andy and Larry Wachowski had grown up in Chicago. Both dropped out of college and started a house-painting and construction business before finding their way into the industry that was to make them famous and bring the world a ground-breaking movie that cost just $70 million to make but went on to gross $470 million worldwide.

Their film, The Matrix, was released this week in 1999

And remember, this was way back in the last century - when $470 million was REAL money. Had the Wachowski brothers decided to invest that $473 million in gold bullion, they would have been able to buy roughly 1,700,000 ounces (gold closed that day in London at $279.45/oz). Today, that gold would be worth $2,441,200,000.

The Matrix is a visually spectacular version of a story which has been retold time and time again: humans are merely inhabitants of a world that is ultimately controlled by machines. It is one part Alien, one part 2001: A Space Odyssey and a whole bunch of parts Alice In Wonderland.

The pioneering special effects included what became known as 'bullet-time'. This was a technique whereby cameras were arranged, behind a green or blue screen, on a track and aligned through a laser targeting system, forming a complex curve through space. The cameras were then triggered at extremely close intervals, so the action continued to unfold, in extreme slow-motion, while the viewpoint moved. Also, Yuen Wo Ping's beautifully choreographed fight scenes were performed with the aid of invisible wires that enabled the characters to fly through the air - adding to the suspension of disbelief.



If we travel a mere nine years forward in time from the release of The Matrix, we come to 2008.

Remember 2008?

On January 1 of that year, Cyprus and Malta became the latest wide-eyed ingenues of the Eurozone as both adopted the Euro as their national currency. Being part of that little club was quite the achievement back then as countries all around the fringe of Europe did whatever they needed to (including, as it turned out, accountancy fraud) in order to be afforded entry into the 'club'.

On January 21, seemingly without warning, stock markets around the world fell. The reason given by the talking heads was 'fears over sub-prime mortgages in the United States'. Subprime fears, however, were nothing new; they had been front page news throughout 2007. Way back in March of that year, the 13th, to be precise, Treasury Secretary Paulson was interviewed on CNBC and said:

> *"...(the fallout in subprime mortgages is) going to be painful to some lenders, but it is largely contained...We have had a significant housing correction in the U.S. The correction has been significant. You can't have a correction like that without causing some dislocation. It is too early to tell whether it has bottomed. We'll know more in the next month or two."*

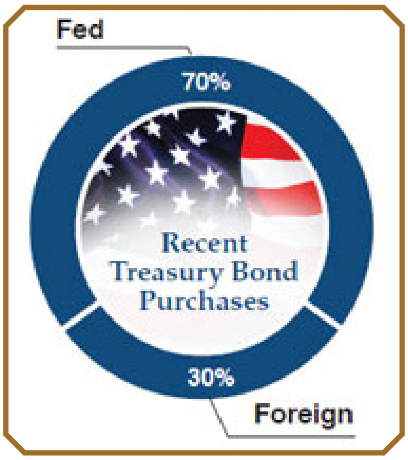
We knew more the next day.

On March 14th Bear Stearns collapsed and the first real domino of the financial crisis (at lest as far as public recognition of the situation was concerned) had toppled.

However, it wasn't until September, as Lehman Brothers tottered on the brink of insolvency, that a group of highly influential bankers and politicians decided to take the red pill.

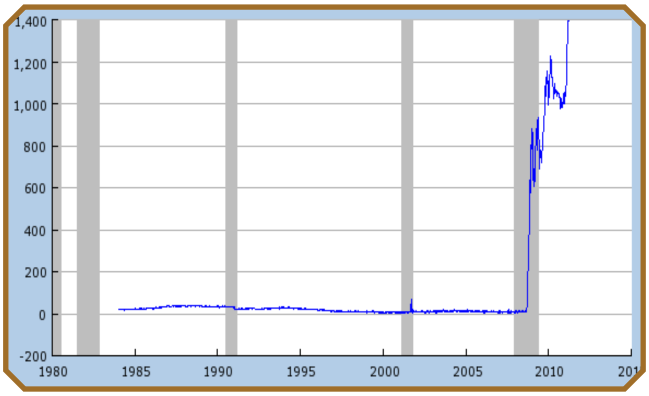
The failure of Lehman Brothers was the catalyst that plunged the world deep into The Matrix - an alternate reality in which, everywhere you looked, things were happening that a mere 24 hours earlier, would have seemed unthinkable.

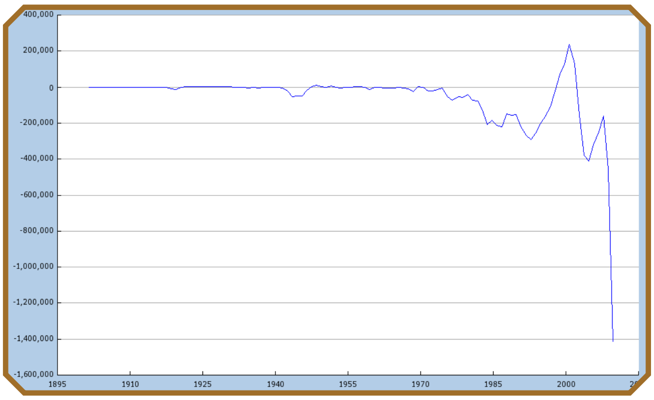
We all know about the TARP, we remember wild swings in markets, plummeting oil and commodity prices, frantic deleveraging and nervous Central Bankers and politicians telling us that everything was going to be OK. But as the days and months have ticked by, the reality inside our own Matrix has become more and more skewed.

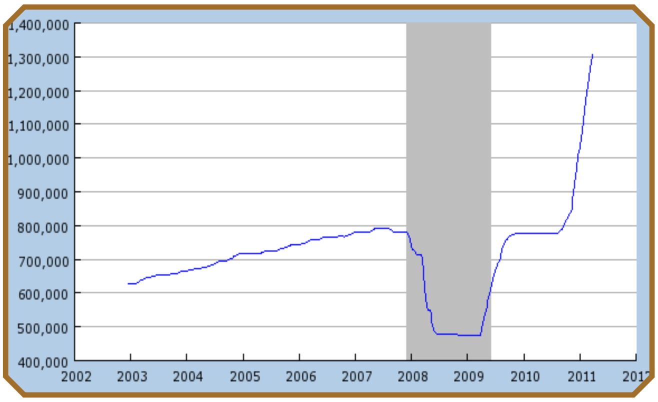


SOURCE: FEDERAL RESERVE/PIMCO

Markets recovered, an eerie calm was gradually restored and slowly things began to return to a semblance of normal. But what is normal in this new paradigm?







SOURCE: ST. LOUIS FED

Is it normal for the Fed to be buying 70% of all Treasuries (graphic, above)? Well it certainly wasn't until we took the red pill and entered The Matrix.

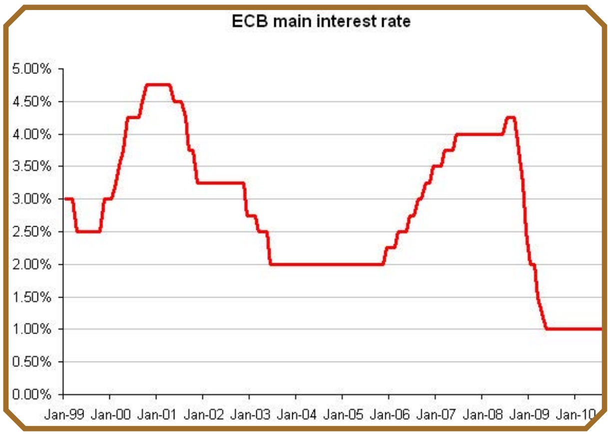
A cursory glance at the charts on the left of this page should also tell you that something is most definitely wrong:

What do they represent? Well, top-to-bottom they are Reserve Balances with the Federal Reserve, the US Federal Budget surplus (or deficit) going back over 100 years and the total amount of Treasuries in circulation.

I intentionally left these charts small and hid their legends to illustrate the point that it doesn't actually matter what they represent - one look at them is enough to tell anyone that things have become severely dislocated in recent years.

