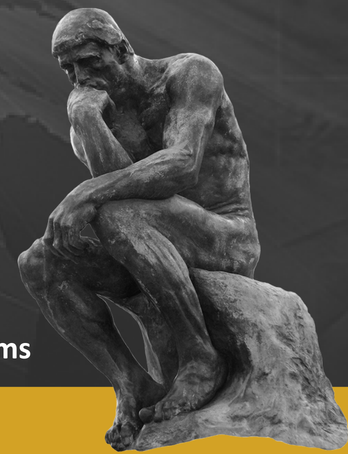
MAULDIN ECONOMICS

# THINGS THAT MAKE YOU GO Hmmm...

A walk around the fringes of finance

By Grant Williams





26 AUGUST 2013

## Never The Twain

"Oh, East is East, and West is West, and never the twain shall meet,
Till Earth and Sky stand presently at God's great Judgment Seat;
But there is neither East nor West, Border, nor Breed, nor Birth,
When two strong men stand face to face, tho' they come from the ends of the earth."

— Rudyard Kipling, The Ballad of East and West

"Sometimes – not often, but sometimes – the cranks and radicals turn out to be right. Sometimes Everyone is wrong."

— Mathew Scully, Dominion

"And the end of the fight is a tombstone white with the name of
the late deceased,
And the epitaph drear: "A Fool lies here who tried to hustle the
East.""

— Rudyard Kipling, The Naulahka

"The farther west he went, the more he was convinced that the wise men came from the East."

— Horace Russell

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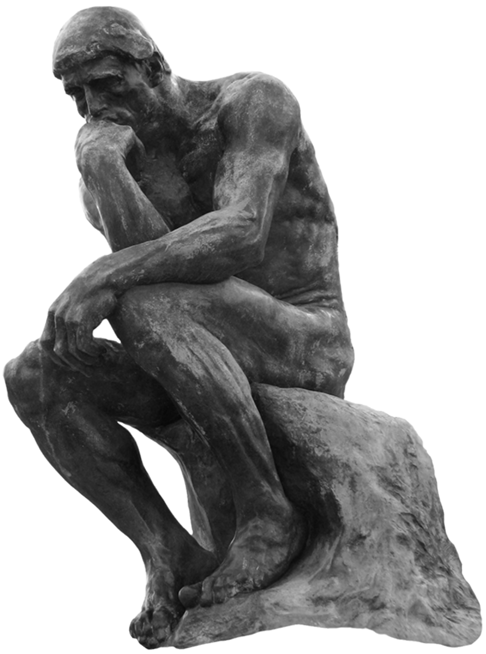
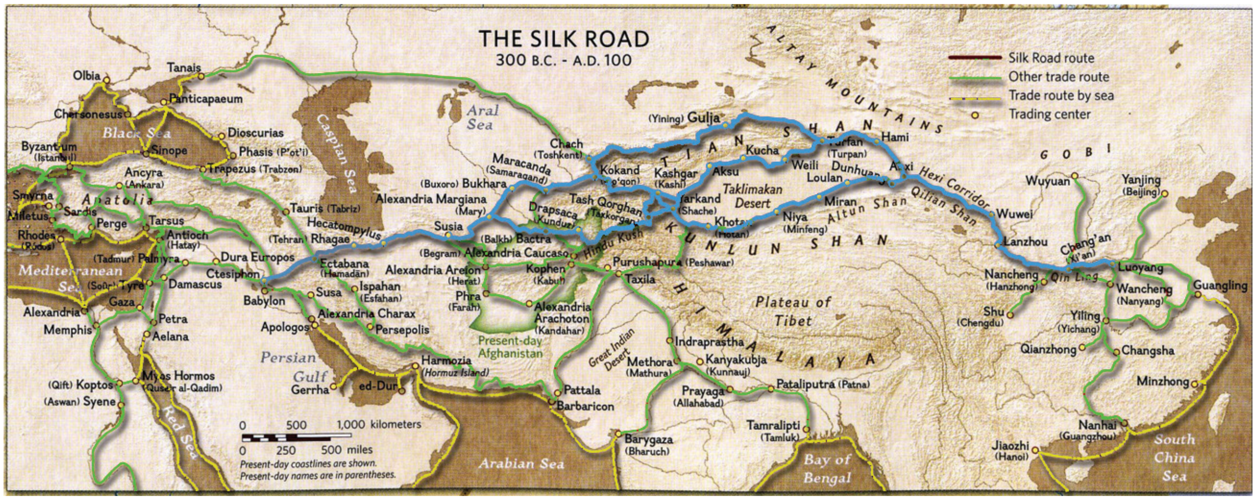


# Things That Make You Go *Hmmm...*




Source: Wikipedia

The mere mention of the Silk Road evokes a very different time and place, pre-Amazon.com, when trade was conducted face-to-face and merchants travelled on horseback and foot the breadth of continents to find buyers for their merchandise, returning with goods in exchange.

The Silk Road was, according to Wikipedia:

> *... a historical network of interlinking trade routes across the Afro-Eurasian landmass that connected East, South, and Western Asia with the Mediterranean and European world, as well as parts of North and East Africa. The Silk Road includes routes through Syria, Turkey, Iran, Turkmenistan, Uzbekistan, Kyrgyzstan, Pakistan and China.*

Extending some 4,000 miles from Europe to Asia, uniting West and East in trade, it took its name from the Chinese silk which, from the days of the Han Dynasty (206 BC – 220 AD), was bought and sold along its length.

Wikipedia again:

> *The central Asian sections of the trade routes were expanded around 114 BC by the Han dynasty, largely through the missions and explorations of Zhang Qian, but earlier trade routes across the continents already existed.*
>
> *Trade on the Silk Road was a significant factor in the development of the civilizations of China, the Indian subcontinent, Persia, Europe and Arabia. Though silk was certainly the major trade item from China, many other goods were traded, and various technologies, religions and philosophies, as well as the bubonic plague (the “Black Death”), also traveled along the Silk Routes.*

Silk and technology, good. Bubonic plague, not so good; but that sort of thing can happen when you open trade routes across continents, I guess.

The Silk Road endured through centuries of human expansion as Chinese emperors, Persian kings, and even Alexander the Great traveled the route, looking to open new markets for trade; but it wasn't until the first century BC that a discernible Silk Road (or rather a network of Silk Roads) was established by the Yuezhi and Xiongnu peoples of China, who forged a complex network of trade routes (and an even more complex set of diplomatic relations) with both India and the Western World.

However, it wasn't until the Romans conquered Egypt in 30 BC that trade and communication among China, India, the Middle East, Africa, and of course Europe exploded in both breadth and depth to levels theretofore unimaginable.

Yes, *theretofore*. I said it. And yes, it IS a word. No, it's not 1789; I just like the sound of it.

Despite the inconvenience of frequent wars, the Silk Roads became the axis along which trade between the continents blossomed; and inevitably, as if to prove Mark Twain's assertion that history may not repeat itself but certainly rhymes, it was cheap Chinese-made goods that found the most favour with the wealthy inhabitants of the Roman Empire in the West, and specifically Chinese hand-spun silks, which the early Romans initially believed grew on trees (like money does in 2013) but which they later discovered were woven from thread created by the larvae of moths. Imagine the guy in the fancy toga who made THAT discovery: "Exspecta ... ex QUO?" (or, in English: "Wait ... it comes from WHAT?")

Now this is where things get interesting.

The Roman Senate tried desperately and, as it turned out, unsuccessfully to prohibit the wearing of silk on — wait for it — both economic and moral grounds.

The real grounds, of course, were economic; but by cloaking its reasons in morality, the Senate wished to appeal to the higher sensibilities of the citizens of Rome in order to ~~deceive them into doing something that was against their better interests~~ persuade them to play ball of their own volition. Of course, appealing on moral grounds to the same group of people who invented the orgy was a strategy flawed in the extreme; but early paparazzi coverage of celebrity lifestyles was patchy at best, and with the invention of the doorstep hundreds of years away, doorstepping was a verb that early Latin students never had to conjugate.

It is in those economic grounds for trying to stop the inflow of silk into Rome that we may find lessons, as historical parallels once again demonstrate the benefits of studying the past.

In his "Declarations" Seneca the Younger laid out the establishment's moralistic case against silk:

> *I can see clothes of silk, if materials that do not hide the body, nor even one's decency, can be called clothes.... Wretched flocks of maids labour so that the adulteress may be visible through her thin dress, so that her husband has no more acquaintance than any outsider or foreigner with his wife's body.*

Nice try, establishment. The real reason?

Gold.

Of course.

The insatiable lust for silk amongst Roman high society sent huge outflows of gold to Chinese coffers, and that was something the authorities simply couldn't allow to continue. Why? Because gold was money. Gold was wealth.

Gold was power.

The merchants of the East knew it and coveted gold for all of those reasons. The ruling class in the West knew it and tried to stop the transfer of gold from their own vaults into those of the Indian and Chinese merchant classes. But the citizens of the Roman Empire, growing ever more decadent by the day, were happy to swap their gold for the luxuriant fabric.

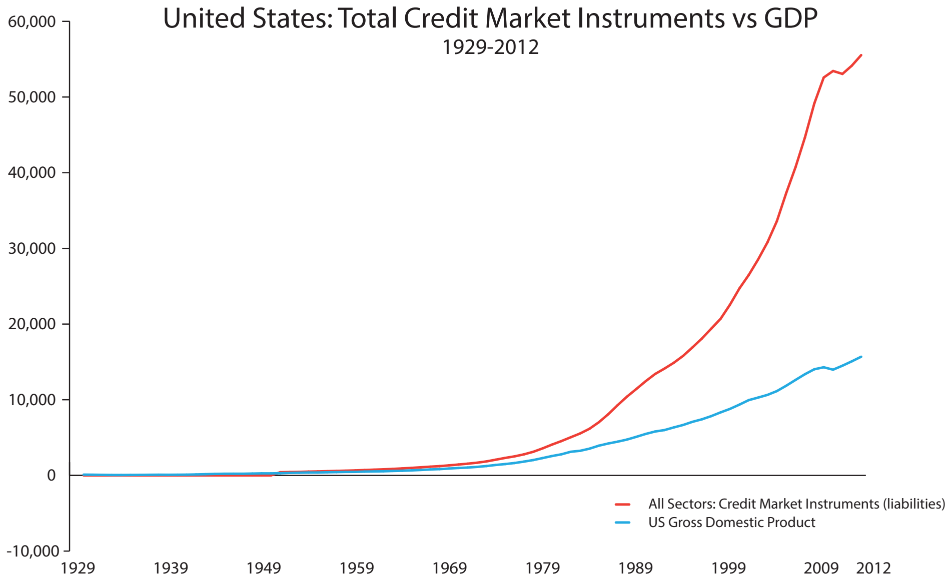
Money for "bling".

Attitudes toward gold persisted through the centuries as citizens of the East grew accustomed to wealth confiscation, regular defaults by their rulers, inflation, hyperinflation, and the need to have their wealth held outside the banking system in a form that was durable, portable, divisible, convenient, consistent, limited in its availability, and widely accepted through history. Wealth was something to be accumulated and passed on to future generations to provide security — not something to squander on holiday villas, speed canoes to waterski behind, and souped-up chariots.

It was once that way in the West, too; but like the Romans two thousand years ago, the modern inhabitants of the Western World grew decadent and preferred to spend their wealth on trophy purchases or use it as collateral in order to engage in speculative leverage.

Growth was converted to wealth, wealth was exchanged for goods, and when wealth expansion subsided, there was always credit, which masqueraded quite nicely as growth in the eyes of people only too willing to confuse one for the other in order that the party continue.

