

# THINGS THAT MAKE YOU GO *Hmmm...*

A walk around the fringes of finance



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“I don’t envisage, not even for one second, Greece leaving.  
This is nonsense, this is propaganda.”

– JEAN-CLAUDE JUNCKER, *Chairman EuroGroup FinMin Committee*

“When it becomes serious, you have to lie.”

– Jean-Claude Juncker, *Same guy*

“Today there are in the European Central Bank,  
as well as in the Commission, services working  
on emergency scenarios if Greece shouldn’t  
make it. A Greek exit does not mean the end  
of the euro, as some claim,”

– Karel De Gucht, *European Trade Commissioner*

“Exit would bring down the whole house of  
cards, with one state falling after another: it  
would reach Portugal, Spain, then Italy and  
France,”

– Romano Prodi, *Former EU Commission chief*

“Better to remain silent and be thought a fool than to  
speak out and remove all doubt”

– Abraham Lincoln



By way of a change, I am going to begin this week's mis-sive with a joke from my youth that muscled its way into my head as I was sitting on a Malaysian Airlines 747 about 30 seconds after take-off with flames pouring from the engine a couple of weeks ago (it truly is remarkable how the human brain functions).

I preface this joke with the now-obligatory warning about political correctness (or lack thereof). The joke was told to me in the 1970s when the existence of any form of 'PC' was a distant prospect and, in those days, every country had their own racial stereotype upon who to project all their 'dumb' jokes; in the USA it was the Poles, in Denmark it was the Swedes (and vice versa) and in England it was the Irish (in Ireland it was the poor folk from County Kerry). As a child, I lost count of how many jokes I was told that began with the line "An Englishman, an Irishman and a Scotsman..." and, invariably, what followed was a situation that made the Scotsman look tight-fisted, the Irishman stupid and the Englishman a cunning and urbane genius. I readily admit, however, to finding reality a little different (unless one includes trying to persuade one of my Scottish friends to buy a round of drinks...).

And so, with apologies to any of my Irish readers out there who are atypically easily-offended here we go:

*Paddy is sitting on a plane to Dublin when the pilot comes over the PA system:*

*"Ladies and gentlemen this is the Captain speaking. I am afraid we have just lost power in number one engine. Fortunately, this aircraft has a total of four engines and is designed to be able to fly perfectly safely in the event of multiple engine failure and so there is no need for alarm - we will, however, now*

*be arriving at our destination 30 minutes late"*

*There is a general murmur amongst the passengers but they settle down quickly.*

*A short while later, the Captain's voice is heard in the cabin once again:*

*"Ladies and gentlemen, this is your Captain speaking once again. I am afraid we have now lost power in number two engine. As I said earlier, we have a total of four engines and so we are still perfectly safe but I am afraid we will now be arriving at our destination 60 minutes behind schedule"*

*A low grumble punctuated by tutting is heard from the cabin but, once again, the passengers settle down quickly.*

*Half an hour goes by and once again, the PA crackles into life:*

*"Ladies and gentlemen, the Captain once again. My sincere apologies but we have now lost power in number three engine. Please do not be alarmed as this aeroplane can function perfectly well on only one engine, but we will, I am afraid, now be arriving 90 minutes behind schedule."*

*The tension in the cabin is palpable, but once again, everybody settles down.*

*After another twenty minutes of uneasy silence has passed the Captain's voice is heard once again:*

*"Ladies and gentlemen, this is the Captain speaking. I am terribly sorry to inform you that we have now lost power in number four engine..."*

*Before he can say another word, up leaps Paddy, who shouts "Ah sure, we'll be up here forever now!"*

What on earth does this have to do with finance I hear you ask? Well I will tell you - in a round-about kind of way.

In March 2001, the Bank of Japan embarked upon a program that was called ‘ryōteki kin’yū kanwa’ or, to put it another way, ‘量的金融緩和’. To the vast majority of us it translated into something we are now intimately familiar with: Quantitative Easing.

Wikipedia describes QE thus:

*(Wikipedia): Quantitative easing (QE) is an unconventional monetary policy used by central banks to stimulate the national economy when conventional monetary policy has become ineffective. A central bank buys financial assets to inject a pre-determined quantity of money into the economy. This is distinguished from the more usual policy of buying or selling government bonds to keep market interest rates at a specified target value. A central bank implements quantitative easing by purchasing financial assets from banks and other private sector businesses with new electronically created money. This action increases the excess reserves of the banks, and also raises the prices of the financial assets bought, which lowers their yield.*

All sounds rather clever, doesn’t it? It’s not.

QE has been around in one form or another for a long, long time—a fact I was reminded of recently when I reread the wonderful ‘[Lords of Finance](#)’, Liaquat Ahamed’s tour-de-force, Pulitzer Prize-winning book about the collapse of the world economy in the late-1920s (if you haven’t read it yet you truly should). I was only 75 pages in when a passage I’d read before—but at a different time—leapt from the pages and punched

“... taxes accounted for but a tiny fraction of the new money raised. Instead, the belligerents resorted principally to borrowing. Once they had exhausted every potential source of loans, they relied on a technique almost as old as war itself: inflation...”

me square in the face:

“...among the first casualties of war is not only truth but also sound finance. None of the big wars of the previous

century — for example, the Napoleonic Wars or the American Civil War — had been held back by a mere lack of gold. These had been fights to the death in which the belligerents had been willing to resort to everything and anything — taxes, borrowing, the printing of ever larger quantities of money — to raise the cash to pay for the war.

By the end of 1915, eighteen million men were mobilized across Europe. On the Western Front, two gigantic armies — three million men from the Allied nations and two and a half million Germans — sat stalemated, bogged down in trenches along a five hundred-mile front stretching from the Channel through Belgium and France to the Swiss border. Like a giant sleeping reptile stretched across the face of Western Europe, the front remained immobile. By a perverse sort of logic, as hundreds of thousands of men were led to the slaughter, their terrible sacrifice was called upon to justify pressing on, and the carnage generated its own momentum.

Still, the complacency of those first few months took a long time to evaporate. Even into 1916 the dogma that this would be a short war lingered as general after general predicted victory in another six months. By then the five major powers — Britain, France, Russia, Germany, Austria-Hungary — were spending a massive \$3billion each month, nearly 50 percent of their collective GDP. No other war in history had absorbed so much of the wealth of so many nations at one time.

Countries varied in how they raised the funds. Nevertheless, there were certain common themes. To pay for such a gigantic effort by taxation alone would have entitled tax rates at confiscatory levels and was therefore impossible. Daunted by the task, none of the governments even tried, and taxes accounted for but a tiny fraction of the new money raised. Instead, the belligerents resorted principally to borrowing. Once they had exhausted every potential source of loans, they relied on a technique almost as old as war it-

*self: inflation. Unlike medieval kings, however, who accomplished this either by shaving pieces of gold and silver off the outer edge of their coins—a practice known as clipping—or of issuing coinage made of cheaper alloys—currency debasement—governments in the Great War turned to their central banks, often relying on complex accounting ruses to disguise the process. Central banks in turn, abandoning their long-standing principle of only issuing currency backed by gold, simply printed the money.”*

I’ll get to the reasons for my (poor) Irish joke a little later, but right there, in those four brilliantly-written paragraphs, Ahamed draws more compelling parallels with what is going on today than would seem possible in a little over one page of a single book and, though the book was published a mere three years ago, those parallels have grown eerily stronger, seemingly with each passing day.

The world IS at war, though this time the enemy is intangible. It is debt sitting in those trenches,

“... “Today the problem is solved,” [Sarkozy] said in the southern French city of Nice. “A page in the financial crisis is turning.”

quietly, dispassionately waiting for its day and that day is rapidly approaching as the stalemate nears its end.

Millions have been mobilized to fight the enemy through a series of ill-conceived methods, all of which have involved throwing yet more debt and more money onto the battlefield and, at each step along the way we *have* seen general after general predict victory and, occasionally definitively (and foolishly) claim it. It began with subprime:

*“At this juncture . . . the impact on the broader economy and financial markets of the problems in the subprime markets seems likely to be contained,”*

- Ben Bernanke, March 2007

*“I don’t see (subprime mortgage market troubles) imposing a serious problem. I think*

*it’s going to be largely contained,”*

- Henry Paulson, April 2007

But then Europe took over and, though finding poorly-judged comments from just about anybody involved is like shooting fish in a barrel, I will eschew the oldies-but-goodies and pick a couple of far more recent vintage to illustrate my point.

