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GLOBAL REPORT

THE DAY AFTER ...

The distractions have finished. In the US, the inauguration is over and President Obama has stepped into the Oval Office to preside over a bankrupt nation. Over the days ahead - reality will return.

The Wall Street Journal reports that the meltdown costs are climbing.

“Estimates from Goldman Sachs - \$US 1.1 TRILLION from US residential mortgages, \$US 390 Billion from US corporate loans and bonds, \$US 234 Billion from commercial real estate, \$US 226 Billion from all credit cards and \$US 133 Billion from auto loans.” The US financial system is facing about \$US 2 TRILLION in losses and does not have the capital to cover.

Wall Street knows this, or course. On the day of the inauguration, the Dow threw away 4 percent with the US financial sector being slaughtered. The Dow closed below 8000. Everybody is now looking for where the support is. That's the wrong question. The real question is what economic means are there to support the US stock market? There are none.

Over at the Congress, the Congressional Budget Office (CBO) has made it known that the US federal budget deficit will be \$US 1.2 TRILLION in fiscal 2009. When the Obama “stimulus” package of \$US 825 Billion (or so) is added, the US budget deficit for this year is \$US 2 TRILLION.

The US faces a double negative - the write-offs in its financial markets and the deficit on its federal budget. Combined, these are \$US 4 TRILLION. Neither the US civil economy with real estate down 35 percent nor the US corporate sector can assist here, they are both in deepening recession.

The fact is that the US is bankrupt, fiscally, financially and economically.

The Slaughter Of The US Banks:

The approach of government to banks is dangerous, especially for stockholders. This is now clearly to be seen as stockholders run away from US banks. In any bankruptcy, stockholders are last after all the creditors. Shares of *Wells Fargo* have lost half their value since the start of the year. *Bank of America* is down 64 percent, *J.P. Morgan Chase* is down 43 percent, *Citigroup* is down 58 percent. These are the four largest US banks. Historically, stock market falls of these magnitudes are a death rattle.

The Slaughter Of The British Banks:

Lloyds Banking Group fell by 48 percent in a day. *Barclays* was down 17 percent and *Royal Bank of Scotland* fell another 11 percent on top of a previous day's collapse. The British banks are near death.

The Real Problem With British And US Banks:

The details which have come out about the actual situation in the British banks demonstrates why they are all being bailed out. The REAL problem is this. The *Royal Bank of Scotland*, *Lloyds* and *Barclays* have total liabilities of £4.5 TRILLION. If they were all to be allowed to go bankrupt, that would tear a hole of the above size in the British financial system and all around the world. To get an idea of what that would amount to in purely global economic terms, it is about twice the size of Britain's GDP. Now add to the liabilities of the British banks the liabilities of the four US banks already mentioned and the end result in global terms is a worldwide banking systemic collapse.

The Banks Are The "Transmission" Of The Credit Money System:

Without the commercial banks, a credit money system would be impossible. It is only the commercial banks which are able to create credit money as a bookkeeping entry in their own accounts and then credit a borrower's account with the amount. They do this, of course, with the blessing of the Reserve Banks which stand behind them. Not one in a hundred everyday bank customer realises this. In everyday life, they deposit money in their own accounts and make payments from their accounts to other people without any problems. Further, they know that they can go to their bank and withdraw a sum of money in cash, either from an ATM or from a teller. All this leads naturally to the inadvertent idea that when they borrow money from their bank, the bank can only lend what others have deposited.

This is NOT the case. Any commercial bank in fact lends multiples of the sums which customers have placed in their accounts. This can easily be seen by observing what a bank has to do if \$US 1000 is deposited in a customer's account. In the US, what the bank does is to promptly send \$US 100 over to the Fed as a reserve to "cover" the \$US 1000 which just arrived. Then the bank promptly sends the other \$US 900 over to its loan desk which happily lends that \$US 900 to the next needy borrower. Of the total money issued by commercial banks, only about 10 percent originated from what people deposited in them. The other 90 percent is created by being "credited" to borrowers' accounts. It is pure CREDIT money.

Commercial banks everywhere operate under a "fractional reserve system". The commercial banks only have sufficient reserves to cover about 10 percent of the total deposits residing in their own accounts.

Commercial Banks - Credits And Assets:

The core problem which is now coming to the fore in both Britain and the US is that in the act of creating the credit money out of thin air as a bookkeeping entry, the bank also creates a "liability".

