



# The Privateer

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## **THE PRIVATEER:**

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## GLOBAL REPORT

### THE LIT FUSE ON THE US DEBT BOMB

Thursday and Friday - June 4 and 5 - were tumultuous days in the huge US bond market. The yields on Treasury paper of two years or longer soared skyward. They got routed. Losses for holders of this Treasury paper were estimated to be in the 20-30 percent range over just those short days.

#### There Is No Safe Place On The US Yield Curve:

At the short end of the Treasury curve, the Fed still exercises some control but nobody knows for how much longer. With longer term (two-years or more) paper, the situation is dire. Prices for 10 and 30-year Treasury paper (which move inversely to yields) are down 8.58 percent and 24 percent respectively for the year to date. For months, buyers of US Treasury debt have been going to the short end, the Chinese in particular, while shying away from longer-term paper. But even here, the recent falls of the US Dollar are making Treasury paper anything but "safe".

#### The Burning Fuse To The US Debt Bomb:

In the week ended as this issue of *The Privateer* goes to press, the Treasury rolled an additional \$US 131 Billion in brand new debt paper down the street. With yields right across maturities having risen the previous week - with commensurate price losses - the point is getting close where the lit fuse on the debt bomb will reach the ignition point.

The signal for the US debt bomb going off will be a Treasury auction where there is an insufficient amount of willing buyers - which means part of the issue is left unsold with some Treasury paper left on the counter. At that point, the only remaining buyer will be the Fed. To "buy", the Fed will have to create HUGE amounts of US Dollars out of thin air.

### June 5 - The Day The Fed Lost Control:

On that Friday in New York, the Fed lost control over even comparatively short-term US interest rates. On that day, the market yield on 2-year Treasury paper exploded upwards from 0.95 percent to 1.29 percent. That's right, the yield on the two-year paper moved up by 36 percent - in ONE day! On the same day, the yield on Treasury 10 and 30-year paper rose 12 and 15 basis points to 3.83 and 4.63 percent respectively. The US and world markets for "official" debt paper issuance are now pushing back. Very soon, spendthrift governments around the world will find that they will have to offer higher rates of interest than before to get the money. If they cannot borrow, they must cut - SPENDING.

The biggest current global "bubble" is US Treasury debt. that bubble has been punctured but it has not been deflated - yet. The fuse is burning closer to the US debt bomb. It explodes when Treasuries crash.

## **US Ripples From The Rout Of US Treasuries:**

The rout of US Treasuries (a US and global benchmark) flowed over into the wider financial system. The average rate on a 30-year US home loan rose to 5.29 percent for the week ending June 5 from 4.91 percent a week earlier, according to Freddie Mac. Seventy to eighty percent of refinancing packages promptly died on the order papers. Now, Americans can only refinance mortgages at higher rates.

## **The True State Of US Business Finance:**

To get a clear view of where US businesses and corporations are commercially and financially, one has to watch commercial paper. Commercial paper is what finances economic goods on their road to the final consumer. When the volume expands, American businesses are getting the finance to make more economic goods. When the volume contracts, they can finance and produce fewer economic goods.

Last week, total US commercial paper decreased by \$US 3.5 Billion to \$US 1.245 TRILLION. More significant in economic terms, commercial paper has declined by \$US 437 Billion so far this year. That's an annualised rate of 61 percent - a SAVAGE rate of contraction. Total US commercial paper has contracted by \$US 509 Billion or 29 percent over the past year, a clear indicator from the financial side that US output and production is diving ever more steeply. Higher unemployment follows naturally.

## **US Bank Credit Is In A Slow Contraction:**

Try as they might, the US powers that be cannot get another credit expansion started. US bank credit has declined by \$US 22.4 Billion to \$US 9.754 TRILLION. Over the past year, US bank credit rose \$US 336 Billion or 3.6 percent. But thus far in 2009, US bank credit is actually down - by \$US 160 Billion.

There was a \$US 15.7 Billion drop in consumer borrowing in April which left total consumer credit at \$US 2.52 TRILLION. The Fed's measure of consumer credit does not include home mortgages or other loans secured by real estate. Even so, this shows American consumers actually paying back their loans.