When Nixon ended the gold standard in August 1971, he sounded the all-clear to really get the credit party started, and as you can see from the chart below (which will be familiar to regular readers, as I have shoved it under your noses several times already), the credit providers in the USA found a public willing to indulge itself with Borgia-like ferocity:




Source: St Louis Fed

The differing attitudes to gold, Western vs Eastern, have been ingrained through centuries of human development; and they have been making themselves abundantly clear in recent times as physical gold moves inexorably from West to East.

I won't go into the recent disconnect between "the Gold Price" and "the Price of Gold" again, as I've written and spoken about it extensively in recent months; but the insatiable demand for physical gold amidst a dramatic sell-off in paper has, I suspect, paved the way for some real problems in the coming weeks and months; and those problems have begun to manifest themselves, bizarrely enough, in the very country that in recent months has topped the buying charts for physical gold.

In the all-important second quarter of 2013, the two biggest buyers of gold in the world were two of the countries at the Eastern extremities of the old Silk Roads — China and India — and it is through journeying to India that we can now learn lessons about the future from the study of the past.


Source: WGC/US Global Investors

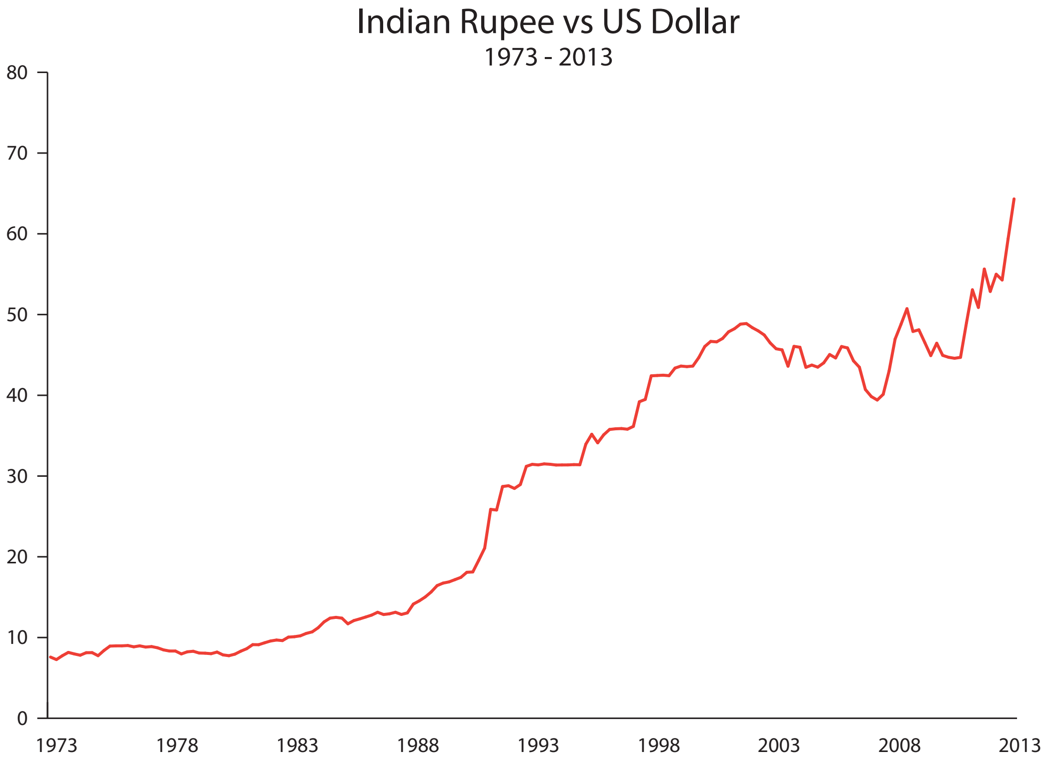
Indian demand for physical gold swamped even Chinese demand in Q2 2013, as Indians stocked up on the monetary metal not only in the form of jewelry ahead of the traditional wedding season but also in investment form: coins and bars. All the while, their national currency, the rupee, was disintegrating before their eyes.

In the absence of monetary mettle, Indians demanded monetary metal.

Between May 1st and August 20th, the rupee fell 20% against the US dollar, and whilst that move may not have resonated with most Westerners, it certainly did with India's richest man:

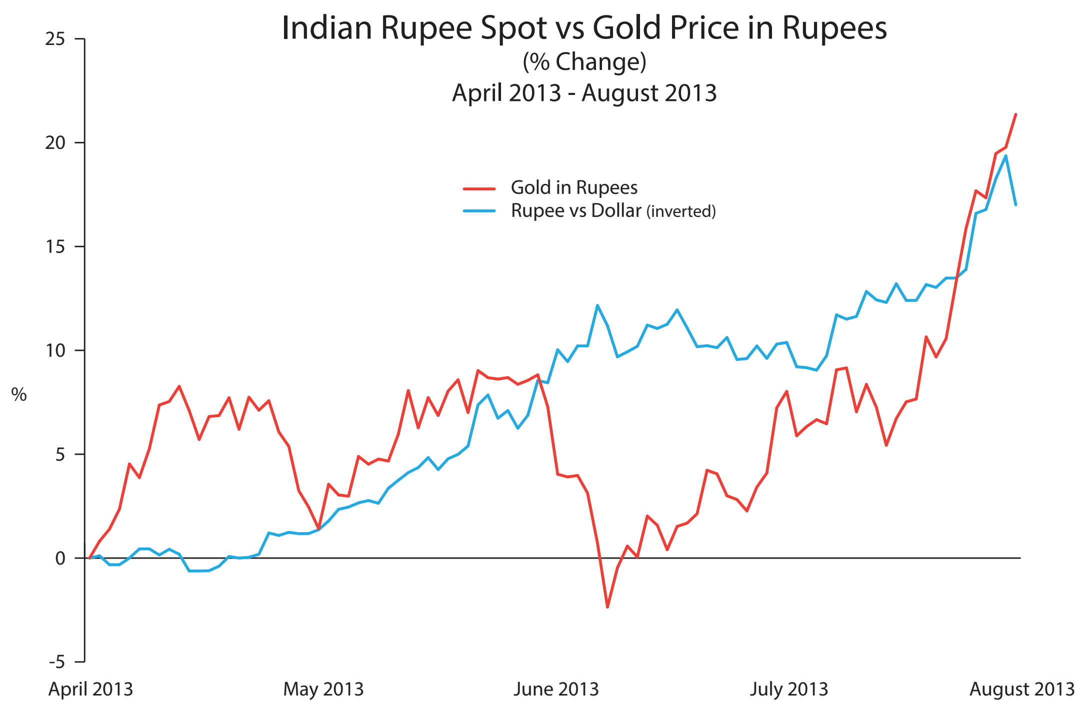
> *(UK Guardian): India's richest man is down to his last $17.5bn (£11.2bn), after the plunging value of the rupee wiped out a quarter of his fortune, in dollar terms.*
>
> *Mukesh Ambani, the chairman of Reliance Industries, which operates the world's largest oil refineries, has lost $5.6bn of his personal wealth since 1 May, according to the Bloomberg Billionaires index.*
>
> *His fortune took a further hit on Thursday, as India's currency hit fresh lows, adding to the sense of panic in emerging markets. Developing economies, excluding China, have seen an outflow of $81bn in emergency reserves since early May, as central banks try to prop up their currencies.*

That's a very real hit, but Indians are used to moves like these in their currency, though the trend over the last 40 years has been largely a one-way ticket to a weaker rupee:




Source: Bloomberg

However, that chart tells only half the story. To really understand why Indians covet gold so much, let's take a look at another chart, this time showing the recent performance of the rupee AND gold:




Source: Bloomberg

Et voilà! Since April, gold has strengthened 20% in rupees whilst the currency has depreciated by a similar amount vs the US dollar.

Purchasing power protection in action, folks. Just one of the beauties of owning gold.

Naturally, the Indian government is concerned that its citizens — conditioned over the centuries to understand exactly why owning gold is important — are exchanging their rupees for gold in droves, because their activity is exacerbating the slide in the rupee. So...

Cue capital controls:

> *(The Times of India, Aug 14 2013): India has banned imports of gold coins and medallions as part of steps to curb its current account deficit, Arvind Mayaram, economic affairs secretary, said on Wednesday, after total gold imports picked up again in July.*
>
> *The federal government will take more steps to stabilize the rupee as and when required, he said, adding the current measures were not permanent in nature ...*

As drastic as the government's action may seem, it is just the latest in a long line of (futile) attempts to curb Indian citizens' ability to own gold:

(Reuters): Following are the measures taken by the central bank and the government in 2013:

Jan 21 - *The government raises the gold import duty by 2% to 6%.*
Jan 22 - *The government more than doubles the duty on raw gold to 5%.*
Jan 30 - *Finance Minister P. Chidambaram says there are no plans for additional taxes or curbs on gold imports.*
Feb 1 - *The Reserve Bank of India (RBI) plans to introduce three or four gold-linked products in the next few months.*
Feb 6 - *The RBI says it would consider imposing value and quantity restrictions on gold imports by banks.*
Feb 14 - *The central bank relaxes rules on gold deposit schemes offered by banks by allowing lenders to offer the products with shorter maturities.*
Feb 20 - *The Trade Ministry recommends suspending cheaper gold jewellery imports from Thailand.*
Feb 28 - *India keeps its gold import duty unchanged in its annual national budget, defying industry expectations.*
Feb 28 - *India proposes a transaction tax of 0.01% on nonagricultural futures contracts, including for precious metals.*
March 1 - *The Finance Minister appeals to people not to buy so much gold.*
March 18 - *The Reserve Bank of India says it is examining banks that sell gold coins and wealth management products to identify "systemic issues", with a view to closing any legal loopholes.*
April 2 - *The Finance Ministry suggests it is unlikely to raise the import tax on gold further to avoid smuggling and would instead introduce inflation-indexed instruments.*
May 3 - *The RBI restricts the import of gold on a consignment basis by banks.*
June 3 - *The Finance Minister says India cannot afford high levels of gold imports and may review its import policy.*
June 5 - *India hikes the gold import duty by a third, to 8%.*
June 21 - *Reliance Capital halts gold sales and investments in its gold-backed funds.*
June 24 - *India's biggest jewellers' association asks members to stop selling gold bars and coins, about 35% of their business.*
July 10 - *India's jewellers announce they might continue a voluntary ban on sales of gold coins and bars for six months.*
July 22 - *The RBI moves to tighten gold imports again, making them dependent on export volumes, but offers relief to domestic sellers by lifting restrictions on credit deals.*
July 31 - *India hopes to contain gold imports well below the 845 tonnes that were shipped last year, the Finance Minister says.*
Aug 13 - *India hikes the import duty on gold for a third time in 2013, to 10%. Duties for silver and platinum are also increased to 10%. The customs duty on gold ore bars, ore, and concentrate are increased to 8% from 6%.*
Aug 14 - *India turns the screws on gold buying again, banning imports of coins and medallions and making domestic buyers pay cash.*

Get the feeling that in the middle of the world's largest democracy, a small group of people doesn't want a large group of people owning something?

