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GLOBAL REPORT

MARKETS OR MONEY: WHICH COMES FIRST?

Christmas is coming, the geese are getting fat
Please put a penny in the old man's hat
If you haven't got a penny, a ha'penny will do
If you haven't got a ha'penny, a farthing will do
If you haven't got a farthing, then God bless you!

When your Captain (now 60 years old) was a child, this was a traditional Christmas carol in the UK. Given today's currency turmoil, it seems absurd to imagine that less than 50 years ago, a "farthing" was still a coin in use in the UK. A "farthing" was the lowest denomination of all British coinage, representing one-quarter of a penny and 1/960 of a Pound.

The farthing was in daily use until the early 1950s and only ceased as legal tender in Britain on December 31, 1960. How times have changed! On October 12, 2010, the exchange rate was one UK Pound to $US 1.59. What would 1/960 of that buy in the UK (or the US for that matter)? Why would a unit of any currency today be divided into 960 parts for exchange purposes? The simple answer is that it wouldn't - and it isn't.

The "Too Hard" Basket Overflows:

Over the week of October 8-10, the IMF and the World Bank held their annual meetings in Washington DC. The major subject up for discussion was a foregone conclusion. It was, of course, world currencies and the looming prospect of currency "wars" as each nation strives to weaken its currency against its trading "partners" to enhance its exports to the greatest extent possible. The IMF/World Bank meeting was expected to "fix" this problem. According to IMF managing director Dominique Strauss-Kahn: *"there is only one obstacle, and that is an agreement of the members."*

It is true that in a situation approaching "war", one typically does NOT find *"an agreement of the members"*. None was forthcoming amongst the ranks of central bankers and finance ministers meeting in Washington.

Money - The Last Ideological Frontier:

Since the Global Financial Crisis (GFC) began, the debate has ranged all over the global financial system. Official studies have examined what happened, how it happened, the course of events and the potential "solutions" (active and proposed) to the problem. These analyses continue, both within individual nations and on an international basis. The IMF itself has pledged to continue its "studies" into the various "frictions" thrown up among the leading economies as a result of the GFC. Innumerable laws have been passed all over the world. Rules and entire regulatory systems have been proposed everywhere. Everything has been examined - except the item over which the world now proposes to wage war.

Their "Formative" Years:

Most of the major global financial potentates who met at the IMF/World Bank meetings last weekend are now in their 50s or 60s. They are all "baby boomers", the majority of them having been born since the end of WWII. Most of them can remember the 1950s, the last decade when most "ordinary" people were still living in what was largely a "coin" economy. The best example of this is probably the UK.

In the 1950s in the UK, one Pound Sterling consisted of 240 pennies or "pence". There were ten coins which circulated as money. They included the farthing (1/4 penny), halfpenny, penny, tuppence (two pence), thruppence (three pence), sixpence , shilling (12 pence), florin (24 pence), half crown (30 pence) and crown (60 pence). The largest paper note in general circulation at the time was the Five Pound note. Today, the Five Pound note is the smallest British paper note in circulation.

Today, in the "developed world", most people carry very little actual money of any description to use in their everyday exchanges. Coinage which is a fraction of the monetary unit (the Pound, Dollar etc) is regarded as a nuisance. Things were VERY different not so many years ago.

On "Main Street" - A Coin-Based Economy:

When Princess Elizabeth became Queen of England on the death of her father in February 1952, the average weekly wage was about six pounds. Credit cards were non-existent and any kind of "electronic" money transfer was strictly for the rich. The majority of people did not have a "checking" account and many British people did not have a bank account of any kind. Paper money certainly existed - in denominations from 10 shillings ("50P" in modern parlance) to Five Pound notes. Savings were kept in a jar in the cupboard and the majority of everyday transactions were done by means of coined money.

In the early 1950s in Britain, and to a lesser but still surprisingly large extent in North America, the "developed" world was still on a "coin standard" as far as the "average" person was concerned. In 1952, the exchange rate was about $US 2.80 to 1.00 British Pound so a British farthing would have been worth 0.70 US cents. Both coins were in full use and there were many items which both coins could actually buy. In Britain in particular, coins much more than paper were still regarded as being "real" money.

The point to be made here is that the attitudes towards money in a predominantly coin-based economy are VERY different from the attitudes towards money today. For years now, the idea of a "cashless" economy has cropped up with increasing regularity. Less than 60 years ago, such an idea would have been thought laughable. Money did not consist of a series of plastic cards, "PIN numbers" and access to Automatic Teller Machines. It consisted of small round disks of, in most cases, silver. Money was tangible. It clinked in your pocket as you walked down the street. It was a real physical object.