The US category in Friday's report that includes credit card debt dropped at an annual rate of 11 percent in April following an 11.2 percent plunge in March. Auto loans and other non-revolving credit fell at an annual rate of 5.3 percent following a 5.8 percent decline in March. This is the face of credit contraction.

In percentage terms, US consumer credit fell at an annual rate of 7.4 percent in April following a 7.8 percent drop in March. The two declines were the largest since an 8.1 percent drop in December 1990.

## **About Face - Americans Are SAVING:**

The personal savings rate for Americans has jumped to 5.7 percent in April, the highest since February 1995, according to government data. Late last year, the savings rate was negative.

The new level of savings - \$US 620.2 Billion - was the most on record dating back to January 1959!

## **The Mean Streets Of Main Street:**

The US government reported that nonfarm payrolls fell 345,000 in May versus expectations for a 525,000 drop. The jobless rate leapt to 9.4 percent from 8.9 percent. US payrolls in construction industries fell 59,000 after dropping 108,000 in April. The US service providing industry shed 120,000 positions after eliminating 230,000 in April. The manufacturing sector purged 156,000 jobs in May after shedding 154,000 in April. Since the start of the recession in December 2007, the economy has lost 6 million jobs, the US Labor Department said. The labour market is hurting US cities with 93 metropolitan areas registering an unemployment rate of at least 10 percent in April, according to the Labor Department data.

## **Outside The Beltway:**

The US Labor Department said that nine of the thirteen metropolitan areas with jobless rates of at least 15 percent were in California. Consider what that means in real terms. It means that when walking down the streets in California, every sixth or seventh person of working age that one sees is out of work.

California faces a deadline at the end of June. It cannot balance its budget which now is in deficit to the tune of \$US 24.3 Billion. Instead of raising taxes, it has to cut spending by \$US 24.3 Billion.

This is the economic territory of spontaneous social upheaval. A tiny spark, an everyday next to nothing incident, can set off a chain reaction. As has happened before, the National Guard is called out to quell the riots. Emergencies are declared with night curfews and mass arrests follow.

## **The Top Of The Debt Pile - The US Federal Budget:**

The US budget deficit is projected to reach \$US 1.85 TRILLION in the year ending on September 30, according to the latest from the US Congressional Budget Office. Last year, it was \$US 455 Billion.

President Obama may borrow a record \$US 3.25 TRILLION this fiscal year, almost four times the \$US 892 Billion borrowed in 2008, according to primary dealer *Goldman Sachs Group Inc.*.

Unlike California, Washington DC has no problems - yet. The US government can still borrow. But they are nearing the point where their lenders have had enough and could act to cut off the global line of credit. At that point, Washington DC can do one thing that the US states cannot. They can print money.

## **A Dawning Rebellion In The US Money Markets:**

Market set interest rates are now climbing all along the line of the US yield curve. These higher market rates are landing on top of a US economy which is still descending - though at a slower pace. If, in these circumstances, the Fed chooses to "monetise" even more government debt by printing money to "buy" it, US interest rates could move explosively upwards in a climbing fear of fast accelerating price-inflation.

## **If The Fed Starts To Really Print New US Dollars:**

If the Fed DOES become the buyer of last resort, the US Dollar will move into the global spotlight. The world will have positive proof that the US intends to literally inflate itself out of its current problems. Foreign central banks right down to any private investor in US Treasury and all other US paper will be staring at enormous losses as the US Dollar falls in value. For Americans, a massive fall in the US Dollar will promptly show up as climbing import prices, followed in short order by climbing internal prices and then US interest rates will really join the party and soar upwards to compensate lenders for the risk.

## **Statistics For Monday, June 8 - Courtesy Of The USA Today Show:**

If you are an American, your family's share of government debt is now over half a million Dollars. A record \$US 546,668, to be exact. Nothing shows more clearly the serfdom of Americans today. Others, the ones in federal, state or local governments, have borrowed the money. It is, of course long gone.

Only the debts remain. Those who borrowed and spent the money will not have to repay it. That will be the task of the American serf, his family and his children.

