

Whatever it Takes?

In the midst of all the recent uproar, one anonymous Twitterer seized his chance to have his Uber-Warholian, 140-characters-of-fame moment and thundered: *'Central banks are losing control of this market!'* no doubt eliciting whatever the social media equivalent of a cry of *'Hear! Hear!'* and an approbatory nodding of the head might be from among his followers.

In truth, that such a sentiment could even be expressed shows how far from grace we have fallen. It truly is a thing of wonder that a small, secretive panel of bureaucrats, career politicians, and largely second-string—if comfortably conformist—academics should be thought to have the duty—as well as, Saints preserve us, the means at their disposal—to ensure that no-one speculating in financial markets should ever suffer a serious loss, or that no company's share price or bond spread should ever move in too adverse a fashion.

Though the history of central banks is nothing if not a tale of unplanned interventions, derogations from the law, behind-closed-doors horse-trading, and hazardous improvisation—often spiced up with a decent dose of personal and institutional favouritism—it has surely never previously been assumed that their role is to act as playground supervisors in quite this way.

Yes, it has been their lot firstly to keep the domestic currency convertible into the international ones of gold or US dollars and, by extension, for trying to manage the balance of payments. Yes, they have gained their often lucrative prerogatives by dint of the assistance they could offer to their sovereign in his conduct of what we would now

recognise as fiscal policy. Yes, they have been called in to act as lender of last resort when less privileged banks have pushed the heady temptations offered by fractional reserve banking too far beyond the bounds of prudence.

Later, when the breakdown of Bretton Woods and the free float of currencies absolved them of much of their traditional purpose, they eventually hit upon the expedient of trying to rein in the modern system's chronic inflationary tendencies, firstly by attempting to control the money supply (even if one may harbour a certain justifiable suspicion that this was no more than a convenient cover for actions taken for more discretionary and often less politically-appealing motives) and later by targeting some given statistical measure of price changes more directly—if indeed one can dignify their nebulous, shifting-horizon, tailored-to-the-moment, oft-deferred and sometimes suspended pursuit of that last objective with the name of 'targeting'.

Be that as it may, from that latter acorn a mighty oak tree has indeed now grown. Today, it seems everyone has decided, in some unexplained cabalistic fashion, that the very Gates of Paradise will be thrown open if the rate of change of CPI comes in at 2.0% per annum (though not only are the societies aiming for this all very different in their make-up but their overseers don't all agree on how to construct the sacred CPI number, or what it is supposed to be *'-cum'* and what it is *'-ex'*, either).

But if the monetary settings instead trigger a glut of over-capacity; or if a burst of technological innovation and entrepreneurial genius delivers us too much stuff too cheaply; or if we're all just too damned old to go shopping, what's a hubristic, Mission Creep-infected central banker to do? If he works for the Bank of England he'll probably just shift position shamelessly and pretend he was never really aiming for 2% in the first place, but the Court Astrologers who do take their Divine Mandate seriously will *never* surrender, for they *know* they only have to show enough *commitment* and their magic will soon begin to work.

We certainly agree that it would serve the common weal incomparably if Mandragora on the Main were committed—if not in quite the same sense that our wannabe wizard perhaps intended.

Sean Corrigan

IL MILIONE: Tales from Cathay

Kung hei fat choi to everyone, here, at the start of the year in which China just might make monkeys out of all of us. Whether or not that transpires, what is more certain is that Xi and Li and their minions will be very happy indeed not to have to make policy on the hoof over the next few days, as they have been doing almost without pause since their Mississippi Bubble Mk II blew up so spectacularly in the summer. A further cause for relief will be the annual hiatus in the flow of potentially embarrassing macro data over the next couple of months, just when the rest of us need it most.

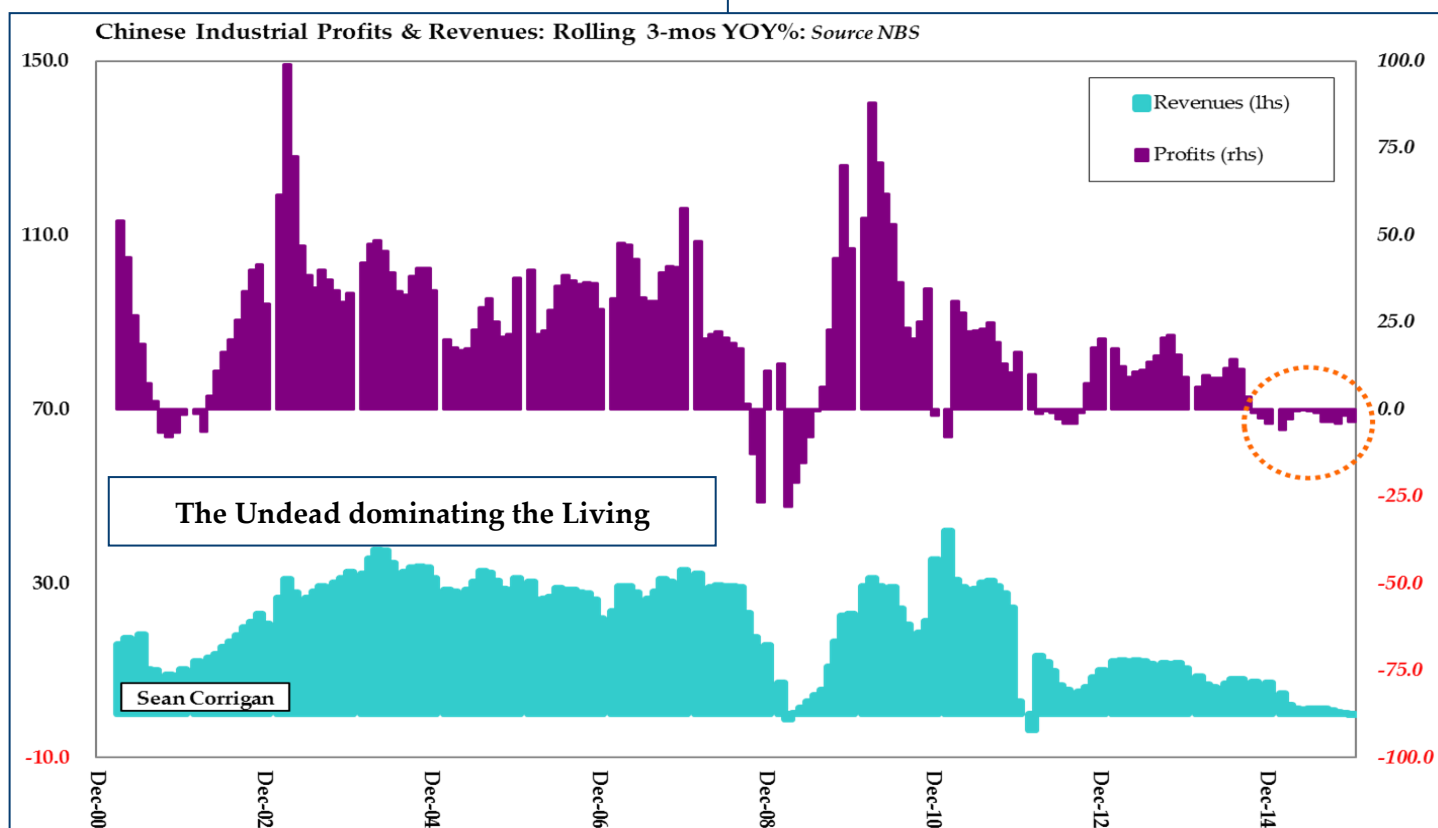
Front and centre, looms the issue of the currency, where the increasing number of stern warnings carried in the press about the foreign imperialist running dogs who are conniving to bring the Middle Kingdom down provides stark testimony to the degree of anxiety being occasioned by this issue.

As is ever the case with China, opinion divides strongly over whether this is just a matter of a minor adjustment for which the nation's unprecedented stock of foreign exchange reserves will provide an ample cushion, or whether the cracks which have appeared in the financial Three Gorges Dam of the capital account – and, less tangibly, in domestic confidence in the regime as a whole – are already

wide enough to threaten the structural integrity of the entire edifice and thus threaten to sweep away everything that lies downstream of it.

Though a side effect of China's recent efforts at winning the IMF to its cause is that we are now blessed with more and timelier data than has ever before been vouchsafed to us, there are still enough gaps and inconsistencies in them to prevent us from viewing a truly definitive picture of what is afoot. We must therefore settle for making a best guess and then use this to guide our reasoning as we try to decide which camp we should sign up for.

As we have previously argued, it makes a world of difference whether the present, rapid drawdown in reserves represents a voluntary paying down of previously contracted, foreign currency, 'carry trade' borrowings – a sensible enough precaution now that the yuan is no longer seen as a one-way bet for appreciation against the dollar – or whether it represents the forced withdrawal of short-term credit extended by frightened lenders. It also matters whether domestics are cashing in their renminbi and transferring the proceeds into dollars – i.e., whether they are changing the composition of their assets rather than reducing their liabilities since this has the potential to run a lot further and even to start to snowball since the domestic stock of



IL MILIONE: Tales from Cathay (*continued*)

exchangeable savings far exceeds the sum of existing foreign claims. Up to a certain point though, we need to remind ourselves that this does not make China as a whole more vulnerable, it simply 'privatizes' some part of the foreign hoard extant.

Let's begin with a review of the information we have to hand.

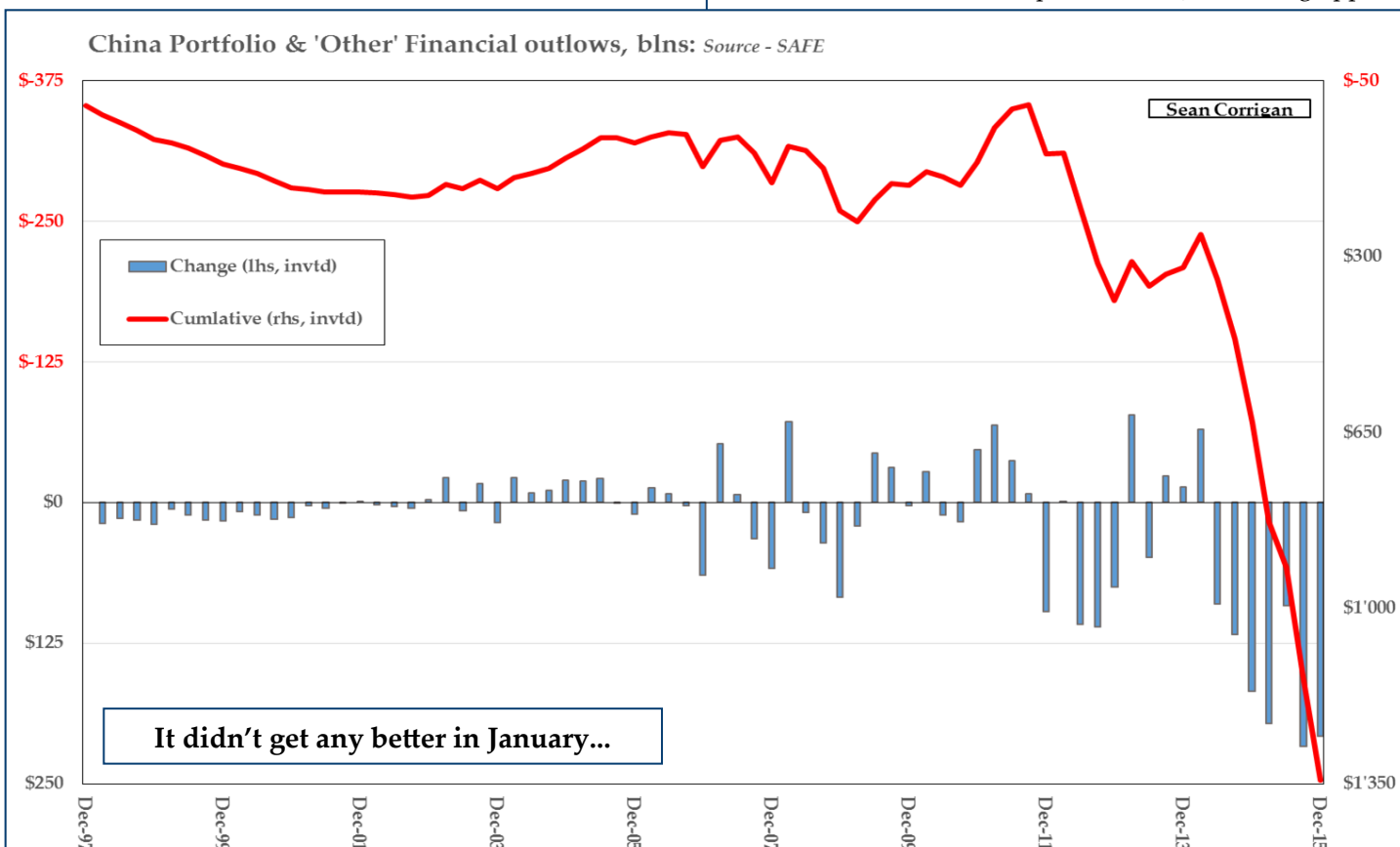
The reserve total topped out in June 2014 just shy of \$4 trillion equivalent. Over the next five quarters, the 'Other' component of the BOP numbers reported by SAFE saw a \$531.5bln outflow split fairly evenly between a \$235.9bln accumulation of foreign assets ('privatization' and/or 'flight') and a \$295.6bln redemption of liabilities. Though this seems clear enough, we should be wary of jumping to any overarching conclusions when we further note that the combined sum of the entries for 'Errors and Omissions' during this period amounted to a comparably-sized \$261.9bln net outflow. Furthermore, it has been noted by reputable researchers in the past that a sizeable proportion of China's ostensible FDI inflows (which amounted to a gross \$349.1bln and a net \$184.7bln movement over our horizon) are in fact recycled domestic monies which have undergone a round trip via the likes of Cayman, HK or

Macau in order to attract both tax breaks and possible extra legal protections.