A commercial bank's "assets" are the loans it has made because the bank earns a rate of interest on the loan. On the other side is the "liability" - the account entries the bank has made in its books when it created the loan. These liabilities are now coming back to haunt both the British and US credit money systems. When a commercial bank makes a loan in this way, it sees it as an investment. That also means that were a loan to go sour, the lending bank takes the hit directly on its own capital. Should there be enough bad loans, any bank could run out of capital and go broke. This is the reason why both in Britain and in the US, the monetary authorities have been working overtime to shovel new capital into the commercial banks. Had this not been done, the banks would have crashed. This why the monetary authorities are fighting so desperately to keep the big commercial banks standing upright and alive. The entire credit money system depends utterly on the banks as the transmission system for the credit money itself! Were it not for the credit money system, it would not be possible for any government to inflate the total quantity of money from the credit money side for long.

If the same amount of monetary inflation was created by simply directly printing more bank notes and then spending these new notes into circulation, the general public would catch on. They would make the connection between more money and later higher prices. Credit money hides inflation from view.

The Fatal Flanks Of A Credit Money System:

A credit money system reaches the dead end of its own inflation when not even zero rates of interest can entice the general public to borrow even more credit money and then spend it into circulation. When that point is reached, a credit money system can only contract. When that takes place, the total quantity of money in use also contracts - it DEFLATES. The system has reached the limits to debt and therefore to credit. For governments then to storm into the breach as they are now doing and to replace the general public as the borrowers of last resort simply loads Treasuries with the debts that the public is no longer willing to carry. At the end of that road lies the bankruptcy of all the Treasuries.

The other flank, the truly fatal one, is where the general public decides that there is no safe place for their money and decides to go into CASH. Today, "cash" is, of course, the national paper money. When that happens, and it would only take a large bank failure or two, then the fractional reserve system swings into reverse. Now, somebody walks into a bank and demands that the \$1000 he has in his account be given to him in cash. But the bank only holds \$100 in reserves, having earlier lent the \$900 out to somebody else. Faced with this demand, the bank has two choices. It can try to recall some earlier loans or it can take the \$900 directly out of its own capital. A mass demand for cash would not only cause a massive deflation of loans already outstanding as these were recalled, it could also cause many banks to run out of capital entirely. That would bankrupt the bank and leave all the remaining depositors standing and staring at the now closed doors, unable to get their money.

These are the reasons why some morbid wits who do understand the situation have said that under any fractional reserve system, only a fraction of the public get their money out, the rest get nothing.

Approaching The Mid Point Of The Great Deflation:

At present, central banks in the US, Switzerland and Japan have official interest rates of zero or near zero. All other central banks are heading in that direction. All governments are "infusing" capital at a massive level. Huge bank bailouts rule the day. Government deficits are exploding. All this in a desperate attempt to keep the global credit money system inflated or at least to avoid an unstoppable deflation. This process will end soon as governments find that they have to offer a higher rate of interest on their new debt offerings and then see those higher interest rates force commercial rates even higher. That will swing many more businesses into bankruptcy and many more economies into deep recession.

If under these economic circumstances, even more people and businesses try to pay down a larger portion of their present debts, both central banks and Treasuries would stand helpless. The real and growing spectre of "quantitative easing" - which means the literal printing of money - will come even more to the fore. Once it is underway, more members of the public will likely decide to take their money out in cash. Governments will have only one basic response - a restrictionist policy. This will mean that the general public will only be allowed to take, for example, \$100 per day out at the local ATM machine with businesses allowed more on a number of employees basis. All other transactions (the powers that be will assure everybody) will still be possible but only through the payments system where all payments go from one account to another, thereby keeping the money INSIDE the credit money system.

What will also happen, of course, is that CASH will truly be King. Cash will command a premium in all transactions over monetary payments made through the financial system. Cash holders will be blamed for all economic ills, black marketing will be the mildest of accusations. Governments hate cash because there are no records of the transactions being made. Inside the credit money system, banks keep financial records of all transactions which make taxation easy. In what is called the "black market", people operate in a way which means that government cannot see what takes place. In reality, these are the free spirits of the free market where reputation is all important.

Any restrictionist policy is a form of rationing - of cash. A so-called black market always results.

America's Lenders:

Alternatively, US commercial banks versus Americans. Just as the reverse side of credit is a debt owed, so the reverse side of any given quantity of bank issued credit money is the debts which the borrowers owe the banking system. This can be best illustrated by an example. *Bank of America* enters 2009 with \$US 61.7 Billion of tangible common equity supporting \$US 2.4 TRILLION of tangible assets. Remember, a bank's assets are the loans it has issued while the credit money issued is a liability of the issuing bank. That means that *Bank of America* has 1 US Dollar in common equity holding up \$US 38.89 in credit money which it has deposited in its borrowers' accounts. Now THAT is "gearing".