Now, naturally, Indian citizens, seeing their government's desire to restrict their ownership of gold, simply stepped up their pursuit of gold dramatically:

> *(Mineweb): Even as gold retailers reel under new RBI curbs, gold smugglers appear to be gaining ground in India. The seizure of smuggled gold has surged 365% in the April to June quarter of this financial year, thanks to the incessant restrictions on the precious metal. Margins for smuggled gold have also jumped, beating other smuggled items like sandal wood and ketamine drugs....*
>
> *Revenue authorities had said smuggling could rise to over 150% over last year. However, the increase in import duty in June, from 6% to 8% as well, as the Reserve Bank of India's (RBI's) recent measures to curb gold imports have precipitated smuggling.*

The *Wall Street Journal* shed some light on just how big the gold smuggling business is in India — and just how little of it gets detected:

> *(WSJ): The number of people arrested by the department for gold smuggling rose to 32 in the quarter that ended in June from four during the same period a year earlier, according to the Revenue Intelligence official.*
>
> *The value of the gold seized during the quarter was 270 million rupees, more than 10 times the 25 million rupees of precious metal retrieved from smugglers during the same period in 2012, said the official.*
>
> *The total number of cases of smuggled gold during the same period shot up to 205 from 21 a year earlier, said an official at the Antismuggling Department, part of the Central Board of Excise and Customs.*
>
> *But this is only a fraction of the gold being smuggled into the country, Revenue Intelligence officials say. "I think we are able to detect only about 5% to 10% of the gold smuggling in the country," said a second Revenue Intelligence official.*

As I said previously, people in the East fundamentally understand the value of owning gold — and not being able to get it just makes them want it more.

Fortunately (for inhabitants of the subcontinent, at least), as the fervor to own gold in India increased, it happened to coincide with the paper-driven sell-off in the West, as traders and weak hands were taken in by the pummeling of COMEX futures and liquidated positions in ETFs.

Richard Dyson laid it out perfectly:

> *(UK Daily Telegraph): Gold market commentators say that, while ETFs account for just 6pc of the overall demand for the precious metal, ETF investors' ability to buy and sell with ease has a dramatic impact on price. The supply chain for gold bars, coins and jewellery, on the other hand, is long and more complex, the argument goes, so that even though these markets generate greater total demand — something like 70pc — it takes longer to filter through.*

> *So western investors in effect presented consumers in India, China and other smaller, Asian countries with a buying opportunity unseen for years.*

Bingo!

That is exactly what has happened.

Physical gold has been sucked into the East and into very strong hands — the kinds of hands that don't let go of it easily. Certainly not as easily as those in the West who were scared out by a 20% correction.

But the level of the frantic desire to accumulate physical gold here in Asia and especially in India has surprised even me (almost); and this week a whole new level of light was shed on just how frantic that desire has been by a data point involving, of all places, the UK and Switzerland:

> *(FT): UK gold exports to Switzerland, the hub of the gold refining industry, leapt to 798 tonnes in the first six months of the year, up from just 83 tonnes in the first half of 2012, according to data from Eurostat, the European Union's statistics office.*

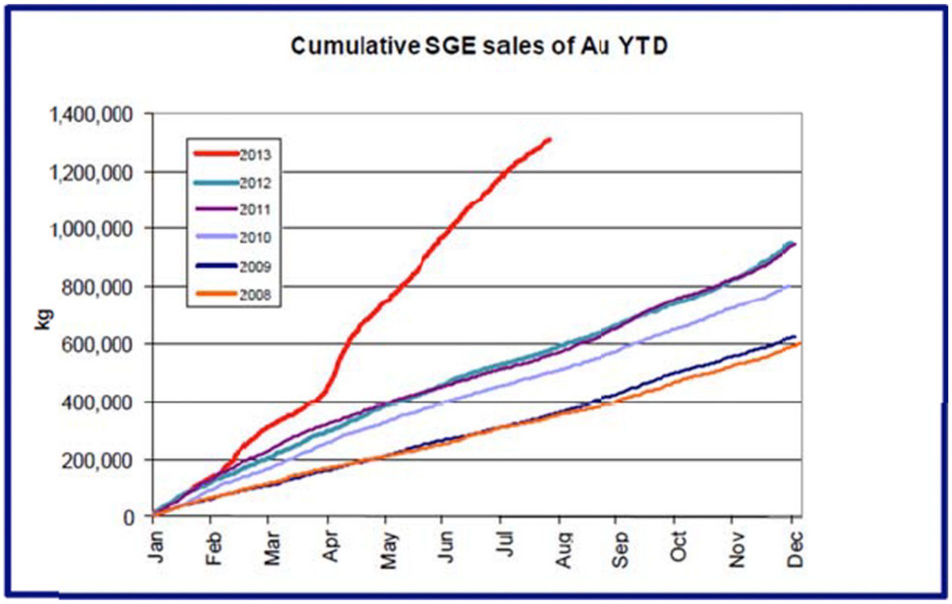
Now, at this point I can hear you asking, "What the heck does this have to do with Asian gold demand?" Well, allow me (or rather, the FT) to continue:

> *(FT): Large-scale selling by investors triggered a 26 per cent slide in gold prices from the start of the year to a near three-year low of $1,180 a troy ounce in June.*
>
> *The price fall has stimulated a huge increase in demand in Asia, particularly China, whose gold association reported a 54 per cent increase in demand in the first half of the year.*
>
> *Matthew Turner, precious metals analyst at Macquarie, said the rise in gold exports had closely tracked outflows of the metal from exchange-traded funds, a popular investment product which helped to popularize gold when they were launched a decade ago.*
>
> *"If investors don't want the gold it has to go somewhere else," said Mr Turner of Macquarie. "The Chinese are simply willing to pay more for it."*
>
> *The large-scale shift of gold out of western trading hubs towards Asia has led to a spike in business for traders and refiners.*
>
> *The London Bullion Market Association said that the daily cleared trading volume on the London market by its members hit a 12-year high of 900 tonnes — worth $39bn — in June on the back of "strong physical demand, particularly from China and India".*
>
> *At the same time Swiss gold refiners, such as Metalor, Pamp, Valcambi and Argor-Heraeus, have enjoyed a boom, melting down large 400oz bars from London vaults and reprocessing them into smaller products that are preferred by Asian buyers.*

> *"The Swiss are running three or four shifts to keep the refineries going non-stop. They're throwing bodies at it," said one senior gold trader.*

The story is the same in Dubai, where refiners have 90-day backlogs in producing the small bars and coins so craved by Asian buyers, while here in Singapore there has been an absolutely extraordinary explosion in gold demand as the Freeport storage facility is deluged with not only Eastern investors but also savvy Westerners looking to move their gold to a jurisdiction they feel won't come under the kind of pressure being exerted in India.

Dennis Gartman published a fascinating chart this week that demonstrates just how crazy demand for gold has been here in Singapore in 2013:




Source: *The Gartman Letter*

Even Indonesia — not known as a huge destination for gold — is getting in on the act:

> *(Bloomberg): Gold jewelry demand in Indonesia is set to expand to a four-year high as consumers in Southeast Asia's biggest buyer join India and China in increasing purchases as prices slump and the middle class expands.*
>
> *Consumption of necklaces, bracelets and rings will probably climb to 40 metric tons this year, according to Iskandar Husin, secretary-general of the Indonesian Goldsmiths and Jewelers Association.*
>
> *That's a 30 percent increase from 30.8 tons in 2012, and the most since 41 tons in 2009, data from the London-based World Gold Council show.*

*Gold fell into a bear market in April as haven demand waned and sales from exchange-traded products reached a record, spurring increased buying from India to China, the world's two biggest consumers. President Susilo Bambang Yudhoyono forecast a jump in per capita incomes this month even as stocks dropped and the rupiah tumbled. Southeast Asia's largest economy has more than quadrupled in the past 10 years to $878 billion.*

*"Gold jewelry is all about lifestyle and saving," Husin said in an interview in Jakarta. "It's a market driven by the increase in GDP and modern Indonesian women, who are following the trends in fashion and design."*

*Lower prices boosted Indonesia's total gold demand, including for investment, 55 percent to 16.4 tons in the second quarter compared with a year earlier, increasing first-half consumption 11 percent to 33.4 tons, according to data from the producer-funded council. Jewelry accounted for 57 percent of demand in the first six months, with the rest in bars and coins. In China, gold purchases advanced 45 percent to 571.2 tons in the first half, and 48 percent to 567.5 tons in India.*

Indonesia, with 240 million inhabitants, is the world's 4th-most populous nation, and as the Bloomberg article points out, things are happening there that make Indonesia yet another rapacious buyer of gold:

*(Bloomberg): Most of Southeast Asia's 650 million people will be middle class by 2020 and that will boost consumer demand, according to Bain & Co. By 2030, Indonesia will have added 90 million people to its so-called consuming class, more than any other country except China and India, McKinsey & Co. estimates.*

*"Some Indonesian women like to wear Tiffany's jewelry," said Husin at the jewelers association, referring to the New York-based company that reported a gain in first-quarter profit led by demand in Asia. "But the main market is the variety of cultural designs, from Aceh to batik to asmat totem in Papua"....*


*Jewelry consumption will remain the biggest market in Indonesia as an instrument for storing wealth, as well as an accessory, said Albert Cheng, Far East managing director at the World Gold Council. The country's rising middle class is very important and will contribute to the growth of sales, he said.*

*"Middle- to upper-class people like 18-carat gold because of its design but the lower class prefer 24 carats for the high resale value," said Poppy Dharsono, a fashion designer turned politician. "Jewelry is a complement to fashion, but the metal can also influence people, who wear it to feel powerful."*

Uh-oh! You do NOT want to bet against a tide like this — not in a commodity with a very fixed existing supply and a very consistent, but small, annual supply increase of around 2,500 tons.

Trust me. You just don't.

| Rank | Country (or dependent territory) | | Population |
|---|---|---|---|
| – | World | | 7,106,700,000 |
| 1 | China[8] | BUYERS | 1,359,530,000 |
| 2 | India | BUYERS | 1,232,960,000 |
| 3 | United States | | 316,517,000 |
| 4 | Indonesia | BUYERS | 237,641,326 |
| 5 | Brazil | | 193,946,886 |
| 6 | Pakistan | BUYERS | 184,040,000 |
| 7 | Nigeria | | 173,615,000 |
| 8 | Bangladesh | | 152,518,015 |
| 9 | Russia | BUYERS | 143,400,000 |
| 10 | Japan | | 127,350,000 |

Five of the ten most populous nations on earth are hungry buyers of gold, and each of them has a burgeoning middle class that has, over the years, embedded in its cultural psyche the idea that owning gold is just what you do when you can afford to.

Period.

What? Pakistan and Russia? Oh ... OK:

> *(Pakistan Express Tribune): In an attempt to address steep devaluation of the rupee against the dollar, Pakistan on Tuesday temporarily banned import of gold to save the precious foreign currency reserves.*
>
> *The Economic Coordination Committee of the Cabinet, headed by Finance Minister Ishaq Dar, took the decision to ban the import of the yellow metal for one month with immediate effect.*

The heavy surge in gold imports into Pakistan (+102% YoY) were undoubtedly linked to the Indian smuggling, but India and Pakistan share no love (except for gold, of course), so Pakistan's actions are in no way designed to protect its neighbours. Good ole-fashioned self-interest in all its glory!

As for Russia, well, the Russian Central Bank very kindly publish their activity in gold markets every month on their website; and my pal Nick Laird at Sharelynx takes all the hard work out of following it by charting it at his excellent site, www.sharelynx.com. (Again, if you want just about any precious metals-related chart, Nick's fantastic site is where you'll find it.)

This past week the Russians announced yet another increase, taking their holdings to 32.2mn ozs.


Source: Sharelynx.com

Hopefully the point is made, so let's get back to India.