On top of this debt is what the American serf personally owes on mortgages, credit cards etc.. These personal debts can be added to what the serf owes government. This is the economic "foundation" upon which the US has to attempt a restart. Without a MASSIVE spending cut in Washington DC - NO WAY.

## **The Central US Economic Problem:**

The US economy has a total debt to GDP ratio of 370 percent. Economic historians point out that when the US stock market crashed in October 1929, the total debt to GDP ratio was 260 percent. Faced with the much worse present situation, there are two economic alternatives. Either the US economy goes to work paying down this debt mountain or the vast majority of this debt is written off. The first is politically unviable. The American public would never stand for it, because it would mean paying taxes without seeing any benefit from doing so except for the fact that the principal owed would be less.

## **The Approaching US Debt Write Down:**

The write-down of debts owed can take place directly in the sense of debt repudiation. Should that happen, then all the present holders of US debt paper, Americans and foreigners, would look at one of history's all time biggest financial losses. The other way is through subterfuge by making pretend payments with new US Dollars printed for that purpose. This is also unlikely to work because the rest of the world is now watching the United States to see if it tries to get out of its debt trap in this manner.

## **Staving It Off:**

The US approach (it isn't a policy because real policies last decades) is to try to stave off what is already inevitable with one jury-rig attempt after another. An example here is what the US is currently doing. The US faces budget deficits that the administration forecasts will hit a record \$US 1.8 TRILLION this year and \$US 1.26 TRILLION in 2010 as the recession reduces tax receipts and forces higher government spending on measures for social security. To see through this attempt, one only has to ask one question: "*What happens in 2011?*" By 2011, the debts of the US Treasury will be higher, according to official estimates, by \$US 3.06 TRILLION! This is an "improved" situation?? Hardly. If the 2009 deficit of \$US 1.8 TRILLION disappeared, so would an equal sized chunk of US economic "growth".

That \$US 1.8 TRILLION deficit is equal to 13.1 percent of the present US GDP. If it was withdrawn, the result would be a contraction of approximately that magnitude in US GDP. The inevitable result would be a savage economic recession bordering on a full scale DEPRESSION in the US.

And that is why the American political establishment is trying to stave-off for a while longer what is coming towards them. What is coming towards them is the bankruptcy of their own federal government and an economy which has long since lost the capacity to pay for or even to service the debt that all their past political leaders have accumulated. Economic history shows that the present US 370 percent debt to GDP ratio has to be taken down below the 200 percent level for the US to become viable again, while still carrying a very high "debt to economy" ratio. The only alternative? Full-scale bankruptcy.

## **US Bond Market Debacle Update:**

Shorter-maturity US debt paper has outperformed longer maturities. Bonds due in three years or less fell 0.7 percent this year compared with a 27 percent decline in 30-year Treasuries according to *Merrill Lynch & Co.* indexes. Why would anybody lend more money at either end of the Treasury yield curve?

## **Central Banks - Slowly Slipping Away In The Night:**

Foreign central banks are trying to slowly slip away from the US Dollar and US Treasury paper, mainly by lowering their holdings of foreign exchange reserves. Smaller Asian central banks ran down foreign exchange reserves by more than \$US 300 Billion in the 12 months to April 30. Russia's reserves slid by \$US 213 Billion in the eight months to March 31, the latest central bank data shows. If this exodus by the smaller central banks is joined by many more, the global run of US Treasuries is on. If even one of the main central banks, China's perhaps, were to join in the sell-off, US Treasuries would be devastated.

## **Current US “Policy” - Waiting For A Miracle:**

The Obama administration’s current policy can logically only be an interim short-term policy. It relies on HUGE budget deficits which are drowning the US Treasury under a tidal wave of debt.

## **In The Dawn’s Early Light - Reality:**

The natural economic end to all such policies is bankruptcy. It should be blindingly obvious that what has to be done first is to stop these US budget deficits from climbing even higher. The next step, the hard one, is to start to bring these budget deficits down towards, at the very least, a state of balance. In his most recent public statements, President Obama seems to be showing a growing awareness of this, even if his past actions on the budget front concretely show the opposite to be the case. He now proposes that Congress be required to pay for new entitlement spending (such as the national health care system) by raising taxes for it - or to come up with budget cuts elsewhere in a “pay-as-you-go” system.