First up, from March, Nicolas Sarkozy—one-time President of France and half of the vaudeville act known as ‘Merkozy’:

*(Reuters: March 10, 2012): Mr Sarkozy, who is trailing his socialist challenger for the presidency before France’s own elections in April and May, pronounced the Greek deal a major success.*

*“Today the problem is solved,” he said in the southern French city of Nice. “A page in the financial crisis is turning.”*

Another general. Another declaration of victory.

Sarkozy, however, (at least, at that time) was a politician seeking reelection. The very same day, we had a slightly more sombre assessment from Wolfgang Schaeuble, Germany’s Finance Minister:

*“It would be a big mistake to give the impression that the crisis has been resolved. They [Greece] have an opportunity to solve it and they must use it.”*

Then, after a couple of quiet months in which Greece melted away from the front pages in favour of a bigger problem—Spain—the problem that never went away came back again, and this time it IS different.

Remarkably, it finally seems to have dawned on people that Greece’s exit from the Eurozone (and the euro) is a fait accompli and the process has even been given its own portmanteau in honour of the historic occasion: ‘Grexit’.

No sooner has the reality been crystallized through the application of a less-than-catchy soubriquet, than the whole world has decided it



is time to weigh in on how such an event would look; the very same event that, until a few short days ago, most commentators deemed impossible.

I repeat my oft-uttered cry: nothing matters to anybody until it matters to everybody. Suddenly, Greece's inevitable departure from the EU is top of everybody's agenda.

Last week, at an extraordinary meeting of Eurogroup finance ministers, it was gloves-off:

*(Economist): One of the bluntest warnings came from the president of the European Commission, José Manuel Barroso, who told Italy's SkyTG24: "If a member of a club does not respect the rules, it's better that it leaves the club—and this is true for any organisation or institution or any project."*

*"...the future of Greece and the welfare of its citizens lie more than ever on the shoulders of Greek politicians to keep their part of the solidarity pact."*

This was like a red rag to a bull for Jean-Claude Juncker, Luxembourg's Prime Minister and Chairman of the Eurogroup FinMin committee who fired back:

*"I made it perfectly clear that nobody was mentioning an exit of Greece from the euro area. I am strongly against. We are 17 member-states being co-owners of our common currency. I don't envisage, not even for one second, Greece leaving the euro area. This is nonsense, this is propaganda."*

*We have to respect Greek democracy. I'm against this way of dealing with Greece, [which consists] in provoking the Greek public opinion and giving advice and indications to the Greek sovereign. Greece has voted, we have to take into account the result. We do hope that a government will be formed in the next coming days or weeks and then we have to deal with that government. We don't have to lecture Greece."*

*But the Greek public, the Greek citizens, have to know that we agreed on a programme and*

*this programme has to be implemented. But I don't like the way of dealing with Greece, those that are threatening Greece day after day. This is not the way of dealing with partners, colleagues and friends and citizens in the European Union."*

Over to Olli Rehn, Finland's commissioner for economic and monetary affairs who, standing next to Juncker, had this to say:

*"... solidarity is a two-way street. It is a fact that calls for respect of commitments both by the 16 euro-area member-states and also by Greece and its government and parliament. Without a Greek commitment this solidarity pact won't work, and this is the responsibility of Greek politicians in this very critical juncture. Hence the future of Greece and the welfare of its citizens lie more than ever on the shoulders of Greek politicians to keep their part of the solidarity pact."*

For the first time in a long time, the unity of political message coming from the powers-that-be in Europe is coming apart at the seams as the refusal to believe that economies and markets can't be controlled by politics is wavering and the rhetoric has moved swiftly to damage-control mode.

**So, what exactly** does the so-called 'Grexit' entail? Well, now that reality seems to have dawned on many, there are no shortage of forecasts amongst what my good friend Scott so perfectly terms the 'Punditocracy' as to what it will look like (we'll get to that shortly), but this past week we saw perhaps the ultimate break in the ranks when European Union trade commissioner Karel De Gucht opened his mouth just a little too wide and told the world what we already knew but had yet to have officially confirmed:

*(UK Daily Telegraph): European Union trade commissioner Karel De Gucht said that both the European Commission and the European Central Bank (ECB) were working behind the scenes on contingency plans for a break-up.*

*"Today there are in the European Central Bank, as well as in the Commission, services working on emergency scenarios if Greece shouldn't make it. A Greek exit does not mean the end of the euro, as some claim," he said.*

As the words came tumbling from De Gucht's lips, a Code Red was sounded in Brussels:

*(WSJ): The European Economics Commissioner Olli Rehn countered De Gucht's comments, saying: "We are not working on the scenario of a Greek exit. We are working on the basis of a scenario of Greece staying in."*

*In an interview to be aired later Friday on Channel 4 Television in the U.K., Rehn also pointed out that his colleague was "responsible for trade. I am responsible for financial and economic affairs and relations with the ECB."*

*Earlier, a commission spokeswoman denied that contingency plans for a Greek exit were under way. An ECB spokesman said in an e-mail the bank doesn't "engage in any speculations about any emergency plans or possible scenarios and therefore do not comment Commissioner De Gucht's statement."*

*The "immutable preference" is for Greece to stay in the currency bloc, he said, echoing comments Wednesday from ECB President Mario Draghi*

Ah yes.... the 'immutable preference'—that age-old guarantee of a preferred outcome.....

Despite the attempts of politicians to keep a lid on speculation about a 'Grexit' in the forlorn hope that if they don't talk about it, nobody will worry, there have been a staggering amount of column inches devoted this week to various roadmaps for such an event. The problem, however, is that, though many of the smartest minds can offer reasoned speculation, nobody knows *exactly* what this will look like. What we DO know is that the first stage of it has begun in the shape of good old-fashioned bank runs:

*(WSJ): Bank runs across Europe are a growing fear. In Greece it appears to be the real thing. Depositors pulled 700 million euros out of banks on Monday, and Reuters reports the pace was basically the same Tuesday and Wednesday...*

*... It's a very bad time to even breathe the words "bank run" anywhere in Europe.*

*Shares of Bankia, Spain's fourth-largest bank and as of last week a ward of the state, were down as much as 29% today after the Spanish paper El Mundo reported that in the past week depositors had withdrawn 1 billion euros.*

*The report was quickly denied by the Spanish government, but the bank itself had no comment.*

Now, whilst the smart money left Greek (and to an extent, Spanish) banks a long time ago, that is always a stealth process - it's only at the end when the disconnected and disinterested in society finally wake up that the real panic starts and, when that happens, things tend to take on a life of their own and have far-reaching consequences. Take for example the consequences of increase capital flight from Greek banks to, in this case, seemingly far safer German banks.



SOURCE: ECONOMIST

**As deposits move** across Europe from South to North, they leave in their wake a big hole in the banking system from whence they came; in this case Greece. The problem comes when the Bank of Greece has to step in and reliquify the system (which it has done recently to the tune of €60 billion). At some point, the BoG will run out of collateral-backing and require permission from the ECB in order to inject further euros into the banking system—permission that will come with an implicit backing from the ECB, something it has been singularly reluctant to give thus far.