A viable and SOUND medium of exchange MUST BE a physical object. Coins are the oldest form of uniform money. From their invention in 700 BC in Lydia (in what is now Turkey) until the first decade of the reign of the current British monarch, coins WERE money to most people. That attitude is now long gone. As previously mentioned, coins are now considered as more of a nuisance than as a means of payment. And with that change of attitude has come the degeneration of two things. The first is the money itself. The second is the level of the debate about what money IS and should continue to be.

Getting Away With Monetary Murder:

A "coin money" system is laughed at today by the economics profession. So is pretty well every other tenet of sound economics. Almost the entire history of indirect exchange took place in the context of a coin money economy. Right up until the mid-'60s, silver coin still circulated as everyday money in the "developed" world, as it had for millenia. It is not the coin economy which is the "anomaly", it is an economy in which coined money plays little part and precious metal coined money no part at all.

The Things That Were ... :

Article 1, Section 8 of the US Constitution reads as follows: *"The Congress shall have Power ...**To coin Money**, regulate the Value thereof, and of foreign Coin."*

At the time that this document was being debated, the 13 colonies which were to become the original US states coined their own money. So did most other states and provinces in nations throughout the world. In most non-English European languages and in languages of nations ever further removed, the words for "coin" and "currency" were the same or synonymous. Money as it passed from hand to hand in the economy of the day was coin everywhere. Paper money had been a disastrous failure wherever it had gained sway, not least the "Continental currency" issued to fight the revolutionary war in the US.

Article 1, Section 10 of the US Constitution reads as follows: *"No State shall ...make any Thing but gold and silver Coin a Tender in Payment of Debts."* Please remember that when this phrase was inserted in the Constitution the federal government in Washington DC did not yet exist. The States were expressly forbidden from coining money. The clear implication in this clause was that they could not replace GOLD and SILVER coin as a means of extinguishing debt. The Congress as it was being set up by the Constitutional convention was given no EXPRESS power except one - the power to COIN money.

Congress still has that power, of course, but it is a minor detail today amongst the printing press and electronic money which represents almost all of the global "supply" of US Dollars.

... And Could Be Again:

In India today, 84 percent of "workers" make less than $US 2 per day. In China, the number is 42 percent. In Brazil, it is 15 percent and in Russia, it is 2 percent. In the US, the federal minimum wage is $US 7.25 per HOUR. Over an eight-hour day, that works out at $US 58.00. Most if not all of those working for less than $US 2 per day in the four nations mentioned above work more than 8 hours a day.

Please note that these four nations - Brazil, Russia, India and China - are the "BRIC" nations. They rank first, second, fifth and ninth in terms of world population. Two of them, China and India, are the two most populous nations on earth with almost 37 percent of the global population between them. The BRIC nations are often singled out as the coming global economic powerhouse, the nations which are and will increasingly drive world economic "growth" in future. In recent surveys done in the US, they were seen as being a better investment bet than is the US itself.

The majority of the "ordinary" people in ALL these nations, but in India and China in particular, are still living in a coin economy. They still conduct their transactions the way the whole world did until the 1920s or 1930s and the way that all but the richest nations (the US and Canada in particular) did until the mid 1960s. Coined money is not a nuisance to these literally billions of people, it remains money itself.

Economic Goods Are REAL THINGS:

There are billions of people throughout the world who still operate all but exclusively with a coin-based monetary system. If there is one thing these people know, it is that there is no such thing as economic "growth" through consumption and debt. These people know that they must produce before they can consume and that they are not in a position to take on any debt for any purpose whatsoever.

These are the simple economic and financial truths which have long since been forgotten in the "developed" world. What has "developed" in this world is the mirage that production and savings are no longer required. In a coin-based economy, the fundamental function of money as a medium of exchange is taken for granted as stark reality. In a paper and debt based economy, that function is lost sight of. The fundamental reason for this is that nobody ever actually sees or handles what they are spending.

The IMF/World Bank Meetings: Tilting At Windmills:

In a world where more than half the ADULT population lives and functions on $US 2 per day or less, we are faced with a debt situation in which the amounts at "risk" in the US alone are in the hundreds of $US TRILLIONS. Taken globally, the amount of debt is much higher than that. No more ridiculous financial or monetary situation has ever existed in the history of the world. To call it "unsustainable" (a word which Fed Chairman Bernanke recently resorted to in a speech to Congress) is laughably inadequate.

To imagine that even the tiniest fraction of all this debt can ever be "repaid" in money which retains the purchasing power it had when the debt was contracted is simply laughable. But what is not funny at all are the lengths that the global financial potentates are willing to go to in order to keep this fairy tale alive.

The latest and most obnoxious example of this was laid out in front of the world at the IMF/World Bank meetings in Washington DC. The next "episode" will come at the G20 meetings in South Korea. The issue, as it has come to be defined by the global financial press in recent weeks, is "currency wars".