Recently, a huge amount of column space in the media has been devoted to the furious debate going on surrounding Quantitative Easing; specifically, whether the Fed will end QE2 in June and whether or not they will then move on to QE3 and beyond.

It surely must be clear to anybody that, regardless of the fact that the unemployment situation has stopped deteriorating quite so rapidly and has even begun to show signs of improvement in places ('green shoots' anyone?), regardless of the fact that corporate results have actually been, for the most part, quite good and the S&P is trading on decent multiples and regardless of the fact that 'core' inflation apparently isn't a problem - the real world inside The Matrix, the one many vested interests would rather we NOT focus on, is an altogether different story.



SOURCE: BBC/ECB

Let's start with Europe.

Jean Claude Trichet steps down as President of the ECB in October of this year and has gone on the record lately with some very hawkish comments about interest rates in the Eurozone. He is clearly committed to raising them at the ECB meeting next Thursday and has, in fact, left himself very little 'wiggle room'. If he DOESN'T raise rates he risks being made to look weak - not the legacy he has in mind.

But what happens if Trichet makes good in his thinly-veiled promises? The last time Trichet talked tough and raised rates into the teeth of a financial gale was 2008 when he hiked them to 4.25% to back up some more tough rhetoric. The ECB then held steady for a whole month before embarking on an historic rate-cutting spree that would see rates plummet to 1% within 9 months as the world fell apart.

Can the Eurozone stand on its own two feet without Central Bank support? Well, Germany's powerhouse economy is expanding strongly however, the worsening situation in Ireland and Portugal would seem to suggest that higher rates may not exactly be the medicine called for at this point in time.

If the contagion DOES spread to Spain (which many fear is a real possibility) and then potentially to Italy (though Italy's 12% savings rate will enable it to at least emulate Japan in funding its debt domestically for the foreseeable future) you can bet your bottom Euro that the ECB will waste no time in throwing renewed stimulus at the problem.

The US is hardly in better shape. Hawkish talk from several high-profile members of the Federal Reserve Board lately belies the fact that, even if the US WANTS to raise rates, there are a couple of little problems in the shape of unemployment and the housing market that will prevent them from doing so - certainly in any meaningful way and definitely for any extended period of time.

Yes, the economy is expanding; but slowly - hardly the sort of outcome you would want as reward for throwing $1 trillion dollars at it courtesy of the American Recovery and Investment Act of 2009. That number doesn't even take into account the $821 billion final bill for TARP. From the Washington Times:

> *Nearly a trillion dollars have been poured into the U.S. economy, courtesy of the American Recovery and Reinvestment Act of 2009. Result? Unemployment has barely budged, housing prices continue to fall in many markets and more mortgages slip into foreclosure.*
>
> *How can this be happening when so many people in government assure us that government spending spurs the economy? Because it's not true. For government to pour money into the economy, it must take money out of the economy in the first place. To hand out money, government must first take money from taxpayers.*
>
> *It's like moving money from the left pocket to the right pocket. It doesn't make us any wealthier.*

What it really stimulates is more government, not more economic activity.

The Wall Street Journal published an amazing article this week entitled '**WE'VE BECOME A NATION OF TAKERS, NOT MAKERS**' in which we discover the following:

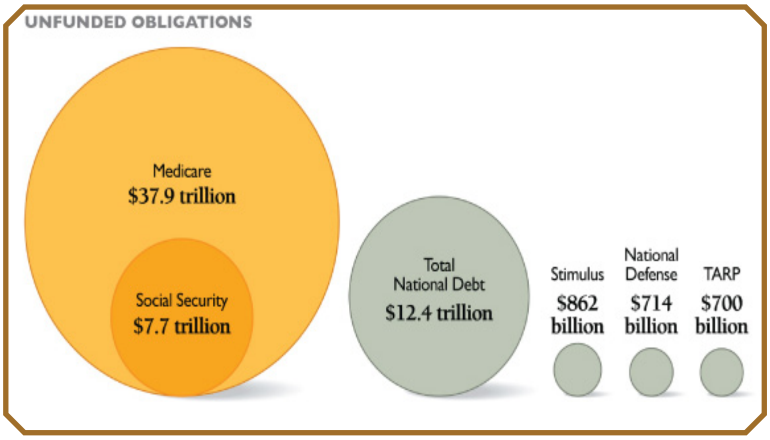
If you want to understand better why so many states—from New York to Wisconsin to California—are teetering on the brink of bankruptcy, consider this depressing statistic: Today in America there are nearly twice as many people working for the government (22.5 million) than in all of manufacturing (11.5 million). This is an almost exact reversal of the situation in 1960, when there were 15 million workers in manufacturing and 8.7 million collecting a paycheck from the government.

It gets worse. More Americans work for the government than work in construction, farming, fishing, forestry, manufacturing, mining and utilities combined. We have moved decisively from a nation of makers to a nation of takers. Nearly half of the $2.2 trillion cost of state and local governments is the $1 trillion-a-year tab for pay and benefits of state and local employees. Is it any wonder that so many states and cities cannot pay their bills?

Does THAT sound like an economy that can stand higher rates?

The government is cornered.

Inflation is soaring (and don't think for a second that even THEY believe the 'core' argument) and the population is stirring. Many states are de facto bankrupt, they can't increase taxes on either a national or even a local level to bridge the gap between income and expenditures, the banking sector is riddled with mortgage debt that everybody knows would render many institutions insolvent if it were marked to market, consumer spending and confidence are both declining materially and then there is the problem of unfunded liabilities.



CLICK TO ENLARGE

SOURCE: US DEPT. TREASURY/CBO/ USGAO

The debt that underpins the problems facing not just the United States, but most of the world today, while larger than could be considered 'normal', is just like every other debt in the world in that there are a couple of ways to deal with it; pay it back, or default on it.

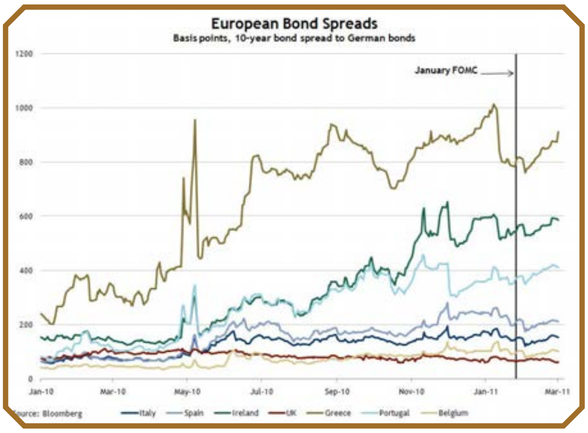
As Bill Gross writes in 'Skunked' (PAGE 15) something has to be done about the situation and that means facing a stark choice:

"...the only way out of the dilemma, absent very large entitlement cuts, is to default in one (or a combination) of four ways: 1) outright via contractual abrogation -- surely unthinkable, 2) surreptitiously via accelerating and unexpectedly higher inflation -- likely but not significant in its impact, 3) deceptively via a declining dollar -- currently taking place right in front of our noses, and 4) stealthily via policy rates and Treasury yields far below historical levels -- paying savers less on their money and hoping they won't complain.

...Unless entitlements are substantially reformed, I am confident that this country will default on its debt; not in conventional ways, but by picking the pocket of savers via a combination of less observable, yet historically verifiable policies -- inflation, currency devaluation and low to negative real interest rates."

For a long time now, ‘tough talk’ has been the leading policy tool of both governments and Central Banks alike. They could jawbone markets, currencies, commodities and even the surprisingly docile vigilantes of the bond markets pretty much any way they wanted to, but lately the reaction to ‘talk’ has been anything but what those doing the talking were looking for.

By cornering 70% of the Treasury market, the government has succeeded in rigging the curve, but the cracks are showing. Equity markets around the world continue to float higher on a sea of liquidity but real returns are hardly making anybody rich. Direct stimulus has saved the banking sector from obliteration but everybody knows where the demons hide - they just choose to ignore them while they remain in the shadows.