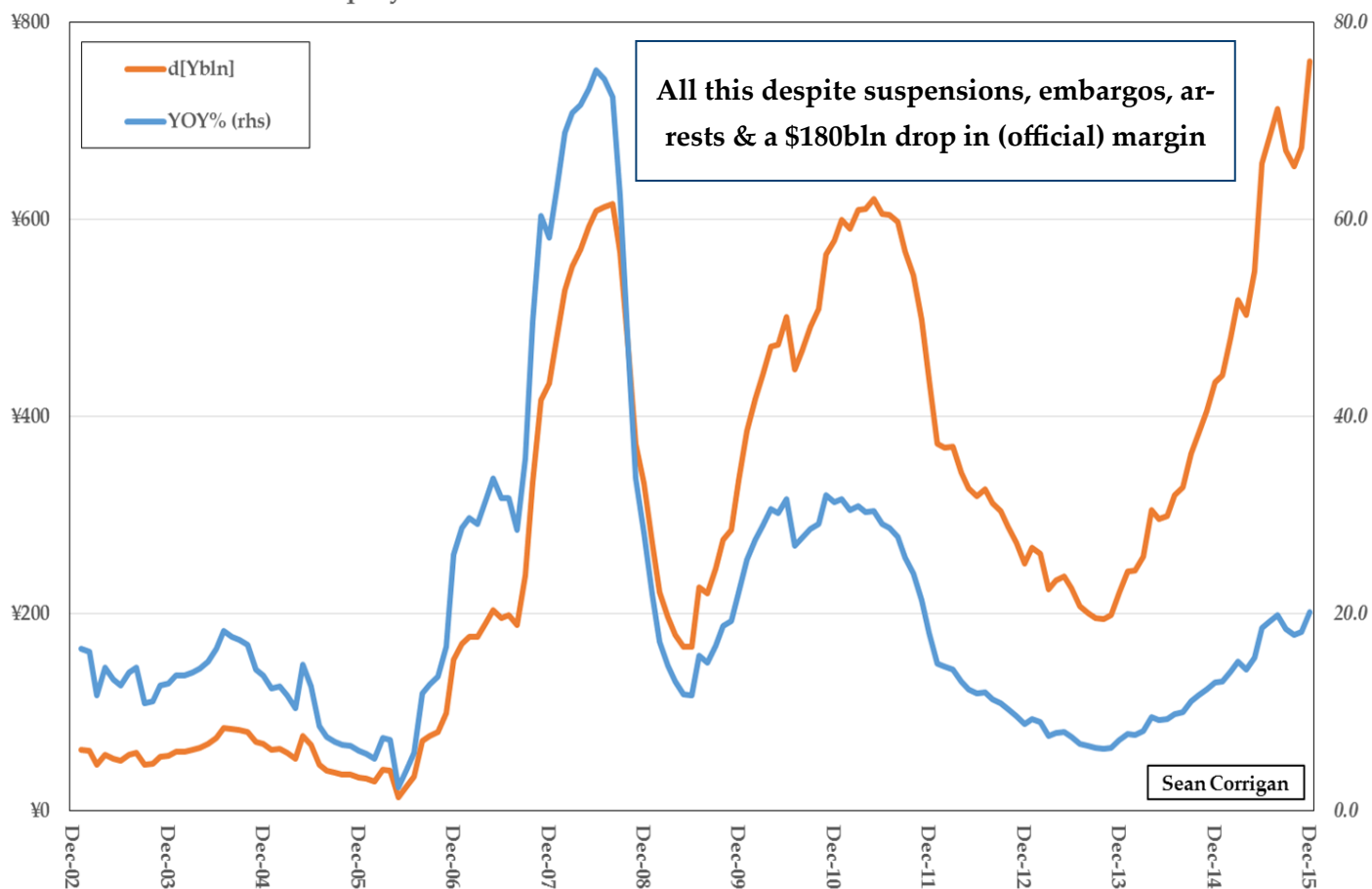
As ever it is the not just in the known unknowns but also in the unknown ones where the real risks are to be found.

Coming at the problem from the other side, SAFE's latest data (for QIII'15) reveal that China has gross external assets to the tune of just under \$6.3 trillion, gross liabilities of a little more than \$4.7tln, and hence a positive net balance of \$1.5 trillion, give or take the odd \$40 billion.

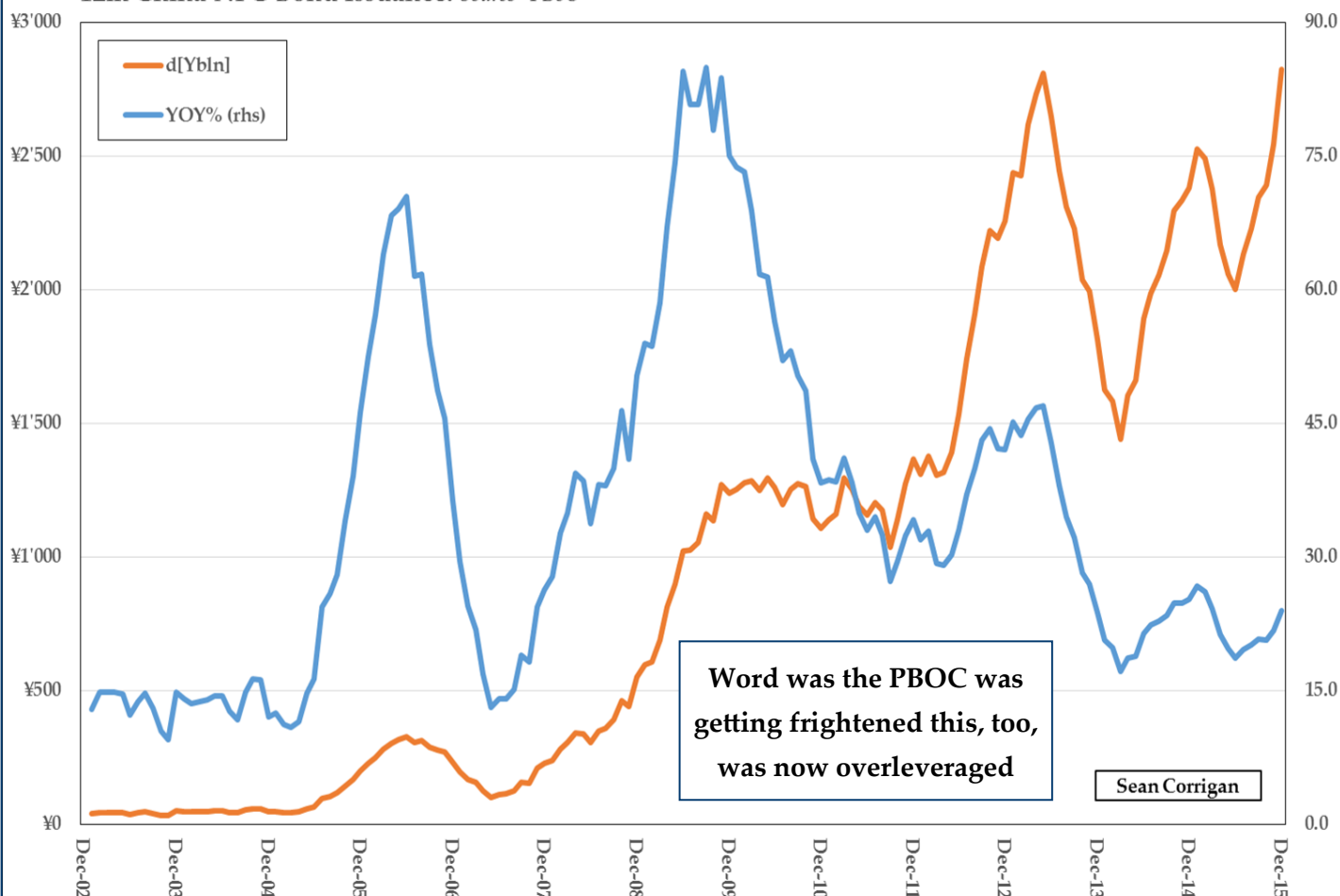
Since that report's cut-off point, the reserve total has fallen by a further \$285 billion. This is made up of a known outflow of \$115bln plus a revaluation effect of \$70bln in QIV to which we need to add what is likely to be mostly an outflow of \$90bln in January – an assertion we make on the basis that there was then too little movement in currency rates to be of much concern for the overall arithmetic. Additionally, net FDI was a paltry \$8bln in QIV and will at best be around \$15-20bln in January but, being received in forex. So, while the *net* positive balance is likely to reflect the estimated current account gain of around \$100-110bln, we are again left to guess how the necessary \$420 billion outflow (that same \$110bln plus the \$25bln needed to offset the FDI and the \$285bln drop in reserves) was being appor-



12m China Non-Fin Equity Issuance: Source - PBoC



12m China NFC Bond Issuance: Source - PBoC



IL MILIONE: Tales from Cathay (continued)

tioned.

Whatever the case may have been, we can definitely say that the reserve component definitively dropped by as much as 8% in that all too short, four month interval - a 25%-a-year clip which is a faster drain than even Saudi Arabia is presently experiencing (see later). Be aware that we have no real idea either how much of this remaining stockpile actually stands at the ready disposal of the authorities - rather than being locked up in quasi-political activities funding Latam, Africa or countries 'Along the Way'. It would be reassuring to know, therefore, that some good part of this latest diminution had gone towards liquidating the more easily withdrawn portion of China's external obligations, not least some chunk of its \$1.1 trillion in 'other' liabilities, such as loans and trade credits.

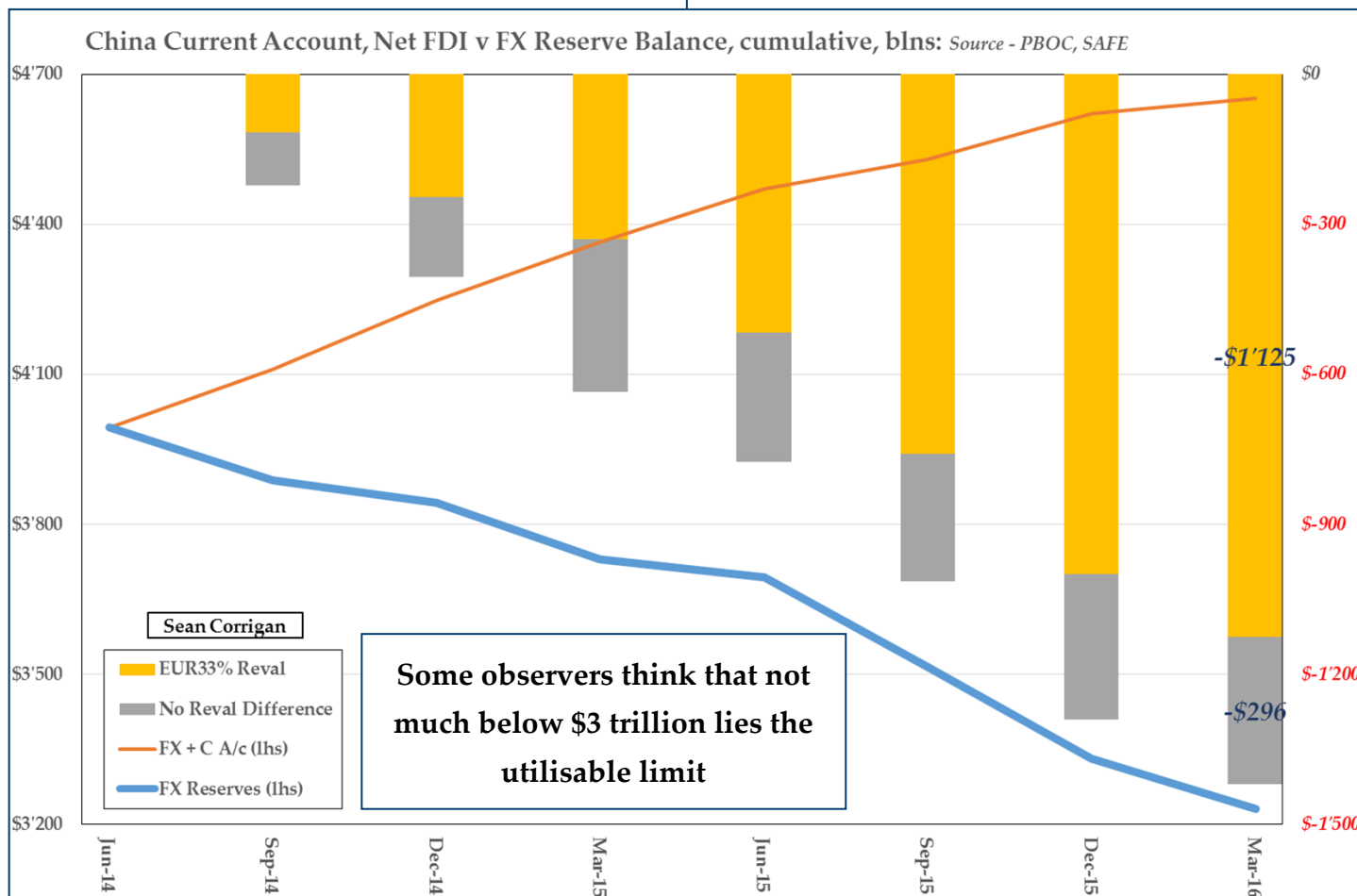
Regarding these, a separate breakdown provided by SAFE tells us that the nation's external 'debt' (a category not entirely consistent with the other tale of its overall obligations) stood at just over \$1.5 trillion in September; that \$1 trillion of this was short-term in nature (half of that related to trade credits); and that just over 50% of the total was

denominated in foreign currencies, of which latter the USD took up the lion's share at four-fifths of the whole, or around \$640 billion.

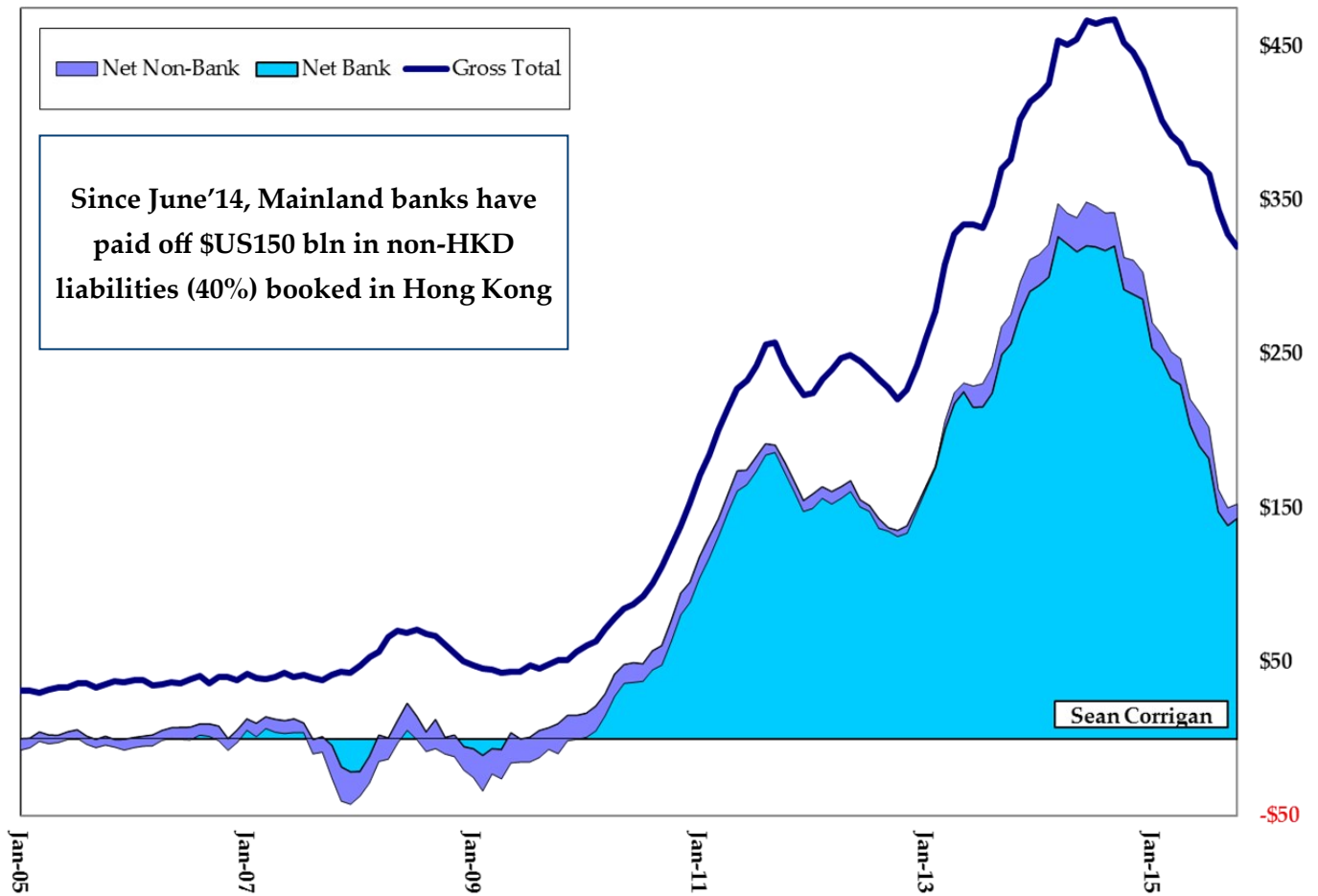
As we say, unknown unknowns abound but there remain enough knowns in that little lot to keep us uneasy in our beds at night.