If new spending or tax reductions are not offset, there would be automatic cuts in the so-called mandatory programs - although Social Security payments and some other programs would be exempt. These so-called “mandatory programs” are the sacred cows of the US welfare state. They account for about 60 percent of the US federal budget and they are supposedly untouchable.

REAL cuts in the US mandatory programs would be a contraction of the American welfare state. Politicians in Washington have shied away from this as a total anathema. In their outlook, if you touch these programs, you die politically. Now, President Obama has actually opened the door.

## **Too Little - Much Too Late:**

On strict economic grounds, a huge cut in the US mandatory programs should have been the first step of the Obama presidency as soon as it was realised that the budget deficit would reach \$US 1.84 TRILLION or 13.1 percent of US GDP. Having signed on the dotted line for this US budget, Obama is now stuck with it. To whimper now that Congress should enact a law to restrict its own spending is as futile as shovelling water after an outgoing tide. President Obama’s most recent comments have all the signs of coming from a man who is beginning to understand that he is presiding over the bankruptcy of the United States. The facts are that the costs of the US welfare state are killing the US federal budget.

## **The Fundamental Facts Remain The Same:**

Either US current expenditures are cut to meet the level of current incoming federal tax revenues or the US Treasury will go broke, collapsing under the weight of its borrowings. In the first instance, the current US welfare state will come to a sudden end and many millions of Americans, most of them elderly, will never see what they have been promised. With that, the post WW II epoch of the US as a global and imperial power will come to an end as the US defence budget is cut down to be sufficient for the defence of the continental United States alone. NATO would be abolished. US military withdrawals would follow from Western Europe, South Korea and Japan. US Forces would be withdrawn from Iraq, Afghanistan the Middle East. The costs of the US global empire are also killing the Treasury.

## **The US Policy Of Guns And Butter Has Failed:**

During the Vietnam war, President Johnson launched his “Great Society” program at the same time as he was escalating his war. That was viable neither financially nor economically over time. Sure enough, both he and the US came to grief. The presidency of George Bush (the younger) made what President Johnson tried to do look tiny. Bush tried to make a “Great Global Society” under the US at the point of a gun in Iraq and in the Middle East while he escalated internal US welfare payments. Today, the fuse is burning towards the US Treasury’s debt bomb. All of the world’s bond markets say so.

## **INSIDE THE UNITED STATES**

### **THE WIDENING DEBT CHASM UNDER THE TREASURY**

That widening chasm is the fast dwindling tax revenues received by the US federal government, a fall which it is covering with rapidly increasing borrowing. The latest official facts are these. A new Treasury report shows that federal government spending totals a record \$US 2.37 TRILLION through the first eight months of the budget year. That's 18 percent more than a year ago. But here's the BIG problem. The report showed government tax receipts reached \$US 1.67 TRILLION through May, down 18 percent from last year. Spending up by 18 percent - receipts down by 18 percent!

#### **We'll Borrow The Difference:**

The US government plans to sell \$US 361 Billion of marketable securities over the quarter ending on June 30 and then borrow another \$US 515 Billion in the three months through September, the US Treasury has said in a quarterly statement. The budget deficit climbed to \$US 189.7 Billion in May, a record for the month, compared to \$US 165.9 Billion a year earlier, the Treasury said on June 10.

For the fiscal year that ends on September 30, the Congressional Budget Office (CBO) forecasts the deficit to reach a record \$US 1.845 TRILLION - FOUR times the previous year's \$US 454.8 Billion.

#### **The Falling US Economy Is Killing US Tax Revenues:**

US corporate tax receipts fell to \$US 69.4 Billion through May versus \$US 178.2 Billion a year earlier, a decline of 61 percent, the US Treasury's budget statement said on June 10. Individual income taxes received were down by 23 percent so far this fiscal year to \$US 592.6 Billion compared with \$US 769.2 Billion in 2008. These falls of 61 percent and 23 percent in tax revenue are a mirror image of the actual state of the real US economy. But Washington DC is ignoring it. Instead, Washington is trying to "stimulate" the US economy with one of the most amazing rescue packages in economic history. The US government and the Fed have spent, lent or committed \$US 12.8 TRILLION. That is almost the value of everything produced in the US last year - trying to stem the longest American recession since the 1930s.