As panic set in, first came the crazy ideas, including one from Jamal Mecklai that involved borrowing gold from one of India's most famous temples:

> *(Moneycontrol): At a time when all steps by government and Reserve Bank of India 's to stem the rupee fall seems to be failing, Jamal Mecklai, CEO of Mecklai Financial Services sarcastically suggested the Finance Minister and RBI governor ... visit Tirupati temple and liquidate its gold assets to save [the] sinking rupee....*
>
> *"I have told everybody what they have to do. Finance Minister and governor have to go to Tirupati. A) They have to pray, and B) they have to talk to the trustees to deposit some part of their gold in State Bank of India. It is the only solution. The truth is, why are we in this mess? Because everybody believes India doesn't have enough money. We spend more than we earn, our fiscal deficit is very high, so too the current account deficit (CAD) is very high.*
>
> *Now the truth is we happened to have 30,000-35,000 tonnes gold, which valued at today's prices is about USD 1.5 trillion; now those are assets; that is money that we own — not like our foreign currency reserves; those are also foreign currency assets.*

*So actually if you do the balance, Mr. Chidambaram says we are USD 20 billion short. We have got hundreds of times that, but of course that is locked up. So very good, over the years many times the government has tried to get it unwound, and they haven't been able to.*

*Now Tirupati, by reports — and I don't have this actual numbers — has well over a 1,000 tonnes of gold, which is sitting there. Now if they were to put 500 tonnes of gold on deposit in [the] State Bank of India, let us say they get two percent interest, that is Rs 3,000 crore* a year. Which trustee can pass that up?*

(* A crore is a measuring unit widely used in the subcontinent, which is equal to ten million.)

But as if that weren't enough, the Reserve Bank of India were rumored to be thinking of a scheme all their own which, in many ways, would be even crazier than Mecklai's:

*(Hindu Business Line via ZeroHedge): In what appears at first glance a throwback to 1991, India will consider leasing out the 200 tonnes of gold it bought from the International Monetary Fund (IMF) in 2009.*

*The gold will be leased in the international market for dollars so as to shore up the sagging rupee, which plunged below Rs 64 against the US dollar in Tuesday's trade.*

*A final decision may be taken next month, Finance Ministry sources said.*

*The move can fetch around $23 billion, David Gornall, Chairman of the London Bullion Market Association, has estimated.*

Leasing some of the country's gold reserves out to earn some income? We know a song about that, don't we, boys and girls?

But here's where things get even more fascinating, as the RBI confirm that the 200 tonnes of gold they bought in 2009 was simply a paper transfer and not an exchange of physical metal:

*This marks a tidy increase in the Reserve Bank of India's investment. In November 2009, the RBI purchased 200 tonnes of gold from the IMF, under the Fund's limited gold sales programme, for $6.7 billion, cash.*

*According to RBI sources, this gold was never brought into the country. It was just a book transfer.*

*Speaking at the India International Gold Convention in Jaipur last week, Gornall had said the RBI can organise a gold-dollar swap without divesting its holding or incurring any further interest charges.*

*"By swapping gold for a payable currency, you can benefit by having access to dollars for a period of your choice, while remaining a long-term holder of the gold, as the swap is a transfer of asset for a limited period.*

> *"You will have bullion bank counter-party risk but this is successfully managed at the RBI, which has the strictest lending criteria of any central bank in the world," Gornall had argued.*
>
> *Finance Ministry officials agree.*
>
> *Talking about the leasing arrangement, a Ministry official said that since gold was the most liquid of assets, it can be readily leased, and returned by the lessee to the lessor any time.*
>
> *Further, a lease transaction means the RBI's gold holding will not come down even as it unlocks the asset's value.*

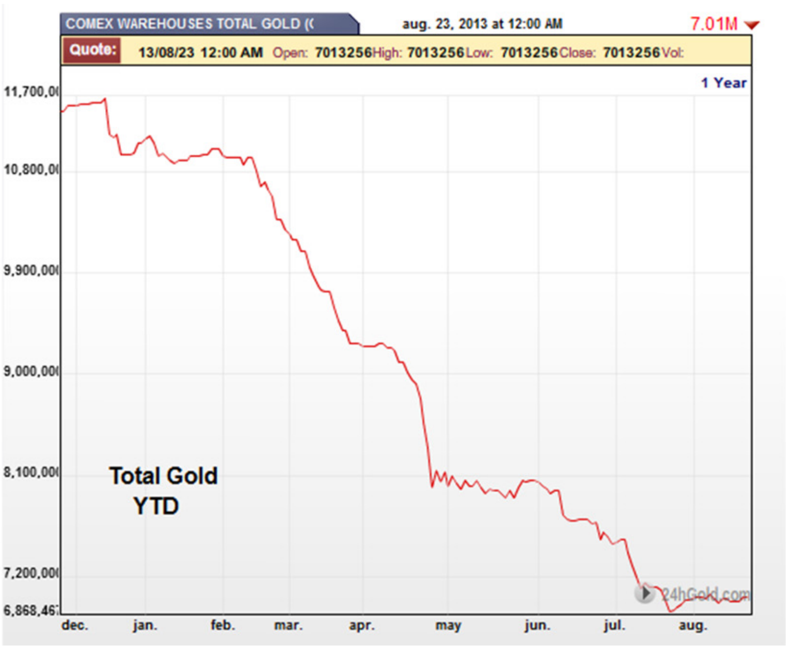
Folks, this is exactly how these people think, so pay very careful attention.

The RBI swaps its gold for dollars, which will leave them "... *with bullion bank risk but this is successfully managed at the RBI*".

The gold "... *can be readily leased, and returned by the lessee to the lessor any time."*

It's all OK, because "... *a lease transaction means the RBI's gold holding will not come down even as it unlocks the asset's value."*

OK. So first of all, about that "bullion bank risk"?




Source: Jesse's Cafe Americain

As I discussed in my recent piece "What If?", since the day the German central bank demanded ***ITS*** gold back, physical metal has been disappearing from just about every vault in the system in almost unimaginable quantities. And as for that bullion bank risk...

According to Zerohedge, the bullion banks are being forced to borrow from each other simply in order to make deliveries:

> *(Zerohedge): And like the last time JPM plundered 20K ounces of Scotia gold on August 8 ... JPM took directly from Scotia's registered gold inventory. We wonder how regular, non-TBTF customers of Scotia would feel if they learned that their registered gold was now in the "possession" of JPMorgan.*

**GOLD** — **Report Date: 8/23/2013**
**Troy Ounce** — **Activity Date: 8/22/2013**

| DEPOSITORY | PREV TOTAL | RECEIVED | WITHDRAWN | NET CHANGE | ADJUSTMENT | TOTAL TODAY |
|---|---|---|---|---|---|---|
| **BRINK'S, INC.** | | | | | | |
| Registered | 129,282.490 | 0.000 | 0.000 | 0.000 | 397.420 | 129,679.910 |
| Eligible | 118,480.915 | 0.000 | 0.000 | 0.000 | -397.420 | 118,083.495 |
| Total | 247,763.405 | 0.000 | 0.000 | 0.000 | 0.000 | 247,763.405 |
| **HSBC BANK, USA** | | | | | | |
| Registered | 154,455.153 | 0.000 | 0.000 | 0.000 | 100.520 | 154,555.673 |
| Eligible | 3,132,474.000 | 0.000 | 0.000 | 0.000 | -100.520 | 3,132,373.480 |
| Total | 3,286,929.153 | 0.000 | 0.000 | 0.000 | 0.000 | 3,286,929.153 |
| **JP MORGAN CHASE BANK NA** | | | | | | |
| Registered | 286,485.185 | 0.000 | 0.000 | 0.000 | 0.000 | 286,485.185 |
| Eligible | 148,786.664 | 28,809.155 | 0.000 | 28,809.155 | 0.000 | 177,595.819 |
| Total | 435,271.849 | 28,809.155 | 0.000 | 28,809.155 | 0.000 | 464,081.004 |
| **MANFRA, TORDELLA & BROOKES, INC.** | | | | | | |
| Registered | 13,002.306 | 0.000 | 0.000 | 0.000 | 0.000 | 13,002.306 |
| Eligible | 6,715.933 | 0.000 | 0.000 | 0.000 | 0.000 | 6,715.933 |
| Total | 19,718.239 | 0.000 | 0.000 | 0.000 | 0.000 | 19,718.239 |
| **SCOTIA MOCATTA** | | | | | | |
| Registered | 207,712.634 | 0.000 | 28,809.155 | -28,809.155 | 4,605.515 | 183,508.994 |
| Eligible | 2,815,860.361 | 0.000 | 0.000 | 0.000 | -4,605.515 | 2,811,254.846 |
| Total | 3,023,572.995 | 0.000 | 28,809.155 | -28,809.155 | 0.000 | 2,994,763.840 |
| TOTAL REGISTERED | 790,937.768 | 0.000 | 28,809.155 | -28,809.155 | 5,103.455 | 767,232.068 |
| TOTAL ELIGIBLE | 6,222,317.873 | 28,809.155 | 0.000 | 28,809.155 | -5,103.455 | 6,246,023.573 |
| COMBINED TOTAL | 7,013,255.641 | 28,809.155 | 28,809.155 | 0.000 | 0.000 | 7,013,255.641 |

Source: Zerohedge

Would YOU be comfortable that your gold would be "... readily returned by the lessee to the lessor at any time" under such circumstances? I sure as hell wouldn't. And as for your gold holdings not coming down in value when you enter into a lease agreement, well that isn't always strictly true now, is it?

Devaluation of your currency is a constant threat in Asia, as is the other peril that gold provides such good protection against: inflation. And this week the *Wall Street Journal* offered an insight into just how terrified Asians are of inflation, when it examined the cost of dying:

> *(WSJ): Deep in China's spirit world, an inflation crisis is brewing that would give central bankers chills.*
>
> *For hundreds of years, Chinese have burned stacks of so-called "ghost money" for their ancestors to help ensure their comfort in the afterlife. The fake bills resemble a gaudier version of Monopoly money, emblazoned with the beatific-looking image of the Emperor of the Underworld.*

> *Traditionally, paper money burned in China came in small denominations of fives or tens. But more recent generations of money printers have grown less restrained. The value of the biggest bills has risen in the past few decades from the millions and, more recently, the billions.*
>
> *The reason: Even Hong Kong's dead try to keep up with the Joneses, and their living relatives believe that they need more and more fake bucks to pay for high-cost indulgences like condos and iPads.*
>
> *This year, on the narrow Hong Kong streets that are filled with shops that specialize in offerings for the dead, there appeared a foot-long, rainbow-colored $1 trillion bill. "What we have right now is hyperinflation," says University of Hong Kong economist Timothy Hau. "It's like operating in Zimbabwe."*


Source: *Wall Street Journal*

> *"Inflation is everywhere, so of course it happens in the underworld too," says Li Yin-kwan, 42. The $1 trillion bill is the most popular note in her shop, she says, "because it allows the ghosts to buy many things, such as a fancy car and a big house."*
>
> *Still, she said that there is also a place for burning smaller-value bills. "The ghosts need spare change to buy daily necessities, too," she says, such as clothes and food. On a recent Friday, all the trillion-dollar bills in her shop and the shops next door were sold out. "I'm sorry," Ms. Li said to one customer. "There are still some $100 billion notes left."*

OK ... you can read the entire article on page 23 here, and I'm belabouring the point now. However, it is SO important to understand it properly.