America's Borrowers:

The borrowers, the opposite party to this credit money issuance, now stand with a household debt as a percentage of disposable income of 141 percent in the United States, according to the latest Fed data. Bank of America is counting on the servicing of these loans with interest payments and an ongoing flow of principal repayments on all these sums owed by American borrowers who are in debt up to their necks. Referring back to the data in the preceding paragraph. It should be obvious that if just \$US 3 Dollars of the loans issued by *Bank of America* were to go sour, then all its equity disappears!

Of course, if just \$US 60 Billion of deposits were taken out of *Bank of America*, its equity would also disappear. Clearly, the fragility today is enormous.

American Taxpayers:

Bank of America and its newly acquired brokerage unit *Merrill Lynch* lost \$US 17.1 Billion in the fourth quarter. This week its shares got smashed on the New York stock exchange. The real absurdity which is now coming to the fore is that the US Treasury (behind which stands the US taxpayer) is being enlisted to supply the backstop funds for over-g geared US banks such as *Bank of America*. The US taxpayers are the same people who are already over-g geared as can be seen from the household debt to income ratio.

Always remember that when the US Treasury borrows, it does so on behalf of the American taxpayer.

That is why, with some useful precision, the US Treasury's debts are called the "public debt" for the very good reason that once the Treasury has borrowed, it is the American public which owes the debt.

Portents - The Turn Of The US Money Flows:

International capital flows into the United States were only \$US 1.5 Billion in October. That flow came nowhere near offsetting a US international payments deficit of \$US 50 Billion to \$US 60 Billion per month. In November, international capital flows were a NEGATIVE \$US 21.7 Billion! That means that this sum flowed OUT of the US! If this outflow accelerates, President Obama can wave goodbye to the foreign funding for his expected \$US 2 TRILLION in new borrowing.

If that happens, his entire design falls to the ground. With no international buyers, US Treasury debt paper will have to be sent over to the Fed which then buys them with its book entry credit money which the Treasury then spends into circulation inside the US. Investors in South Korea cut their holdings of US debt to \$US 28.6 Billion in November, less than half of what they owned in 2006, based on Treasury data. Were other foreign investors in US debt paper to follow South Korea's lead, the "run" would be on to not only get out of US debt paper investments, but also to get out of US Dollars.

A "run" of foreign money out of the US financial system is the greatest danger. It would tighten liquidity inside the USA at the same time as Mr Obama's government is trying to increase liquidity in a vain attempt to overcome its internal deflation. A higher outflow of money will sink any currency.

The Tidal Wave Of Budget Deficits:

Official interest rates around the world are either at or near zero or moving towards zero. Clearly, the powers that be are realising that even this is insufficient to so much as slow down the accelerating global deflation. Now, governments all over the world are swinging into climbing deficit spending. Of course they have to borrow that money before they can spend it. Further, because the deflation is swinging more and more western economies into economic recession, tax revenues are falling fast.

Borrow And Spend:

The already existing facts are that the British budget deficit will equal 9.4 percent of Britain's Gross Domestic Product (GDP). This compares with 4.9 percent in the Euro zone and 8.4 percent in the US. When President Obama's \$US 825 Billion "stimulus" package is added, this year's US budget deficit will climb to an historic 14.5 percent of US GDP. The farce that is the official US debt ceiling will have to be raised yet again to make room for this deficit explosion. Instead of Congress all standing with red faces, the climbing political likelihood is that the US will simply dispose of the "debt ceiling" and simply remove any legal "limits" to the debt of the US Treasury. The road is then open to unlimited debt.

It's Banana Republic Time:

What is happening at present is tragic and rather hilarious. Incontinent governments are engaging in the futile exercise of borrowing what the public is no longer willing to borrow, spending the money so borrowed, and then handing the bill to their own taxpayers. Deflations, contractions in the total quantity of the means of payment, this time from the credit money side of the monetary system, cannot be treated this way. In deflations, the most critical thing to strive for economically is to NOT have governments stand in the way of the markets. It is essential that the price mechanism find the real clearing levels where goods and services again change hands. At all times, prices have economic work to do. In deflations where the total means of payment has contracted in volume, there is no more urgent task than to let all prices fall to their clearing levels. Until they do, no economy can revive, let alone prosper.

Borrowing And Spending The Civil Economy Into Extinction:

Governments borrowing insane amounts of money and then spending it into circulation is an attempt to keep current prices at near their present levels. Such actions are, in effect, intended to act as a version of price support mechanisms. Deficit spending with the aim of holding prices above the level that the broader deflation calls for leads to a situation in which goods don't clear their markets. The same goes for labour, which means that willing workers get laid off or cannot even find a job. The whole process is cruel in the extreme. What governments in fact can and SHOULD do is to first cut their own spending to leave more money in the private and civil economy so that it can better deal with the deflation. Then, and only then, governments should cut taxes - to a lesser degree than the spending cuts - to lower the budget deficit and the pressure on the money and credit markets.