One thing that the Chinese authorities cannot afford at this tricky juncture is to excite any loss of confidence in either their leadership or their perceived grasp of events. If that were to happen, not only could the currency come under an insupportable degree of pressure, but the whole internal architecture could be threatened, and Xi's seemingly iron grip on power along with it.

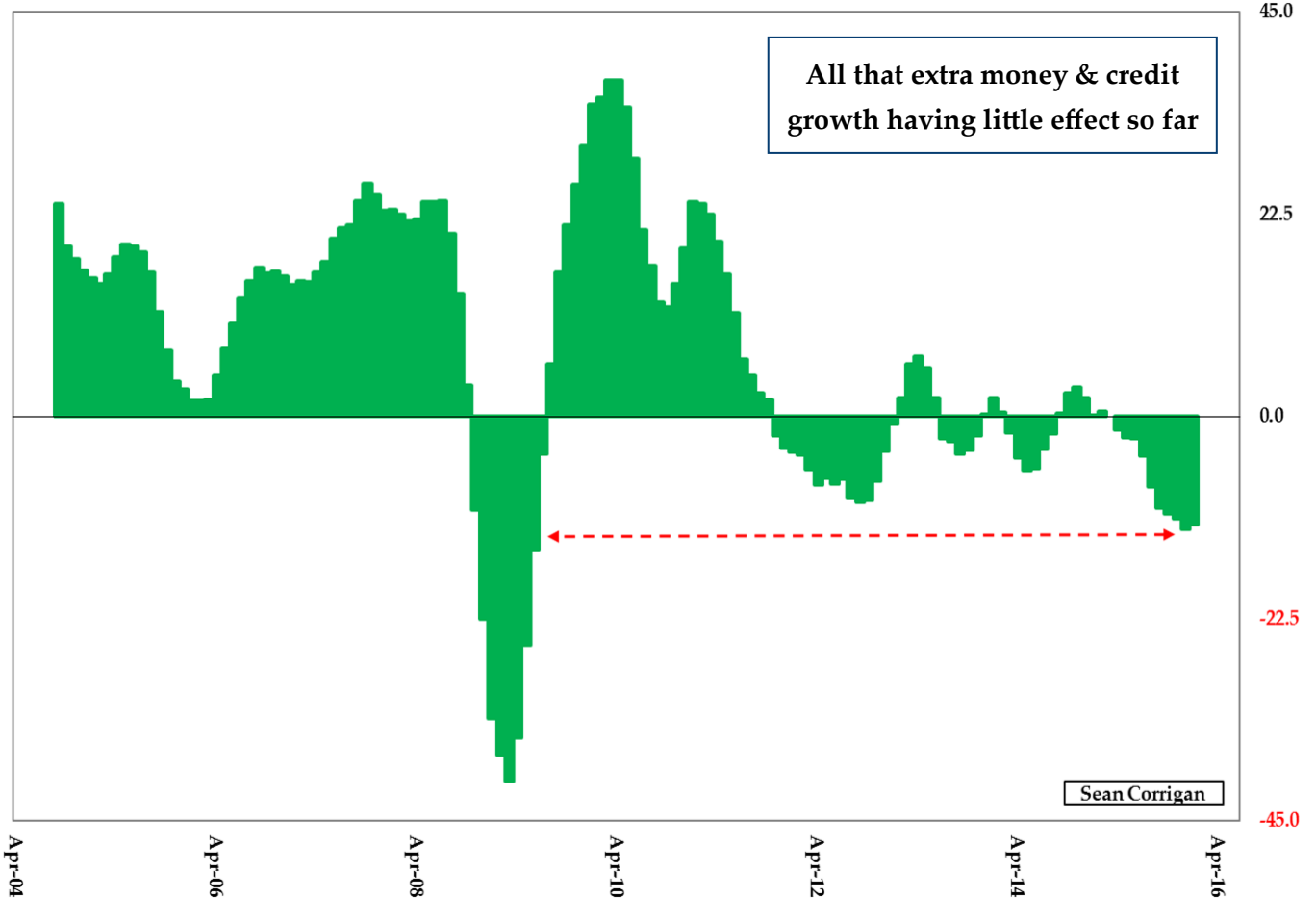
Thus the recent spate of revelations of what Walter Bagehot memorably termed 'ingenious mendacity' been anything but helpful. First there was the CNY4 billion bill scandal at ABC where a pair of chancers at the firm emptied a safe of banker's acceptance certificates, stuffing the strongbox with newspapers by way of disguise, before selling them on and using the proceeds to play the summer's stock market bubble.



HK Net Forex Claims on China in USD: *Source - HKMA*



CSLA/HSBC/CAIXIN PMI-50 6MOS SUM



Then there was the CNY1 billion embezzled for much the same purpose in what looks like a classic, 19th century episode of bill 'kiting'. This took place at another of the countries giants, namely CITIC – an institution often referred to as the 'Goldman Sachs of China'. Here, a group of enterprising employers first forged evidence of collateral (surely not a commodity warehouse receipt!) in order to raise an acceptance which was then sold on not once, but multiple times.

Next up was the egregious case of Ezubao a firm which purported to be one of the country's larger P2P lending brokerages but which, it turns out, was little more than a crude, \$7.6 billion Ponzi scheme. The result of the defalcations here – to use a suitably Victorian word to describe a typically Victorian crime - was that the savings of up to 900,000 (sic) small investors were frittered away on a short, but undoubtedly sweet, spell of high living on the part of the company's 'executives'.

Deplorable enough in their own right, the fact is that in China's financial *demimonde* of wildcat banking, shadow lenders, and off-balance sheet vehicles – one half set up to circumvent regulations, the other to perpetrate outright fraud – such operations are all too common; each exploiting with consummate ease the average Chinese Auntie's hunger for an outlet for her family's savings which pays something above the rise in her household's cost of living.

Having been burned in real estate, the stock market (twice), gold, rare earth metals, and who knows what else besides, if this sort of thing continues, the authorities must presumably dread the day that she steels herself to take one more gamble, places a bet against the yuan, and simultaneously puts her hard-scrimped pin money far beyond the reach of the local charlatans, once and for all.

As for the PBoC, the complexities of its task become more entangled by the day. Supposedly *en route* to liberalizing interest rates as well as currency settings, it is now resorting to a jumble of ad hoc policy directives which – with more than a touch of irony – are being openly derided by the same Western experts who wax so lyrical about their own dubious practice of applying 'macro-prudential' regulation as a sticking plaster for the sores of inappropriate monetary settings.

On the one hand, the Bank is all too cognisant of the liquidity effects of the FX loss and so is anxious not to pull out too many sticks at once from the teetering Jenga pile that is its gargantuan debt load. On the other, it is fearful of sparking of a new round of indiscriminate capacity duplication as well as supporting a further episode of ever-greening a whole host of failing Zombie firm loans such as comprise the Y5.5 trillion which Haitong calculates is concentrated in just the four struggling industries of coal, steel, other metals and cement.

Another dilemma is that it is a keystone of policy to help clear the sprawling property overhang plaguing the lesser cities and townships – hence why the regulators have just reduced deposit minima on both first- and second-homes there by 10% - but it also knows it must not do anything to add further fuel to the wild property mania blazing through the principal Tier-1 cities of Shenzhen, Shanghai, Beijing, and Guangzhou - in the first of which, for instance, prices are up by an incredible 74% YOY.

Thus, rather than effect across-the-board RRR cuts, the Bank now proposes to offer access to its facilities on what amounts to a case-by-case basis. Does the commercial bank in need of funds lend money to 'green' or technology companies or the VCs guiding them (good), or to steel mills and coal mines (bad)? Does it operate in a province or lower tier city where extra credit support has been deemed appropriate or in a megalopolis where the aim is to discourage inward migration? Has the bank minutely observed the latest directives on leverage, loan ratios, LGFV bond buyback quotas, mortgage down-payments, and a host of other stipulations? If so, it can borrow this much but not that much, at this rate but not that, and for this period not the other.

This is all so mind-boggling and so resistant to rational planning that it's surely much easier to lift the very next offer for greenbacks one sees and be done with? If enough locals come to share this conclusion, we could be in for a pretty wild ride in the coming months.

WHERE THE MONEY GROWS: Wall St. and West

Bubbling in the background of all this is largest question of all, viz., whether the US is already in a 'recession'. In part this is a meaningless debate since it tends, for the majority, to be framed in terms of the arbitrary yardstick of the 'two successive quarters of GDP contraction' which they were taught to think of as decisive and we are a long way from that yet.

What is true, as we hope to demonstrate (not for the first time!), is that what we call the 'upper end' of our productive structure is struggling. Extractive industries, of course, are a horror story but problems can be discerned also in the equipment and capital goods industries – in fact, in manufacturing in general. Foreign trade is similarly depressed, as it is for so many great commercial nations. Domestic freight is feeling the strain alongside this, with the CASS indices showing an unusual YOY retracement.

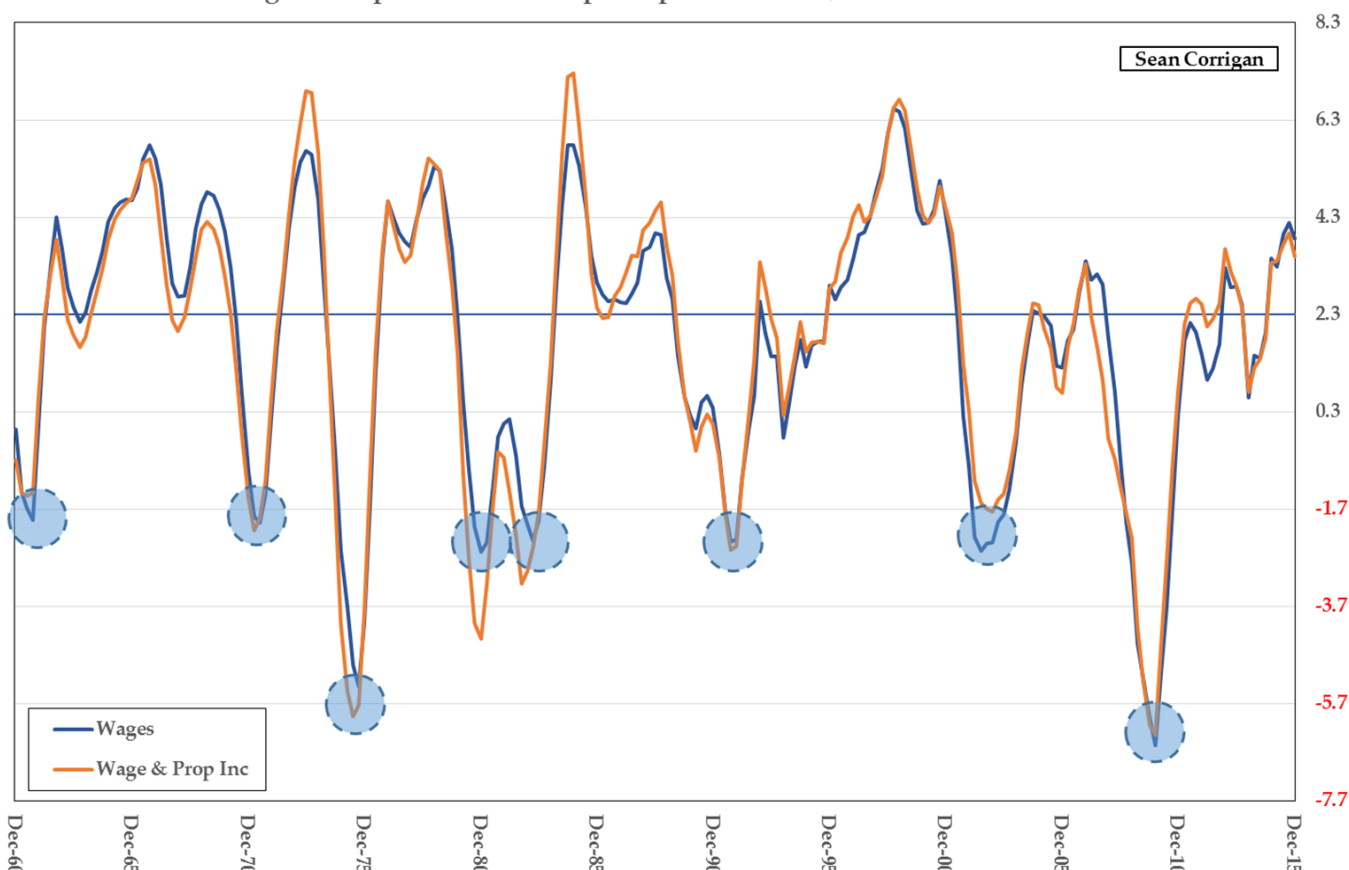
In that other great cyclically-sensitive sector – construction – there is, as yet no real sign of weakness. Spending remains robust in both the RE and the non-housing subdivisions, running at double-digit rates in each though, if one squints closely at the chart, with a hint of deceleration

in the former. Nothing so far to trouble employment, however, with headcount, hours worked, and wages all rising admirably.

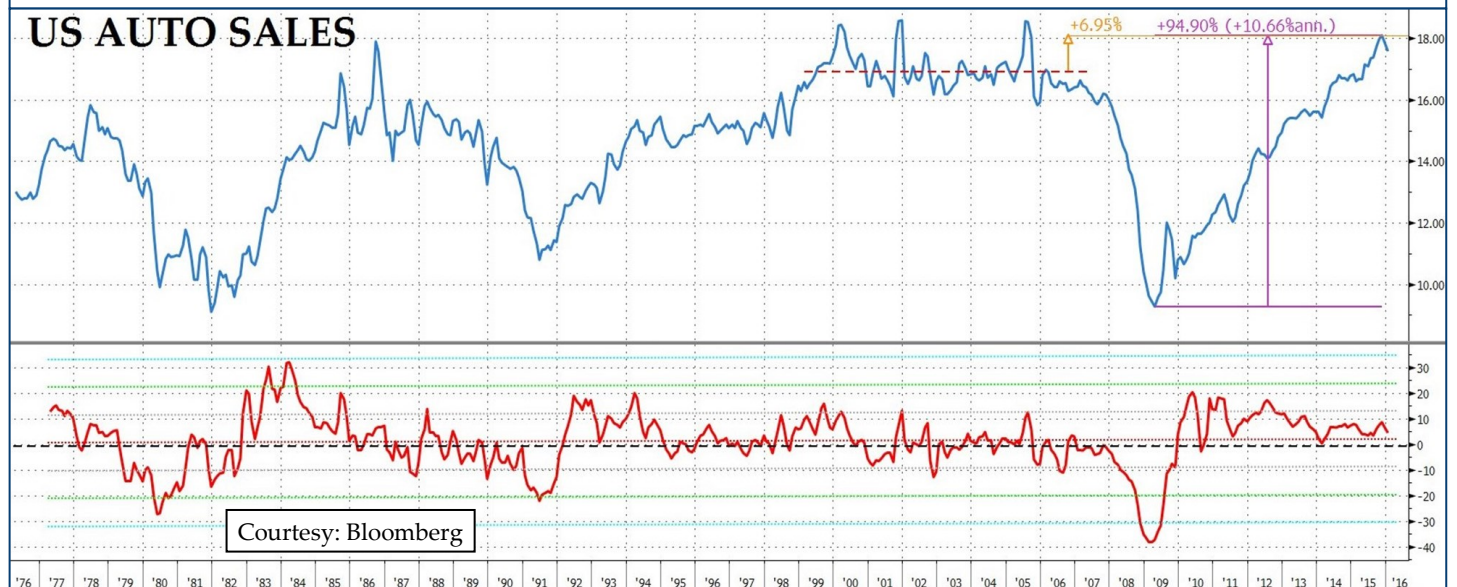
Right downstream at the retail end, revenues (especially ex-fuel and gasoline), jobs, and pay are also on an upward trend insofar as we credit the official numbers. Standard-bearer for this has been the auto industry, where sales have doubled since the trough of 2010 to stand close to a record high – in part, thanks to a 50% surge in auto credit which now stands 25% over the pre-Crash peak at no less than \$1,040 billion – or almost two years' worth of sales valued at \$30,000 apiece.