It is this part of the trail that leads us back to our old friend, Target2 and this week, this long-overlooked payment transfer system caught a lot of people's attention with one of the most succinct summaries of the possible outcome coming from JP Morgan:

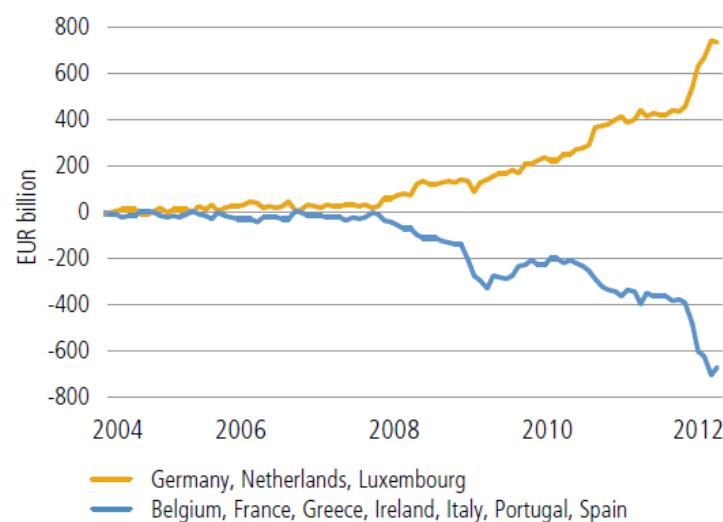
*(JP Morgan via ZeroHedge): The Greek central bank creates euros when it grants loans to Greek banks via either repos or ELA [emergency liquidity assistance]. In the first instance, these show up as reserve holdings by the Greek banks at the central bank when the euros are credited to their account. But with euros leaving the Greek banking system, Greek banks lose reserves as transactions*

*are settled through the payments system. As Greek bank's reserves fall, this is replaced by a liability to the Target2 payments system for the Greek central bank. The Greek central bank's liability to the rest of the Eurosystem via Target2 is currently near €130bn. As we move toward the Greek election next month, that is likely to climb given deposit flight. But we expect the ECB will do all within its power to keep the Greek banking system afloat until the election, even if some of the loans to Greek banks are redirected via ELA. The terms of ELA can be stretched so that Greek banks do not run out of collateral, while banks can issue bonds to themselves backed by a government guarantee to create more collateral.*

*But a much more challenging question is what happens after the election. Let's imagine Syriza is able to form a government, declares a debt moratorium, and antagonizes the rest of the region by rejecting the Troika programme in its entirety. Even with no further disbursements of official loans, the region's loans to Greece via the target 2 system will be continuing to grow. Loans from the Greek central bank to Greek banks would be almost completely forced into ELA.*

*The ECB can "shut off" the Target2 loans if it exercises its veto over ELA loans (requiring a two-thirds majority on the Governing Council), and if the Greek central bank respects that veto. But the Greek central bank would likely be faced with the need to impose very restrictive controls on Euro deposits to limit outflows if ELA loans to Greek banks cannot be made. If the Greek central bank is faced with the prospect of imposing capital controls, a collapse of the Greek banking system, or defying the ECB's veto on ELA loans, what route would it take? If it chose the latter, the only way for the ECB to "shut off" the Target2 loans would be to prevent Greek access to the payments system itself, refusing to accept payments of euros to and from Greek banks. At that point, Greek created euros are no longer euros. That decision would not be*

Figure 1: National Central Banks' TARGET2 Net Positions



SOURCE: PIMCO

*made by the ECB alone, but would likely be deferred to European Heads of State.*

[Citigroup also laid out their views](#) on the possible outcomes and, the summary points alone make for a chilling read:

- *There are many scenarios for a Greek exit; almost all of them are likely to be EUR negative for an extended period*
- *Some scenarios could be positive in equilibrium but the run-up to the new equilibrium could be nasty, brutal and long*
- *The positive scenarios for the euro involve aggressive reduction of tail risk; none of these seem likely*
- *It is unlikely that central banks busily substitute EUR for USD in their portfolios during periods of intense political uncertainty.*

**So what does** all this have to do with the joke with which I began this week's Things That Make You Go Hmmm.....? Well, I'll tell you.

As things stand, the waves of reality are finally crashing upon the shores of Europe's own Fantasy Island and we are nearing the endgame.

As I have said repeatedly over the past year or so in these pages, it is only a matter of time before Greece is forced to leave the EU and abandon the euro in favour of a return to the Drachma. The rationale of trying so desperately to keep the Greeks inside the construct was flawed from the beginning as political desire was allowed to fog the simple mathematics of debt and a rigid belief that markets could be bent to the will of politicians subsumed the reality that those markets care not for words, but only for numbers—numbers which have been growing ever more frightening by the day.

The only options now left for Europe are either for the ECB to assume the debts of Greece (and, once that were done, most likely Portugal, Ireland, Italy, Spain and, one day, possibly even France), guarantee them and print the trillions of

euros necessary to underwrite them or, should that prove unpalatable to the ~~German electorate~~ elected heads of the continent, allow Greece to leave and risk the contagion that such a precedent would set—contagion which would mean the printing of trillions of euros needed in order to compensate for the massive imbalances in the Target2 payment system and stop the entire European banking system from imploding.

Either way, somebody, somewhere is going to have to come up with trillions of euros and ultimately it won't matter what the German electorate might think about it as they don't go to the polls until 2013.

To that end, this week, the preparations began in earnest:

*(FT): Wolfgang Schäuble, German finance minister, has given vital political cover to the Bundesbank, speaking out in support of the idea that Germany could tolerate a rate of inflation above the eurozone average.*

*Making a rare exception to the rule that Berlin does not comment on central bank policy, Mr Schäuble declared that price rises "in a corridor between 2 and 3 per cent" would be "tolerable" in Germany – slightly above the European Central Bank's target of keeping average inflation across the eurozone at close to but below 2 per cent.*

The oft-repeated opinion that Germans are fixated by Weimar-era history will surely be tested and, I suspect, found to be slightly misguided. Yes, the hyperinflation that swept across Germany in the late 1920s was a seminal event in the country's history and yes, it led to horrors from which Germany is still recovering almost a century later, but in practical terms, despite the obvious reservations, it will be far easier to sell the German public on "slightly elevated inflation for a short period of time" (or "leicht erhöhter Inflation für eine kurze Zeit"—a translation you can write down because I have no doubt you'll be hearing it very often, very soon) than the press would have us believe because Germans, like Americans, Brits and everybody else are, in



the main, ignorant of the dire situation facing the global economy—and besides, 3-4% inflation, for a modest period, of course, is hardly going to be difficult to get back under control now, is it? Just ask Mervyn King.

**Just like the** aeroplane that stayed aloft longer the more engines it lost, the belief that the more money that gets printed, the better the global economy will be is comical and will ultimately be proven so, but, to a politician, the pushing of an imaginary button to produce trillions in imaginary currency is far more palatable than imposing ‘austerity’ upon their already-agitated electorates as we have seen only too clearly in Greece these past two weeks and, if there is one thing we have been taught over recent years it is that politicians can be relied upon 100% in one area and one area only—the pursuit of political expediency.

**“...Think of what we can do with all that money...”**

Whilst fears of deflation continue to paralyze investors still traumatized from 2008, what we have in actuality is what Bill Murphy so eloquently calls

‘deflation in everything we own and inflation in everything we use’, a condition that will prove disastrous as politicians continue to push the same buttons harder in expectations of a different result.

Somebody, somewhere is going to have to print a LOT of money to try and make this all go away and that is the joke in all this.

Having taken my own (probably misguided) swing at humour, I will leave the final word this week to one of America’s most-underrated comediennes, former FDIC Chairwoman Sheila Bair, who recently took a swipe at the continued belief in money-printing being the cure for the world’s problems in a ~~stand-up routine~~ Washington Post op-ed:

*“Under my plan, each American household could borrow \$10 million from the Fed at zero interest. The more conservative among us can take that money and buy 10-year Trea-*

*sure bonds. At the current 2 percent annual interest rate, we can pocket a nice \$200,000 a year to live on. The more adventuresome can buy 10-year Greek debt at 21 percent, for an annual income of \$2.1 million. Or if Greece is a little too risky for you, go with Portugal, at about 12 percent, or \$1.2 million dollars a year. (No sense in getting greedy.)”*

*“Think of what we can do with all that money. We can pay off our underwater mortgages and replenish our retirement accounts without spending one day schlepping into the office. With a few quick keystrokes, we’ll be golden for the next 10 years.”*

She was joking, right?

\*\*\*\*\*

**And so to** this week’s interesting reads and, as you would probably expect, they centre largely on Europe, so if the ‘Grexit’ is giving you ‘Grindigestion’ or Spain’s woes are causing you ‘Spalpitations’ then you may want to pick your way selectively through the pages that follow.

For those of you who’ve really had enough, I would recommend skipping straight to the penultimate page where there is an amusing cartoon, but for those brave souls amongst you who have the grit (that’s not a portmanteau, by the way—just good old-fashioned grit), you’ll find several articles on Europe’s pain, some possible solutions and accounts of the dreadful state of affairs in Spain and Greece as well as an inside look at JP Morgan’s recent troubles and the booming sales of adult diapers in Japan.

Robert Reich pens a commencement address that he’ll never give, Patrick Chovanec explains the unraveling of China’s real estate market and we hear how Germany’s leaders are getting a little uncomfortable about their gold held abroad.