What Other Choice Is There??:

In the hundreds of articles appearing in the mainstream financial press all over the world and especially the English-speaking world, one headline stood out. It was this - *"Currency wars are necessary if all else fails"*. The headline appeared in the October 11 edition of the *UK Telegraph*.

The contents of the article are not germane. What is germane is the naked contention that the nation or nations which will emerge the "strongest" from the current financial malaise is the nation or nations which succeed in devaluing their currency faster than any other. Only in that way can the "currency wars" be won. If these "wars" develop further, they will become a race to see who can come up with a worthless currency faster than anybody else. The 1930s coined the phrase *"beggar thy neighbour"*. Today, the financial potentates have gone one better. They are working on a *"beggar thyself"* policy.

Co-operative debt-based stimulus didn't "work" and neither have "austerity" programs, according to the IMF. Their *"World Economic Outlook"* comes to the conclusion that the world can neither "stimulate" its way out of the current GFC nor get there via "austerity" programs. And it isn't too sanguine on the prospects of currency wars either. As the IMF report noted: *"Not all countries can reduce the value of their currency and increase net exports at the same time"*. After all, they tried that in the 1930s. The only thing that "saved the day" then was a REAL war, not one on the foreign exchanges.

But still, the global financial potentates keep thrashing around inside their own context looking frantically for a way to overcome their plight. As they want the citizens of the nations they "represent" to see it, they have no choice. If they for one second admitted that the entire system as it is presently constituted is deficient by its very nature, they would instantly have the "social instability" they are warning us against.

A Sound Money Is A Tangible Money:

The history of indirect exchange developed in two main stages. First came a steady narrowing down of the physical economic goods which were seen as having the utility to be a medium of exchange. That ended when Gold (and silver) were singled out. The next development was a tangible form that these two metals could take so as to be used as money. Gold and Silver coins emerged and lasted (in the case of silver coin) right up until the mid 1960s. As an illustration of the consequences of the banishment of precious metal coin money, consider this: The US stopped minting Silver dimes (10 cent pieces) in 1965. At current prices, the silver in one of these coins is now worth just under $US 1.70. A pre-1930s US Gold $US 20 Double Eagle coin is now worth about $US 1310 in Gold content. In the early 1930s, $US 20 was a month's wages for many. At today's minimum wage, $US 1310 is considerably more than a month's wages. The difference is that the wages then were TANGIBLE. Today they are promissory.

Imaginary Money - Imaginative Markets:

Ever since the US Fed announced a cautious second chance of straight (no chaser) money printing (aka "quantitative easing") at their August 10 FOMC meeting, markets everywhere have gone haywire. In the US, after a 260 point relapse immediately after the FOMC announced its plan, the Dow has forged steadily ahead. On October 8, the index closed above the 11,000 level for the first time since the height of the Greek sovereign debt crisis in April. US Treasury yields have plummeted right alongside with two-year yields falling below 0.50 percent within days of the Fed's announcement and recently dropping as low as 0.26 percent - on the same day as the Dow breached the 11000 barrier.

On the "flip side", the US Dollar has been trending inexorably lower and $US Gold has been setting new records on an almost daily basis for the past month. Money flows globally have been manic, with "emerging" stock markets booming and currencies everywhere rising against the US Dollar. Capital controls have been put in place in many nations, as have taxes on foreigners buying sovereign debt.

Those who "trust" government are flocking into Treasuries and, to a lesser extent, into US stocks. Those who don't are buying precious metals, commodities of all descriptions, and anything they can find anywhere which offers a yield.

The "Game" Explained:

On October 12, the minutes of the FOMC's most recent meeting (on September 21) were released for scrutiny. The gist of these "deliberations" are contained in one sentence **- *"Policy-makers had a sense that*** (more) ***accommodation may be appropriate before long."*** This is the expectation on which the world has been basing its investment decisions ever since that September 21 meeting.

The reaction to the release of these minutes was by no means confined to the US. An excellent example of this is a quote from Brazilian Finance Minister Guido Mantega. For weeks, Mr Mantega has been maintaining (quite rightly) that the world is already in a currency war. This is what he had to say about the US central bank - *"The Federal Reserve is promising quantitative easing, **which is monetary policy's last resort**. I don't think it will reactivate the economy, but it will weaken the Dollar."*

This is more than *"monetary policy's last resort"*. It is Ben Bernanke's "helicopter money" scenario writ large. The US central bank proposes to use the Federal Reserve notes it creates out of thin air to "buy" the debt of the US government which the Treasury creates out of thin air. This is the last gasp of a monetary "system" which is as far from sane and historically sound money as it is possible to get. Not only is it doomed to failure, it will doom the US Dollar if it is put into practice to any substantial extent.

Since the US Dollar remains the premier global reserve currency, that will leave the rest of the world with absolutely no choice but to institute radical changes to the money which underpins everything. In the modern sense of the term, there can be no markets without a viable money. The Fed is on a path which will remove the money. The markets can only then survive with a different, and better, underpinning.