Foreseeable Events In The Second Stage Of The Global Deflations:

It has begun! The first buyers' strike has occurred, in Germany of all places. On January 7, a 6 Billion Euro 10-year issue was only 85 percent covered by bids! These are the future events to look for as the buyers of government debt paper refuse to accept the paper at the interest rates offered. Clearly, to sell the debt paper necessary to cover the budget deficits, governments are soon going to have to offer higher interest rates. That will force all other money market and commercial interest rates to climb even faster. That will put the fourth horseman of deflation - a potential crash in the GOVERNMENT bond market - in the saddle. The last stage of the global deflation begins when the world's bond markets start to collapse.

The global credit money mechanism is broken. Budget deficits are no alternative. Next, a bond crash.

INSIDE THE UNITED STATES

IN DEFLATION'S GRIP

San Francisco Bay area home prices fell 44 percent last month from a year earlier. The December median sales price for all Southern California homes fell to \$US 278,000, a 35 percent drop from the same month a year earlier. US mortgage lenders must be cowering in fear as more borrowers hand in their house keys.

Deflation Hits The Ground:

The US cost of living (CPI) fell 0.7 percent in December, capping the smallest annual increase since 1954, the Labor Department said on January 16. Industrial output shrank by 2 percent in December while the capacity-utilisation rate slid to 73.6 percent, the Federal Reserve said. The capacity-utilisation data shows that just over one-quarter of the entire US industrial plant is standing idle. The falling CPI shows that American consumers are cutting back and that the US retail market is following with lower prices.

The Contracting US Economy:

The US economy lost 2.6 million jobs in 2008, making it the worst year since 1945. This has brought the official annual unemployment rate up to 7.2 percent. For the fourth quarter, industrial output fell at an 11.5 percent annualised rate! Compared with December 2007, industrial production was down 7.8 percent, the biggest 12-month drop since September 1975. US December sales at US retailers fell by 2.7 percent, the sixth consecutive drop, extending the longest string of declines on record, the Commerce Department said on January 14. US consumer price inflation was -1.7 percent in November, and -1.0 percent in October. Falling consumer prices is classic sign of a deflation, in this case a credit deflation. In 2008 as a whole, nearly 800,000 US manufacturing jobs were lost. *Shadowstats.com* suggests that if unemployment were tallied the way it was in the 1930s, the jobless rate would be closer to 16.5 percent.

The US Credit Data:

After being near zero for much of the decade, US savings as a portion of disposable income rose from 2.4 percent in October to reach 2.8 percent in November, according to the US Bureau of Labor Statistics. In November, auto loans, credit cards and all other forms of consumer borrowing fell (repeat FELL) by \$US 7.9 Billion, the largest Dollar total in more than 50 years. Climbing savings reverse all credit expansions.

No Help From Here:

“More capital injections and guarantees may become necessary to ensure stability and the normalization of credit markets.” So said Fed Chief Bernanke in a speech at the London School of Economics. Here, in bold words, is proof of the economic incomprehension of events at the highest levels, the US Fed itself.

Guarantees are one thing. They depend upon the liquid assets of the issuer of the guarantee. But if the one making the guarantee is in debt to the tune of TRILLIONS and running a deficit also to the tune of TRILLIONS per year, such a guarantee should look at least doubtful. Capital, and injections of same, are entirely different. Capital is PRODUCTIVE plant and tools. Capital is NOT the monetary value of such plants and tools. This is what Fed Chief Bernanke has reversed in his own mind! Clearly, from the words out of his own mouth, he thinks that if he injects a huge sum of money in the US financial system, then in an act of spontaneous generation, a matching quantity of new plant and tools on their factory floors will spring forth! This is not economics. This is magic, with Mr Bernanke as the magician in chief. If what Bernanke thinks is so WAS so, then one could plant a pile of \$US Dollars and watch wealth spring forth!

President Obama wants to deficit spend, to spend what does not exist on what is still here. Deficit spending is a contradiction in terms and of facts. One can only spend what IS here.

INSIDE CHINA - AND - JAPAN

ASIA'S MAIN ECONOMIES CAVE IN

The economic data rolling in since the start of this year concerning the Asian economies is awe-inspiring. In economic terms, Asia is now in a full scale crash. The last large economic pillar, China, is slowing so fast as to make one's eyes water. China's National Bureau of Statistics said annual growth almost halved from 13 percent in 2007 to 6.8 percent in the year to December! China's exports fell by the most in a decade in December as the deepening global recession cut demand. Chinese export shipments dropped by 2.8 percent, the Chinese Customs Bureau said. That compares with a 21.7 percent gain a year earlier. China's imports plunged by 1.3 percent, leaving a December trade surplus of \$US 39 Billion.