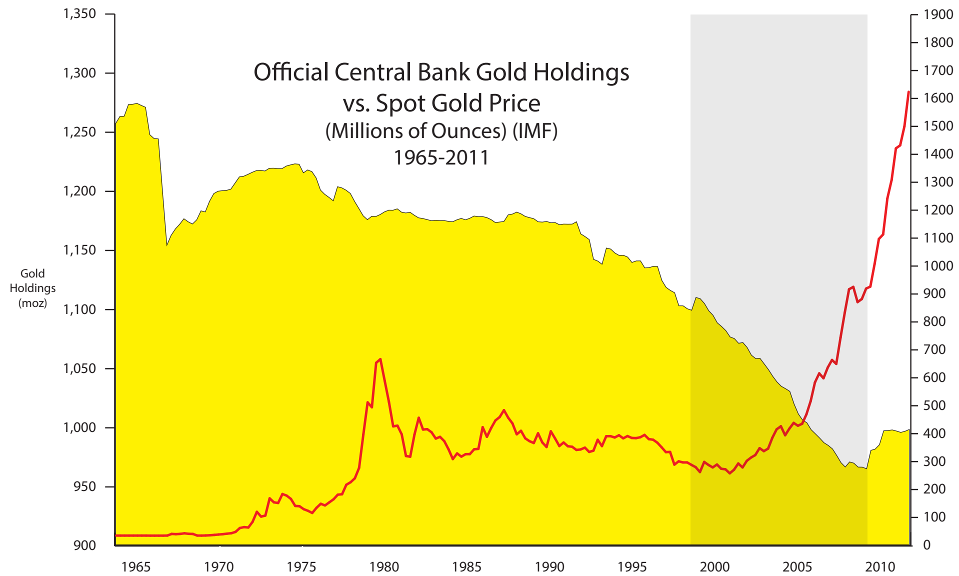
Here in the East, there is a desire to own gold that utterly transcends anything commonly understood in the West. It is hard-coded into the DNA of several billion people, who, acting together, will provide a strengthening bid for gold for decades to come. Those people are getting wealthier, and with their increased wealth comes both an increased need to protect it and an increased desire to hold it in a form they have come to trust. And THAT, dear reader, is gold.

It's simple.

The exodus of gold from the UK to Asia via Switzerland is no accident and no one-off. The surge in imports of gold into China through Hong Kong is, likewise, not a flash in the pan. Indians' desire to own bullion, jewelry, coins — anything golden — is not going away. Trust me.

It is time to put aside Western attitudes to gold and gain an understanding of how it is viewed by the real buyers — those in the East. Those who buy physical metal to hold and to bequeath — not those who sit at home in front of their computers, buying and selling paper claims on a metal most of them have never seen up close — are going to determine the future path of the metal.

In the late 1970s, Asia was a poor continent, and though its appetite for gold was undiminished, its ability to purchase it was restricted.




Source: IMF/TTMYGH

Through the 1980s and 1990s, central banks were continuous sellers of gold (chart above), which helped keep a lid on the price, but now ... NOW, we have the makings of a perfect storm:

- *The East has become far wealthier, and that wealth is increasing steadily.*
- *The large pool of available (and eager) buyers in the East is growing every day.*
- *Central banks — once the biggest sellers of gold — have not only become buyers but have begun to seek the return of their gold held overseas in a quest to perfect their assets.*
- *The central bank leasing scheme is unraveling before our eyes.*
- *Available physical supplies of gold have plummeted.*

All these factors will undoubtedly conspire to make the next six months (and beyond) a lot less painful for holders of gold than the last six were — a shift that has already begun to take shape

As Roger Waters once wrote:

Who is the strongest?
Who is the best?
Who holds the aces?
The East
Or the West?

Those 'aces', in the form of physical gold, are moving inexorably East, and with them go prosperity, influence, strength, and, eventually, power.

*******

Right. That was a long (though chart-heavy) introduction, so let's get on to the rest of the fun and games. This week we kick things off in Italy, where what seems at first glance to be merely a funny story turns into a frightening look at how European bureaucracy works and ends up being quite terrifying.

Then we head to Hong Kong to get the whole story on ghostly inflation mentioned in this week's introduction, before tuning into the deep thoughts of a true investment legend, Howard Marks, who concludes, rather worryingly, that "there is no free market in money today".

*The Economist* ponders what a new central bank toolkit might look like; Greece is once again warming up in the wings (this time in the middle of the German election campaign); and in another frightening development, new BoE governor Mark Carney is apparently disappointed with the market's reaction to his recent forward guidance, so this week he is setting out to make sure it falls into line.

One large order of hubris, table 3.

Elsewhere, we find that Inner Mongolia suffers from dodgy bankers just like everywhere else, the absence of Ben Bernanke from Jackson Hole this year doesn't mean there will be any less discussion about QE, and the possibility of a bond boom (this time the bad kind) is causing conniptions in emerging markets.

Eric Sprott, Christine Lagarde, and yours truly (again!) grace the interviews page; there are charts on inflation, the Indian rupee, and miles driven in the US; and we take a look at an upcoming movie that will be required viewing for regular readers of *Things That Make You Go Hmmm....*

What are you waiting for?

## Until Next Time.

*******

# Italian factory owner moves company to Poland while staff are on holiday

Earlier this month, the owner of an electrical components factory in the north of the country waved his employees off on their summer holidays. Then, without informing them, he moved the entire operation, lock, stock and barrel, to Poland.

Fabrizio Pedroni, 49, said he was driven to the drastic course of action because his factory, located near the city of Modena, had not turned a profit for five years and he was being strangled by high salaries, crippling taxes and dismal rates of productivity.

Moving the factory to Eastern Europe was the only way of saving his company, which was founded 50 years ago by his grandfather.

When his 40 employees found out what had happened, they were furious. They were not due to return from holiday until next week but got wind of the covert operation in mid-August and turned up at the Firem factory in the town of Formigine to find the place devoid of machinery.

They blocked the last of around 20 trucks from leaving the plant, but the rest were long gone, en route to the town of Olawa in south-west Poland.

Mr Pedroni says he has received death threats and will not be returning to Italy anytime soon.

“If I had told the unions that I intended to transfer production to Poland, they would have had my property confiscated, just as they tried to block the lorry,” the businessman told Radio 24, an Italian radio station.

“I had to make a choice. Our competitors in Romania and Poland offer much lower prices. I had three options — either close, move the factory, as many other businesses have done, or shoot myself in the head.”

Labour costs were high because firms like his had to pay generous social insurance, health insurance and pensions, he said.

“An employee who is paid €12,000 a year in fact costs the company €30,000. It’s unacceptable. We haven’t made a profit since 2008.”

The saga has become a national cause celebre, sparking a debate about the number of Italian companies that are relocating their business to Eastern Europe and beyond, prominent among them Fiat, which has a plant in Poland.

Italy’s thickets of red tape, high social welfare costs and corruption mean that it fares dismally in terms of economic competitiveness.

In the World Bank’s most recent Ease of Doing Business survey, Italy ranks 73rd out of 185 countries, behind the likes of Tonga, Kazakhstan and Belarus.

While much of Europe appears to be slowly emerging from the worst recession since the Second World War, the Italian economy is going backwards, shrinking 0.2pc in the second quarter of this year.

Prosecutors in Modena announced this week that they had launched an investigation into the closure of the factory.

“Even in a period of serious economic difficulties, the behaviour of the owners of the Firem factory deserves censure, both in the way it was done and in the timing,” the local town council said in a statement, vowing to rally around the abandoned workers.

“Employees are not lemons to be squeezed or machines which you can move around at your pleasure in the name of profit,” said Giancarlo Muzzarelli, a regional politician.

Even if businesses had faced acute economic challenges, they needed to face them “without resorting to subterfuge or sleight of hand”, he said....

*** UK DAILY TELEGRAPH / LINK

## In Hong Kong, Inflation Worries Spook the Spirit World

For hundreds of years, Chinese have burned stacks of so-called "ghost money" for their ancestors to help ensure their comfort in the afterlife. The fake bills resemble a gaudier version of Monopoly money, emblazoned with the beatific-looking image of the Emperor of the Underworld.

Traditionally, paper money burned in China came in small denominations of fives or tens. But more recent generations of money printers have grown less restrained. The value of the biggest bills has risen in the past few decades from the millions and, more recently, the billions.
The reason: Even Hong Kong's dead try to keep up with the Joneses, and their living relatives believe that they need more and more fake bucks to pay for high-cost indulgences like condos and iPads.

This year, on the narrow Hong Kong streets that are filled with shops that specialize in offerings for the dead, there appeared a foot-long, rainbow-colored $1 trillion bill.

"What we have right now is hyperinflation," says University of Hong Kong economist Timothy Hau. "It's like operating in Zimbabwe."

The inflation problem is expected to worsen during this year's Hungry Ghost festival, when the gates of the underworld are believed to open and ghosts are allowed to wander the earth. For the next few weeks, residents across the city are staging traditional opera performances to entertain their supernatural guests (leaving the front row of seats empty for ghost spectators), cooking elaborate meals of roast meats for their enjoyment and burning wads of fake money on the sidewalks in their honor.

The inflation in the underworld mimics what is happening above ground. In recent years, both Hong Kong and mainland China have felt the impact of higher prices. With its rising cost of food and housing, Hong Kong in particular has its hands tied in fighting inflation, thanks in large part to its currency peg with the U.S. dollar, which keeps the city's interest rates low.

The local funeral trade is feeling the pinch as well. In Hong Kong Island's rapidly gentrifying western reaches, nearby the city's ginseng and shark's fin sellers, is a row of half a dozen funeral shops. Their shelves are stacked high with gaily colored rows of dim sum baskets, air conditioners and DVD players, all made out of paper and intended to be burned as offerings. Situated adjacent to a hospital and several coffin shops, these stores all offer items for the needy dead.

The shops have been around for decades, but one is shutting down next month. "The rent is so expensive, and it's hard for us to carry on," says the 62-year-old manager, Tony Tai.

"Inflation is everywhere, so of course it happens in the underworld too," says Li Yin-kwan, 42. The $1 trillion bill is the most popular note in her shop, she says, "because it allows the ghosts to buy many things, such as a fancy car and a big house."

Still, she said that there is also a place for burning smaller-value bills. "The ghosts need spare change to buy daily necessities, too," she says, such as clothes and food. On a recent Friday, all the trillion-dollar bills in her shop and the shops next door were sold out.

"I'm sorry," Ms. Li said to one customer. "There are still some $100 billion notes left."

Vendors like Ms. Li point to other worrying signs of an underworld economic crisis, including the proliferation of paper credit cards from the Bank of the Underworld—some adorned with pink diamond motifs and VIP stickers, and others colored mint green like American Express. Other symptoms of a splashed-out consumer economy are afoot, including paper iPads, flat-screen TVs with 3-D glasses and sports cars.

Economists say the problem is that the underworld has no control over how much currency enters its economy. The more "ghost money" burned, the more inflation continues to zoom upward. "Inflation is everywhere a monetary phenomenon," says Mr. Hau, citing the late economist Milton Friedman. "It's the money supply that's causing it."...

*** WALL STREET JOURNAL / LINK

## "There's No Free Market In Money Today" And Other Observations By Howard Marks

Oaktree's Howard Marks, one of the better investors of his generation, is interviewed by GS' Hugo-Scott Gall on everything from investing choices, to behaviorism and trading psychology, to market cycles, to ZIRP, to the "great rotation", and last but not least, to free markets, or the lack thereof, and central planning, and what happens next.

*Hugo Scott-Gall: How can we understand investor psychology and use it to make investment decisions?*

Howard Marks: It's the swings of psychology that get people into the biggest trouble, especially since investors' emotions invariably swing in the wrong direction at the wrong time. When things are going well people become greedy and enthusiastic, and when times are troubled, people become fearful and reticent. That's just the wrong thing to do. It's important to control fear and greed.

Another mistake that people often make is that they compare themselves with others who are making more money than they are and conclude that they should emulate the others' actions ... after they've worked. This is the source of the herd behaviour that so often gets them into trouble. We're all human and so we're subject to these influences, but we mustn't succumb. This is why the best investors are quite cold-blooded in their professional activities.

We can infer psychology from investor behaviour, and that allows us to get an understanding of how risky the market is, even though the direction in which it will head can never be known for certain. By understanding what's going on, we can infer the "temperature" of the market. In my book, I give a list of characteristics that can give you an idea whether the market is hot or cold, and by using them we can control our buying patterns. They include capital availability, the eagerness of lenders and investors, the ease of entry for new funds, and the width of credit spreads, among others.