Our charts section focuses on unemployment, taxes, Italian and Spanish equity markets and, of course, the Facebook listing while we have interviews with Nassim Taleb and my friend Jeremy Gray as well as another towering performance

in the European parliament by the scourge of MEPs—Nigel Farage.

**That's all from** me for this week. I will be in Sydney next week but will try to write something if time allows.

Before I go—and to steal a line from the late Steve Jobs:

One more thing:

**T**his is the first time I have used Things That Make You Go Hmmm..... to talk about anything other than my own thoughts on a variety of topics, but in this instance I think it is altogether appropriate for me to do so as I have had many inquiries about a particular project after [this article](#) appeared on Bloomberg a couple of weeks ago.

Vulpes Investment Management is in the process of launching a new agricultural farmland company that will invest exclusively in agricultural, food-producing properties around the world. We currently have three such holdings in three different 'hubs':

- La Loma: a 3,144 ha/7,800 acre cattle, sheep and timber farm in Uruguay
- Whatitiri Orchards: a 21.5 ha/53 acre avocado and kiwifruit orchard in New Zealand
- Iroquois/Greene Counties: 781 hectares/1,945 acre corn and soybean farms spread over two locations in Illinois, USA

The valuation of these properties is currently around US\$35 million and, over the next few months, we will be looking to offer co-investment opportunities as we seek to raise a further \$150 million from outside investors in order to expand our 'hubs' by adding properties in Eastern Europe and Africa. Our goal is to build a globally-diversified land holding and food-producing company—ensuring differentiation by climate, produce geography and political jurisdiction.

This will be a private company with a minimum investment of US\$1 million

Throughout June, the Founder of Vulpes Investment Management, Steve Diggle, along with the CEO of this venture, Jonathan Pendock and myself will be traveling through Asia, Europe and the USA to talk to interested parties about our plans for this new agricultural farmland vehicle which will be launched later this year.

If you would like to receive information or potentially arrange a meeting to discuss our plans, please contact Vulpes' Business Development Manager, Rebecca Walters, by clicking [HERE](#)

Many thanks

Grant

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## The Gonnies, Gonnies Banks

#	Bank	Assets (\$m)	Deposits (\$m)	Cost (\$m)
24	Alabama Trust Bank NA, Sylacauga, AL	51.6	45.1	8.9
<b>Total Cost to FDIC Deposit Insurance Fund</b>				<b>8.9</b>

## Economists warned that

the Greek financial system could crumble within weeks or days unless the European Central Bank steps up support.

President Karolos Papoulias told party leaders that banks had lost €700m in withdrawals on Monday alone as citizens rush to pre-empt capital controls and a much-feared return to the Drachma.

He cited central bank warnings that “great fear” might soon escalate to panic. The leaked details lend credence to claims that capital flight by both savers and firms have reached €4bn a week since the triumph of anti-bailout parties on May 6.

Steen Jakobsen from Danske Bank said outflows are becoming unstoppable, not helped by open talk in EU circles of ‘technical’ plans for Greek withdrawal.

“... Julian Callow from Barclays Capital said the ECB risks grave contagion if it lets go of Greek banks. “We have reached the point where the ECB needs to come in with massive intervention and outright quantitative easing,”

“This has a self-fulfilling prophecy built into it and I don’t think we can get to June. The fuse is burning and the only two options now are a controlled explosion where Germany steps in to ensure an orderly exit, or an uncontrolled explosion,” he said.

The growing alarm comes as judge Panagiotis Pikrammenos was picked as Greece’s caretaker leader until the next vote on June 17. Polls show the Left-wing Syriza leader Alexis Tsipras emerging as clear victor.

Mr Tsipras has vowed to tear up the EU-IMF bailout ‘Memorandum’, exhorting German Chancellor Angela Merkel to “stop playing poker with the lives of people”. The Greek impasse has rattled markets, with the FTSE 100 down 0.6pc to 5,405 yesterday. Spanish lender Bankia fell 11pc in Madrid. Gold tumbled \$17 to a ten-month low of \$1,540 on dollar strength.

The crisis is replicating the pattern of fixed-exchange ruptures through history. Britain was forced off the Gold Standard in 1931 after pay-cut protests in the navy triggered capital flight.

Greek banks have lost 30pc of their deposits since late 2009. The total fell to €171bn in March. “The surprise is that there is still so much left. I can’t believe it will stay much longer,” said Simon Ward from Henderson Global Investors.

The ECB is holding the line with an estimated €100bn of Emergency Liquidity Assistance (ELA) for lenders, channeled through Greece’s central bank. Supplicants must pawn their loan book in exchange. “The risk is that banks will run out of collateral since these are low quality assets with haircuts of 50pc or more. The ECB could relax the rules but they would have to take an active decision to do so,” said Mr Ward.

JP Morgan said Greek banks have already exhausted their collateral. A refusal by the ECB to ease rules would amount to expulsion, forcing Greece “to issue its own money.”

The ECB said it had stopped routine operations with certain Greek banks with depleted capital buffers, but underscored that they are still able to access the ELA scheme.

There is already a political storm in Germany over “junk collateral”, as well as anger over the Bundesbank’s €645bn exposure to Club Med debtors through the ECB’s internal ‘Target2’ payments nexus. Mr Ward said it would be hard to justify to German taxpayers why the Bundesbank should lend more to “austerity-resistant Greeks” so that they can squirrel money abroad.

Julian Callow from Barclays Capital said the ECB risks grave contagion if it lets go of Greek banks. “We have reached the point where the ECB needs to come in with massive intervention and outright quantitative easing,” he said.

★ ★ ★ AMBROSE EVANS-PRITCHARD / [LINK](#)

**Germany has gold** reserves of just under 3,400 tons, the second-largest reserves in the world after the United States. Much



of that is in the safekeeping of central banks outside Germany, especially in the US Federal Reserve in New York. One would think that with such a valuable stash, worth around €133 billion (\$170 billion), the German government would want to keep a close eye on its whereabouts. But now a bizarre dispute has broken out between different German institutions over how closely the reserves should be checked.

Germany's federal audit office, the Bundesrechnungshof, which monitors the German government's financial management, is unhappy with how Germany's central bank, the Bundesbank, keeps tabs on its gold. According to media reports, the auditors are dissatisfied with the fact that gold reserves in Frankfurt are more closely monitored than those held abroad.

“... “The scope of the checks that the Bundesrechnungshof wants does not correspond to the usual practices among central banks,” the Bundesbank said in a statement quoted by the Frankfurter Allgemeine Zeitung newspaper. “There are no doubts about the integrity and the reputation of these foreign depositories.”

In Germany, spot checks are carried out to make sure that the gold bars are in the right place. But for the German gold that is stored on the Bundesbank's behalf by the US Federal Reserve in New York, the Bank of England in London and the

Banque de France in France, the German central bank relies on the assurances of its foreign counterparts that the gold is where it should be. The three foreign central banks give the Bundesbank annual statements confirming the size of the reserves, but the Germans do not usually carry out physical inspections of the bars.

According to German media reports, the Bundesrechnungshof has now recommended in its confidential annual audit of the Bundesbank for 2011 that Germany's central bank check its foreign gold reserves with yearly spot checks.

The Bundesbank has rejected the demand, arguing that central banks do not usually check each others' reserves. “The scope of the checks

that the Bundesrechnungshof wants does not correspond to the usual practices among central banks,” the Bundesbank said in a statement quoted by the Frankfurter Allgemeine Zeitung newspaper. “There are no doubts about the integrity and the reputation of these foreign depositories.”

Now the finance committee of the German parliament, the Bundestag, has gotten involved. Parliamentarians apparently demanded to see the Bundesrechnungshof's audit report on the Bundesbank after they were alarmed by a report in the influential tabloid daily Bild, which claimed that the central bank had not checked its gold reserves in five years.. The Bundesrechnungshof will now provide the committee with its report, a spokesman for the federal auditors confirmed on Monday.

Germany moved some of its gold reserves abroad during the Cold War to protect them from a possible Soviet attack. Some of the gold was moved back to Frankfurt after the collapse of communism. But the Bundesbank argues that it still makes sense to store some gold in major financial centers so that it can be sold quickly if necessary. Although the Bundesbank does not provide exact details about the distribution, it has revealed that the largest share of Germany's gold is held in New York, followed by Frankfurt, London and Paris.