Japanese exports plunged a record 35 percent in December from a year earlier as the US recession crushed the demand for exports. Japan's exports to the US fell by a savage 36.9 percent in December!

Japan's current account surplus narrowed for a ninth month in November, shrinking by \$US 65 Billion or 65.9 percent from a year earlier, the Ministry of Finance said in Tokyo. Japanese exports to Asia sank 36.4 percent, the third straight month of decline. Japanese shipments to China fell 35.5 percent.

South Korea's economy shrank 5.6 percent during the last quarter. Singapore's GDP has declined an annualized 16.9 percent during the fourth quarter, the biggest drop ever. This is Asia CRASHING.

The Huge Contraction Of World Trade:

There has been a record collapse in global shipping hire rates. Ports across the world look as if they are used car lots filled with unsold cars. The cost of second-hand "Cape sized" (the largest size) of commodity carriers plunged by 70 percent last year, according to the Baltic Exchange. Nations with large shipbuilding facilities like South Korea are looking at empty order books. The second tier shipping lines are reverting to an old ploy. They are buying very cheap modern ships, offering them for charter at rock bottom rates, running them into the ground with minimum maintenance and then buying another one.

In Deep Recessions - He Who Cuts Prices First Wins:

This is actually a general principle in deep recessions and economic depressions. There are always a lot of high quality tools and equipment standing idle. These can be bought for cash at rock bottom prices. Use them up, wear them out and when the time comes, buy another such tool.

This is a very good way to offer cheaper prices in a falling market. Operating this way also means that the faltering economy gets a source of supply at lower prices than it would otherwise get, which is exactly what it needs. Lastly, unused capital plant and tools can be put to use and used up.

A Global Warning - Concerning The US:

New York University Professor Nouriel Roubini, one of the few economists who called the US dive into recession, estimated on January 20 that US financial losses may total \$US 3.6 TRILLION.

"If that is true, it means the US banking system is effectively insolvent because it starts with capital of \$US 1.4 TRILLION," he said. *"This is a systemic banking crisis."* This is what *The Privateer* has also analysed, perhaps to the point of boredom for some of our readers. Still, it's nice to have friends.

What Professor Roubini's research also shows, based upon the above numbers, is that the US banking system is deficient in capital to the tune of \$US 1 to 1.4 TRILLION. There is no way between heaven and hell that the missing capital can be found. The US banking system is on the verge of a crash.

INSIDE THE EUROPEAN UNION

INDUSTRIAL PRODUCTION IN EUROPE IS COLLAPSING

A violent collapse of industrial production in Europe is now taking place. The latest European monthly data shows falls in annual rates of production of 17 percent in Spain, 13 percent in the UK, 9 percent in France and Italy and 6 percent in Germany. These falls are awe-inspiring in historic terms.

Germany, the industrial powerhouse of Europe, is now being badly affected. Worldwide German exports, once a mainstay of the Euro area, tumbled 10.6 percent in November, implying that the largest economy in the region contracted by up to 2 percent in 2008. This month, the German automaker Opel cut prices on some models by more than 8 percent and rolled out a cheap financing package to boost demand. German car sales fell 6.6 percent last month. This again shows the global deflation effects. It also shows that Opel is cutting prices and following the deflation downwards to clear its market of cars.

Deflation Effects On EU Prices:

Europe's price inflation rate dropped to its lowest in more than two years in December. The annual price inflation rate in the Euro area has fallen to 1.6 percent from 2.1 percent in November, the European Union statistics office in Luxembourg said on January 15. This shows that the EU's consumer prices are still a fair distance behind the global deflation which means that they have much further to fall.

Looking For Other Uses Of American Paper:

The major German banks have so far written off only about a quarter of the nearly 300 Billion Euros (\$US 397.7 Billion) in toxic US paper assets on their books. This is just the scale of Germany's financial troubles with American paper assets. Globally, the situation with US paper assets is much worse and is becoming much clearer. The total worldwide loan losses and securities write-downs on US originated financial paper assets is expected to reach about \$US 3.6 TRILLION! About half of that is still on the books of US banks. But even if the US and German banks' holdings are added together, it means that the rest of the world still holds about \$US 1.4 TRILLION of this US toxic paper. Tragically, this paper is likely to form the main financial assets of many second and third tier nations. It is near worthless.