Finally, Leviathan is starting to shell out after five years of highly uncharacteristic restraint. Though as yet modest in historical terms, Federal government outlays are rising at a 5% annual pace, state and local ones a touch more slowly. Between them, they are borrowing over \$2 billion a day in order to do issue their tickets, fill in their forms, and dream up more pettifogging productivity killers, mobilizing other people's idle cash where not being monetized directly by the banks, as they do.

US Real Private Wage & Proprietors' Income per capita: Source - BLS, BEA



WHERE THE MONEY GROWS: Wall St. and West (continued)



For a mainstream pundit, that might be good enough, but we Austrians tend to fret that the imbalances in the system which arise from an injudicious use of credit and the capital misallocation which usually follows it can keep the lower orders simmering nicely while the higher end has come badly off the boil – indeed, in the classic narrative of the cycle's progression, that very combination itself provides the clearest evidence that a bust may well be imminent.

The most positive feature of the overall economy at the moment is the state of income and employment, especially when one takes into consideration the presently subdued rise in the cost of living being felt. Initial claims sit at major lows, the moreso if we adjust for population size, while the development of real earnings *per capita* arising from productive work – which we define here as private wages plus proprietors' income – is well above the long-term median and, indeed, at the top end of the past 15 years' range. A fact not as widely appreciated as it might be, it is nevertheless the case that the slowing rate of population growth which obtains in the US – most markedly in comparison with the 'Echo Boom' years of the 1990s – should not allow the casual use of the gross numbers in isolation to paint us a deceptive picture of an overly anaemic upward phase.

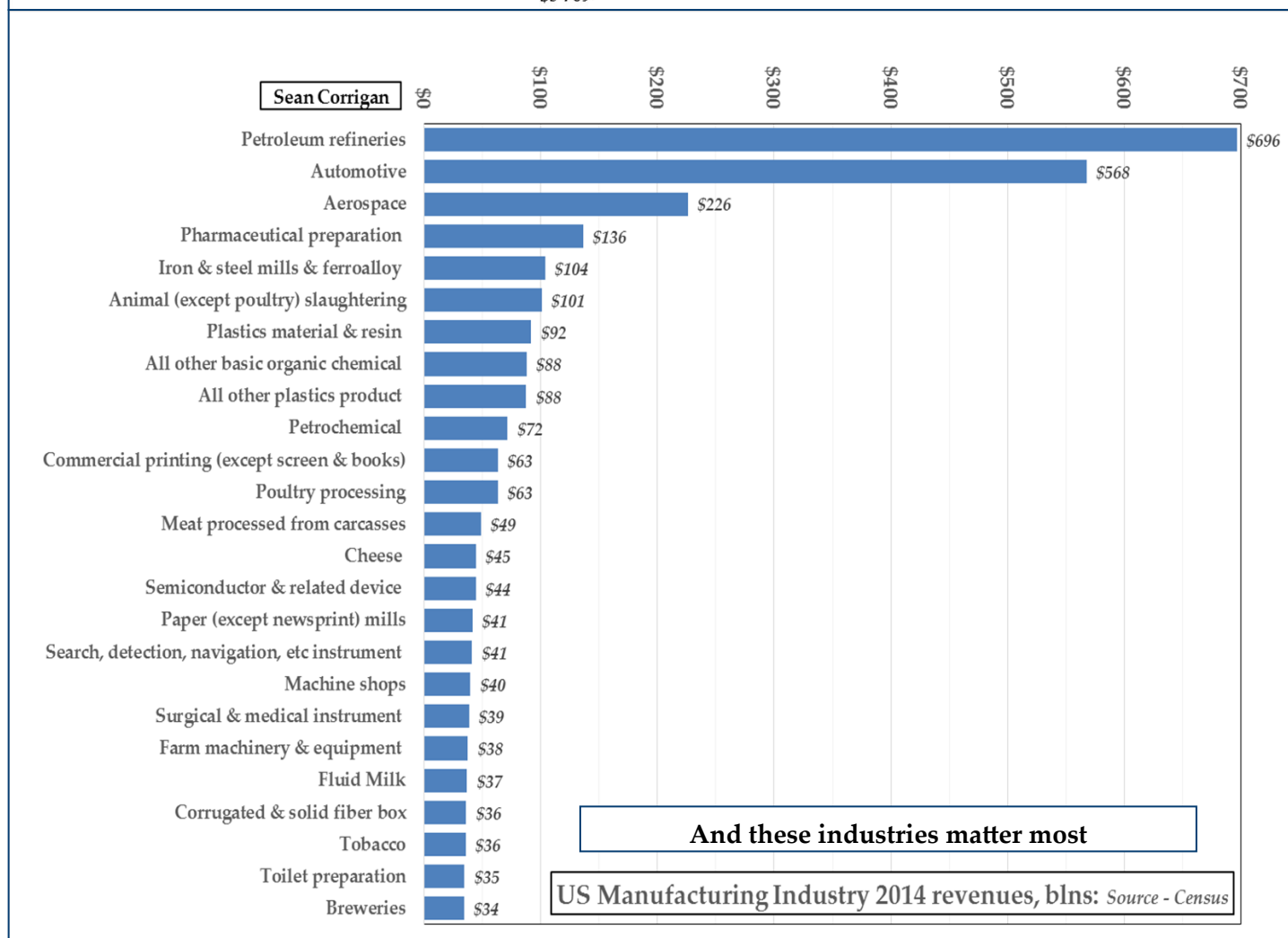
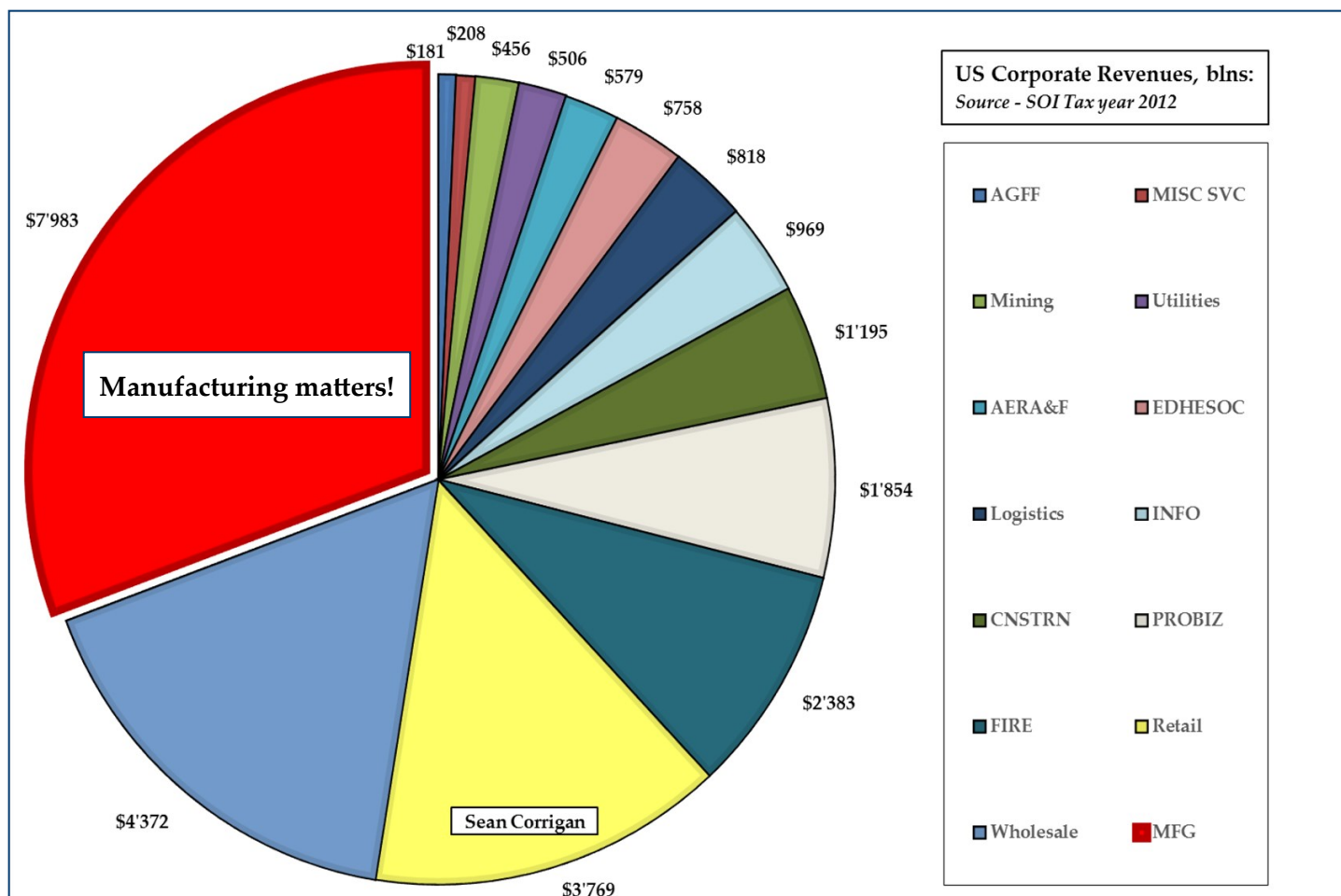
Supporting this – though with the caveat that the latest month's NFP data may well have some of its slightly anomalous strength revised away in the coming releases – we find that the last seven months have delivered private wage fund growth (hours worked x wage rates) of 5.9%

annualized, an 18-month high, the second fastest since the height of the last boom, and 1.8 sigmas above the tight, rising trend of 4.5% per annum enjoyed during the whole of the last 6 1/2 years of recovery. Strip out the lowly rise in the personal consumption deflator and that same 7 months' change translates to real gains of 5.1% annualized – the second best recorded in almost a decade.

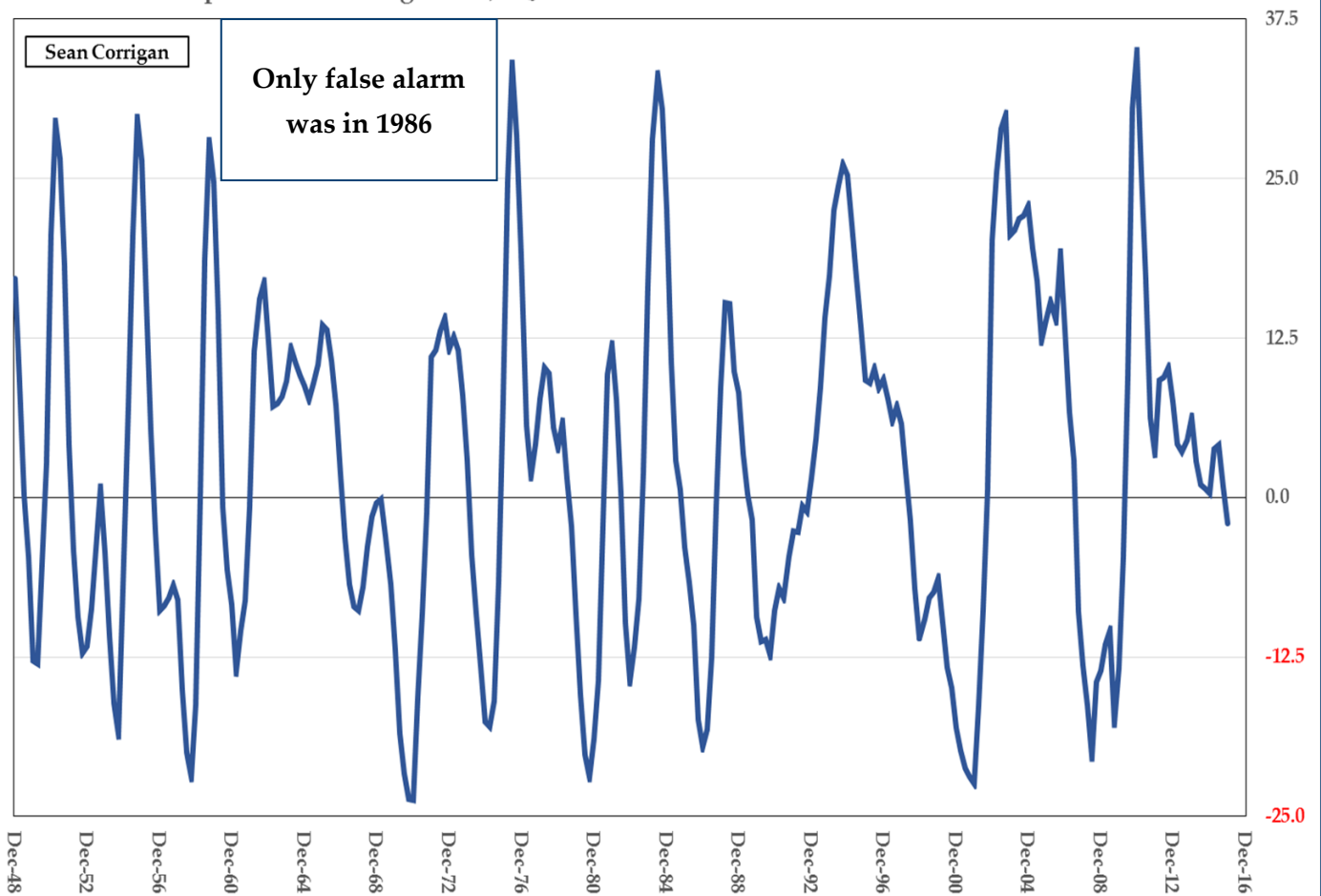
In terms of sectors, the divergence we have mentioned above is also obvious. Wages earned in the extractive industries were off 18.3% on a year ago – continuing a slump which is now of a kind with the previous great collapses of 1983, 1987 and 2009. For its part, the manufacturing wage fund eked out a 1.7% YOY rise in the past three months, even with January's mildly suspicious upward jink there to boost the result. That is the most tardy gain in the past 2 1/2 years and as such lies well below the 2.9% recovery trend.

By contrast, though somewhat softer than of late, retail wages earned were increasing at an above trend 4.2% pace and construction, as was to be expected from the robust spending numbers, was climbing by 7.5% yearly, clearly ahead of even its own, rapid 6.2% trend.