From Coin To Chaos:

In essence, that is what the history of the global fiat money era has been. The masters of the universe have taken a simple thing like precious metal coinage and turned it, in stages, into a galactic game of GIGO (Garbage In - Garbage Out). Computers, without which our modern monetary "system" would be impossible, will accept anything that is fed into them. So will a lot of people. But many will not.

The idea of Gold and Silver coin circulating as money may seem like something out of the distant past. But Gold coin DID circulate until about 65 years ago. And Silver coin was still circulating as money in the US when Kennedy was assassinated in late 1963. For half the world, coins still ARE money.

INSIDE THE UNITED STATES

SHUT UP - OR PUT UP

With less than three weeks to go before the mid-term Congressional elections, that seems to be the attitude of Americans of pretty well all political persuasions. They have been listening to their political and financial leaders telling them that the recession is "over" for well over a year. Officially, they are told, it ended way back at the end of June 2009. There is only one problem. Few Americans believe any of it. The majority in pretty well every poll that is taken think (quite rightly) that the US economy never emerged from the "recession" and that things are getting worse, not better.

Even more encouragingly, there is a quickly growing resolve among many Americans to vote the incumbent OUT. This is most prevalent amongst voters who class themselves as "independent" of course, but it is by no means confined to them. The party affiliation of the incumbent doesn't matter to these people. They want to punish politicians who are in office in the only way they can, by firing them at the ballot box. As *The Privateer* has pointed out on many occasions, the best thing Americans (and most other people who live in "democratic" nations) could to is to vote incumbents out at every opportunity. That way, a political "career" might actually become a thing of the past. From there, it is but a short step before the pressure starts to build on the REAL "careerists", the bureaucrats.

Poking Through Very Dead Ashes:

On October 4, Fed Chairman Ben Bernanke went to the smallest state in the Union - Rhode Island - to give a speech to their *"Public Expenditure Council"*. Mr Bernanke chose to use the occasion to issue a stern warning of dire economic consequences if the Congress and the administration do not "do something" about the size of their deficits. Specifically, he pointed to the inevitability of higher long-term interest rates, which would of course put even more upward pressure on the deficits.

In almost the next breath, however, Mr Bernanke hedged his "bets" into fiscal oblivion. He said that the weak condition of the US economy provided little scope for reducing deficits "at present". *"Indeed"*, he intoned, *"premature fiscal tightening could put the recovery at risk!"* Then, Mr Bernanke put the cherry on top. He advocated the installation of a *"fiscal rule"* to provide a signal to the public that Congress is actually serious about long-term fiscal sustainability.

As Mr Bernanke is well aware, the US Congress has had a "fiscal rule" in place for 70 years. It is called a "debt ceiling" and applies to the amount of official funded debt put out by the US Treasury. When it was inaugurated shortly before the US entered WW II, the Treasury ceiling stood at $US 41 Billion. It now stands at $US 14,294 Billion. The routine raising of the Treasury's debt limit for seven decades should have long since been enough to clue the public in as to the intentions of their elected officials.

Mr Geithner And The IMF:

As US Treasury Secretaries always do, Timothy Geithner cut as wide a swathe as he possibly could at the recently completed IMF/World Bank meetings in Washington DC. The only thing Mr Geithner was silent about was the traditional and knee-jerk announcement that the US continues to have a "strong Dollar policy". The question never came up, or perhaps Mr Geithner made sure that it never came up. As is well known, what he wants is a strong Yuan policy, as do his compatriots in the US Congress.

Mr Geithner even went so far as to suggest that "awarding" more power to China within the IMF should be linked to a greater willingness by the Chinese government to "reform" its currency system. Ever since its inception, the only nation which has had REAL power in the IMF is the US because the US is the only nations whose voting "quota", at 17 percent, is large enough to veto important decisions. In mid September, Germany suggested the US should give up that veto power. Mr Geithner didn't mention that.

INSIDE ASIA

THE WEAK US DOLLAR POLICY - AND ASIA'S RESPONSE

On October 14, the trade-weighted measure of the global "strength" of the US Dollar - the USDX - closed at 76.88, equalling its 2010 low closing level. Over the weekend of June 18-20, China announced that it would *"proceed further with reform of the RMB* (Yuan) *exchange rate regime and enhance the RMB exchange rate flexibility"* (see the Late June issue of *The Privateer* - Number 656). In the not quite four months since then, the USDX has dropped steadily - from 86.40 to 76.88. That's a fall of 11.0 percent. No, the Yuan has not risen against the $US by an equivalent amount over that period. But then again, ridiculously enough, the Yuan is not a constituent currency in the USDX.