★ ★ ★ DER SPIEGEL / [LINK](#)

**As a prelude** to a broader analysis of China's GDP, and the accuracy of its official GDP figures, I want to start by examining the national real estate statistics for the first four months of 2012. This discussion feeds into the broader GDP picture, but the property story that has been unfolding is important and interesting enough to be worth taking a close look at on its own.

Getting an accurate view of the property sector is complicated by the fact that neither the official price index, nor the Soufun price index, nor the average price/square meter that can be calculated from the investment numbers seem to track

very well with each other or with point-of-sale impressions of steep developer discounts over the past eight months. Developers and local governments also enjoy a great deal of discretion in deciding what to count as a “start” or a “completion.” Monthly data releases are never revised, which often gives rise to huge corrections that are simply lumped into the end-year December data release, giving a distorted impression of how trends are unfolding (so, for instance, the

19% drop in property starts in December 2011 probably wasn’t as sudden as it appears, and more likely reflected an unreported decline spread over several preceding months).

All that being said, I’m seeing some rather striking patterns in the

Very few people paused to ask where this investment growth was actually coming from. After all, the market was clearly struggling. Year-on-year sales in Q1, for all real estate, was down -14.6%. The decline was even steeper, -17.5%, in residential property, which accounts for about 80% of the market. Office sales were down -10.2%, while growth in “commercial” (i.e., retail) property sales, which saw a boom in 2011, decelerated to +10.5%. Although many people were touting a month-on-month sales recovery in March, compared to the Chinese New Year period, March sales were still down -7.8% from the year before, for the sector as a whole, and -9.7% for residential properties (by comparison, sales in January-February were a disaster, falling -20.9% overall, compared to the first two months of 2011, -24.7% for residential).

Given this consistent fall-off in sales, it’s not surprising that new property starts began to stall. I already mentioned that the 19% drop in new starts in December may have been a bit of a statistical aberration. Starts (measured in floor space) in Jan-Feb were up 5.1%, although the gains came entirely from office and retail — housing starts were flat. But overall starts fell by -4.2% in March, with housing starts down -9.8%, ensuring that overall starts for Q1 were flat (+0.3%) with residential starts down -5.2%. Land sales for Q1 were also flat, with sales proceeds rising 2.5% but land area sold down -3.9%. In March, they were negative (-3.6% sales revenue, -8.5% area sold).

☆☆☆ PATRICK CHOVANEC / [LINK](#)

**Spain was forced** to revise its 2011 budget deficit upwards on Friday, after three of the country’s regions restated their own figures, exposing the struggle the autonomous communities have had curbing spending even ahead of deeper cuts this year.

Spain said its 2011 public deficit now came in at 8.9 percent of gross domestic product, up from the 8.5 percent initially stated. The country had already widely overshoot its deficit target of 6 percent for last year.

**The Dynamics Driving China's Real Estate Downturn**  
(Prof. Patrick Chovanec, Tsinghua University, May 16, 2012)

	2010		nominal rate of growth year-on-year, same period				
	2010	2011	1Q	YTD	Jan-Feb	Mar	Apr
<b>Property sales are falling ...</b>							
Property Sales (in RMB)	18.3%	12.1%	-14.6%	-11.8%	-20.9%	-7.8%	-4.5%
Residential only	14.4%	10.2%	-17.5%	-13.5%	-24.7%	-9.7%	-2.9%
Office	31.2%	16.1%	-10.2%	-14.0%	-23.5%	5.9%	-23.4%
Retail	46.3%	23.7%	10.5%	4.2%	17.2%	4.5%	-9.5%
<b>... leading to a deepening decline in new starts ...</b>							
Floor Space Started	40.7%	18.2%	0.3%	-4.2%	5.1%	-4.2%	-14.6%
Residential only	n/a	12.9%	-5.2%	-7.9%	0.0%	-9.8%	-14.4%
<b>... which is driving down land sales.</b>							
Land Sales Revenues (in RMB)	65.9%	-1.9%	2.5%	-13.7%	5.8%	-3.6%	-54.7%
Total Land Area Sold	28.4%	2.6%	-3.9%	-19.3%	-0.5%	-8.5%	-52.5%
<b>Financially pressed developers rushed to cash out whatever was already in their pipeline ...</b>							
Floor Space Completed	4.5%	13.3%	39.3%	30.2%	45.2%	32.4%	2.8%
Residential only	2.7%	13.0%	40.0%	30.1%	47.9%	31.4%	0.8%
<b>... but in the face of slowing sales, this only added to the stock of unsold inventory.</b>							
Floor Space "For Sale"	n/a	26.1%	n/a	n/a	39.4%	35.5%	33.4%
Residential only	n/a	35.8%	n/a	n/a	52.0%	47.4%	44.1%
<b>As burst of completions peters out, and new starts drop, investment growth noticeably decelerates ...</b>							
Investment in Real Estate	33.2%	27.9%	23.5%	18.7%	27.8%	19.6%	9.2%
Residential only	32.9%	30.2%	19.0%	13.9%	23.2%	15.2%	4.0%
<b>... and foreign investors pull back</b>							
Foreign Investment in Property Development	66.0%	2.9%	-27.4%	-43.9%	24.4%	91.4%	80%

[CLICK TO ENLARGE](#)

[SOURCE: CHOVANEC](#)

data that tell us two main things:

- The market is not poised to recover, but will continue to see greater downward pressure on prices; and
- Real estate investment is likely to flatten out or start falling, erasing several percentage points of GDP growth.

Last month, many observers took comfort from reports that overall real estate investment in Q1 rose 23.5% (in nominal terms) compared to the same period the previous year. To be sure, this was a comedown from 2011, when property investment rose 27.9%, or 2010, when it rose 33.2%. But it still seemed to reflect resilient growth: hardly a collapse in market, more like the kind of modest slowdown consistent with “soft landing.”

The country's treasury department, which disclosed the new figure late on Friday, said Spain was sticking by its 2012 budget deficit target of 5.3 percent of GDP, despite the setback with last year's numbers.

The move came after three of Spain's 17 regions - Madrid, Valencia together with Castilla and Leon - earlier revealed in their budget plans for this year that their own 2011 budget deficits were higher than initially stated.

The central region of Madrid said it finished 2011 with a deficit of 2.2 of gross domestic product, rather than the 1.13 percent it had initially

*"... Spain said its 2011 public deficit now came in at 8.9% of gross domestic product, up from the 8.5% initially stated. The country had already widely overshoot its deficit target of 6 percent for last year."*

released. Valencia's budget deficit came in at 4.5 percent at the end of 2011, instead of 3.78 percent.

Castilla and Leon's deficit was also slightly higher than previously stated.

The three regions are among the most important in Spain - Madrid is the second largest by GDP, and Valencia the fourth.

Though the autonomous communities have already struggled to rein in spending, deeper cuts now loom, after the central government on Thursday approved their plans to cut spending by 13 billion euros (\$16.54 billion) and increase revenue by 5 billion euros.

Of the 17 highly-devolved regions, only Asturias, in the north-west of Spain, had its budget rejected, meaning it will have to present a new one for approval.

The communities' commitment to savings this year will be crucial for Spain to get its overall budget on track.

Fitch said on Friday the government's approval of the regions' budget plans was positive, adding that the willingness of autonomous regions to pass structural reform had increased, but

warned there was still a risk they could yet miss 2012 targets.

"We ... expect the central government to put considerable pressure on the regions to cooperate," the rating agency said. "Nevertheless, in the current economic context we consider that there is a risk that potential reforms might have a limited impact on 2012 accounts."

★ ★ ★ REUTERS (VIA ZEROHEDGE) / [LINK](#)

**Normally I don't** like to write about European prospects in the midst of a very rough patch in the market because in that case there isn't much I can say that isn't already being said. I find it more useful to wait for those recurring periods in which the markets recover and optimism rises. Still, given the conjunction of political uncertainty in Beijing, low Chinese growth numbers, and another round of deteriorating circumstances in Europe, I will spend most of this issue of the newsletter trying to outline the possible paths countries like Spain must face.

For several years I have been saying that Spain would leave the euro and restructure its external debt. I should say that I specify Spain because it is the country in which I was born and grew up, and so it is also the country I know best. When I say Spain, however, I really mean all the peripheral European countries that, like Spain, are uncompetitive, have high debt levels, and suffer from low savings rates that had been forced down in the past decade to dangerous levels.