Over in Europe, it’s hardly a secret that there are several countries vying over which one of them will be the first to fall, but everybody carries on as though it doesn’t matter.

Sure, rates have crept higher, but does that mean when the first of the PIIGS to fall is finally revealed, there will be no contagion? Of course not. If Portugal or Ireland default we will see rates spike across Europe and, let’s face it, nobody is betting the farm on both of them coming through this unscathed.

There is a palpable sense that fingers are hovering over ‘SELL’ keys all around the world waiting to see who blinks first but as long as things hold together and keep going in the right direction, nobody wants to rock the boat. It’s the ultimate inside joke.

The Matrix ends with Neo (played by Keanu Reeves) telling those imprisoned inside The Matrix that he will return and prove to them that anything is possible.

Here, in 2011, anything is still possible, but it’s time we started focussing on the probable.

Today’s edition of Things That Make You Go Hmmm..... includes a look at the turmoil in the Spanish banking sector as the Cajas flex their muscles to block new regulation, a trip to Australia to see a grass roots campaign aimed at reducing house prices in one of the most overpriced markets in the world, a terrifying story from the streets of Jakarta and an investigation into China’s high speed rail network.

Andy Xie is rethinking his views on nuclear power, the SEC mulls over having a quiet word with David Sokol in the wake of this week’s revelations, Boeing’s Dreamliner becomes a nightmare and Dan Norcini explains why apparent ‘confusion’ amongst Federal Reserve Board governors may be just that - ‘apparent’.

In the US, 57% of the population would embrace austerity if it came about because of a government shutdown, Bill Gross is ‘Skunked’, Bill Bonner points out the REAL victims of monetary largesse and the Fed finally open their books to show the world who borrowed what in the dark days of 2008. Unsurprisingly there are a few surprises contained in their pages.

Our charts take an in-depth look at Friday’s NFP number, the effect of quality on a home’s value and a fascinating look at bilateral trade between China and Africa.

Rick Santelli, Rob Arnott and Jim Cramer round things out.

What are you waiting for?

Contents

02 April 2011

Three Spanish savings banks rejected a plan to merge into the nation's third-largest caja, forcing Caja de Ahorros del Mediterraneo (CAM) to seek a state bailout.

Cajastur, Caja de Extremadura and Caja Cantabria voted against combining their businesses with CAM in a new entity known as Banco Base. CAM said it would seek support from the state rescue fund, which operates by taking ordinary shares with voting rights, meaning at least partial nationalization of any lender that seeks help.

The decision, two days after a Bank of Spain deadline for lenders to submit capital-raising plans, may complicate government efforts to rebuild confidence in Spain's financial system by shepherding savings banks into mergers and strengthening their capital. CAM and Cajastur agreed last May with lenders in the regions of Cantabria and Extremadura to explore a merger that would create a bank with 124 billion euros ($175 billion) of assets.

"This shows that this is anything but a clean process," said Cesar Molinas, an independent consultant and former head of European fixed-income strategy at Merrill Lynch & Co., in an interview, "The longer it takes the higher the cost is going to be because the balance sheets can deteriorate by the day."

Banco Base, which sought 1.49 billion euros from the state fund last year, had planned to seek an additional 2.78 billion euros from the rescue pool. That's almost double the amount the Bank of Spain said the lender would have to raise to meet minimum capital requirements. Banco Base was one of a dozen Spanish lenders that need a combined 15.2 billion euros in capital, the regulator said on March 10.

Cajastur is now free from the terms of the merger contract it signed last July because "the necessary condition" to set it in motion wasn't reached, the bank said. CAM said it "deeply regrets the decision taken by its partners" and will press ahead with the Banco Base project.

Lenders that need to raise capital must have their recapitalization plans approved by April 28, the Bank of Spain said in a statement yesterday, as it called on the Banco Base cajas to present their new strategies "immediately."

★ ★ ★ *BLOOMBERG* / **LINK**

A majority of voters are fine with a partial shutdown of the federal government if that's what it takes to get deeper cuts in federal government spending.

A new Rasmussen Reports national telephone survey finds that 57% of Likely U.S. Voters think making deeper spending cuts in the federal budget for 2011 is more important than avoiding a partial government shutdown. Thirty-one percent (31%) disagree and say avoiding a shutdown is more important. Twelve percent (12%) are not sure.

Republicans want to make more spending cuts in the current budget than Democrats do, but 36% of voters think it would be better to avoid a government shutdown by authorizing spending at a level most Democrats will agree to. Fifty-seven percent (57%) would rather have a shutdown until Democrats and Republicans can agree on deeper spending cuts.

This shows little change from late February when 58% of voters said it was better to have a partial government shutdown than to keep spending at current levels.

Since then, congressional Democrats have agreed to spending cuts but now are accusing Republicans of being held hostage by the budget-cutting demands of Tea Party voters. The legislators have avoided a shutdown by passing a series of stopgap budget bills, but several conservative Republicans now say they will not support any more of these measures. In the event of a shutdown, payments for things like Social Security, Medicare and unemployment benefits would continue.

Still, a plurality (44%) of voters thinks a partial shutdown of the federal government would be bad for the economy, down four points from February. Twenty-three percent (23%) say a shutdown would be good for the economy, while a similar number (22%) say it would have no impact, a seven-point increase from the previous survey.

★ ★ ★ *RASMUSSEN* / **LINK**

A tiny land tax lobby group has sparked a storm by suggesting first home buyers go on strike to force property prices lower.

Prosper Australia is an organisation devoted to promoting the ideas of 19th-century political economist Henry George, who suggested that income and company tax should be replaced by land tax.

"The housing market has spiralled off into ridiculous pricing that nobody can possibly afford, and it gets to the point where if nobody can afford it the prices must change,"

It launched its call for an Australian first home buyer strike on March 15 - since then the idea has gone on to become the number one suggestion on GetUp's campaign ideas forum with 5,644 votes, followed by another housing-related campaign idea to abolish negative gearing.

The online interest has translated into coverage in major daily newspapers and breakfast television, but Prosper Australia spokesman David Collyer says thousands of Australians were already boycotting home purchases before the campaign launched.

"The aim of the campaign is to make first home buyers who are locked out of the market aware that they're not alone, and that their private economic decisions are actually being made by all of their peers at the same time," he told ABC News Online.

Mr Collyer says two average incomes, even with significant savings for a deposit, are no longer enough to secure many prospective home buyers a property, even on the urban fringe.

"The housing market has spiralled off into ridiculous pricing that nobody can possibly afford, and it gets to the point where if nobody can afford it the prices must change," he added.

Mr Collyer says first home buyers have been duped into entering the bottom rung of a nationwide property ponzi scheme.

"The first home buyers are the greater fools of the real estate market - that is, the entire edifice of land prices in particular depends upon this constant influx of new first home buyers naively entering into outer suburbs, into lower-priced housing to boost the price of everybody else's housing up the chain," he explained.

"Now, when you remove that first stage of real estate pricing, the whole edifice collapses - it's the end of the game."

★ ★ *ABC NEWS (AUSTRALIA)* / **LINK**

US authorities are reportedly considering an investigation into the purchase of shares by one of Warren Buffett's top lieutenants in a company that weeks later he advised the billionaire investor to buy.

The Securities and Exchange Commission is contemplating examining purchases that Dave Sokol made in shares of chemicals maker Lubrizol in January, according to the New York Times. A spokesman for the SEC declined to comment.

Mr Sokol, widely seen as the top candidate to succeed Mr Buffett as the head of Berkshire Hathaway, resigned on Monday as Mr Buffett revealed the sequence of share dealings in Lubrizol. Mr Sokol said his exit was not prompted by his share dealing as both he and Mr Buffett insisted he had done nothing unlawful.

Mr Sokol's surprise exit is a major blow to Mr Buffett and has reignited speculation over who will succeed the 80-year old at Berkshire's helm. Legal experts said the SEC's decision on opening an investigation is likely to depend on whether Mr Sokol's purchases of Lubrizol shares were based on non-public information.