#### **The Cratering US Bond Market:**

US thirty-year bonds have handed investors a 28 percent loss this year versus 11 percent for 10-year paper and 0.4 percent for two-year securities according to indices compiled by *Merrill Lynch & Co.*. US Treasuries of all maturities have fallen 6.2 percent this year according to these latest indices.

#### **The US Treasury Is Running Out Of Time:**

The reason *The Privateer* has included several US Treasury bond updates in this particular issue is that they have been falling nearly every day, handing American and foreign lenders to the US Treasury a climbing tidal wave of losses which keep on rising. Inherently, this is now a global situation which is no longer viable. Nobody, not even the US, can with impunity hand global investors mega \$US Billions in losses over a long period of time. A point is near in global financial events where all those who have already suffered steep losses from holding US paper balk at buying more such paper. At that point, the US loses its present external means of funding its exploding budget deficits.

The fuse on the US Treasury debt bomb is well alight and shortening all the time. As long as the US federal budget is in the mode of accelerating deficits, the closer the fuse will come to the "ignition point", setting off the biggest post WW II explosion as these US Treasury debts blow up in a huge debt default that will shake the world's financial foundations. Global bonds were always going to be the last bubble. When the US Treasury's debt bomb blows, the world bond market write-down will exceed all others.

## INSIDE CHINA - AND - JAPAN

### THROWING “BRIC(K)S” AT THE US DOLLAR

The leaders of Brazil, Russia, India and China, known by their “BRIC” acronym, are due to meet in the Russian city of Yekaterinburg on June 16 for the first summit since the international downturn struck.

#### **Periphery Moves Away From The US Dollar:**

Noteworthy here is the presence of Brazil which brings South America into the new global economic and geo-political equation. The four BRIC nations have an openly expressed common denominator in geo-monetary terms. That is their dissatisfaction with the US Dollar as the general world reserve currency. Brazil and China have already established, through central bank currency swaps, the basis for bilateral trade taking place in their own national currencies, bypassing the US Dollar entirely. Russia has altered the balance of its foreign currency reserves and now holds more Euros than US Dollars. Russia and the EU are rapidly increasing their mutual barter trade, settling any differences in short-term Euro or Ruble mutual credits. What this all amounts to is a bypassing the US Dollar as a means of full, final payment.

#### **Currency Displacement And Its Effects:**

The US Dollar is being displaced from its global role as the sole reserve currency and as the main trading currency for the world’s major commodities. A spreading global network of bilateral currency agreements would displace the US Dollar from this role. All the nations participating in these arrangements would no longer need to buy US Dollars before they could pay their cross border bills since they could pay these bills in their own national currencies. Their demand for US Dollars would fall to what they need for buying in the US market. In this situation, they would stand with an excess of US Dollars in their foreign exchange reserves. At some point, they would sell these excess US Dollars.

Once such a global network of bilateral agreements becomes wide enough, it can be taken to its next stage and made multi-lateral. Then, this arrangement is but a short step away from being able to establish its own reserve currency as the currency common denominator. After all, this is what was done in Europe with the arrival of the Euro and the extinction of national currencies which had lasted centuries.

Not being needed or wanted, the displaced US Dollar will therefore start falling in international value.

#### **China Turns Hard Inwards:**

China’s spending on factories, property and roads has surged by the most in five years as the government’s 4 TRILLION Yuan (\$US 585 Billion) stimulus package takes effect. Urban fixed asset investment climbed 32.9 percent in the five months to the end of May from a year earlier, the Chinese statistics bureau said on June 1. Overseas shipments declined 26.4 percent last month from a year earlier, the customs bureau said. China is artificially booming under this force-fed money and credit infusion and will do so until climbing internal prices show signs of an overheating economy. Then comes the fall.