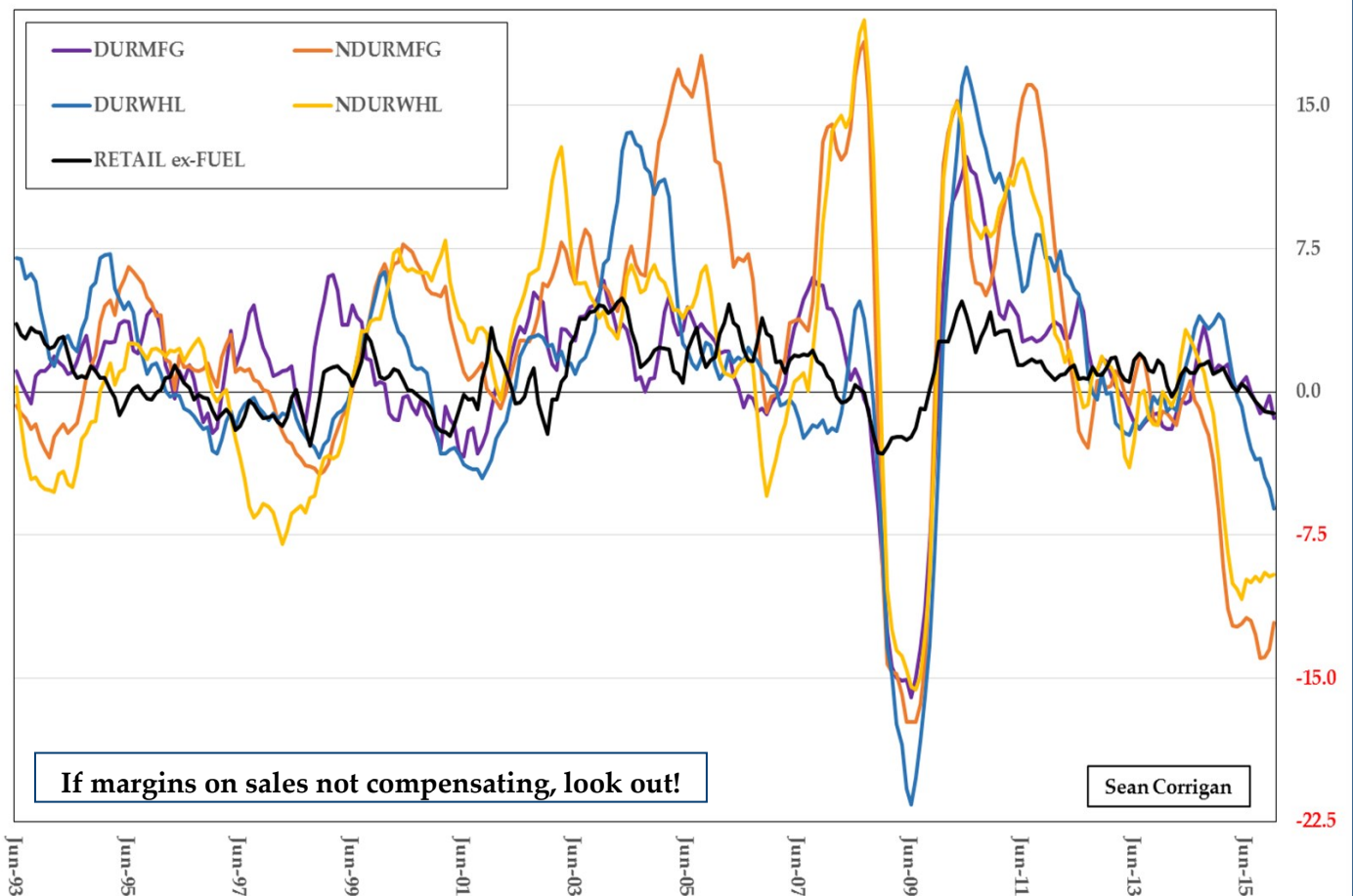
While no-one would be churlish enough to gainsay such an improvement in the lot of the working man (or at least of working *men*, collectively), basic reasoning tells us that outlays on labour must be compensated for by sufficient returns to capital to make its continued employment worth its hirers' while. Thus, if wages outstrip profits, the likelihood is that jobs will eventually suffer. Likewise – with the

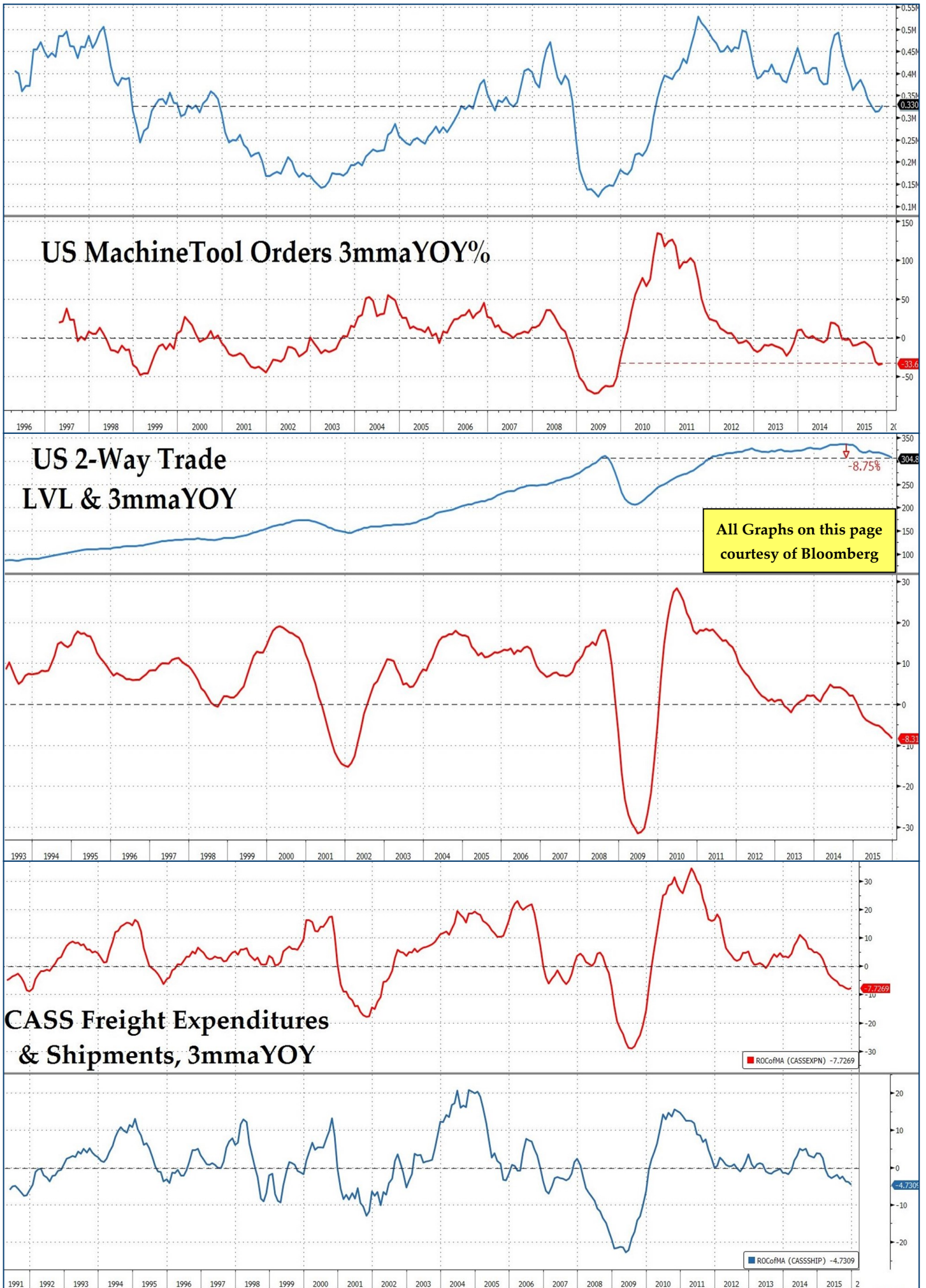


US NonFin Corporate Profit/Wage ratio, 4QmaYOY%: Source - BLS



US Biz Revenue v Wage Fund, 3mmaYOY%: Source - BLS, Census

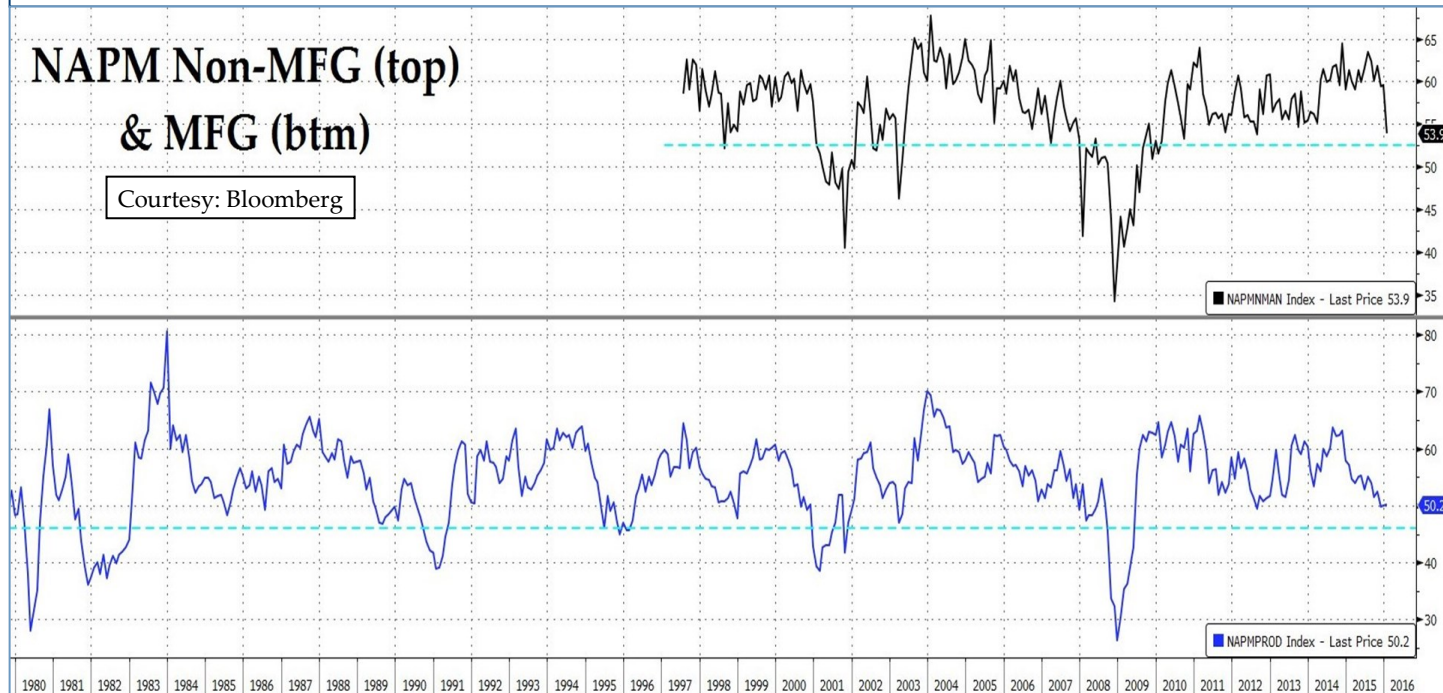




WHERE THE MONEY GROWS: Wall St. and West (continued)

NAPM Non-MFG (top) & MFG (btm)

Courtesy: Bloomberg



caveat that large changes in the price of other inputs may not always be wholly reflected in all important operating margins – we should start to worry if wages grow, but sales fall, not rise.

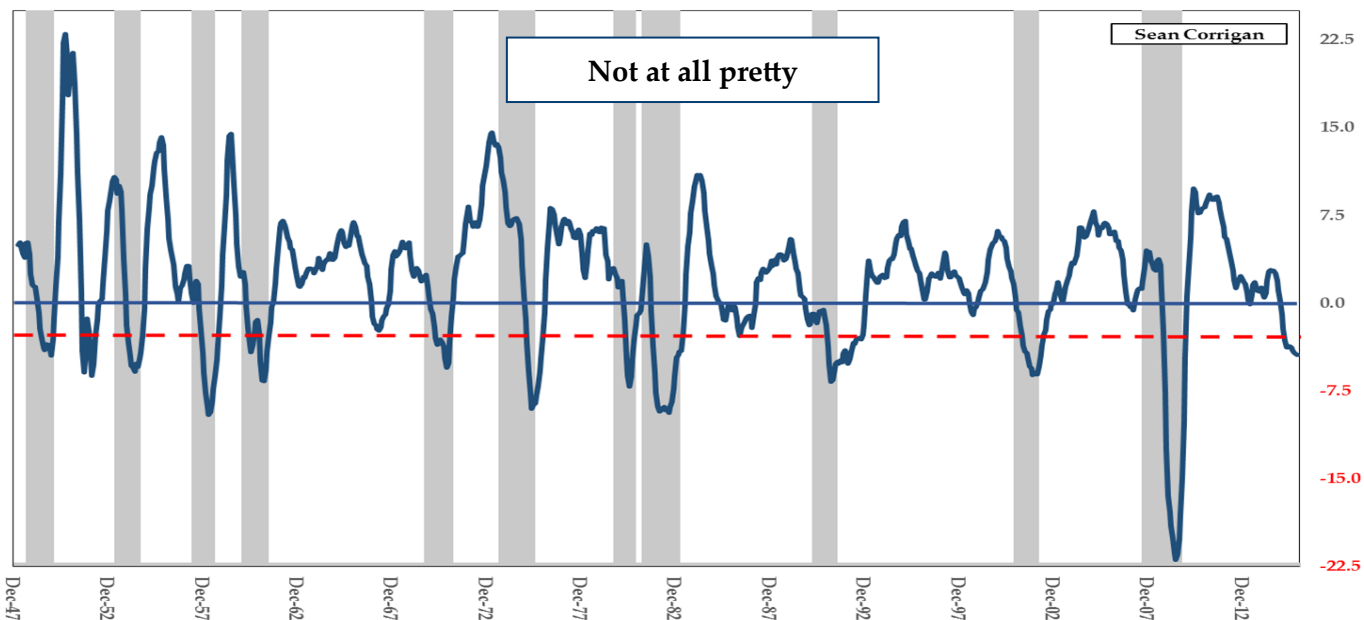
On this basis, we should be far less sanguine that the current spell of good fortune is destined to continue. Reported company earnings – especially when adjusted for share count – are nothing about which to be overly joyful (one can draw a suitably jaundiced conclusion about what such easily manipulated numbers mean for the actual cash jangling into the till). Sales are even more decidedly soggy, if a little less so once we strip out all energy-related activities.

Turning away from the real side of the economy, on the surface of it, the growth in money supply – both in real and nominal terms – is far too rapid at the moment for us to fret about an impending collapse in activity. Here, however we must be careful not to draw too rigid an analogy from the past. In a world of QE and ZIRP/NIRP, it really might be somewhat 'different this time' when it comes to low opportunity cost money being used just as much as a savings outlet as a transactional medium. Furthermore, the general economic uncertainty which has resulted from governmental caprice as well as from extreme central bank heterodoxy may also have heightened the precautionary demand for money, further depressing the active nature of the whole.