The catalyst for this US Dollar fall does NOT come from China or from anywhere else in Asia. It comes from the US central bank, the Federal Reserve. The first step came at the August 10 FOMC meeting when the Fed announced that it was NOT going to shrink its balance sheet after all and it WAS going to embark on another round of Treasury debt monetisation. The amount mentioned by the Fed was much too small to "suit" global markets, so ever since then the speculation has risen everywhere that the Fed is going to announce a "real" (estimates range between $US 500 Billion and $1 TRILLION) bout of "QE" any minute now. The consensus is that it will be announced at the November 3 FOMC meeting.

With the US money "spigot" expected to keep gushing, the new and anticipated new money is flowing freely. Naturally, it is flowing towards areas where it can earn a rate of return and where economic "growth" above the global "norm" is expected to persist. In short, it is flowing towards Asia. In the process, it is distorting Asian markets, Asian interest rates and, in particular, Asian CURRENCIES.

The Response From Asia:

The only official announcement of intervention in the currency markets so far came from Japan a month ago on September 15. The Yen did fall against the US Dollar on the announcement, but that didn't last. By October 6, the Yen had exceeded the pre September 15 highs which brought on the intervention. It has continued to rise since then. Most if not all of the other major Asian nations are "suspected" of intervening in the currency markets to try to keep their currencies down against the US Dollar. The public reason for this is their desire to preserve their US export markets. To find the real reason, all that is necessary is to consider the fact that net private capital flows to "emerging" (including Asian) economies are projected to rise by 42 percent in 2010 compared to their levels in 2009.

Asian nations are trying to damp down this flood of VERY "hot money" by instituting capital controls, limiting their banks' ability to re-lend the capital into the local economy and even by taxing any foreign purchases of their sovereign debt paper. All the Asian nations, most certainly including China, are doing what they can to minimise the distortions to their economies. And all the Asian nations, most certainly including China, are well aware that the SOURCE of the problem is the US and its central bank.

China Puts It In Perspective:

On October 13, the *Chinese Peoples' Daily* carried a front page headline which described the US as *"the first maker of tomb figures"* in the currency wars. This is a Chinese expression which equates to a person or event that creates a bad precedent. It was written by Li Xiangyang, the head of the Asia department at the Chinese Academy of Social Sciences. Li put the situation bluntly - *"The dollar's depreciation may appear to be market-driven. In reality, it is a depreciation coloured by very strong, deliberate actions."* He unerringly pointed to the Fed's announcement of QEII as being the main catalyst.

The "great leap forward" in the valuation of Chinese reserves over the third quarter has been scoffed at by China. All the non-US currencies in the reserves have soared. There's your "leap".

INSIDE THE EUROPEAN UNION

THE NOT VERY SPECIAL US/EUROPEAN RELATIONSHIP

In mid June this year, the Euro was trading at about $US 1.19, down from the $US 1.50 it had reached in early December 2009 - before the US ratings agencies pulled the rug out from under Greece and initiated the European sovereign debt crisis. By October 8, the Euro was back above $US 1.40. By October 14, it was back to $US 1.415. The European sovereign debt crisis has not gone away. But it has faded into the background in the face of the US sovereign debt crisis - brought into sharp focus by the Fed's plans to buy much more Treasury debt. US "analysts" are fobbing off the Euro's rebound since June by saying that the European currency is playing the role of a "safety valve" in the global currency system.

The only concrete reason given for this categorisation of the Euro is that the Fed has announced another round of QE while the UK and Japanese central banks have never really stopped monetising their government's debt paper. In the increasingly murky world of "reserve currencies", that leaves the EU and its Euro as the "safe" candidate if all else - specifically the US Dollar - fails.

The Adversarial Relationship - Germany And The US:

In late September, as the financial potentates of the world were gearing up for the IMF/World Bank meetings in Washington, the German government made a "suggestion" to their US counterparts in Washington DC. The suggestion (which was not reported at all in the US financial press) was that the US give up its veto in return for Europe accepting a smaller say in the decisions of the IMF. This suggestion was instantly rejected in Washington. Small wonder, since the US veto is a cornerstone of the post Bretton Woods global system with the US Dollar as the sole reserve.

We mentioned this German "suggestion" at the end of the *Inside the United States* section in this issue. The voting "quotas" of the constituent members of the IMF change very infrequently. In recent years, and especially since the GFC hit, this has led to more and more dissatisfaction from nations whose "quotas" in the IMF system bear no resemblance to their economic and financial clout in the world. The IMF was designed for a US/Europe financial world. The world is no longer constituted that way.

Any "important" IMF decision requires an 85 percent majority vote to be implemented. The US quota is 17 percent. That makes the US the only single nation which can block any IMF decision it sees as inimical to its interest. The German suggestion is not that the US necessarily accept a smaller quota, it is that the present "85 percent rule" be scrapped. That would stop any single nation (like the US) or small group of nations (like the Euro nations or the BRIC) from controlling the IMF by themselves.