What Was The US Financial Establishment Counting On?:

At least \$US 1.8 TRILLION of toxic US-originated financial paper has been sprayed across the world. It has in effect been bought by the rest of the world with US Dollars hard earned in trade. It has now been found to be of little if any value at all. The American financial salespeople got their money but what the rest of the world got was an immense loss, a REAL loss which is still working its way through national financial systems. Was the US financial establishment expecting that they could repeat that performance forever? Probably. This same US financial establishment still holds about \$US 1.8 TRILLION of the junk paper on their own books. They actually thought that it could work!

What is certain from now on is that the rest of the world has already built up an aversion to US financial paper in nearly all its forms. Today, it is only other central banks across the world which are still buying US Treasuries and (some) Agency paper. They are doing so solely for political reasons. What is also certain is that the US will find it enormously hard to find foreign funding for its triple deficits - the budget, trade and current account deficits. The \$US 1.8 TRILLION still on the books of the main US players in the American banking and financial system is now acting like a poison killing its hosts.

The US banking system is effectively insolvent - see "*Inside The United States*". Trying to borrow the sums now required will break the US Treasury. Using the Federal Reserve to print the additional sums required would break the US Dollar. To do nothing will break the main US banks.

AUSTRALIAN REPORT

THE AUSTRALIAN EXTERNAL PAYMENTS CRISIS ARRIVES

The Privateer has forecast this event. It has now arrived. Some foreign lenders refused to roll over their loans to Australia. Instantly, an external payments crisis has arrived. Overseas banks have accounted for more than half of the \$A 285 Billion in syndicated loans that have been lent to Australian business since 2006. Prime Minister Rudd has said this: *“Of those outstanding loans, \$A 75 Billion is scheduled to fall due over the next two years.”* Mr Rudd said that he will take *“whatever action is necessary”* to stabilise Australia’s financial markets if foreign banks do not roll over the \$A 75 Billion in business loans.

“If foreign banks do not roll over their share of these loans, it will be difficult for Australia’s four major banks to fill the gap on their own,” Rudd said. Treasurer Swan is already on his way to the US to ask American banks not to call back our loans with them and to roll over the loans Australia already has.

Quoting Mr Rudd again: *“... If banks do not allow clients to refinance as they would in normal conditions, then companies can be forced to sell assets, often at a low price”*.

The problem is that Australia does not have the money. The Federal government will become lender of last resort to Australian businesses and create a multi \$A Billion scheme partly funded through the sale of Commonwealth bonds! Once again, the Aussie taxpayer will be roped in to carry the burden of all this. The latest talk is that Rudd will come up with \$A 40 Billion and the four main banks with \$A 35 Billion.

Who Did This To OZ?:

The flight from the Australian market is being led by the Halifax Bank of Scotland and the Royal Bank of Scotland which this week booked the largest ever loss in British corporate history. They need the money.

Running Up Quite A Tab:

Since October, Prime Minister Rudd and Treasurer Wayne Swan have announced almost \$A 45 Billion in aid for families, pensioners, bond markets, home buyers, car dealers etc. and extra spending on schools and roads to ensure the economy does not dive into its first recession in 17 years. One wonders where the money is to come from. That \$A 45 Billion is in addition to this new \$A 40 Billion to bail out the Aussie companies. They don’t have the money themselves to repay the foreign loans they signed up for.

Prime Minister Rudd might be in for a surprise when he sends his Aussie Treasurer out into the wild world of international finance and tries to borrow all this money. People in finance already know that the total public sector deficit - which combines federal, state and local government balances - is forecast to blow out to \$A 10.5 Billion this financial year mostly due to Canberra’s stimulus packages. They also know Australia’s current account deficit could reach \$A 100 Billion in 2009-10, up from \$A 65 Billion in 2008-09. When Treasurer Swan does his impression of Oliver Twist - *“Please sir, I want some more!”* - he might find it falling on deaf ears. Then, it is over to the Reserve Bank to have it print the money.

Where The Economy Is:

The Aussie economy lost 44,000 full-time jobs in December as companies reduced payrolls to brace for a “possible recession”. The Reserve Bank has said credit card use slumped 9 per cent in November and cash advances slipped 8 per cent to the lowest level since 1999. The Australian Bureau of Statistics (ABS) has reported that lending for commercial purposes slumped by 10.4 per cent in November while personal financing was 1.8 per cent lower and lease finance was down 3 per cent for the month. Financing for commercial purposes was down for the fifth month in the past six. It was 37.6 percent lower year on year. And with all that, Prime Minister Rudd is talking about emergency tax CUTS!