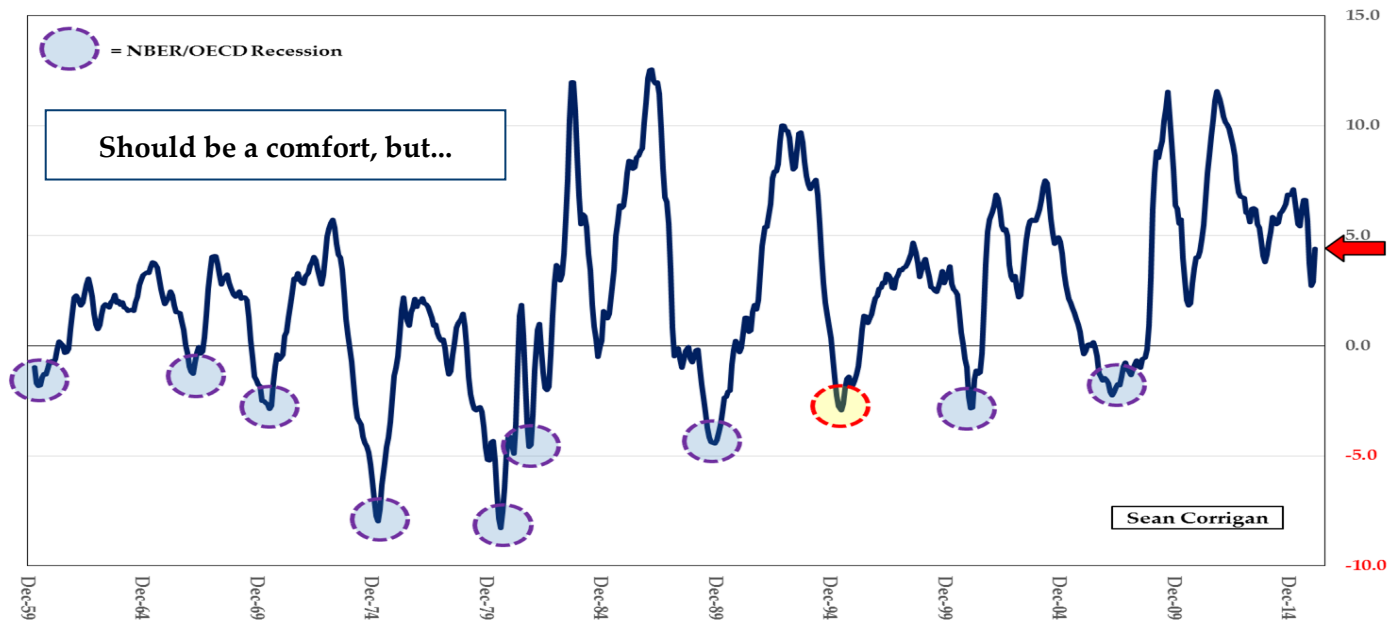
To sum up, several indicators are clearly in the danger zone, one or two others – the likes of the NAPM series (which do admittedly tend to move in a loose correspondence with revenue), and credit spreads (even now!) – have fallen into the grey zone between expansion and contraction. Against that, the only ones still above the economic Plimsoll Line are to be found mainly in the jobs market – usually more of a weathervane than a satellite forecast, of course – and involving businesses which are highly dependent on individual outlays of cheaply borrowed money – cars and homes, to the fore.

Wealth creators in the doldrums: wealth consumers making way under full canvas. We've all been *there* before!

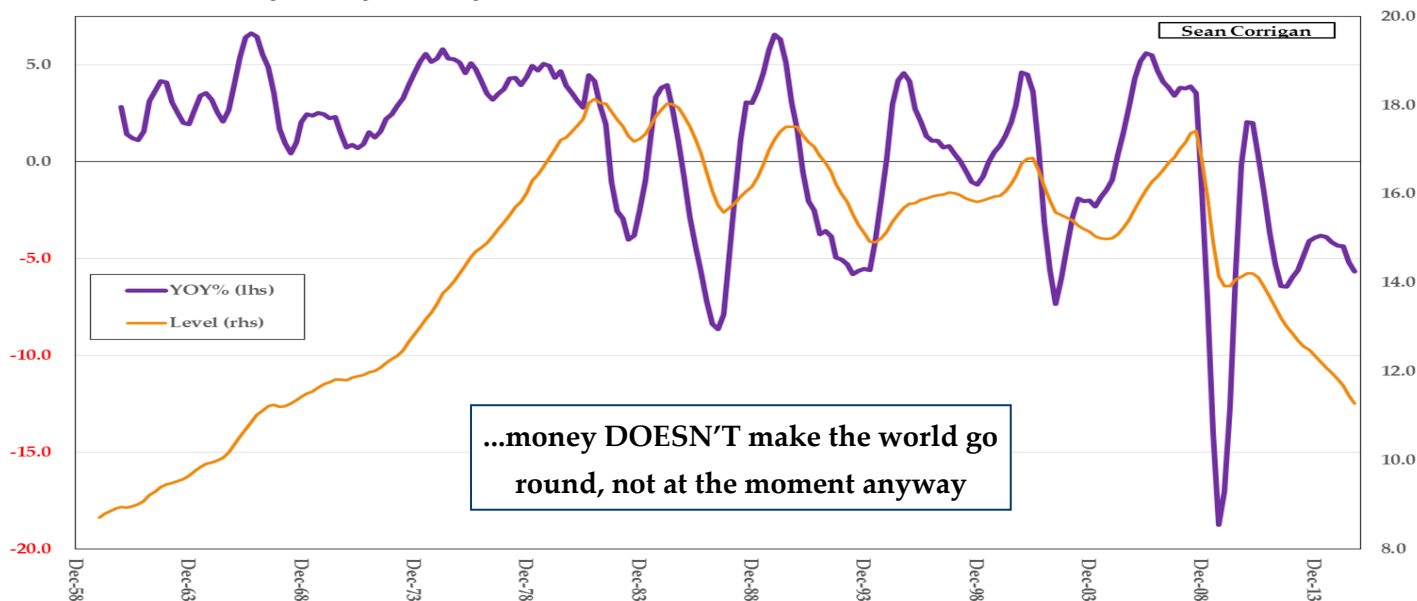
US Real MFG, Trade & Construction Sales, 3mmaYOY%: Source - Census, NBER, FRB



US Real M1+, 3mma YOY: Source - FRB, Cleveland Fed



Whole Economy Outlay Velocity, 4Qma: Source - BLS, BEA, FRB



DRILLING DOWN: Thoughts on the price of oil

There has been a great deal of confusion generated recently about whether or not the fall in oil prices is beneficial or harmful, a hubbub in which some pundits have totally (and shamelessly) flipped position and in which some have tried to make a virtue out of their own incomprehension by trying to pretend that what was true at one level of prices is precisely not so at another.

As usual, the difficulties lie in the same two areas where most such faulty reasoning originates: the tendency to think in too aggregative a fashion and the inability to distinguish between 'what is seen and not seen'.

True, lower prices are *not* the same as a tax cut. Yes, the extra dollars either do get spent somewhere else or do not now need to be borrowed. But, no, this is *not* a neutral event.

If we suddenly all decided that we would walk everywhere tomorrow and not use our cars at all, dollars would still be spent, yes - but, on shoes, and socks, and foot lotion—the suppliers of which stand to make sizeable potential gains from the change in the *Zeitgeist*. This will not happen automatically, however, since they may not be able to expand supply rapidly enough at first to cope without causing undue disruption, due to an intrinsic lack of resources, skills, plant, and perhaps the finance to acquire them - and this no matter how great the incentive of the now higher prices they feel they might be able to charge or the greater volumes they look forward to selling.

Crude Keynesian hydraulics notwithstanding, the demand for water does *not* magically conjure up reservoirs, aqueducts, filtration plants, pumping stations, and municipal and domestic plumbing upon command. To lay down such things takes capital and – crucially – the time to employ it. Both those elements may have to be wrested away from other activities first, via the operation of the price system on the free market.

Conversely, now we have all taken to Shanks' Pony as our preferred means of transport, the whole of the vast industrial capital which has been tied up in the car plants, the toll bridges, the garages and gas stations and so forth would be thrown into chaos and relative disuse. Capital - real hard-won physical capital - would be in danger of being eradicated by becoming economically unviable under

the new circumstances. This is an undeniable loss which makes it clear that a sudden change in any economic variable, especially one as important and all-pervasive as the price of energy is potentially disruptive and inimical to entrepreneurial calculation.

If a marginal business which does not count too many members of the industry among its own customers now pays less for its oil, it has more for investment, perhaps for the payroll. Its shareholders, employees, and suppliers will be happy and will care little enough for the fact that the price of Houston Texan executive boxes goes down, or Monaco casinos get fewer thobe-clad punters rolling through their doors.

In the short run, such a redirection of flows would seem to balance out, but let us not forget the delays which will be suffered as the one industry expands and the other shrinks its footprint. Let us not forget either that the enhanced financial standing of the winners may not immediately compensate for the losses – to themselves and to their lenders – being endured by the losers. Such matters can be decidedly asymmetrical to the point that – in a worst-case scenario – the fall of one industry might so impair their creditors, especially the bankers among them, that the transfer of financial capital to the other might be less easily achieved than one might wish.

In the long run, matters are far less equivocal: cheaper oil takes us one small, but nonetheless significant, step back in the direction of Eden. It is impossible to deny that if we were suddenly to be showered with manna from heaven that the price of farmland would plunge and Massey Ferguson dealerships would be shuttered. But it would also be the case that human wants would be satisfied at no cost (beyond a little thankful devotion to the benign deity now smiling more expansively upon us), freeing us from some portion of our daily toil and allowing us to devote our efforts to either the satisfaction of other, previously excluded material desires or to the enjoyment of leisure, or the pursuit of culture or the arts. The same applies to oil.

The fraccers, in the end, may not have done themselves too many favours by being as successful as they have, but that is, after all, the nature of profit-based capitalism. That the outsize gains it can initially deliver are ephemeral, lasting

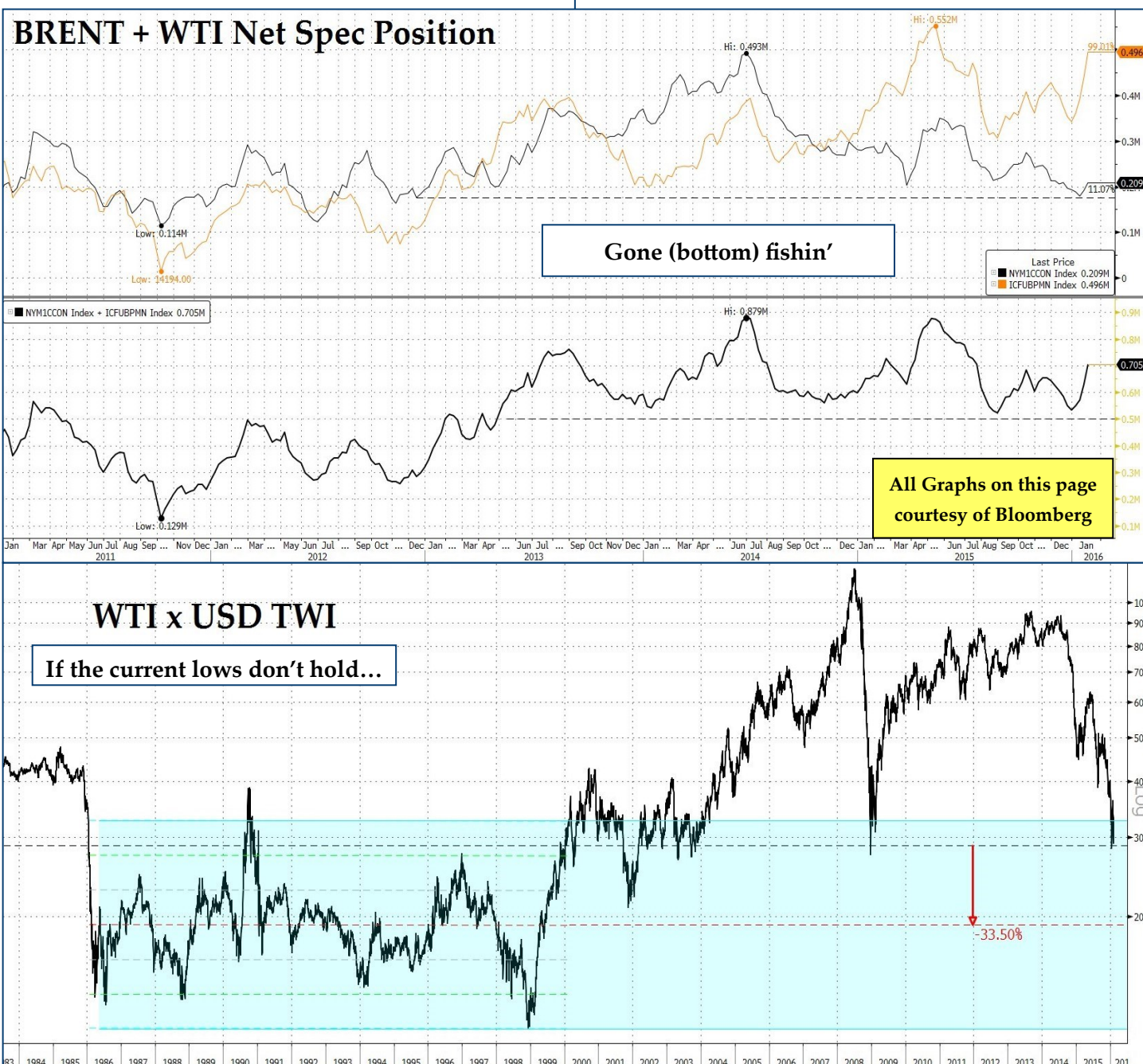
DRILLING DOWN: Thoughts on the price of oil (continued)

only until the grosser misalignments of ends and means which were spotted by the early entrepreneurs are arb'ed, innovated, and emulated away by their Johnny-come-lately peers is a well-known phenomenon of the free market – for all that such beneficent workings are often frustrated by those with the power to enlist the state to forcibly subsidize their loss of market standing at the expense of the unconnected populace at large.

What they, the fraccers, have done, however, is provide us with substantial benefits in the form of cheap, reliable, and - particularly in the case of natural gas – relatively clean energy with which to power our civilisation and to make

better progress in many other areas of our lives and businesses.

Thanks, fellas! Hope you make it out OK.



SEVEN PILLARS OF WISDOM: Fair Exchange is no Robbery

A closely-related area of muddle-headedness is the brouhaha over the dire financial state of the oil-producing nations and how dreadful it is that the likes of Saudi Arabia are no longer racking up enormous surpluses and keeping LBO specialists and Lamborghini dealers alike in clover as they variously speculate with it or spend it.

The first riposte we would make to the doomsters on this is, please at least *pretend* to be consistent! As addled Keynesian underconsumptionists, you usually whine that saving is an act of self-improvement and that nations daring to run a positive external balance are malicious free-riders, greedily sucking 'demand' from the rest of the world.

Well, now one large group of such culprits has had no choice but to undergo what you typically demand should be enforced upon the likes of Germany or China: its hapless members are spending more than they are taking in, running down their savings, and even posting current account deficits. How can you, of all people, bemoan this?

To the extent that there is anything at all bad in this, it is again a matter of adjustment: of hoping the eventual good accruing to the energy consumers will not be lost in the fall-out of the disappointment of those to whom they either had once to go in hock, or under whose groaning tables they used to scramble for crumbs.

As for the supposedly malign side-effects of large, relatively price-insensitive buyers of securities now becoming sellers, this too is a canard. However indirectly, the funds being 'invested' were effectively an exercise in vendor finance. Petrostan was supplying our needs on tick, now we are redeeming our debt by selling to it more than we are buying from it. Period.

As for the effects on the market, yes, there may be specific pockets of activity wherein the lack of means of its former sponsors is hurting, but if Saudi, say, sells a dollar CD from its stash to pay for its new import surplus, the buyer - if a bank - can record that IOU as an asset with which to offset the new deposit liability booked against Riyadh's supplier. In the somewhat rare event that the latter used to supply his energy needs from Aramco on credit what we have here is not a problem but rather the completion of an economic exchange - which is the point of it all, isn't it?