Such an outcome would, over time, be the inevitable final nail in the US Dollar's sole global reserve currency status. If the US could no longer control the IMF, it could no longer control the international agency which has presided over the US Dollar's reign as the world's "key" currency. Even to suggest such an idea is financial treason in Washington DC.

The No Longer So Special Relationship - The UK and the US:

Prime Minister Cameron's announced plans for a major cut in British public spending is not welcomed in the US. Recently, the Obama administration has found a way to inject themselves into the issue. The "lever" is the intense debate inside the Cameron government over his plans to cut Britain's defence budget by 10 percent. Both US Secretary of State Clinton (in Britain) and Defence Secretary Gates (at NATO headquarters) have gone public with their "concern" over the prospect of such cuts. This direct intervention into the political affairs of another nation by the US has been called "unusual". It is not. It is par for the course. But as a rule, such debates with special allies are sorted out behind closed doors. For the US to go public about their relationship with Britain IS unusual - and smacks of desperation.

AUSTRALIAN REPORT

PLASTIC FANTASTIC - AND - A TICK FROM *FITCH*

On October 5, the Reserve Bank of Australia (RBA) met and decided to keep its official rate at 4.50 percent. The reaction on the markets was the biggest one-day drop in the Aussie Dollar against the US Dollar for two months. That drop has since been more than regained. The day after the RBA released its latest decision, its "head of financial stability", Luci Ellis, proudly stated that Aussie households and businesses have entered a new phase of expansion. This had to be said, since the RBA freely acknowledges that up until recently, most of the "expansion" in the local economy has been driven by government stimulus measures. These measures are now winding down, largely due to the Labor party's near death experience at the recent elections.

If the government isn't "stimulating" and the RBA refuses to step into the breach to any greater extent than postponing any more rate rises, somebody out there must be "expanding". After all, economic "growth" is at stake here. So, right on cue, the RBA passed the parcel back to the private sector and the commercial banks. The fly in the ointment here is unmistakable evidence that the much vaunted housing boom is, at best, levelling off. But as yet, neither growth figures or employment are suffering, not officially anyway. Hence the "new phase of expansion".

The Enterprising RBA:

For many years now, Australia has boasted a state-of-the-art plastic money. By money we are talking about the actual RBA notes - $5-10-20-50-100 notes - which Aussies carry around with them in their wallets and purses. These notes are produced by an RBA subsidiary called *Securency*. But *Securency* doesn't only make Australian banknotes. The plastic currency they produce is so admired by other central bankers around the world that *Securency* has "secured" contracts to manufacture banknotes for many other nations. And manufacture them they have.

They have been so industrious that both Australian and overseas police agencies have smelled a rat. They recently launched raids in Melbourne, Spain, Britain and several other countries in an attempt to uncover evidence that *Securency* has been bribing foreign officials to win contacts to print their money ever since the late 1990s. The RBA has inevitably come under the spotlight here, since it has appointed half of the *Securency* board since 1996. Indeed, since 2008, the Chairman of *Securency* has been an RBA assistant governor. Before that, the person in the position was a deputy governor. It seems that not being content with counterfeiting "money" for Aussies, the RBA has striven to widen this service internationally. Of course by its nature, all "money" created by central banks is counterfeit. But most of these same central banks are a little more circumspect than is the RBA and *Securency*.

Saved By The US Ratings Agencies?:

During the first week of October, the IMF had the temerity to suggest, in public, that Australia was faced with a property bubble. That got the attention of the US ratings agency - *Fitch* - the same ratings agency which pulled the plug on Greece in December 2009 and brought on the European debt crisis. *Fitch* decided to run a "stress test" on the big Aussie commercial banks to see if they could withstand a fall in property prices. The test even included an extreme case in which 8 percent of Aussie mortgages went into default along with a 40 percent dive in Aussie property prices.

Kris Sayse at *Money Morning* couldn't resist this, with very good reason. He makes the point which is so germane that nobody in the mainstream media inside or outside Australia mentioned it. As Kris points out, in late 2008, Aussie housing prices barely budged. Yet had it not been for a blanket bank deposit guarantee by the government and a freeze on redemptions by many mortgage funds, the entire Aussie financial system (including the housing market) would have melted down. *Fitch* didn't consider this.

GLOBAL MARKET REPORT

THE PERILS OF MONETISING MARKETS

February 19, 2010 seems a long time ago. The US Dollar was starting to rise against its major trading partners. US stock markets were looking back on almost a year of heady gains after their near death experience of late 2008/early 2009. The Fed was well into its second year of holding its controlling funds rate at a level of 0.00 - 0.25 percent. Unemployment had eased from the 10.1 percent level it had reached in October 2009. And on top of it all, there was universal "consensus" that the economic "recovery" was well in hand. Any lingering effects of the GFC were seen as a European - not a US problem. The US ratings agencies had seen to that with their dire warnings and European sovereign debt downgrades.