Spain had a stronger fiscal position and healthier bank balance sheets than many of its peers when the crisis began, so any argument that applies to Spain is likely to apply more forcefully to its peers. As an aside I will add that France is for me the dividing line between countries that will be forced into devaluation and restructuring and those that won't - in my opinion France could go either way and we will get a much better sense of this in the first year of Hollande's presidency.

There are two reasons why I was and am fairly sure that Spain cannot stay in the euro (or, which amounts to the same thing, that Germany will

leave the euro instead of Spain). The first has to do with the logic of Spain's balance of payments position, and the second has to do with the internal dynamics that drive the process of financial crisis.

To address the first, I would start by noting that thanks to excessively loose monetary policies driven primarily by German needs over the past decade, Spain has made itself wholly uncompetitive in the global markets and in so doing has run

“... Until Spain reverses its savings and consumption balance and drives down its current account deficit into surplus, which is what a reversal of these distortions would imply, it should be pretty clear that Spain will continue struggling with growth and will continue to see debt levels rise unsustainably”

large current account deficits for nearly the entire past decade. Its fundamental problem, in other words, has been the process by which its savings rate has collapsed, its cost structure forced up, its debt levels soared, and a great deal of investment directed into projects, mostly real estate, that were not economically viable.

As I have discussed often enough in previous issues of this newsletter, I think all of these problems are related and are the automatic consequences of the same set of policy distortions implemented in Spain and in Germany.

Until Spain reverses its savings and consumption balance and drives down its current account deficit into surplus, which is what a reversal of these distortions would imply, it should be pretty clear that Spain will continue struggling with growth and will continue to see debt levels rise unsustainably. But the balance of payments mechanism imposes pretty clear constraints on the process of adjustment. In that sense there are really only three ways Spain can regain competitiveness sufficiently to raise savings and reverse the current account:

- Germany and the other core countries can take steps to reverse the policies that led to the European crisis. They can cut consump-

tion and income taxes sharply in order to reduce domestic savings and increase domestic consumption. These would lead to a reversal of the German trade surpluses and higher inflation in Germany, the combination of which would allow Spain to reverse its trade deficit and regain competitiveness via lower inflation relative to that of Germany and a weaker euro.

- Spain can force austerity and tolerate high unemployment for many more years as wages are slowly pushed down and pricing excesses are ground away. It can also take measures to reduce costs by making it easier to start businesses, reducing business taxes, and by improving infrastructure, but these latter provide too little relief except over a very long period, especially given the difficulty Spain will face in financing infrastructure and reducing taxes.
- Spain can leave the euro and devalue. This would leave it with a problem of euro-denominated debt, whose value would soar relative to GDP denominated in a weakening currency. In that case Spain would almost certainly be forced to halt debt payments and restructure its debt.

★ ★ ★ MICHAEL PETTIS / [LINK](#)

### *Members of the Class of 2012,*

*As a former secretary of labor and current professor, I feel I owe it to you to tell you the truth about the pieces of parchment you're picking up today.*

*You're f\*cked.*

*Well, not exactly. But you won't have it easy.*

*First, you're going to have a hell of a hard time finding a job. The job market you're heading into is still bad. Fewer than half of the graduates from last year's class have as yet found full-time jobs. Most are still looking.*

*That's been the pattern over the last three graduating classes: It's been taking them more than a year to land the first job. And*



*those who still haven't found a job will be competing with you, making your job search even harder.*

*Contrast this with the class of 2008, whose members were lucky enough to get out of here and into the job market before the Great Recession really hit. Almost three-quarters of them found jobs within the year.*

*You're still better off than your friends who didn't graduate. Overall, the unemployment rate among young people (21 to 24 years old) with four-year college degrees is now 6.4 percent. With just a high school degree, the rate is double that.*

**"... The decline in the earnings of college grads really began more than a decade ago. Young college grads with jobs are earnings 5.4% less than they did in the year 2000, adjusted for inflation..."**

*But even when you get a job, it's likely to pay peanuts.*

*Last year's young college graduates lucky enough to land jobs had an average hourly wage of only \$16.81, according to a new study by the Economic*

*Policy Institute. That's about \$35,000 a year – lower than the yearly earnings of young college graduates in 2007, before the Great Recession. The typical wage of young college graduates dropped 4.6 percent between 2007 and 2011, adjusted for inflation.*

*Presumably this means that when we come out of the gravitational pull of the recession your wages will improve. But there's a longer-term trend that should concern you.*

*The decline in the earnings of college grads really began more than a decade ago. Young college grads with jobs are earnings 5.4 percent less than they did in the year 2000, adjusted for inflation.*

*Don't get me wrong. A four-year college degree is still valuable. Over your lifetimes, you'll earn about 70 percent more than people who don't have the pieces of parchment you're picking up today...*

★ ★ ★ ROBERT REICH / [LINK](#)

**"Grexit"** is an ugly term for what may soon become an even uglier reality: Greece's departure from the euro zone. As fury in Athens runs up against frustration with Greek recalcitrance in the rest of the European Union, the EU's most troubled economy could be heading out of the single currency within weeks. If Greek banks suffer a mass run, as depositors withdraw euros for fear they will be forcibly converted into new drachmas, Greece's fate could be settled even sooner.

Greece's ascendant politicians, particularly Alexis Tsipras, leader of the radical left Syriza party, want to repudiate Greece's rescue deal with its European and IMF creditors. The creditors, particularly Germany, are standing firm, rightly making clear that they will not be blackmailed into repeatedly rewriting bail-outs. If in fresh elections on June 17th the objectors have a majority, as the polls suggest, and if they renege on Greece's bail-out deal, then the world will cut off the supply of rescue funds. It is hard to see Greece then staying in the euro.

There is already a whiff of inevitability about an outcome once deemed impossible. Central bankers now openly discuss the possibility that Greece may leave. As the impossible lapses into the inevitable, a growing chorus is arguing that it is even desirable. Advocates of an exit say that Greece would gain from a cheaper currency, and that the politics of forging a closer fiscal and financial union between the euro zone's remaining members would be easier without a country that should never have joined in the first place. But it is wrong to pretend that a Greek exit is an easy or desirable outcome. Before it is too late, Greek politicians need to be honest about what an exit implies. And Europe's politicians need to act far more boldly to protect the rest of the euro zone in case the worst happens.

Start with the Greeks. Most of them want to ditch the hated austerity policies that they blame for their plight. Mr Tsipras and his colleagues are fuelling the belief that Greece can somehow avoid austerity and still stay in the euro. In fact Greeks cannot avoid austerity, either within the euro or outside it.

It is true that Greece can survive within the euro only with a gruelling downward adjustment of wages and prices, which demands painful budget cuts and structural reforms. Yet even stronger medicine would be required if Greece left the euro. Cut off from foreign funds, the country would be forced into still tighter fiscal austerity. It would need a disciplined monetary policy and bold structural reforms to retain the gains from its cheaper currency and avoid hyperinflation. Discipline and reform are not familiar concepts in Greek politics.

“... It is true that Greece can survive within the euro only with a gruelling downward adjustment of wages and prices, which demands painful budget cuts and structural reforms”

Moreover a chaotic Greek departure would devastate the country's political life, because Greece would risk expulsion from the single market and perhaps even the EU itself. A place that shed dic-

tatorship as recently as 1974 would find exclusion from Europe traumatic. For a taste of what might ensue you only need to look at the rising power of extremists such as the neo-Nazi Golden Dawn party.

If Greek voters deserve greater honesty about the Grexit, so do those in the rest of the euro zone. Greece may be a small economy, but a Greek departure from the euro, amid brinkmanship and bluster, would not be a small event. Most obviously, exit—and the subsequent default on its private as well as official debt—would cost European banks, firms and taxpayers a lot of money (see article). And that is without counting the danger of a general contagion in weak euro-zone economies.

★ ★ ★ *ECONOMIST* / [LINK](#)

**Unicharm Corp's sales** of adult diapers in Japan exceeded those for babies for the first time last year. At Daiei Inc. supermarkets, customers can feel Japan aging -- literally: It has made shopping carts lighter.

Companies are rushing to grab a bigger chunk of the estimated 109 trillion yen (\$1.4 trillion)

that consumers over 60 spent in the year ended March 31 in Japan. The number of Japanese over 65 hit a record 23.3 percent of the population in October.