We need to remember to buy more when attitudes toward the market are cool and less when they're heated. For example, the ability to do inherently unsafe deals in quantity suggests a dearth of scepticism on the part of investors. Likewise, when every new fund is oversubscribed, you know there's eagerness. Too little scepticism and too much eagerness in an up-market — just like too much resistance and pessimism in a down-market — can be very bad for investment results.

Warren Buffett once said, "The less prudence with which others conduct their affairs, the greater the prudence with which we must conduct our own affairs." I agree thoroughly, and in order to understand how much prudence others are applying, we need to observe investor behaviour and the kinds of deals that are getting done. In 2006 and 2007, just before the onset of the financial crisis, many deals got done that left me scratching my head. That indicated low levels of risk aversion and prudence. We can't measure prudence through a quantitative process, and so we have to infer it by observing the behaviour of market participants.

The fundamental building block of investment theory is the assumption that investors are risk averse. But, in reality, they are sometimes very risk averse and miss a lot of buying opportunities, and sometimes very risk tolerant and buy when they shouldn't. Risk aversion isn't constant or dependable. That's what Buffett means when he says that when other people apply less, you should apply more....

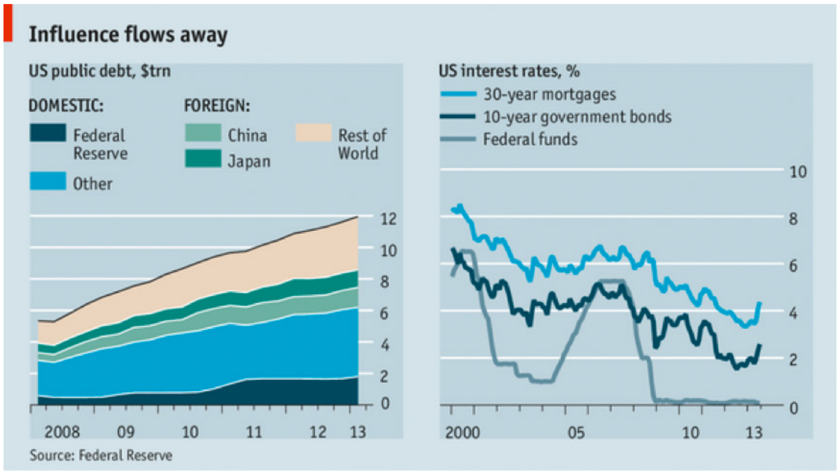
*** ZEROHEDGE / LINK

## A new toolkit

In the late 1990s and early 2000s central bankers in America and Europe had it easy. By raising or lowering the official interest rate, they could stimulate or dampen the economy at will. Rate changes would ripple fairly predictably through the banking system and bond markets, thereby affecting the price of borrowing across the economy. But following the 2008 crash, central banks were forced to pin their official rates to the floor. After five years of holding them near zero, monetary policymakers have become ever more reliant on "unconventional" measures.

Two policy tools in particular have become important. The first is making large-scale asset purchases. Since 2009 the Federal Reserve has been buying financial assets including government and corporate debt and pools of household mortgages.

Over the same period the Bank of England has purchased £375 billion ($585 billion) of government bonds. The aim in both cases is to push prices up, thereby pushing down the yields, or interest rates, on these assets. This cuts the costs of finance across the economy.




Source: *The Economist*

If asset purchases target the cost of borrowing now, the second tool targets the rates that people expect to pay and receive in the future. In 2008 the Federal Reserve indicated that its policy rate, then below 0.2%, would be low "for some time". In 2011 it was more explicit, saying that low rates would be "warranted" until mid-2013. In 2012 it went further still, committing to keep rates low until unemployment, currently 7.6%, falls below 6.5%.

The idea behind such "forward guidance", a tactic since adopted by both the Bank of England and the European Central Bank (ECB), is that anyone considering a loan needs to take into account both the rate of interest today and the likely rates in the future. If central banks can make a credible commitment to keep rates in the future down, the expected payment on floating-rate mortgages and car loans will drop. Even those borrowing at fixed rates will be able to save money by refinancing at lower costs. Consumption and investment will be more attractive as a result.

But both these tools have their problems. Start with asset purchases. At a combined $9.7 trillion, central banks in America, Britain, Japan and the euro area have big balance-sheets. But other investors have more heft in the markets central banks are trying to influence. Close to $5.6 trillion of Treasury securities are held by foreign investors, around half the supply. China and Japan together hold more than the Federal Reserve (see left-hand chart). In Britain a third of the £1.4 trillion debt stock is held by foreigners. They are active investors, buying over £250 billion since 2008....

*** ECONOMIST / LINK

## More Aid? Greece Funding May Come from EU Budget

Greece needs more aid, German Finance Minister Wolfgang Schäuble said on Tuesday, putting the euro crisis at the forefront of an otherwise languid election campaign. A news report on Wednesday indicates the aid might come from the EU budget.

That Greece will ultimately need more money to stave off insolvency has largely become common knowledge in the halls of power in Brussels. Indeed, SPIEGEL reported on a financing shortfall of up to €11 billion ($14.7 billion) back in early July. The hope in Berlin, though, was that this uncomfortable truth could be somehow avoided until after the September general election in Germany so as not to endanger Chancellor Angela Merkel's bid for a third term.

On Tuesday morning, however, German Finance Minister Wolfgang Schäuble of Merkel's conservative Christian Democratic Union (CDU) party said during a campaign event that Athens would indeed need a third aid package. And, on Wednesday, the Munich-based daily Süddeutsche Zeitung reports that the bailout money may have to come out of the European Union budget for lack of other options.

The paper claims that Brussels is considering tapping EU structural funds so as to avoid the massive political problems — first and foremost in Berlin — that a third bailout would stir up. Furthermore, a second debt haircut for Greece has been ruled out by Schäuble and is seen with skepticism elsewhere as well. There is also concern that additional loans would only serve to inflate Greece's already untenable debt load.

"The only option besides debt forgiveness remains a transfer from the EU budget or from the budgets of its partners," the paper cites an unnamed source familiar with the negotiations as saying.

Greece has already benefited from two bailout packages totalling €230 billion, €22 billion of which is still to be paid. The aid money was designed to keep Athens solvent through the end of 2014, at which time it was hoped the country could return to international financial markets. Most experts, however, believe that the timeline is far too optimistic. The third bailout package, however, is likely to be much smaller than the previous two, an unnamed government source told the Süddeutsche.

Schäuble's public comments about the need for additional aid for Greece came as a surprise, especially given Berlin's previous unwillingness to directly confront the issue. The finance minister said on Tuesday that "the public had always been told" about the need for a third bailout package. In the past, however, Schäuble had opted for vague statements, saying in February of 2012, for example, that "one can't entirely rule out" the possibility that Athens will need additional help. When the second bailout package was rubber stamped by Germany's parliament that same month, he said it "likely wasn't the last time that the Bundestag will have to address financial assistance for Greece."...

*** DER SPIEGEL / LINK

## Carney set to bolster forward guidance drive

Mark Carney is expected next week to try to force markets into line with the Bank of England's guidance that interest rates will be on hold for three more years.

In his first speech as Governor, to be given in Nottingham on Wednesday, he will reinforce the Bank's landmark "forward guidance" pledge to leave rates unchanged until unemployment falls to 7pc. It was a clear signal that the Bank does not expect to lift them above their record 0.5pc low until late 2016.

Traders have challenged the new Governor's authority by largely ignoring the commitment. Since it was unveiled earlier this month, markets have brought forward their forecasts for a rate rise to the middle of 2015 and pushed up government borrowing costs.

The reaction has been the polar opposite of Mr Carney's intention. On announcing the new policy, he said it was designed "to avoid an unwarranted tightening in interest rate expectations as the recovery gathers strength".

In a speech last night, Charlie Bean, the deputy governor, sought to clarify the Bank's ambition for the policy. He accepted that the move in markets was due to the recent "good news about the economy", but claimed guidance "should temper the extent of any tightening".

The commitment should not be as stimulus, like quantitative easing. He said it was "intended primarily to clarify our reaction function and make policy more effective, rather than to inject additional stimulus by pre-committing to a 'lower for longer' policy path".

Even if market rates do rise, he said, "by reducing uncertainty about our behaviour, we are aiming to encourage households and businesses to spend and invest". "The knowledge that monetary policy will not be tightened until the UK's fledgling recovery is secured should boost confidence," he added.

Mr Carney has a track record for following up his words with actions. In Canada, after pledging to hold rates steady for a year, he provided C$30bn (£18bn) of liquidity in a move he described as putting "our money where our mouths were".

The Bank has money market operations it could use to influence market behaviour. Beyond that, Mr Carney stressed earlier this month that rate-setters could still use QE if necessary.

Philip Shaw, UK economist at Investec, said: "Forward guidance has not had the desired effect on markets, with the first rate hike now priced in earlier than it was pre-guidance. Hence, we suspect the Governor will mount a defence of forward guidance."

Last week's second-quarter growth upgrade, from 0.6pc to 0.7pc, "could add to the difficulties the Bank is having in convincing markets about forward guidance", said HSBC's Simon Wells. "Mark Carney ... is likely to explain further why the [rate-setters] think policy can be loose for years to come."

*** PHILIP ALDRICK, THE TELEGRAPH / LINK

## Kuroda-Bean Say Policies Spur Growth as Fed Weighs Tapering QE

Central bankers from Japan and the U.K. predicted their new campaigns to encourage expansion will work, sustaining support for global growth even as the Federal Reserve considers a reduction in stimulus.

As the annual gathering of central bankers and economists in Jackson Hole, Wyoming, drew to a close yesterday, Bank of Japan Governor Haruhiko Kuroda said his souped-up asset-buying "has started to exert effects" on the world's third-largest economy.

Bank of England Deputy Governor Charlie Bean said the U.K.'s pledge this month to avoid raising interest rates before unemployment falls to 7 percent should restrain U.K. gilt yields and boost confidence among consumers and companies.

"We don't think that all central banks will phase out from unconventional monetary policies," International Monetary Fund Managing Director Christine Lagarde told Bloomberg Television's Sara Eisen. "In Europe and Japan there is a lot more to be done."

Such sentiments may help offset concerns among emerging markets as Fed officials consider whether to start reducing their $85 billion in monthly bond buying as soon as next month. Buffeted by a recent sell-off in emerging-market stocks and currencies, officials from developing nations, including Mexico's central bank governor Agustin Carstens, cautioned the symposium about unintended harm from advanced nations' monetary policies.

The European Central Bank cannot "rule out" cutting its benchmark interest rate to a new record low even amid signs the euro-area economy is on the mend, said Governing Council member Panicos Demetriades.

"That option is still on the cards," he said in an interview. "We cannot rule out that possibility although one has to take a look at the new data. That data is more encouraging."

Emerging-market stocks have lost more than $1 trillion in market value since May, when Chairman Ben S. Bernanke testified to Congress that the Fed “could take a step down” in its bond purchases, according to data compiled by Bloomberg. Such buying helped channel $3.9 trillion in capital flows to developing nations in the past four years.

The MSCI Emerging Markets Index has fallen 12 percent this year, compared with a 13 percent gain for MSCI’s gauge of shares in advanced economies. The 20 most-traded currencies among emerging economies have fallen about 4.3 percent in the past three months, data compiled by Bloomberg show.

Japan’s central bank is buying more than 7 trillion yen ($70.9 billion) in bonds each month to expand the monetary base by 60 trillion yen to 70 trillion yen per year. It seeks to generate inflation of 2 percent within two years after 15 years of battling deflationary forces.