"I don't believe I did anything wrong,"

In a statement released on Wednesday, Mr Buffett said Mr Sokol had acquired shares in Lubrizol in December and early January. Later that month he suggested Mr Buffett acquire the business, but mentioned to Mr Buffett he owned shares in the potential target.

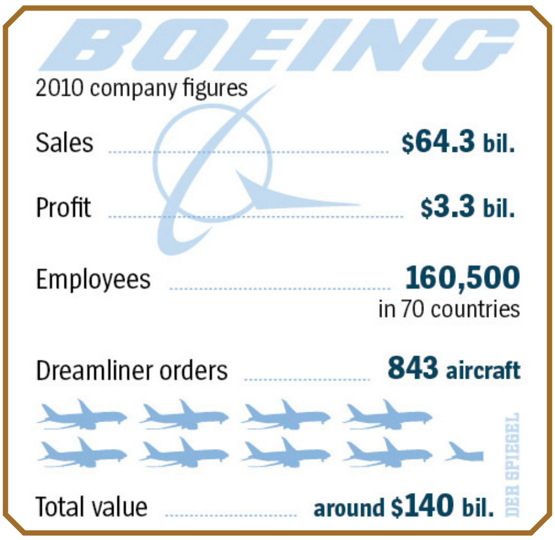
In total, Mr Sokol bought nearly $10m (£6.2m) of shares in Lubrizol prior to its acquisition by Berkshire. The move by Berkshire for Lubrizol increased the value of Mr Sokol's stake in the company by about $3m.

"I don't believe I did anything wrong," Mr Sokol said in a television interview on Friday. "I can understand the appearance issue, and that's why we made it public."

★ ★ ★ *UK DAILY TELEGRAPH* / **LINK**

Boeing wanted to revolutionize the airplane business with its Dreamliner, which was to be built using a modular approach. But the US company went too far in its outsourcing, and the aircraft has been plagued by production problems. Delivery is now way behind schedule and the delays could cost the firm billions.

Eight years ago, managers at the American airplane manufacturer Boeing had a brainstorm. Their idea: Build airplanes the same way the automobile industry manufactures cars, with contractors producing entire components that are then assembled in a final step. That dream resulted in Boeing's new long-range 787, the first model to be built using this modular principle. And perhaps it was that approach that inspired the plane's name: Dreamliner.



CLICK TO ENLARGE

SOURCE: DER SPIEGEL

A visit to Boeing's factory in Everett, Washington, north of Seattle, shows what's become of that heady vision. Here, gleaming airplane bodies stand nose to tail on a long factory work floor, as if on an assembly line. Most of them have already received the final coat of paint, adorned with logos for airlines such as Air India and Japan Airlines.

So far, though, not one of the planes, which cost up to $185 million (€131 million) each, has been delivered to buyers. They haven't even received official authorization, due to problems with the software and electronics. Instead, the finished jets are taking up space in the area behind the building and on a nearby airfield.

There are already around two dozen planes waiting here, with more set to join them in the coming weeks and months. Boeing also plans to move part of the fleet to Texas for retrofitting. This spectacular airplane stockpile in Washington could one day go down in aviation history -- as a monument to the hubris of Boeing managers and a warning for future generations.

Hardly any other project, with the exception of Airbus' A380 wide-body jet, has fueled the imaginations of aviation experts and fans around the world as strongly as Boeing's hypermodern showcase jet.

When the project officially began in 2003, it looked as if a new era in civilian aviation was about to dawn. Boeing managers promised their passengers more room, better cabin air quality and larger windows made of "smart glass" which could be adjusted to let in different amounts of light. It was all to be made possible by the increased use of a novel composite material called carbon fiber reinforced plastic (CFRP), instead of the traditional aluminum. The efficient new jet was also supposed to consume 20 percent less fuel and be easier to maintain.

★ ★ ★ *DER SPIEGEL* / **LINK**

Three Citibank debt collectors allegedly killed Irzen Octa, 50, secretary general of the National Unity Party (PPB), on Tuesday after he protested an increased credit card bill, the police said on Thursday.

"The motive of the murder is due to debt [issues], a credit card bill that didn't fit [the formerly-given figure]," South Jakarta Police chief detective Adj. Sr. Comr. Budi Irawan said on Thursday.

Budi said the victim objected to his Citibank credit card bill, which had grown to Rp 100 million (US$11,500) from the Rp 48 million of which Irzen had been expecting.

Irzen only learned of the "unfitting" bill as he was about to pay it at the Citibank office branch at Jamsostek Tower in South Jakarta on Tuesday, the police said.

"We've found evidence at the crime scene in form of blood traces on the curtains and on the walls of the room on the fifth floor," he added.

Budi said Citibank debt collectors A., H. and D., now named suspects, attacked Irzen because they were angered by his protest.

Forensic results show broken blood vessels in the victim's brain.

Citibank has not made any statements regarding the case.

★ ★ ★ *THE JAKARTA POST* / **LINK**

At the height of the financial crisis, the Federal Reserve allowed the world's largest banks to turn more than $118 billion in junk bonds, defaulted debt, securities of unknown ratings and stocks into cash.

Collateral of those asset types made up 72 percent of the total $164.3 billion in market-rate securities pledged to the Fed on Sept. 29, 2008, two weeks after the bankruptcy of Lehman Brothers Holdings Inc., according to documents released yesterday. The collateral backed $155.7 billion in loans on the largest day of borrowing from the Primary Dealer Credit Facility, which was created in March 2008 to provide loans to brokers as Bear Stearns Cos. collapsed.

"The fact that the Fed was willing to accept that collateral was indicative that collateral was very hard to come by at the time," said Craig Pirrong, a finance professor at the University of Houston. It also highlights "the seriousness with which the Fed viewed the situation," he said.

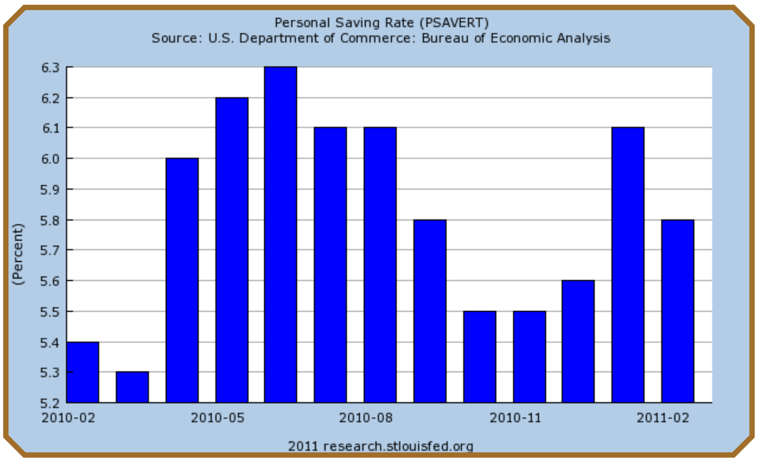
Fed spokesman David Skidmore declined to comment yesterday. No public money was lost in the Fed's emergency lending programs, Chairman Ben S. Bernanke testified to the Senate Banking Committee in July, 2010. The loans didn't represent permanent cash given to the dealers and had to be repaid the next day.

The Fed loans on Sept. 29, 2008, represented a 5.49 percent "collateral cushion," the amount by which the pledged assets exceeded the loan value, according to the Fed data. Equities comprised $71.7 billion, or 43.6 percent of the total. High- yield debt, including the defaulted issues, accounted for $18.4 billion, or 11.2 percent. Collateral of unknown rating was $28 billion, or 17 percent.

★ ★ ★ *BLOOMBERG* / **LINK**

The more we read about recent US consumption activity, the less we seem to understand exactly what's happening.

But that won't stop us from trying. Get comfortable, folks — this will take a while.