“We perceive this change as a golden opportunity for growth,” Shohei Murai, executive vice president of supermarket operator Aeon Co., told reporters in March. “In the ‘80s and ‘90s, Aeon set families that were the massive majority in terms of population as its main target. Now the elderly are going to be the engine of consumption.”

Aeon, Asia's largest retailer, is putting medical clinics in some of its locations.

Japan's fertility rate is 1.39 for women, compared with 1.93 in the U.S., according to the Ministry of Health, Labour and Welfare. Japan's population, which peaked in 2005, is poised to shrink to 125.2 million in 2014 from 126.5 million last year, according to data compiled by Bloomberg.

The country is becoming a test case of how a modern retail economy can switch from focusing on traditional, younger customers.

“It could be a model case,” said Naoki Fujiwara, chief fund manager at Shinkin Asset Management Co. “They are remodeling stores and changing products portfolios. It may take time, but their efforts will be successful not only in Japan, but also overseas.”

Unicharm, Japan's largest diaper maker, said it's counting on just that. The Tokyo-based company said the lessons it's learning in Japan will help its expansion in China, where the population at or above 65 rose to 8.87 percent of the total as of Nov. 1, 2010, up 1.91 percentage points from the 2000 census. China introduced a one-child policy in 1979 to curb population growth.

“China will necessarily face the aging society at a faster pace than Japan because of the one-child policy,” said Unicharm Chief Executive Officer Takahisa Takahara in April. “We have the responsibility to take Japan's standards and spread it into Asia.”

★ ★ ★ *BUSINESSWEEK* / [LINK](#)

**The [JP Morgan]** debacle has raised broad questions on Wall Street and in Washington about whether any executive can properly oversee such a large financial institution, whether new regulatory rules will do anything to prevent another financial crisis and whether tougher regulation is needed to further rein in risky bank trading, particularly at financial behemoths that are viewed as too big to fail.

The bank has ousted the executive in charge of its Chief Investment Office, a huge trading unit at the heart of the scandal that has contributed more than \$4 billion of net income over the past three years—nearly 10% of J.P. Morgan's overall profit during that period.

The stakes are high. Mr. Dimon personally approved the concept behind the disastrous trades, according to people familiar with the

“... Last year, Mr. Macris dropped risk-control caps that had required traders to exit positions when their losses exceeded \$20 million. Ms. Drew and Mr. Macris declined to comment.”

matter. But he didn't monitor how they were executed, triggering some resentment among other business chiefs who say the activities of their units are routinely and vigorously scrutinized.

J.P. Morgan executives—including General Counsel Steve Cutler, the former Securities and Exchange Commission enforcement chief—weighed whether or not to disclose the losses immediately.

Some argued that the losses weren't material, that the firm didn't have all the details and that there was a chance the trades could ultimately turn around.

J.P. Morgan chief James Dimon, regarded as one of Wall Street's best risk managers, has come under fire for failing to prevent a huge trading loss.

Mr. Dimon directed the bank to delay a quarterly regulatory filing, scheduled for April 27, that would provide the status of its business for this year's first three months, because he didn't have

a firm understanding of the trades' impact.

On Thursday, the chairman of the Senate Banking Committee, Sen. Tim Johnson (D., S.D.), said he plans to ask Mr. Dimon to testify before the committee about the loss.

Mr. Dimon has weathered difficult times before. He was the protégé of former Citigroup Inc. CEO Sanford Weill before being fired in 1998 after clashing with Mr. Weill. He joined Bank One, which was bought by J.P. Morgan Chase, where he took the helm in 2005.

That year he named Chase executive Ina Drew to head of the Chief Investment Office, or CIO. The unit was responsible for taking charge of the bank's overall risks, and for managing what is now \$360 billion of safe, highly liquid securities. Ms. Drew hired Achilles Macris the next year to oversee trading in London, and the CIO group began to expand into riskier derivatives, instruments that derive their value from an underlying financial index or product.

Blessed by Mr. Dimon, the activity originally was designed to provide an economic hedge for the bank's other holdings, executives say. It expanded, particularly after J.P. Morgan in 2008 bought troubled lender Washington Mutual, which held riskier securities and assets that required hedging.

In recent years, some of the group's trading morphed into what essentially amounted to big directional bets, and its profits and clout grew. Last year, Mr. Macris dropped risk-control caps that had required traders to exit positions when their losses exceeded \$20 million. Ms. Drew and Mr. Macris declined to comment.

Mr. Dimon was unaware of the risk-control change, according to colleagues. Indeed, he had appeared to have started paying less attention to details of the group's trading activities amid the hefty profits, colleagues say.

★ ★ ★ [WSJ / LINK](#)



SOURCE: RICHARD ROSS

There we were, now here we are...

[Richard Ross](#) reminds us exactly where Spain and Italian equity markets stand. Not pretty.



SOURCE: RICHARD ROSS

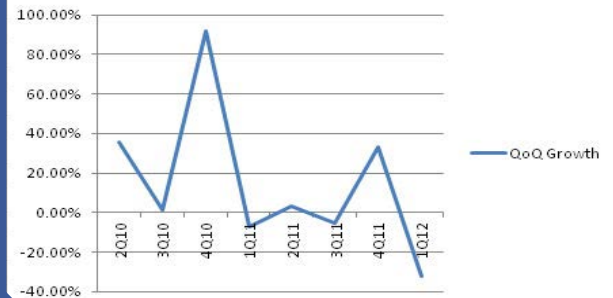


# CHARTS THAT MAKE YOU GO *Hmmm...*

**Facebook QoQ Daily Active Users Growth**



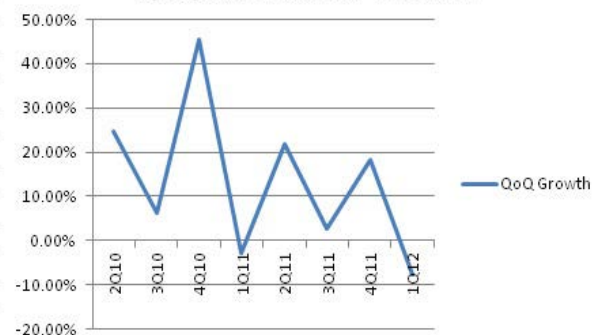
**QoQ Net Income Growth**



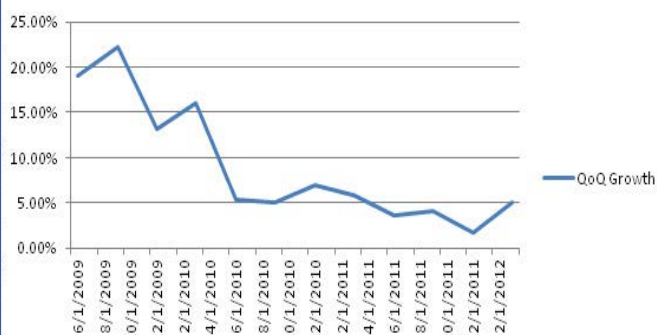
**Facebook QoQ Monthly Active Users Growth**



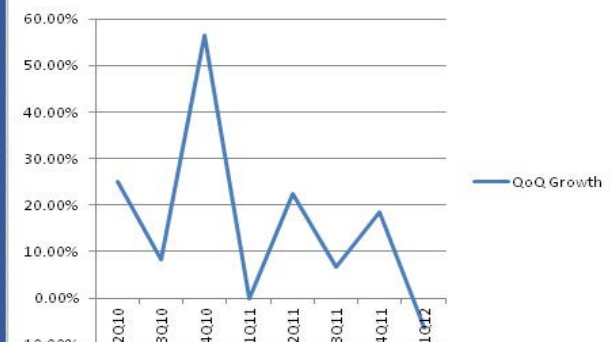
**QoQ Ad Revenue Growth**



**US & Canada QoQ MAU Growth**



**QoQ Revenue Growth**



Source: facebook

facebook

a few random numbers...