THE GLOBAL MARKET REPORT

THE VERY LAST BUBBLE OF THEM ALL

On December 16, 2008, the US Fed took the last step down the conventional road which they had been travelling ever since they came into existence at the end of 1913. In mid 1913, as a pre-requisite, the federal government got a constitutional amendment (the 16th Amendment) giving them the power to tax the income of their citizens - "*from whatever source derived*". To do this effectively and efficiently, a uniform medium of exchange under the control of and issued by the government was required. This, in turn, required a central bank with the sole authority to issue what would circulate as money. The creation of the Federal Reserve, ten months after the passage of the income tax amendment, took care of that.

The income tax amendment "guaranteed" the federal government an internal income stream. The establishment of the Fed "guaranteed" the federal government a means of payment over which they had sole control. The Fed took care of the "elastification" of the US Dollar which, henceforth, would be issued exclusively in the form of a "Federal Reserve NOTE" - long the only "legal tender" in the US.

The next time you hear an economist or government "expert" holding forth on the subject of the "failure" of the free market and/or the absolute necessity for government intervention and "supervision", keep the above firmly in mind. The power to interfere with, intervene in and "oversee" economic freedom and therefore, political liberty has been the exclusive preserve of the US government in Washington DC for almost a century. And the US was a latecomer on the international scene.

The next time you hear your local central banker and/or Treasurer maintain that the current global financial crisis is a failure of regulation and supervision of the financial markets, keep the above firmly in mind. Neither the US nor any other nation in the world - whether developed, "developing" or in dissolution - has political or economic freedom or liberty. Nor, as a direct and inevitable result of that fact, does any of them have a SOUND MONEY. The global theme of the century since the onset of WW I in 1914 is INTERVENTION - with money, with property, with incomes, with employment and with the choices that individuals are NOT allowed to make concerning all these (and many other) vital ingredients of the free market. What is failing, as it was always destined to do in the nature of things economic and as it has always without exception done in history, is government manipulation of money and markets.

Every frantic effort by every government in the world taken to "shore up" a failing credit money system over the past eighteen months has been designed to obscure this simple fact. Every claim that the present credit crisis "could not have been foreseen" or that "nobody knew it would get this bad" is warding off dark fears. These fears are not so much that the "system" is failing, it has been failing for decades. The fear is that the system is SEEN to be failing. No system based on "*full faith and credit*" can survive that.

"Qualitative Easing":

This is what the Fed has been doing ever since it was born in 1913. It is the manipulation of "market" interest rates through changing the level of interest it charges to make "reserves" available to its captive commercial banking system. The banking system, in turn, inflates the "money supply" on the basis of these "reserves" - see the explanation of "fractional reserves" in the *Global Report* in this issue. On December 16, 2008 - see above - the Fed completed the process of "qualitative easing" by lowering the target of their Fed Funds rate to between ZERO and 0.25 percent. Reserves are now essentially "free" and therefore new credit money can, supposedly, be created in unlimited quantities. The problem is that there is now a missing ingredient - someone must be willing to borrow this money into circulation.

"Quantitative Easing":

If the world's central banks can't get anybody else to borrow and spend, they must do it themselves.

Ben Bernanke on “Quantitative Easing” and “Seigniorage”:

“Governments that want to finance their deficits through seigniorage (the revenue from printing legal tender) do not simply print money but use an indirect procedure. First, the Treasury authorises government borrowing equal to the amount of the budget deficit, and a correspondent quantity of new government bonds are printed and sold. However, the new government bonds are not sold to the public. Instead, the Treasury asks (or requires) the central bank to purchase the ...new bonds. The central bank pays for its purchase by printing new currency which it gives to the Treasury in exchange for the bonds.”

That is straight from the “horse’s mouth”, it is a quote from a “macroeconomics” textbook which Ben Bernanke co-authored with Andrew Abel in the 1990s and has gone through six editions. The quote reproduced above appears in an article published in the *AsiaTimes* on January 23. It is a MUST read: <http://www.atimes.com/atimes/Japan/KA23Dh01.html> (with thanks to *321Gold* for posting the link at their site)

“Seigniorage”, in the context of the Bernanke quote and in the *AsiaTimes* article, is simply the difference between the nominal cost of a government printing money “say a \$US 100 bill) and what it can raise from such printing. In this, the US has a unique position in that it issues (by printing and by other “*indirect procedures*”) the world’s “reserve” currency. This is the reason why the US has been able to maintain chronic budget, trade (and more recently current account) deficits for half a century. The US Dollar and debt paper denominated in US Dollars are international reserves and international means of payment.

That means that the US is the only country which can print “money” and exchange it for real goods and services. No other nation’s currency is a RESERVE currency.