Kuroda said the push has helped boost stock prices and restrain bond yields, while supporting bank lending and bolstering confidence among consumers and businesses. Inflation expectations are also picking up, he said.

“We think that at least in the next two years or so we would be able to contain increases in long-term interest rates, so as to maintain low real interest rates,” he said.

Consumer prices rose in June, and the world’s third-biggest economy expanded at an annualized 2.6 percent in the three months through June 30. The benchmark Nikkei 225 Stock Average is up 31 percent this year.

Japan will maintain the strategy “while continuing to make efforts to maintain the stability of the global financial system,” Kuroda said...

The Fed found support from Luiz Awazu Pereira, deputy governor of Brazil’s central bank, who said slowing stimulus from the Fed should be “positive” for his country because it would show the U.S. economy is gaining strength. Brazil this week sought to stem the world’s worst currency decline by announcing a $60 billion intervention program involving swaps and loans to prop up the real after it fell to a four-year low.

“For us, the exit from unconventional monetary policy was perhaps a long-awaited predictable process,” Awazu said. “The puzzle is why is it with all this careful preparation things got a little bit out of hand.”

Lagarde said in the Bloomberg Television interview that “clarity of when things will happen, how things will happen” is needed as the Fed considers unwinding its bond-buying program in order to minimize the impact on financial markets and the effect on emerging markets.

*** BLOOMBERG / LINK

## Fears of global credit shock rising as the bond boom unravels

The $9 trillion accumulation of foreign bonds by the rising powers of Asia, Latin America and the emerging world risks going into reverse as one country after another is forced to liquidate holdings to shore up its currency, threatening to inflict a credit shock on the global economy.

India's rupee and Turkey's lira both crashed to record lows on Thursday following the US Federal Reserve releasing minutes which signalled a wind-down of quantitative easing as soon as next month.

Dilma Rousseff, Brazil's president, held an emergency meeting on Thursday with her top economic officials to halt the real's slide after it hit a five-year low against the dollar. The central bank chief, Alexandre Tombini, cancelled his trip to the Fed's Jackson Hole conclave in order "to monitor market activity" amid reports that Brazil was preparing direct intervention to stem capital flight.

The country has so far relied on futures contracts to defend the real — disguising the erosion of Brazil's $374bn reserves — but this has failed to deter speculators. "They are moving currency intervention off balance sheet, but the net position is deteriorating all the time," said Danske Bank's Lars Christensen.

A string of countries have been burning foreign reserves to defend exchange rates, with holdings down 8pc in Ecuador, 6pc in Kazakhstan and Kuwait, and 5.5pc in Indonesia in July alone. Turkey's reserves have dropped 15pc this year.

"Emerging markets are in the eye of the storm," said Stephen Jen at SLJ Macro Partners. "Their currencies are in grave danger. These things always overshoot."

It was Fed tightening and a rising dollar that set off Latin America's crisis in the early 1980s and East Asia's crisis in the mid-1990s. Both episodes were contained, though not easily.

Emerging markets have stronger shock absorbers today and largely borrow in their own currencies, making them less vulnerable to a dollar squeeze. However, they now make up half the world economy and are big enough to set off a crisis in the West.

Fears of Fed tightening have pushed borrowing costs worldwide to levels that could threaten global recovery. Yields on 10-year bonds jumped 47 basis points to 12.29pc in Brazil yesterday, 33 points to 9.72pc in Turkey, and 12 points to 8.4pc in South Africa.

There had been hopes that the Fed might delay its tapering of bond purchases, chastened by the jump in long-term rates in the US itself. Ten-year US yields — the world's benchmark price of money — have soared from 1.6pc to 2.9pc since early May.

Hans Redeker from Morgan Stanley said a "negative feedback loop" is taking hold as emerging markets are forced to impose austerity and sell reserves to shore up their currencies, the exact opposite of what happened over the past decade as they built up a vast war chest of US and European bonds.

The effect of the reserve build-up by China and others was to compress global bond yields, leading to property bubbles and equity booms in the West. The reversal of this process could be painful.

“China sold $20bn of US Treasuries in June and others are doing the same thing. We think this is driving up US yields, and German yields are rising even faster,” said Mr Redeker. “This has major implications for the world. The US may be strong to enough to withstand higher rates, but we are not sure about Europe. Our worry is that a sell-off in reserves may push rates to levels that are unjustified for the global economy as a whole, if it has not happened already.”...

*** CALGARY HERALD / LINK

## Inner Mongolia: Where Bankers Sold Bunk

Underlying the trial of a woman authorities say drained bank accounts and kidnapped a banker's wife are vexing questions about account security and teller supervision at China's state-run bank branches in Inner Mongolia.

Hundreds of millions of yuan were stolen from customer accounts at the Bank of China's (BOC) branch and the Agricultural Bank of China's (ABC) branch in the city of Bayan Nur between 2007 and 2011, say prosecutors who have charged Tu Ya and 23 alleged accomplices. These include Tu's husband Jin Junping, a boyfriend named Li Shengrong and 11 former BOC employees.

Tu has been charged with scheming with bank executives and tellers to defraud 83 bank clients, draining a combined 2.7 billion yuan from their accounts. Authorities have forced Tu to repay victims about 2.2 billion in principal and interest, but the rest of the money – much of which she allegedly used for bribes – has been deemed unrecoverable.

The trial began in Hohhot on August 1 when prosecutors from the Xing'anmeng bureau of the Inner Mongolia People's Procuratorate formally charged the suspects with financial fraud, illegal bank deposit marketing practices and other crimes.

After reviewing the indictments and hearing witness testimony, the presiding judge adjourned the proceedings at Hohhot's Intermediate People's Court on August 7. Most defendants have been jailed pending a verdict, for which a date has not been announced.

Banking regulators have been paying close attention to the Tu case and its implications for managing employee-related risk at bank branch offices, a source at the China Banking Regulatory Commission (CBRC) said.

As of the first quarter of this year, over 60 percent of illegal fundraising cases involved participation of bank employees, CBRC chairman Shang Fulin said at a Beijing conference on July 31.

"In almost all cases of operational risks leading to investigations at banks, the perpetrators colluded with bank insiders to different degrees," a high-level bank regulatory official said. And Tu's case triggered a wave of investigations.

Insider crime at bank branches was cited as a nationwide concern recently by Shang. He urged regulators to watch for bank employees who, for example, write high-interest loans for bank clients outside official channels.

Authorities say Tu pulled off a colossal Ponzi scheme that would have been impossible without help from inside the banks. Attorneys representing some of her co-defendants who used to work at banks say the scheme is quite common in Inner Mongolia.

Tellers and bank executives have been known to get involved. One of Tu's fellow defendants, a woman named Tonglaga who was fired from a job she long held at BOC's Inner Mongolia business office, did not deny joining Tu, but testified that the scheme also must have had high-level support.

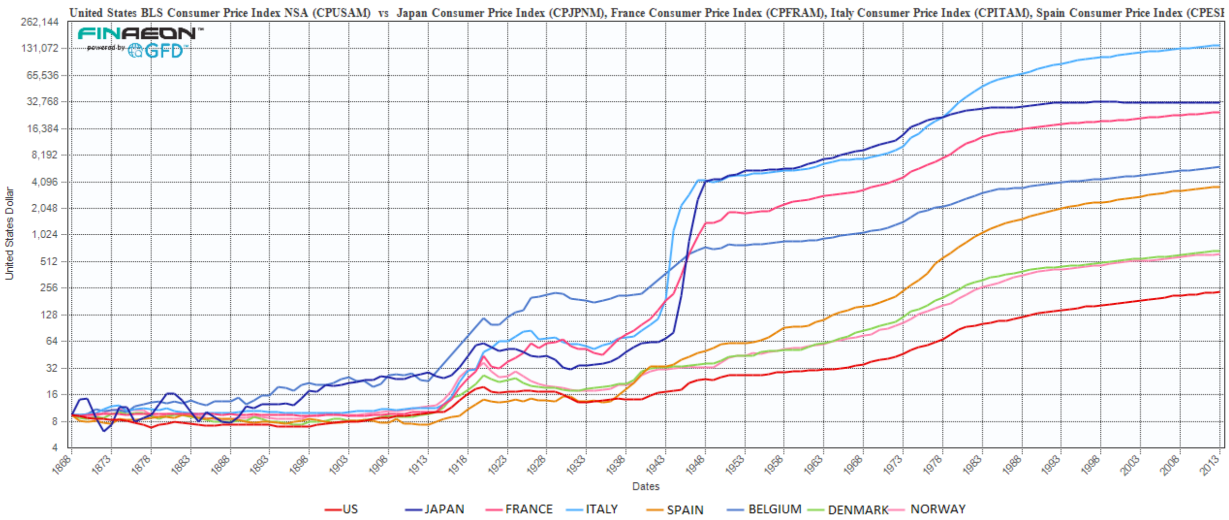
On the witness stand, Tongala said getting a superior's permission to move any large sum of money at the bank was easy. "Whenever they saw Tu's name, they authorized it in two or three seconds."

Tonglaga also testified that she always worked within full view of surveillance cameras, which meant superiors must chosen to have ignore transactions and other office activities related to Tu.

Complicity apparently ran deep because even basic transaction rules were flaunted at branches where Tu did business. For example, according to BOC rules, a window teller is never supposed to move more than 50,000 yuan in a single transaction, nor handle more than 500,000 yuan worth of transfers in a single day. But tellers allegedly routinely moved millions and sometimes tens of millions of yuan on Tu's behalf in just a few transactions, prosecutors say....