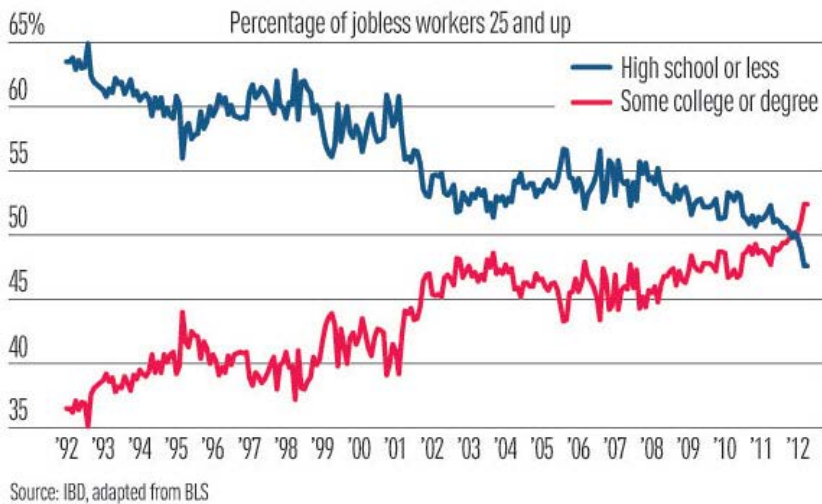
(thanks Jon)



like?

## Higher Ed, Higher Unemployment

For the first time in history, a majority of jobless workers 25 and over have attended some college



[CLICK TO ENLARGE](#)

SOURCE: IBD/BLS

For the first time in history, the number of jobless workers age 25 and up who have attended some college now exceeds the ranks of those who settled for a high school diploma or less.

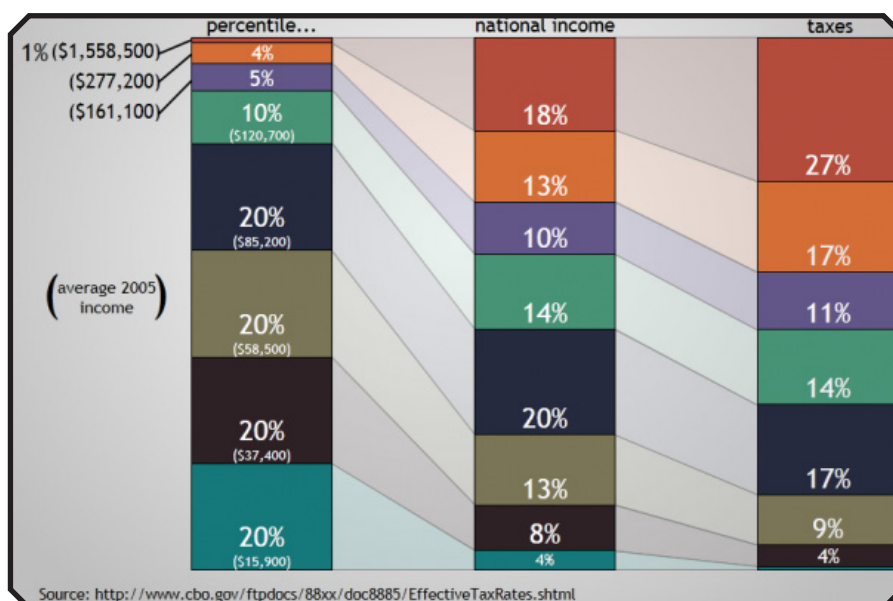
Out of 9 million unemployed in April, 4.7 million had gone to college or graduated and 4.3 million had not, seasonally adjusted Labor Department data show.

In 2011, 57% of those 25 and up had attended some college vs. 43% in 1992. Those without a high school diploma fell from 21% to 12% over that span.

★ ★ ★ [INVESTORS.COM](http://investors.com) / [LINK](#)

Here is a graph showing how the rich make more income and pay even more in taxes. While the upper middle class pay about the same percentage in taxes as the make. Finally the lower 60% pay less in taxes than their % of the nation income.

★ ★ ★ [VIZUALIZINGECONOMICS](http://visualizingeconomics.com) / [LINK](#)



[CLICK TO ENLARGE](#)



[CLICK TO WATCH](#)

**Two and a** half minutes of Nigel Farage is more entertaining and contains more honest appraisal than hours of most other politicians.

I strongly suspect that, in years to come, Farage's many speeches in the European parliament will be looked back upon with a very different attitude than the mild amusement with which he has been greeted thus far.

Interestingly enough, the boos have begun slowly turning to cheers amongst his peers which is a hugely interesting development...

## Funnily enough, Nassim

Taleb has a few thoughts on the JP Morgan scandal. If you'd like to hear them, click here.

Interestingly, it seems as though it's not just the US networks who decide time's up whenever Ron Paul's name gets mentioned...!

Oh.... and there's even a bonus minute of Donna Summer's 'I Feel Love'. Something for (nearly) everyone...



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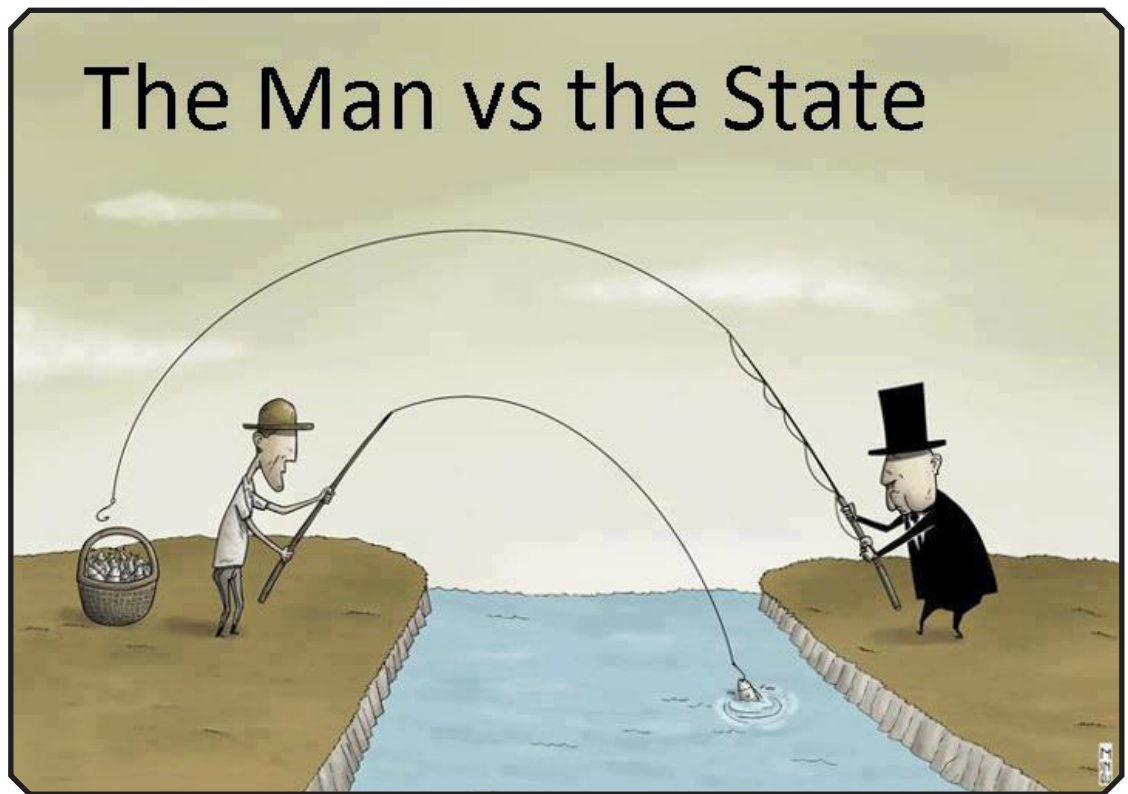
for those of you who have an interest in that space, it really is a best-in-class event. You can find out more about the line-up by clicking on the banner above.

**My friend, Jeremy** Gray, of Standard Chartered Bank spoke at length with Jim Puplava this past week about the extremely bullish set-up in gold after the recent sell-off and highlighted the incredible increase in imports into China.

Jeremy does a fantastic job in laying out just what is happening in the gold market.

As an aside, Standard Chartered's 2nd Earth's Resources Conference will take place in Hong Kong June 20-21, 2012 and

*and finally...*



SOURCE: HIPSTERLIBERTARIAN.COM

*Hmmm...*

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## Grant Williams

Grant Williams is a portfolio and strategy advisor to Vulpes Investment Management in Singapore - a hedge fund running \$200million of largely partners' capital across multiple strategies.

In 2012, all Vulpes funds will be opened to outside investors.

Grant has 26 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.....' for the last three years.

For more information on Vulpes please visit [www.vulpesinvest.com](http://www.vulpesinvest.com)



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*

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