CLICK TO ENLARGE **SOURCE: ST LOUIS FED**

Certainly the discouraging news on consumer sentiment was coming in spades through the middle of this week. Last Friday's UMich consumer sentiment index hit a five-month low, Tuesday's Conference Board survey was equally bad, and a Gallup tracking poll reported a big weekly decline in self-reported spending. (We're including the Gallup poll as a sentiment measure because of its imprecision.)

On Thursday came a new report, this one from RBC, telling a different story — the consumer outlook for April is better than it was for March.

Not helping the confusion has been the variability from month to month of each indicator. Both the UMich and Conference Board numbers each hit three-year highs just in February. The Gallup poll showed consumption behaving erratically since the start of the year, and the RBC report was a reversal of three straight monthly declines.

There is, however, one thing that's been consistent across these reports, which is that consumers increasingly expect higher inflation this year. No surprise there.

Forget sentiment: understanding actual consumption trends hasn't been much easier.

Monday's personal income and outlays report for February was mostly interpreted through the lens of rising oil and food prices, with the savings rate declining as Americans spent more on the basics while their spending on everything else was stagnant. Makes sense, but that's not the whole story.

Incomes climbed 0.3 per cent in the month, following a big 1 per cent increase in January, mostly a one-time boost from the December tax cut compromise.

Overall spending (before adjusting for inflation) in February climbed by an impressive 0.7 per cent, much better than the 0.2 per cent increase in January, which was the lowest increase since last summer. But when stripping out food and energy costs, that February number was itself a less impressive (though still positive) 0.2 per cent.

Adjusting for inflation, overall spending in February climbed 0.3 per cent in after staying flat (revised) in January. Not good, and certainly a steep decline on the trend in the fourth quarter.

But it wasn't all bad news. Spending in February increased across nearly all items. And inflation-adjusted spending on everything save food and energy increased 0.4 per cent.

FT / **LINK**

The Dow went up more than 70 points yesterday. The higher it goes, the more dangerous it becomes.

What's the matter with this downturn? Shouldn't it lower stock prices? Shouldn't it empty tables at fancy restaurants? Shouldn't it close down some of these luxury shops and make it easy to upgrade to business class?

Nah... The Great Correction is a failure. At least so far. It's correcting only the people at the bottom.

Last week, we went shopping for a birthday present. We went around Bethesda, to Bloomingdales... to Saks...even to Tiffany's. In one shoe store there were five middle-aged clerks, ready to help us. How could there be enough profit in a pair of shoes to support so many clerks? Then we found out...when Elizabeth bought a pair. Leaving the store, she picked up the wrong bag... The clerk called her. He offered to meet her to exchange bags. "Just look for me. I'll be in my black Mercedes," he said.

What? How can shoe clerks afford Mercedes?

...The Great Correction is a failure. At least so far. It's correcting only the people at the bottom.

Then, we went to Tiffany's, where there were so many Asian customers, the clerks barely gave us the time of day.

Everywhere we went we found shockingly high prices – and people paying them.

Here in LA too...the numbers show typical families are poorer – thanks largely to falling house prices. But there are still many people at the top...with expensive cars... expensive habits...and the money to keep at it. And despite all the talk of downsizing chic – we don't see much evidence of it.

At the upper income levels, there doesn't seem to be much correction happening. And why should there be? The feds give them money.

Stocks have recovered most of their losses. Bonds – which should be worthless by now – still trade hands at par. Corporate profits are at record levels.

Where's all this money coming from? You guessed it, the feds.

BILL BONNER / **LINK**

Nearly 300 spacious train stations replete with marble and amenities have opened across China in recent years to complement a fleet of white "Harmony" bullet trains that whisk passengers between cities at jaw-dropping speeds.

Indeed, the nation's modern network of high-speed rail lines, grand stations and sleek trains has forever changed the world's impression of China's once-backward railroads.

More track for high-speed railways was laid in China over the past decade than all new rail installed in western countries combined over the past half-century. What's more, China's railway companies now export technology and heavy manufacturing capacity to other countries.

All this fast-track growth has cheered supporters of high-speed rail in China, who call the bullet trains more comfortable and a lot faster than the rusting coaches that typically crisscross the country. They also claim heavy investment for the network will eventually pay off through economic expansion in areas newly served by fast trains.

Opponents of the ongoing project, however, say high-speed trains serve only the rich. They call the build-up wrong for China's strategic positioning, citing serious market, debt and financial risks. They also point to technical dangers and safety issues that run against the grain of China's push for "scientific development."

...The ongoing investigation may shed light on the scope of the alleged financial malfeasance.

A subdued debate over the pros and cons of high-speed expansion bubbled beneath the surface of Beijing policymaking for years even while the railway revolution roared forward. Nothing slowed the nationwide initiative led by the central government's Ministry of Railways and its then-chief, Liu Zhijun, also known as China's Father of High-speed Rail.

Yet suddenly, following an announcement by authorities in February, allegations of financial corruption and all-too-cozy relations with railroad construction contractors blacklisted Liu and led to his demise. He's been detained by Communist Party investigators, removed from office and replaced. Some of his associates are in trouble as well.

A source close to the ministry said inspectors started carefully combing through the railway system's investment records shortly after Liu's dismissal. The ongoing investigation may shed light on the scope of the alleged financial malfeasance.

Meanwhile, the Liu case has raised questions about the quality, safety and sensibleness of high-speed railroads, bullet trains and related equipment. Separate concerns swirl around the future of traditional train lines, many of which offer slow but inexpensive travel, some of which have already been forced out by high-speed lines.

★ ★ ★ *CAIXIN* / **LINK**

Remarks from analysts this morning about Federal Reserve Bank of New York President William Dudley's dovish comments on the state of the US economy mostly miss the mark in my view.

Dudley's words stood out in stark contrast to those by other Fed officials last week and this week who have been sounding a hawkish tone and chattering about ending QE. To paraphrase some of his comments: The US economic recovery is 'still tenuous' and 'far from the mark' of the Central Bank's goals of full employment and price stability, according to a report carried by Bloomberg this AM.

Dudley remarked that we must not be overly optimistic about the growth outlook".

Almost as if on cue, the bond market sharply reversed course after selling off this morning on the payrolls number. The Dollar simultaneously began slipping off its session highs.

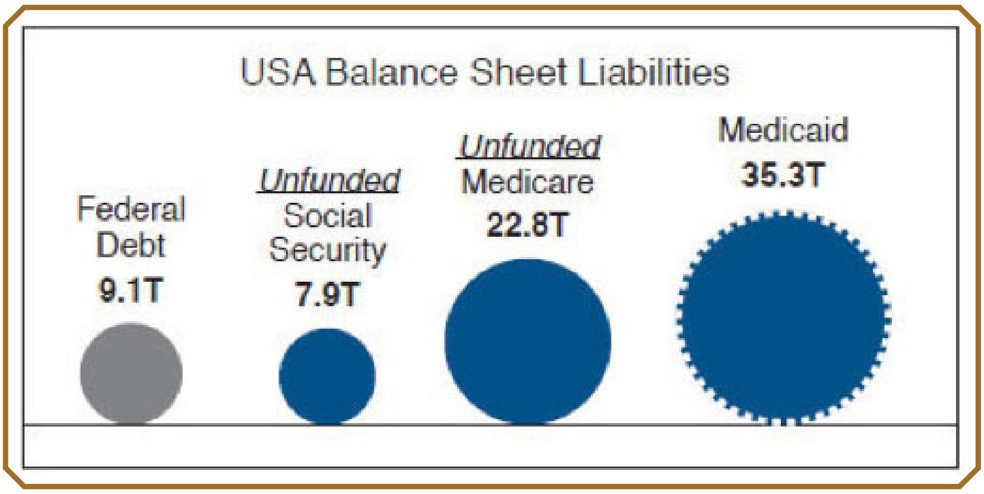
Analysts were quick to chime in stating that the comments reflect the confusion and lack of consensus within the Fed. I do not think so to be perfectly honest for the reason that I have stated previously here at this site.