Saudi itself is undoubtedly facing challenges of a different order. The lack of revenue and the associated external bleed saw forex reserves drop last year by a sixth, or around \$115 billion. Things only got worse in the latter half of 2015, with SAMA's own share of forex slumping at a 19.3% annualized pace, dragging the monetary base down with it in a 13.2% annualized decline. Money itself underwent a 17% annualized contraction - a severe shock to any economy, much less one accustomed to that same measure showing a trend increase of more than *plus*-17% p.a. for much of the past decade.

Economics aside, in a country where politics is a matter of jockeying for position among the extended clan of descendants of the founding father of the kingdom and where the quietude of the indigenous masses is basically bought, not earned, any diminution of the flow of dole and patronage could be intensely damaging, even without the tensions which have only been heightened by wider regional differences and by Saudi's prosecution of a war with neighbouring Yemen.

All in all, the fraccers might yet have the last laugh.



Riddle me this, if you will.

‘Europe’ as a concept has perhaps never stood in lower regard, whether in the eyes of its citizens or those of us thankfully beyond its reach.

The Eastern Europeans are either incensed that Brussels is not being aggressive enough in its dealings with their ancient Russian foe, or are hopping mad that the EU’s poltroonery in the face of the American Neo-Con demands to help purge Putin is costing them valuable commercial links with their cousins across the steppe. The South still sees the North as a bunch of joyless Calvinist hairshirts, while the North is steeped in disdain for the workshy, transmontane spongers who lust after their carefully accumulated savings. And as for Perfidious Albion? *Ooh la-la!*

Meanwhile, across the continent, ‘Populism’ has sprung up in all its sweaty, uncultivated, culturally-conservative horror, much to the consternation of the Michelin star mandarins who are supposed to have their—and only their—momentary prejudices passed into law with few difficulties and even less discussion with members of the underclass.

Ah, yes, ‘populism’. That bitter harvest of disillusion which has spread at the fact that the promises of a chicken in every pot have not been kept by those who never *quite* seem to take a personal share in the same daily struggle to make ends meet that their misrule has inflicted on their electors. Can you imagine? The ingrates have cast about for other leaders, presenting the opportunity to a few bold men and women from beyond the privileged Platonic circle of the establishment to stand at the head of the *canaille* and scream ‘*Ca ira!*’ while pressed up against the pitiless railings which ring their local branch of the Ministry of Truth.

‘Populism’ - which is to say, that purer form of democratic politics which more closely tries to reflect the mood of the demos itself, of the grass roots, of the man in the street (not that a Burke or a de Tocqueville—or perhaps even a Jefferson—would see much merit in that purity beyond its sole virtue of displaying a refreshing lack of cant).

‘Populism’ - which sees the path to office in consulting and echoing the Mass as opposed to treating it with a weary contempt if only because the niceties of the exercise of power mean that the near-perpetual jacks-in-office who wield it must occasionally persuade a few among the tiny minority of the proletariat who can be bothered to do so to put a cross in the correct box on a rare visit to the hustings.

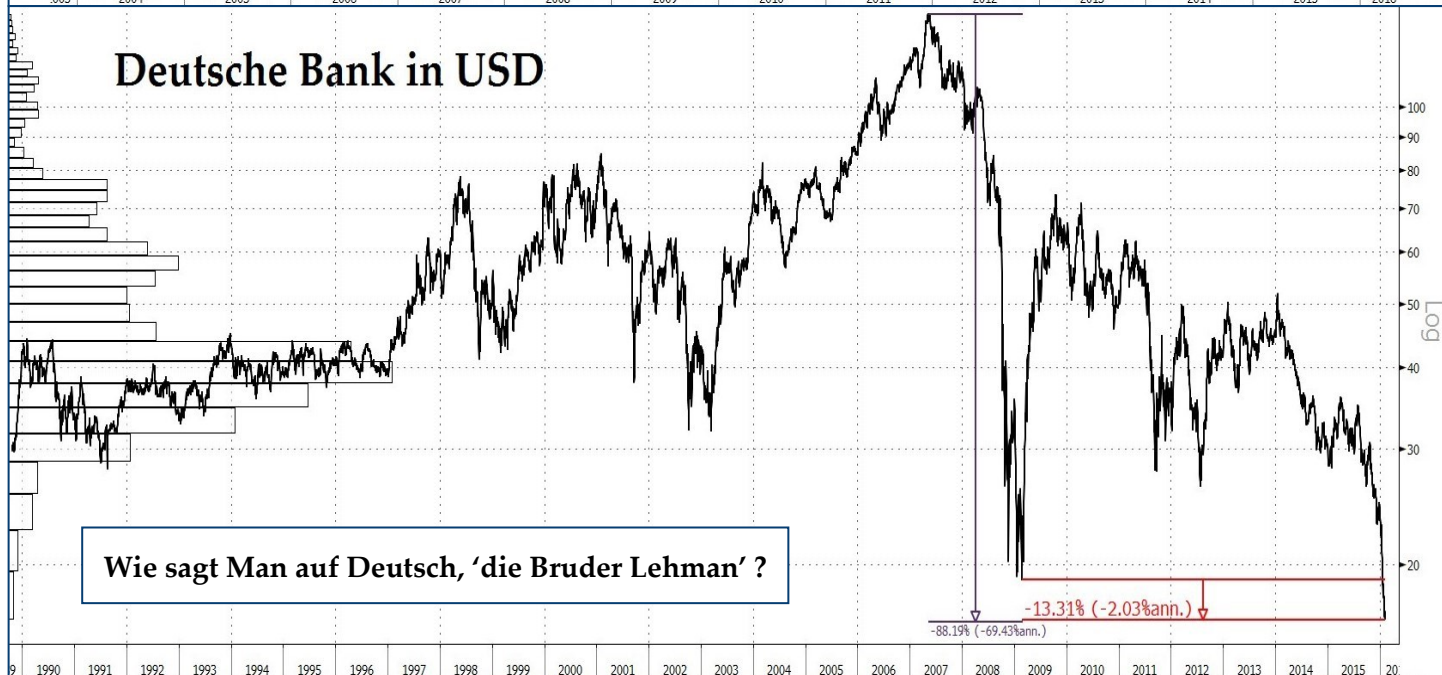
‘Populism’! Fancy having to rub shoulders with the *hoi polloi* and canvass their opinions at every turn! How can the expense-account be fully exploited and the necessary quota of virtue-signalling be carried out if one actually has to *represent* the plebeians? Do they not understand that politics is nothing more than a well-paid internship for the *Nomenklatura*, the men and women who are only engaged in ‘climbing the greasy pole’ in order to prove to some willing investment bank or accommodating hedge fund that they merit the rapid offer of a lucrative sinecure? How utterly distasteful all that ‘people’ stuff is when you have a nest to feather!

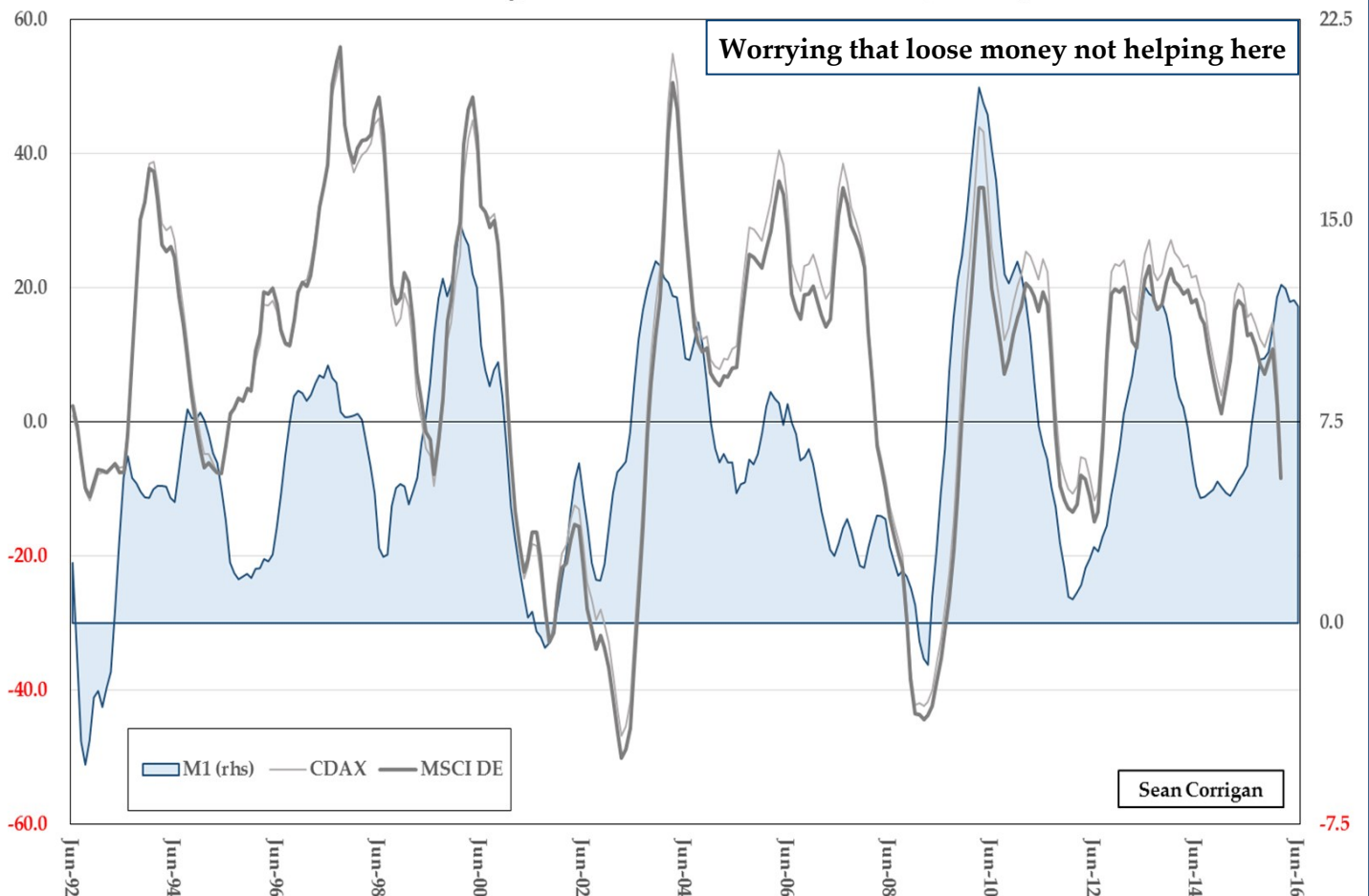
Then there are the nationalist and the separatists, the *Lega Nord*, the Catalans, Grexit, Brexit, the AfD, Pegida. There is Orban and Klaus, Le Pen and Farage, and a whole host of unsavoury Dutch and Flemings and Bretons and Savoyards and who knows what else besides? Mensheviks, and Splittists and Schismatics, every last one of them!

Do they not know that the only solution is MORE Europe? Monetary union? Fiscal union? Banking union? Legal union? Union union? More centralism? A greater monolith? Less accountability? Less local representation? Less appeal to difference, to culture, to local tradition? That every successive failure of the existing order only gives conclusive proof that the vestiges of the nation state, the regional council, and the parish committee must be unsparingly swept away so that the Europe of the overlords can triumph? Have they never even *heard* of Robespierre?

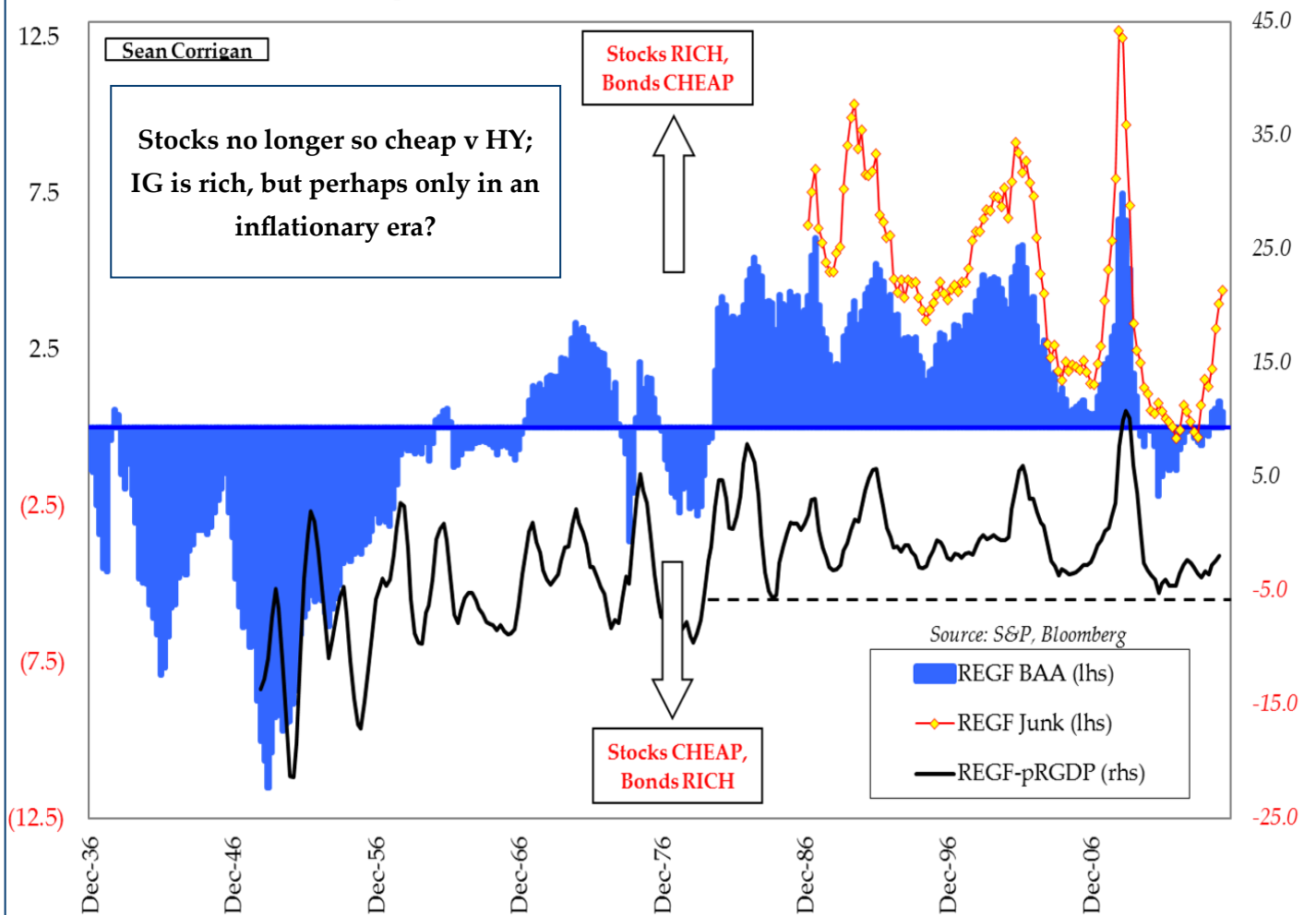
Negative interest rates meeting negative worth banks and insurers. Mass unemployment to be treated with mass immigration. Restructuring the restructurings and bailing out the bail-outs for Club Med forever. A vehement defence of the right of the accession-minded client kings who ring its borders to pursue their—but not necessarily their fellow citizens’ - unique vision of subjugative ‘self-determination’ in Western (but not Eastern) Ukraine and Moldova and Montenegro and Georgia and even in non-Alawite Syria, but none for those who would quit the Beast’s less than tender embrace and opt for a vigorous independence from the writ of its soft Soviets in session in Strasbourg.