*** CAIXIN / LINK

# Charts That Make You Go *Hmmm...*




Source: Zerohedge

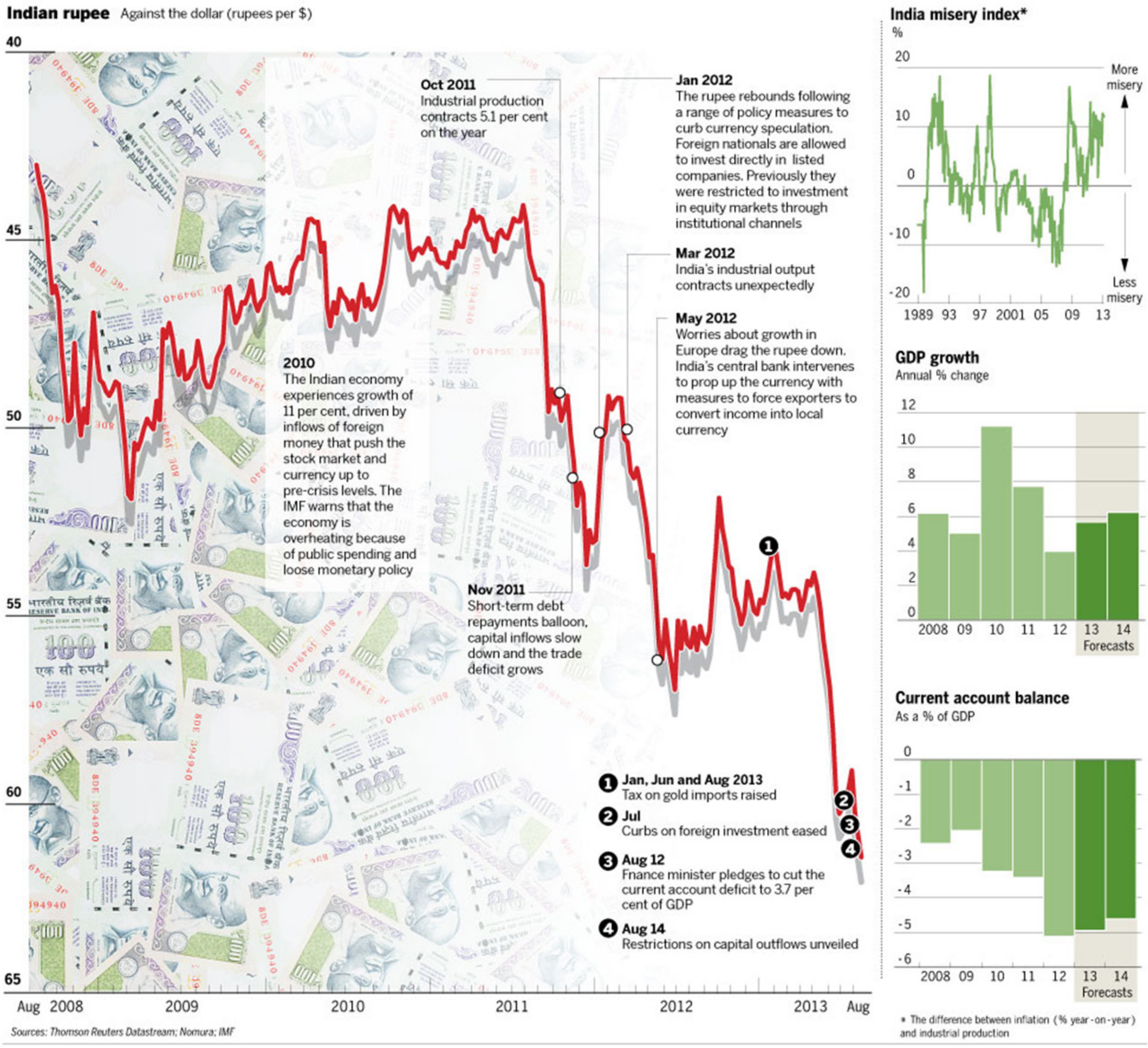
The Twentieth century may be remembered as the century of excess. In every area, more things were done in the Twentieth century than in any other century in history, and in many cases, more than in all previous centuries combined. The Twentieth century saw some of the most destructive wars in history, the development of the Atomic Bomb, the beginning of air and space travel, the colonization and decolonization of the Third World, the rise and fall of Communism, dramatic improvements in the standard of living, the population explosion, the rise of the computer, incredible advances in science and medicine, and hundreds of historically unprecedented changes. The Twentieth century also produced more inflation than any other century in history.

Inflation is nothing new. Roman rulers produced inflation in Third Century Rome by debasing their coins, China suffered inflation in the fourteenth century when the Emperors replaced coins with paper money, Europe and the rest of the world suffered inflation when gold and silver started flowing into the Old World from the New World in the sixteenth century, and the French and American Revolutions destroyed currencies in each of those countries.

Nevertheless, as we shall see, the Twentieth century produced the worst inflation in human history. Every single country in the world suffered worse inflation in the Twentieth century than in any century in history.

What lies ahead in the Twenty-first century? No one knows, of course.

*** ZEROHEDGE / LINK




Source: Zerohedge

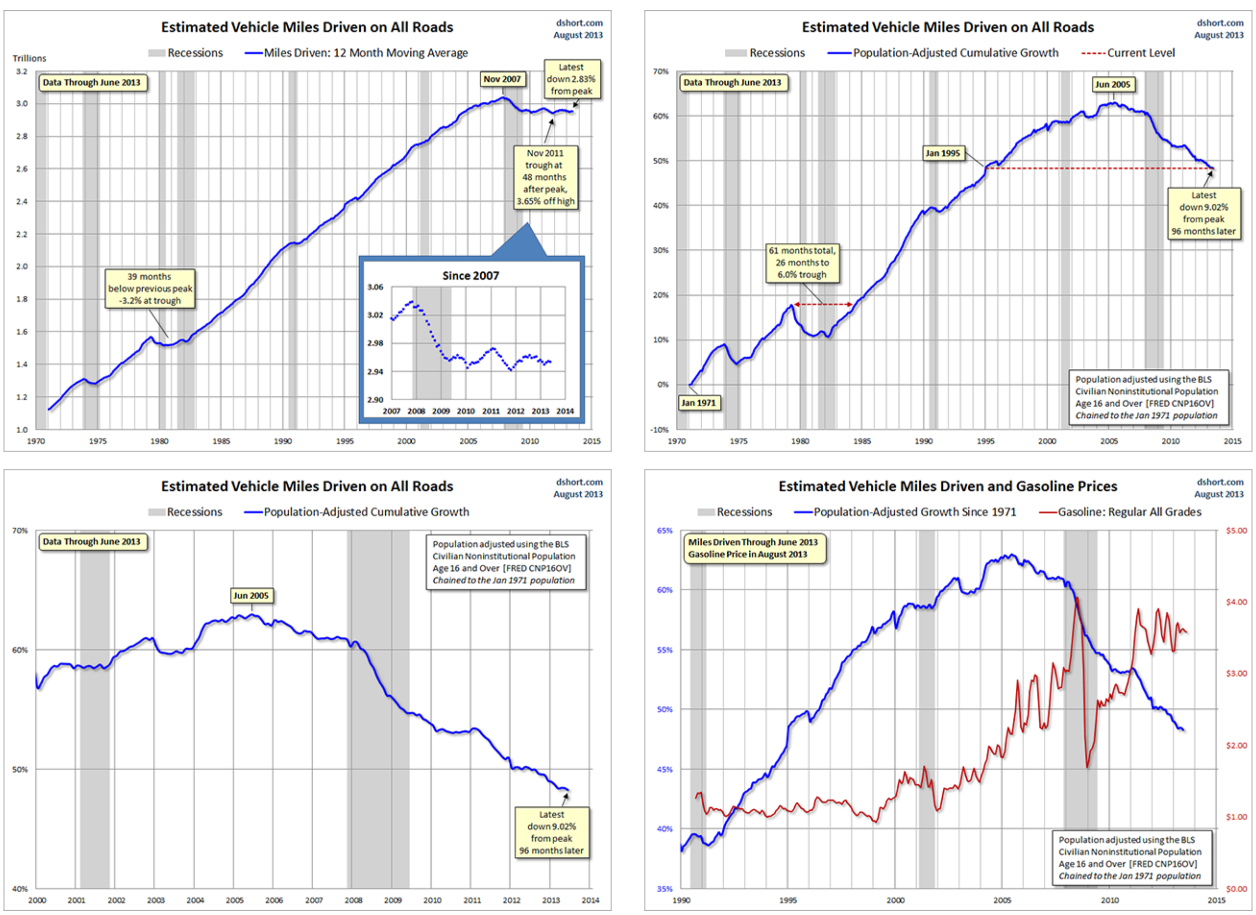
Having spent the first 20 pages of this week's *Things That Make You Go Hmmm...* discussing India and the decline of the rupee alongside the deterioration of the Indian economy, it makes sense to ask the good folks at Zerohedge to lay it out in graphic form — much easier that way, don't you think?

**The Department of Transportation's** Federal Highway Commission has released the latest report on Traffic Volume Trends, data through June. Travel on all roads and streets changed by -0.4% (-0.9 billion vehicle miles) for June 2013 as compared with June 2012. Travel for the month is estimated to be 258.1 billion vehicle miles. Cumulative Travel for 2013 changed by -0.1%. Cumulative estimate for the year is 1,461.7 billion vehicle miles of travel (PDF report). Both the civilian population-adjusted data (age 16-and-over) and total population-adjusted data have set new post-financial crisis lows.

The Driving Boom — a six decade-long period of steady increases in per-capita driving in the United States — is over.

Americans drive fewer total miles today than we did eight years ago, and fewer per person than we did at the end of Bill Clinton's first term. The unique combination of conditions that fueled the Driving Boom — from cheap gas prices to the rapid expansion of the workforce during the Baby Boom generation — no longer exists. Meanwhile, a new generation — the Millennials — is demanding a new American Dream less dependent on driving.

*** DOUG SHORT / LINK




Source: Doug Short

# Words That Make You Go *Hmmm...*


Christine Lagarde talking to Bloomberg TV at Jackson Hole about the IMF's "containment strategy" for Europe provided great insight into how the strategy was shaped.

Hint: It involves crossing fingers...

CLICK TO WATCH

Eric Sprott is one of guys anyone who looks at precious metals ought to listen to whenever they get the chance, so I'm only too happy to help facilitate that.

This week he talks to Eric King about the potential moves in gold and silver stocks, should the recent strength in the underlying metals continue...

CLICK TO LISTEN

Last week I ran out of space to include an interview I did with the ever-charming Jim Puplava, so I'm including it this week.

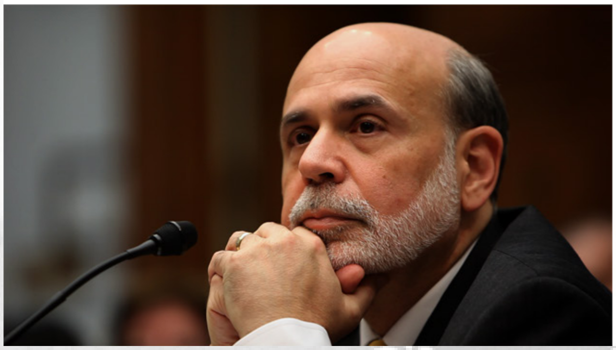
Jim and I chatted about the slowdown in China and what that means for commodity markets, the unintended consequences of QE, and, of course, gold...

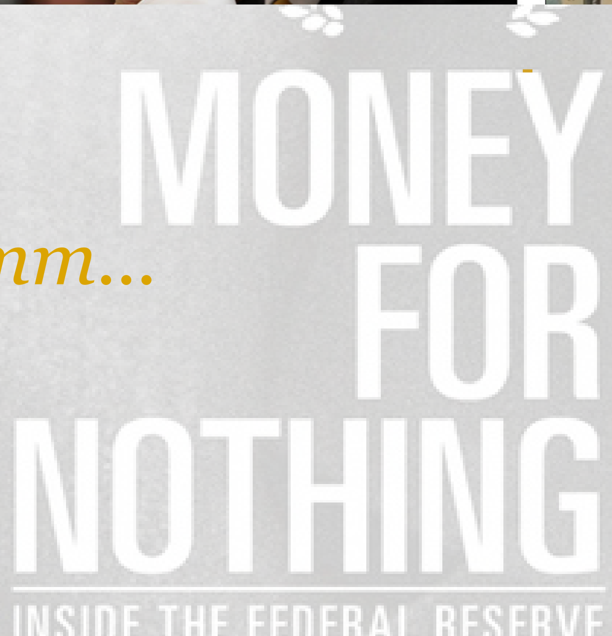
CLICK TO LISTEN

# and finally...

Money for Nothing *is a new documentary about the inner workings of the Federal Reserve. It looks at the level of their responsibility not only for the last crisis but, more importantly, for the NEXT one.*

*The movie is screening across the US in September, and I urge readers to seek it out and support what is a very important film. Watch the trailer and find out more about the schedule at the movie's homepage:* [www.moneyfornothingthemovie.org](http://www.moneyfornothingthemovie.org).






*Hmmm...*

## Grant Williams

Grant Williams is the portfolio manager of the Vulpes Precious Metals Fund and strategy advisor to Vulpes Investment Management in Singapore — a hedge fund running over $280 million of largely partners' capital across multiple strategies.

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

Grant has 28 years of experience in finance on the Asian, Australian, European and US markets and has held senior positions at several international investment houses.

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

For more information on Vulpes, please visit [www.vulpesinvest.com](www.vulpesinvest.com)

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66th Annual CFA Conference, Singapore 2013 Presentation: 'Do The Math':

Mines & Money, Hong Kong 2013 Presentation: 'Risk: It's Not Just A Board Game':

Fall 2012 Presentation: 'Extraordinary Popular Delusions & the Madness of Markets':

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

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

Grant Williams

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