If the Fed starts sounding hawkish in an attempt to keep the Dollar from collapsing through a major chart support level near 75 on the USDX, they cannot prevent the long bond from breaking down technically and thus commence a rise in long term interest rates which will bury what might be any signs of life in the comatose housing market.

If they sound too dovish then the Dollar will come under renewed selling pressure potentially setting up a serious move lower in the greenback as it remains sitting perilously just above technical price chart support.

The Fed is attempting to keep both the Dollar from collapsing lower (they do want a sustained and gradual move lower - not a crash) and the long bond from collapsing. This is the reason for the conflicting signals being put out.

★ ★ ★ *DAN NORCINI* / **LINK**



SOURCE: **BILL GROSS/MARY MEEKER**

The above four multi-trillion-dollar liability balls are staggering in their implications. Remember first of all that the nearly $65 trillion of entitlement liabilities shown above are not some estimate of future spending. They are the discounted net present value of current spending should it continue at the projected demographic rate (importantly – it is much higher than the annual CPI + 1% used as a discounter because demand for healthcare rises much faster than inflation.) And while some Honorable Congressional Le Pews would counter that Medicaid is appropriated annually and therefore requires no discounted reserve, those words would surely count as "sweet nothings," believable only to those whom they romance every several years at the polls. The incredible reality is that the $9.1 trillion federal debt that constitutes the next-to-tiniest ball in our chart is nothing compared to unfunded Medicaid and Medicare. It is like comparing Pluto to Saturn and Jupiter. The former (the $9.1 trillion current Treasury debt) does not even merit planetary status in our solar system of discounted future liabilities. It's really just a large asteroid.

Look at it another way and our dire situation becomes equally revealing. Suppose that the $65 trillion of entitlement liabilities were fully funded in a "lockbox," much like Social Security is falsely imagined to be. Just suppose. And say the cost of that funding (Treasury debt) was the same CPI + 1% that was used to produce the above discounted present value in the first place. Actually, that's not a bad guesstimate for the average yield of all Treasury debt. If so, then the interest expense on the $75 trillion total debt would equal $2.6 trillion, quite close to the current level of entitlement spending for Social Security, Medicare and Medicaid. What do we pay now in interest? About $250 billion. Our annual "lockbox" tab would rise by $2.35 trillion and our deficit would be close to 15% of GDP! The simple conclusion would be this: Unless you want to drastically reduce entitlement spending or heaven forbid raise taxes, then Pepé, you've got a stinker of a problem.

Previous Congresses (and Administrations) have relied on the assumption that we can grow our way out of this onerous debt burden. Perhaps we could, if it was only $9.1 trillion, as shown in Chart 2. That would be 65% of GDP and well within reasonable ranges for sovereign debt burdens. But that is not the reality. As others, such as Pete Peterson of the Blackstone Group and Mary Meeker, have shown much better and for far longer than I, the true but unrecorded debt of the U.S. Treasury is not $9.1 trillion or even $11-12 trillion when Agency and Student Loan liabilities are thrown in, but $65 trillion more! This country appears to have an off-balance-sheet, unrecorded debt burden of close to 500% of GDP! We are out-Greeking the Greeks, dear reader.

★ ★ ★ *BILL GROSS* / **LINK**

Japan's 9.0 earthquake will increase global inflationary pressure through means such as the Bank of Japan's monetary expansion policy, disruptions for automobile and electronics industrial supply chains, and rising demand for fossil fuels.

Meanwhile, the Japanese yen is likely to depreciate substantially this year, pressuring other Asian currencies. And the catastrophe has exposed Japan's incompetent leadership as well as forced the world, including China, to dramatically change course on nuclear power development.

> ...It is virtually impossible to eliminate human error from nuclear power plant operations.

In the long run, the disaster and its aftermath discredit the nuclear power industry. No matter how well a nuclear power plant is designed, risks of an unanticipated event or human error always remain significant. When a nuclear power plant breaks, the consequences can be catastrophic and long-lasting.

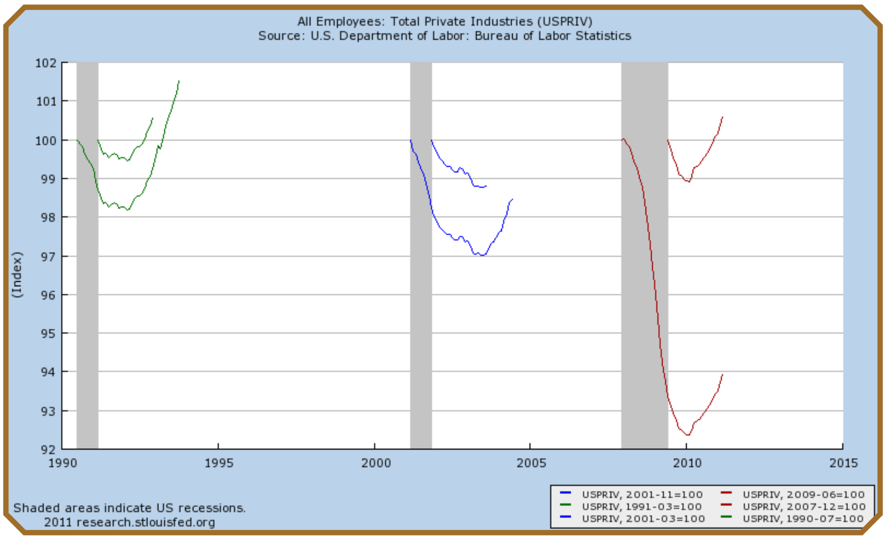
I had always been a big nuclear energy supporter. I argued in its favor on environmental grounds and for reasons of economic efficiency. Earth may not be able to sustain the pressure if developing countries, which now account for 80 percent of the global population, consume as much fossil fuel as developed countries while they undergo economic development. I saw nuclear power as a lesser evil and, hence, worth trying.

The Fukushima Daiichi Nuclear Power Plant incident changed my mind. It reminds us that human error could bring the world to an end sooner than global warming. It is virtually impossible to eliminate human error from nuclear power plant operations.

Fukushima reminds us all that overconfidence in man's ability to control nuclear power is folly. At a moment like this, we see that it would be better to give up 10 times the benefits of this plant's 40 years of power than face this catastrophe.

In the wake of the crisis, China has suspended expansion of its nuclear power industry. This was the right thing to do. Despite reassurances we've heard from many government officials, China should suspend the country's nuclear power expansion plan indefinitely and shut down existing plants located near population centers as soon as possible.

★ ★ ★ *ANDY XIE* / **LINK**



CLICK TO ENLARGE **SOURCE:** **FEDERAL RESERVE**

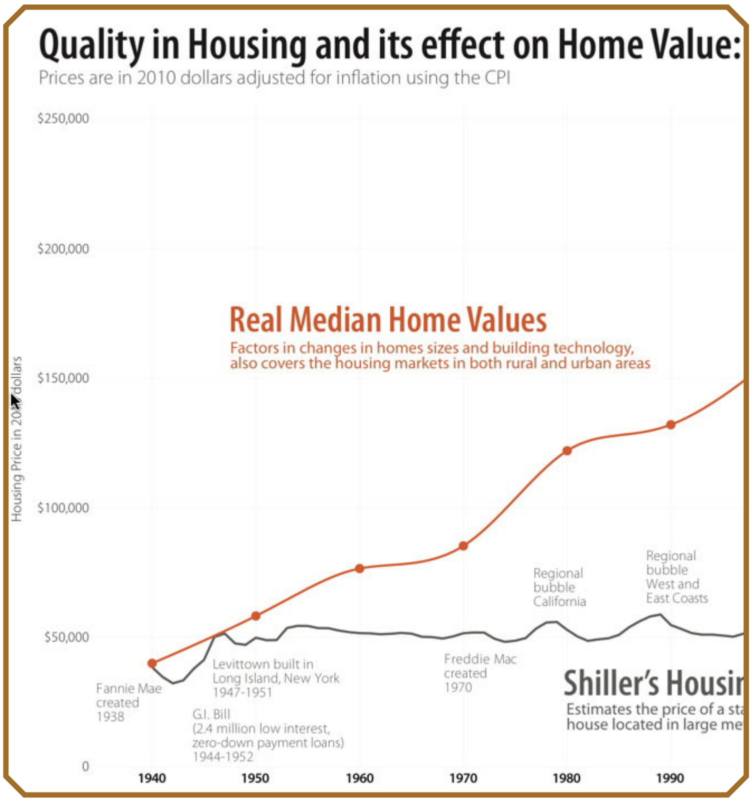
Want a decidedly different way to think about the post recession employment situation? Try indexing the jobs recovery to the beginning and end of Recessions (see chart below).