And yet, amid all this the EURO IS GOING BID and FX options skews have hardly ever been MORE BULLISH? What do we think will happen to the currency if the likes of Deutsche Bank have their Lehman moment or, conversely, if Gosplan-am-Main comes once more publicly to their rescue, carpet-bombing the Continent’s thrifty in a thousand billion bomber raid of ‘whatever it takes’?? Ye Gods!

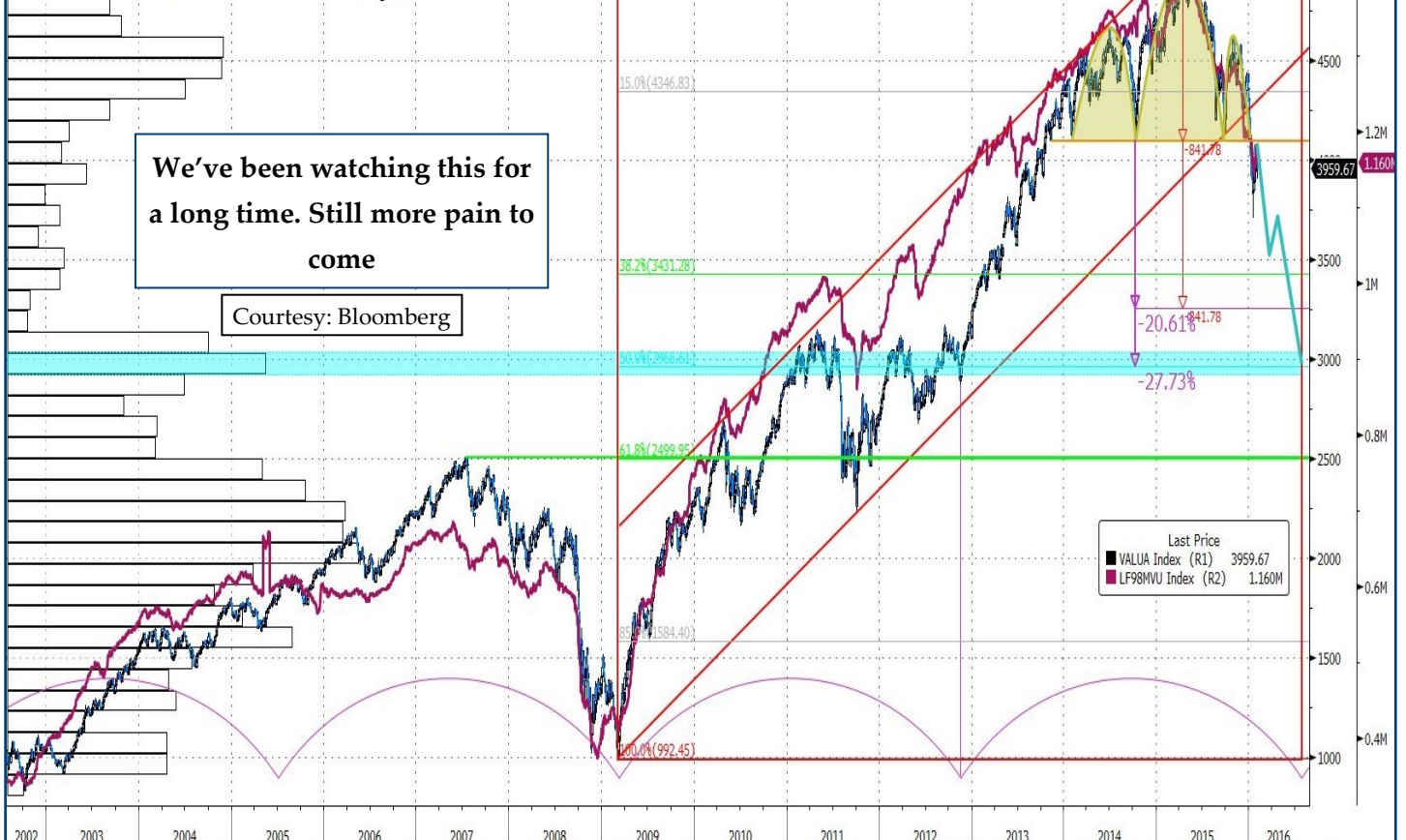




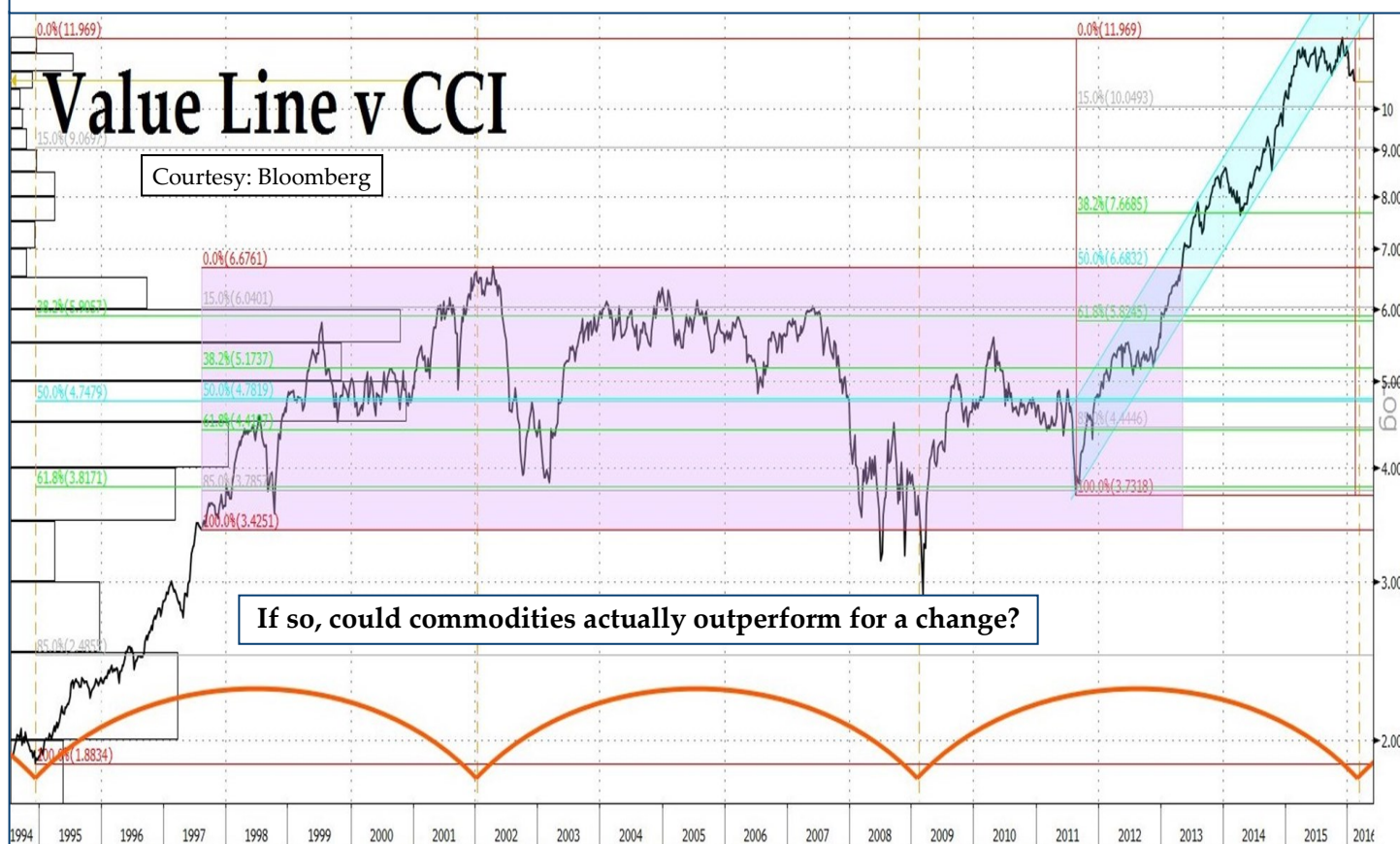
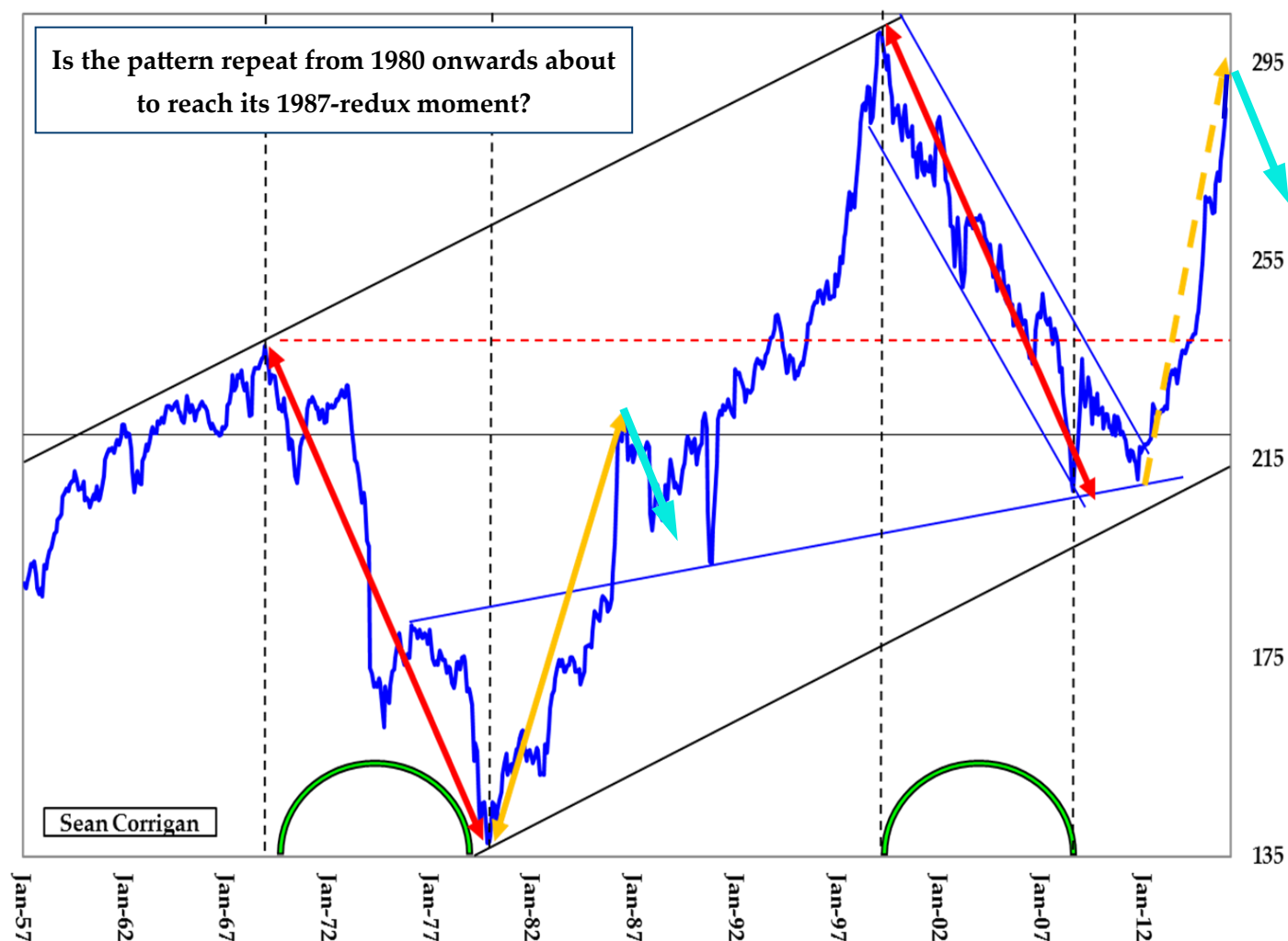
US S&P500 Real Earnings Growth Factor via BAA & Junk Yields



Value Line v Junk

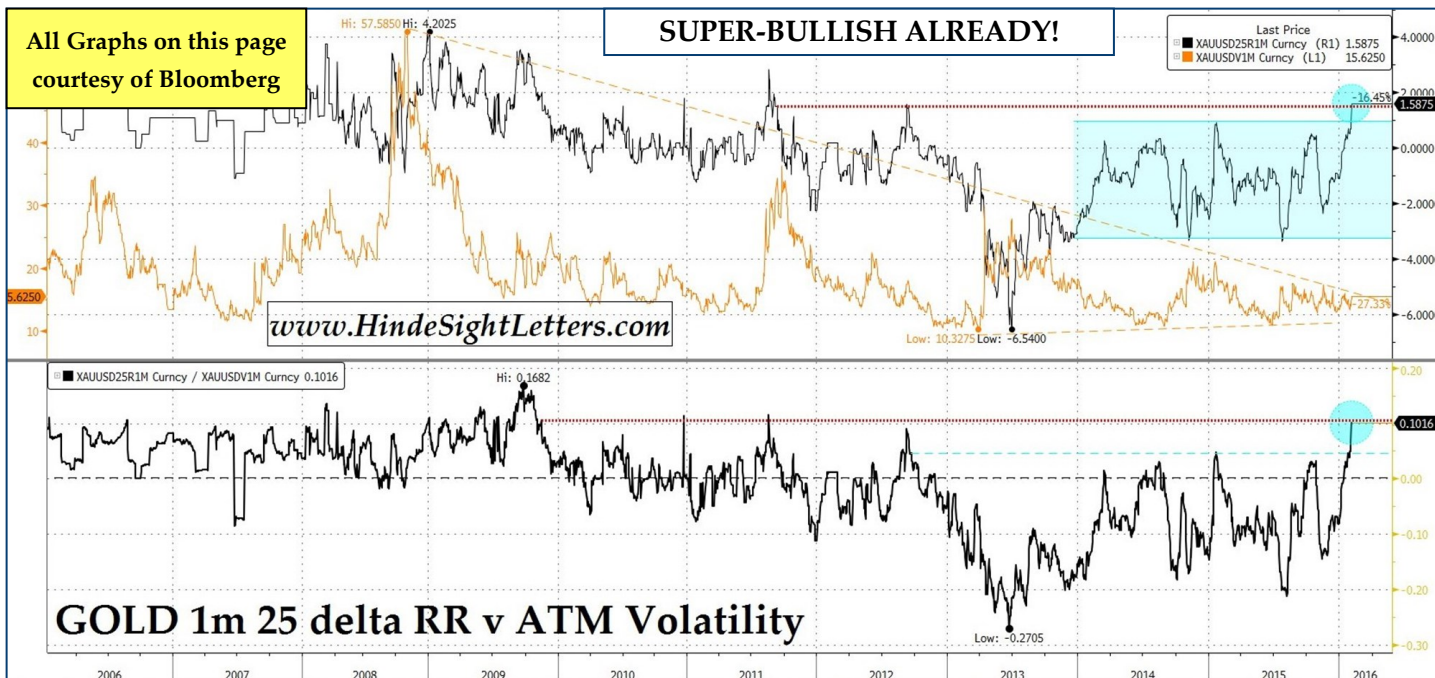


SPX v INDUSTRIAL CMDTY (log, rebased): *Source - IMF, CRB, IBRD, Bloomberg*



All Graphs on this page
courtesy of Bloomberg

SUPER-BULLISH ALREADY!



GOLD 1m 25 delta RR v ATM Volatility

**GOLD v IND CMD v
DB SUB CDS (red)**

Stress Magnet in operation



GOLD

Nice rally back to HVP/Trendline but now...?





All Graphs on this page
courtesy of Bloomberg

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