So, what happened on February 19, 2010? The Fed actually RAISED an interest rate. Specifically, they raised their discount rate, the penalty rate charged to banks who borrow directly from them, by 0.25 percent to 0.75 percent. This was an entirely symbolic gesture. It was meant to signal that the Fed was "serious" about its plans to begin to exit from its "stimulus" and to start to wind back the huge blowout in its balance sheet fostered by the *Lehman* crisis. It was even meant as a "hint" that the Fed would soon start to raise its REAL rate - the Fed Funds rate. It was, as events have proved, a very red herring.

As we said, February 19, 2010 seems a long time ago, especially in light of the Fed's CURRENT plans. Over the first half of 2010, the Fed and the Treasury were trumpeting the contention that their "stimulus" had "fixed" the US economy and that they could now safely withdraw from their "unusual" policies. They have not done so. Instead, they now propose to further ramp up the "stimulus" and to add some new "wrinkles" which were deemed too dangerous and untested for use even in late 2008/early 2009.

The Paper Asset Markets Hang By A Single Thread:

We're not talking about only the US markets here. We're talking about paper asset markets all over the world. The "single thread" is the steadily growing expectation that the Fed will embark on a second round of direct Treasury debt monetisation in the very near future. That very near future has a "use by date" of November 3, the second day of the next two-day FOMC meeting and the day AFTER the upcoming US mid-term elections. Many large US fund managers are complacently pointing to the conclusion that US stock markets, for example, have already "discounted" (built into present prices) a $US 500 Billion to $US 1 TRILLION program of new monetisation. The Fed knows this, of course, and is equally well aware of the potential for a global market meltdown - led by the US markets - if they DON'T monetise again. The fact that they already have a US Dollar (aka Federal Reserve note) market meltdown on their hands is not deemed a sufficient deterrent. Nor is the market "melt up" in the form of soaring US Dollar prices for commodities of all descriptions - including Gold and silver.

As soon as attention was deflected from the European debt fiasco with the EU bailout of late June this year, that attention began to refocus on the main game. That main game is and always has been the situation at the core of the global financial system, the US. Perversely enough, as concern grew that the US economy was in danger of lapsing back into recession (the first recession had officially ended in June 2009), the paper markets surged higher. In late June - early July, the Dow had dipped back below the 10000 level. It is now more than 1000 points higher. The spread between two and ten-year Treasury yields was hovering between 2.50 - 2.60 percent. It has recently fallen as low as 2.05 percent. Two-year yields have dropped from about 0.80 percent to a recent low of 0.26 percent while five-year yields have been cut in half since mid/late June. As recession fears have grown, US paper markets have risen.

Internationally, the "carry trade" has revived with a vengeance, but this time the trade is all one way. US Dollars are being used to buy almost any non US currency - even the Yen. So much has "risk" appetite grown that Mexico recently sold $US 1 Billion of 100-year bonds! Gold has soared against the US Dollar since June, but it is DOWN against other major currencies. Never has so much been bet on one outcome.

Even Monetising Is No Longer Enough:

Ever since the Fed announced a new round of monetisation on August 10, global interest has grown as to what precisely Mr Bernanke has in mind as the components of his new plan to resuscitate the US economy. In a speech delivered to a Federal Reserve conference in Boston on October 15, Mr Bernanke came as "clean" as a central banker ever comes on what the Fed intends to do.

Mr Bernanke offered no insights into the Fed's new monetisation program, he simply took it for granted that what everybody now expects was indeed Fed policy. He declined to put a "number" on the plan, unlike the $US 300 Billion "quantitative easing" round of March to October 2009. Instead, as reported in the *New York Times*, Mr Bernanke chose to focus on the Fed's *"dual mandate"* to foster maximum employment and price stability. Mr Bernanke is concerned that the first part of the mandate (the employment part) is not being met while the second part (the price part) is getting too "stable" for comfort. His proposed solution is to jettison any pretense of price stability in the hope that this will lead to an upsurge in US employment. In short, he proposes to ditch the second part of the Fed's "dual mandate" in a *"risky and unproven"* attempt to meet the first.

And how is this supposed to work? According to Mr Bernanke, price inflation is *"too low"* in the US while unemployment is *"clearly too high"*. His solution is to embark upon the riskiest single action that any central banker in charge of a purely paper currency can undertake. Mr Bernanke proposes to RAISE the "inflationary expectations" of Americans so that (he hopes) they will get out there and borrow and spend before prices rise further in future. This process of borrowing and spending (according to the "elegant" theory which has been concocted to justify the action) will lead to increased employment.