That relative perspective informs you as to what the last business cycle recession we saw way back in 1990. Whenever economists talk about Post WW2 recession/recoveries, what they mean is "a cycle like 1990." Note that we haven't had an ordinary recession/recovery cycle like 1990 in the 21 years since (perhaps this helps to explain why economists as a group have stunk the joint up).

The 2001 contraction was a post-market bubble/crash recession. The booming economy and technological gains drove things for a decade until they went full on bubble. That ultra-low rate driven recovery took 47 months — an unusually long time — for jobs to come back.

The 2007-09 contraction was a credit crisis driven recession. Its depth and breadth make it different than ordinary cyclical recessions. It was caused in part by the Fed action following the 2001 recession.

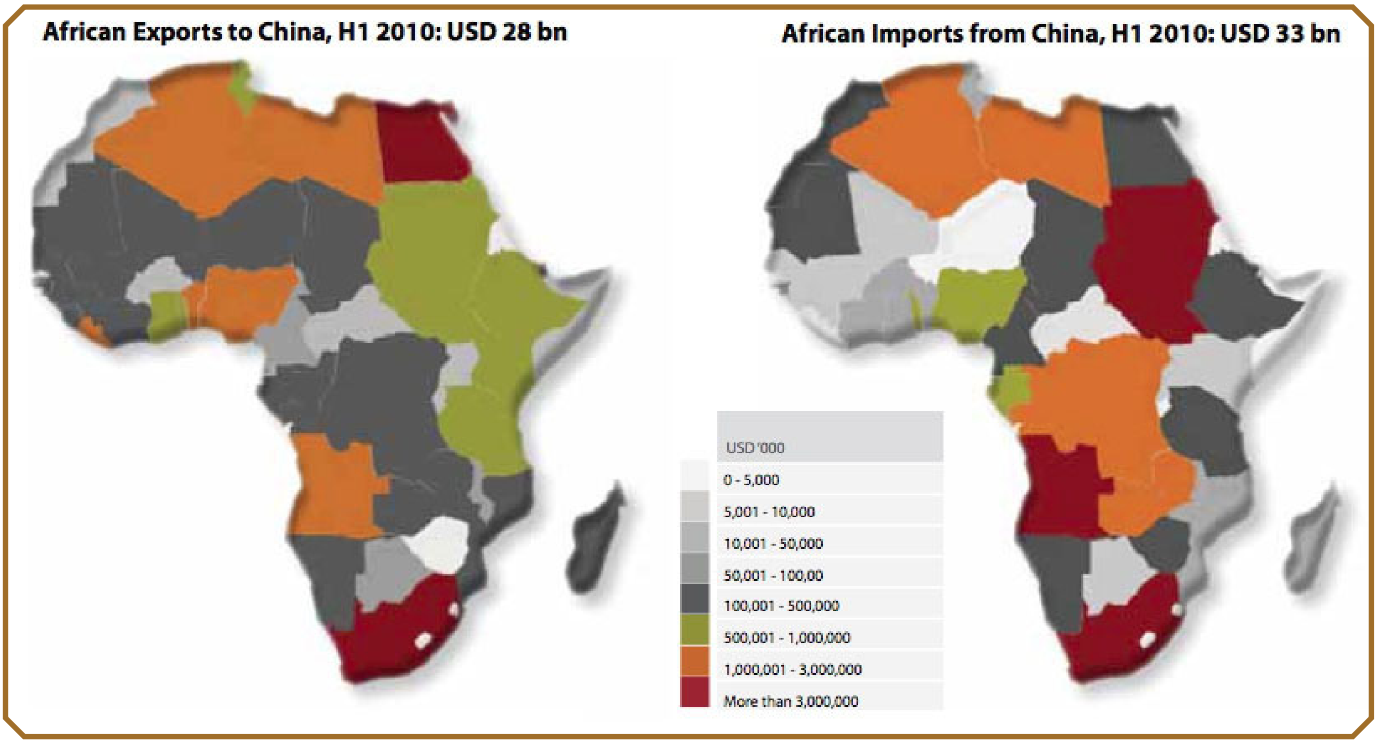
★ ★ ★ *BARRY RITHOLTZ* / **LINK**



CLICK TO ENLARGE **SOURCE:** **VISUALIZING ECONOMICS**

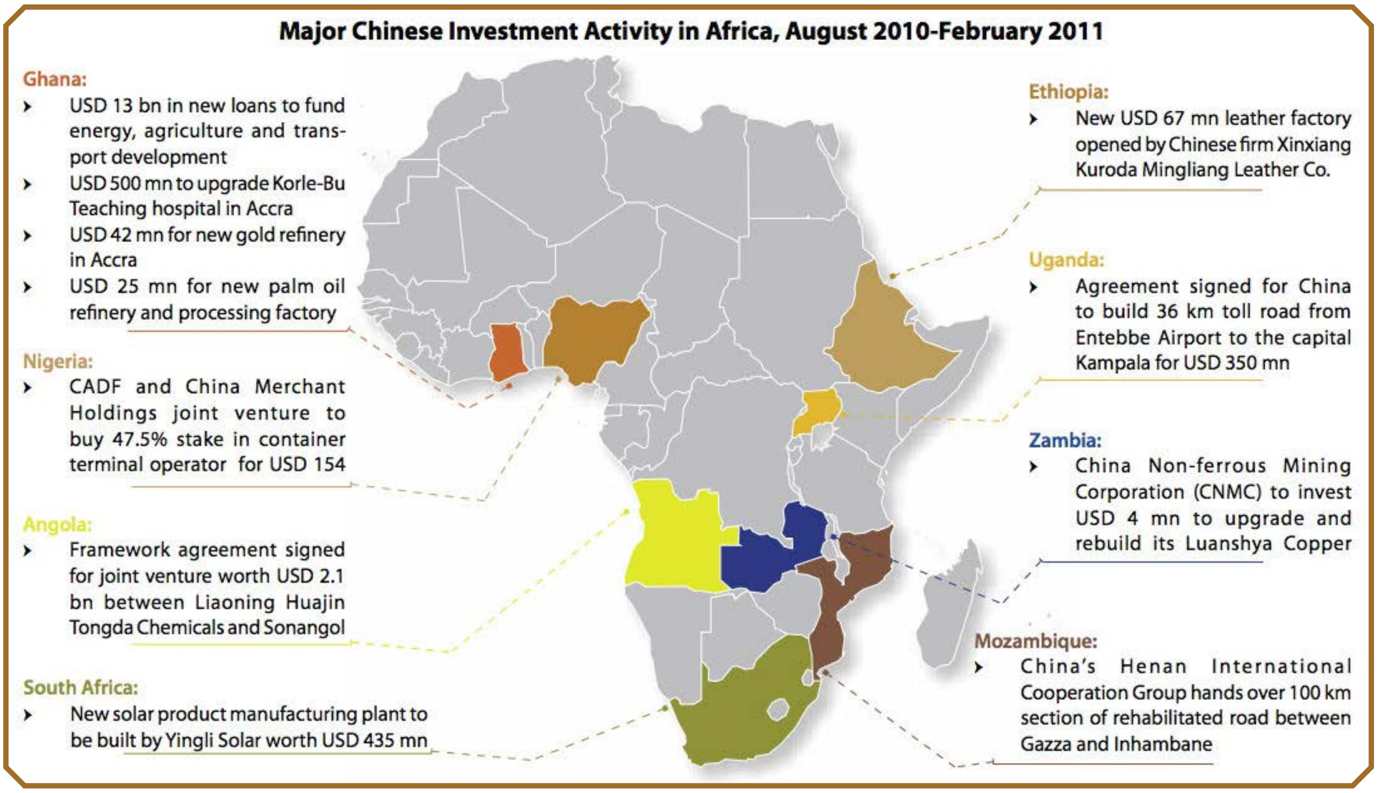
Our homes have changed over the last 70 years, including homes size, building technology, family size, and a rise in standard of living. As people's income increased over the 20th century they bought bigger and better homes. This caused the median home value to go up even when taking into account the effect of inflation. For example a full bath cost a lot since you need double plumbing for hot and cold water while a flush toilet needs a home connected to a sewer system or septic tank. In addition, housing costs include both land and the house; where building space in limited (i.e. cities) land will increase in value with population growth.