The process of “qualitative” easing has been going on for almost a century. It has now reached its end point. When the central bank of the nation which provides the world with its “reserve” currency cuts its controlling interest rates to ZERO, it has effectively admitted that it has reached the end of the line. The value of the financial “assets” it issues are not “impaired”, they are worthless. They earn NOTHING.

That being the case, their future viability as a reserve asset or even as a financial instrument commanding a price in international or domestic markets is DOOMED - unless and until they once more pay a rate of return to those who choose to buy and hold them. In the meantime, only “quantitative easing” is left. In a less polite era, that was called monetising the debt, a process which Mr Bernanke describes in his quote.

The \$US 825 Billion (Or More?) “Stimulus Package”:

With controlling short-term US interest rates at ZERO and with the 2008-09 US federal government deficit OFFICIALLY predicted to be in the \$US TRILLION(S), President Obama proposes to “borrow” and spend \$US 825 Billion (or more) in an attempt to stave off an already inevitable and already underway economic collapse. The blithe assumption behind it all is that someone out there will lend it.

Will they? Foreign private investors have been selling US corporate, Agency and Treasury paper for months. Foreign central banks no longer buy anything but Treasury debt, and they could certainly not “absorb” the amount which Mr Obama proposes to spend into existence without literally printing the money with which to do so. That is all very well, it has always happened in the past, why not now?

Why would a foreign government and/or central bank NOT buy paper issued by a nation which is already in debt to an extent never approached by any other nation in history? Why would they NOT buy it when the interest rates being offered on this paper are the lowest in the history of the nation which is offering it? Why would they NOT buy it when the announced future borrowing requirements of the nation issuing the paper guarantee that the principal on the debt will NEVER be repaid and interest payments even at rates approaching ZERO will almost certainly not be politically or economically possible?

The Last Bubble - US Treasury Debt Paper:

Put any word you like - quantitative, qualitative or anything else - in front of it. All that does is to attempt to obscure the fact that central banks in the US and everywhere else are “easing”. They are desperately trying to set up conditions where voluntary borrowing will once again put a floor under the credit money system. The problem is that the more they “ease”, the more reluctant the borrowers become.

In the latter half of last year, the world went through an excruciating period of “deleveraging” as desperate attempts were made to pay down debt. That, combined with capital repatriation led by the US forced the US Dollar upward. Towards the end of the year, there was a desperate stampede into perceived safety as any financial “asset” which was not government “guaranteed” was shunned. That brought interest rates on US Treasury debt down to historic lows, and prices to historic highs. Hence - the LAST bubble.

This week - January 19-23 - yields on longer-term US Treasuries have skyrocketed (as has the “price” of Gold). With Mr Obama’s “stimulus package” now not scheduled to pass through Congress until mid February, we are seeing unmistakable signs of the beginning of a “buyers’ strike” against US Treasuries. If this trend continues, it will burst the LAST credit-money era bubble and leave the “authorities” with only two remaining choices. Either get out of the way of the markets - OR PRINT.

Recent Events:

January 2008 was a bad month for world stock markets, ushering in the worst full year since the depths of the 1930s Depression. January 2009, to date, has been MUCH worse. As of this week, the MSCI world (stock market) index was down 6 percent for the month. Several global markets, including the Aussie stock market, have fallen below their November 2008 levels this week to plumb new lows in their bear markets. In the US, the Dow closed below 8000 on January 20, down over 9 percent on the month. It has recovered slightly since then as have the other major US stock indices.

The US Dollar continues to “hang in there”, only because of the more visible credit and banking chaos outside the US. The latest nations in the firing line are Britain and Ireland. Ireland, being a Euro nation, is dragging down the Euro against the US Dollar.

Please take a good look at the charts which accompany this issue online:

<http://www.the-privateer.com/subs/charts.html>

Pay particular attention to the charts of US Treasuries. This is a “spike top” if ever we’ve seen one.

Gold:

For MUCH more on Gold - please see Gold This Week (GTW):

<http://www.the-privateer.com/subs/goldcomm/gold.html>

What’s Next?:

On January 27-28 the FOMC meets in a situation in which, for the first time ever, they do NOT have an official interest rate to lower. Then, from January 28 to February 1, the world’s “movers and shakers” get together in Davos, Switzerland for their annual talk fest. The theme of this year’s meeting is: “*Shaping the post-crisis world*” and is being billed as “the most crucial in the organisation’s history”.

The Dow is hovering just above the bear market lows it set last November while several other markets have already succumbed. Gold is at all time highs in several currencies. US Treasuries are plummeting in price while yields surge. Mr Obama’s “stimulus package” is, reportedly, still three weeks away.