The Monetary Equivalent Of Nuclear Hand Grenades:

Apparently there was a time when the concept of "nuclear hand grenades" was actively entertained by the Pentagon. The idea was knocked on the head when some reprobate pointed out that nobody could throw one far enough to prevent the attackers as well as the defenders from being reduced to radioactive dust.

When it comes to MONEY, specifically government control over money, such piddling concerns cannot be allowed to impose themselves upon an elegant theory. Monetising government debt is bad enough. Combining the monetisation of government debt with an attempt to convince the public that prices are going to start rising is pressing the outer limits of economic folly. Only the desperate would go there.

Caroline Baum put the situation succinctly in the title of a piece she wrote on October 15 for (of all websites) *Bloomberg*: *"Fed Wants to Hoodwink Public, Only Fools Itself"*. We suggest you *Google* the piece, it is well worth reading. Here's the relevant quote: *"After 30 years* (actually, it's been much more than 30 years) *of price stability uber alles, the Fed now wants us to believe that it wants higher inflation. ...And that's not all. We're asked to believe that the Fed can hit a precise inflation target."*

To her great credit, Ms Baum points out that inflation is a MONETARY (her emphasis) phenomenon. Even so, the problem remains the confusion between what the Fed wants everyone to believe inflation is and what it actually is. Inflation is indeed a monetary phenomenon. It is an increase in the total stock of money. A glance at the total stock of money in the US will show that inflation has been a constant feature ever since the Fed was born in 1913. The reciprocal of this is the decreasing purchasing power of the US Dollar, another constant feature of the entire tenure of the US central bank. Inflation is what the Fed (abetted by the fractional reserve policies so beloved of the commercial banks) DOES. Its original and defining mandate was and is to provide an "elastic currency".

An elastic currency requires an effective camouflage. This has always been the Fed's management of "inflationary expectations". The damping down of these "expectations" has always been the only thing preventing mass runs on the banks and an utter collapse of the Dollar. To tamper with it is insane.

Not All Americans Are "Masters Of The Universe":

Like his predecessor Mr Greenspan, Ben Bernanke has a very well honed appreciation of the monetary ignorance of the great majority of market analysts and investment "professionals". To this day, very few of them have realised that the MASSIVE bull markets in paper "assets" of all descriptions was fuelled and continues to be fuelled almost in total by the issuance of new "money" by the Fed and the US commercial banks. What was it that rocketed the Dow from 776 to nearly 12000 between 1982 and 2000? It was inflation, pure and simple. What was it that kept the standard of living of the average American static over that period and going backwards for the subsequent decade? That same inflation.

Today, the "masters of the universe" (aka the investment "professionals") are celebrating the prospect of a new and even bigger round of inflation (aka "quantitative easing"). After all, the new money being pumped out by the Fed is still affecting prices in the paper investment markets even though it is not affecting the prices of the REAL economic goods which are the collateral underpinning the whole house of cards which is the US economy. The Fed has spent 30 years encouraging the view that the prices of paper assets would go up forever. Unfortunately, they stopped going up ten years ago. Now, the Fed proposes to encourage the view that the price of EVERYTHING will start going up.

The move to start tampering with "inflationary expectations" will probably fool the market gurus. It will not fool the "average" American. Nor will it fool anyone else who does not concoct "elegant" theories to try to explain away any real event which does not fit into his or her "model". The economic and political establishment in the US has become so desperate (and so confused) that they are proposing to embark on a course of action that the Fed has avoided literally like the plague since its inception. Success here will absolutely guarantee the demise of the US Dollar as a viable currency, let alone a viable RESERVE currency. And with that will come the long-delayed collapse of US paper of all descriptions.

Recent Events:

On October 5, the Bank of Japan announced that it was expanding its balance sheet by Yen 5 TRILLION ($US 60 Billion) and lowered its benchmark rate from 0.10 percent to 0.00-0.10 percent. Three days later on October 8, the Dow regained the 11000 level and has been hovering at or about that level ever since. Also on October 8, US Treasury two and five-year note yields hit all time lows of 0.26 percent and 1.10 percent respectively. A week later, on October 14, the trade-weighted US Dollar index (USDX) equalled its 2010 low of 76.88 while Gold hit yet another all time high of $US 1377.60.

By the end of this week, two ominous US market "signals" had emerged. With the Dow having more or less stalled just above 11000, it is a reasonable assumption that the Fed's new bout of "QE" has been fully discounted - even before it has been announced. And Treasury yields have bolted upwards since October 8 - especially at the longer-term end. For global markets, November 3 can't come soon enough.

Gold:

For more on Gold - please see Gold This Week (GTW):
http://www.the-privateer.com/subs/goldcomm/gold.html

What's Next?:

First there is the first round of the G20 meetings - the finance ministers' meeting - in South Korea. After that comes the US mid-term elections on November 2 and the FOMC meeting on November 3. After that comes the big one - the G20 heads of state meeting in Seoul, South Korea on November 11-12.