★ ★ ★ *VISUALIZING ECONOMICS* / **LINK**



SOURCE: THE CHINA ANALYST

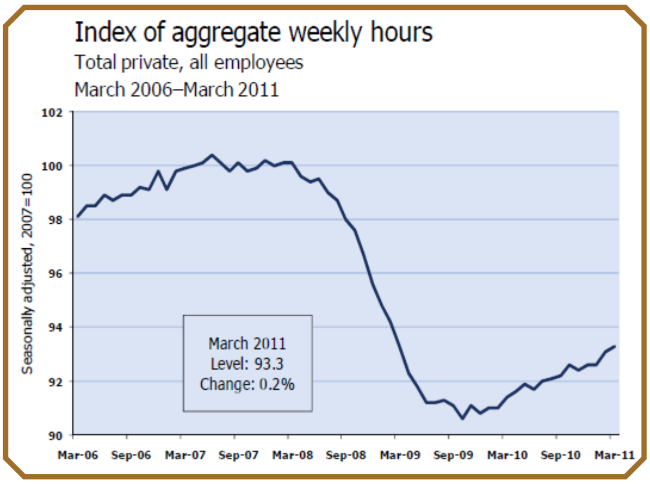
You Scratch My Back.....?

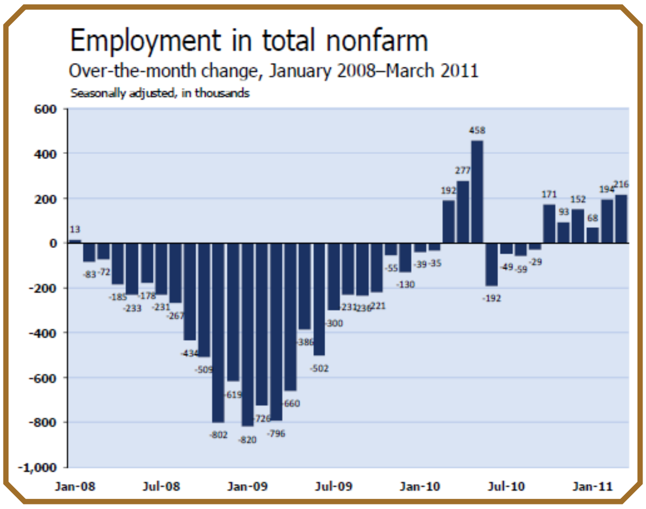


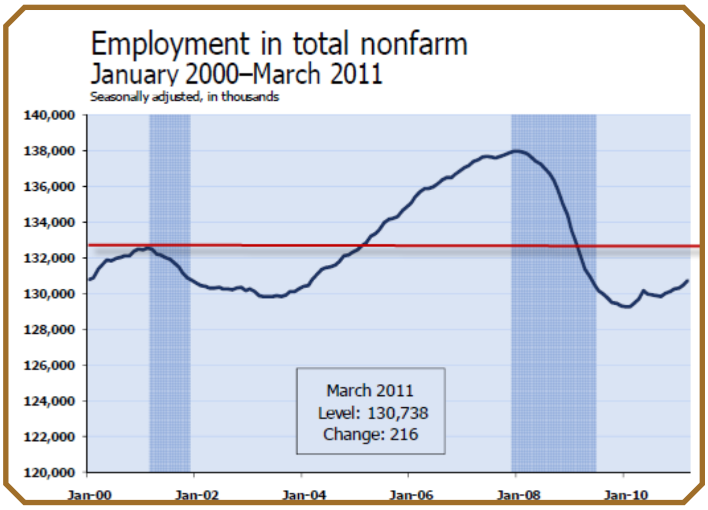
SOURCE: THE CHINA ANALYST

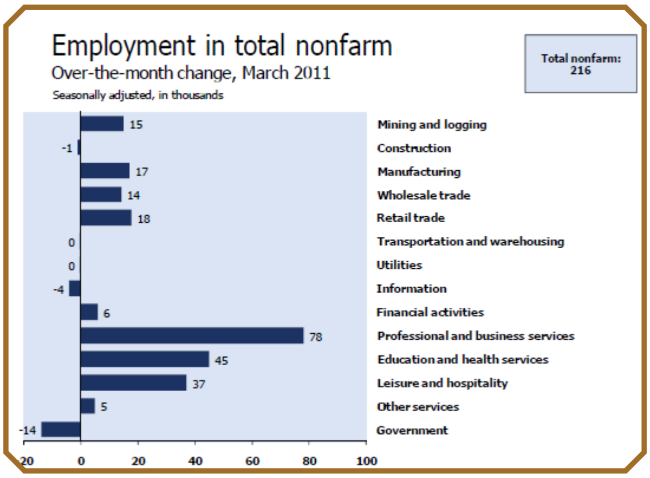
The Non-farm payrolls number in graphs: Taken from ‘Thoughts on the Jobs Report’

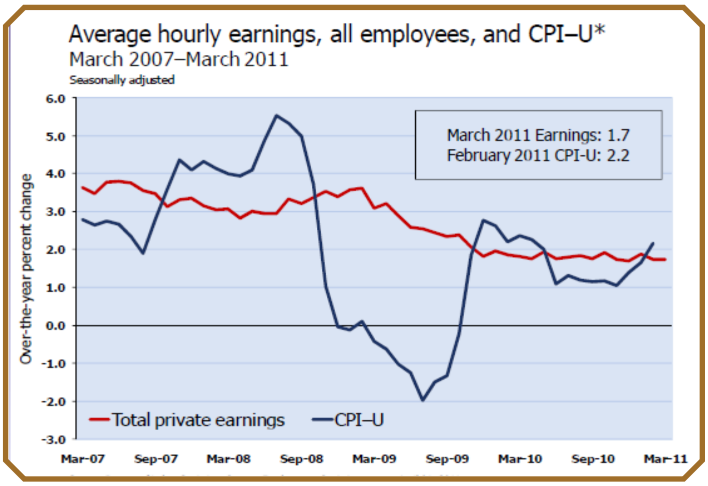
MIKE SHEDLOCK / LINK











CLICK ANY CHART TO ENLARGE

SOURCE: MIKE SHEDLOCK

CLICK TO WATCH

Earlier this week we spoke about the Martingale betting system (a technique in which someone with unlimited funds is supposedly guaranteed to make money by constantly doubling a 50/50 bet until they eventually win).

Yesterday, Rick Santelli took this theme and ran with it on one of the better 'Rantellis' of recent times when he called out the 'DONs'...

CLICK TO LISTEN

Rob Arnott of Research Affiliates talks to Eric King about the fact that the US is in danger of a 'Greek-style collapse'.

Rob is also concerned about a topic that has been a focus in these pages recently - core inflation.

A few years ago - before we entered The Matrix - a headline like this, appearing on April 1 would have been one of the more obvious April Fools jokes.

Now? Not so much.

CLICK TO WATCH

Jim Cramer 'continues' to love silver.

Which is nice.

This could be the must-see movie of the summer.....

CLICK TO WATCH

Hmmm...

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COMMENTS