#### **Japan’s Economy Is Contracting At An Alarming Rate:**

A new survey published this week by the *Nikkei* newspaper showed that Japanese companies plan to cut capital spending by an unprecedented 15.9 percent this business year. Japanese companies have cut spending at the fastest pace in 54 years as a slump in global demand erodes profits, leaving less money for plant and equipment. Capital spending fell 25.4 percent in the three months to March 31 from a year earlier in the largest drop since the government began the survey in 1955, the Ministry of Finance said. Japanese company profits have tumbled by a record 69 percent. Physical output slid 31.2 percent in April from a year earlier and Japan’s global exports have dropped 39.1 percent. This is now a full scale crash.

## **INSIDE THE EUROPEAN UNION**

### **THE IMPORTANCE OF A TRUE SCALING OF THE WORLD**

The European Union of 27 countries is the world's most formidable economic bloc today. It incorporates 491 million people in an integrated market with its own reserve currency, the Euro, that produces nearly a third more than the United States. This alone makes the US led NATO alliance an obsolete concept.

#### **Worldwide Deflation Effects - An Update:**

Consumer prices are falling in countries including the US, Japan, Spain, Singapore and Thailand. In China, consumer prices fell for a fourth month in May, down 1.4 percent from a year earlier, after falling 1.5 percent in April, the statistics bureau said on June 10. The CRB Index of 19 raw materials including oil and copper is down about 39 percent from a year ago, having climbed about 14 percent in 2009. De-leveraging is on a global scale and private monetary savings are climbing in more and more nations.

Euro-area producer prices fell 4.6 percent in April from a year earlier, the most since the data was first compiled in 1981. Falling producer prices is a sign of companies fishing for their market clearing prices.

#### **In Deflations - If Wages Don't Fall - Unemployment Climbs:**

Ireland's unemployment rate hit a 13-year high of 11.8 percent in May as a deepening recession pushed the welfare lines to record lengths, the Irish Central Statistics Office has reported. The report said that the number of people claiming jobless benefits has nearly doubled over the past year to 397,000. That is an unprecedented high, dating back to the foundation of the Irish state in 1922. Among European Union members, the highest unemployment rates were seen in Spain, at 18.1 percent and Latvia at 17.4 percent. The lowest unemployment rate was 3 percent in the Netherlands, followed by 4.2 percent in Austria. The unemployment level in France was 8.9 percent while in Germany, it was 7.7 percent. For all 27 members of the European Union, the unemployment rate was at 8.6 percent in April, up from 8.4 percent in March and 6.8 percent in April 2008. This is a slowly deepening economic recession.

#### **Global Ocean Shipping Update:**

*The Privateer* is keeping a sharp lookout here and has in many past issues. The very first signs of a temporary economic plateau is always a short-term revival in ocean traffic. Ocean shipping is still falling, by 15 percent, and has suffered a 39 percent reduction in freight rates. Total cargo revenues fell 35 percent during the first quarter. No economic revival here. Air freight volumes fell by 20 percent in the first quarter with a 7 percent fall in freight load factors - the amount of available freight space being used.

#### **Europe's Economy - An Overview:**

The European gross domestic product (GDP) shrank 2.5 percent from the fourth quarter, the biggest fall since data was first compiled in 1995, the European Union's statistics office in Luxembourg said.

Household consumption contracted 0.5 percent while exports dropped 8.1 percent and imports fell 7.2 percent, all figures the highest since the series began in 1995. New investment fell 4.2 percent after a 4.3 percent drop in the previous quarter. The fall in new investments is bad but the global situation is worse.

#### **A Global Appreciation:**

The global centre of gravity, economically and politically, is shifting towards Europe and away from the US. This is fully understood in both Russia and China. That is why they are bringing India and Brazil into their BRIC four-power talks in Russia on June 16, to counter balance Europe. Europe is back.

## **AUSTRALIAN REPORT**

### **WALKING RIGHT ON THE EDGE OF RECESSION**

So far, the Australian economy has avoided following the rest of the world into recession or depression. With the latest data of a 0.4 percent increase in GDP over the second quarter, Australia has also avoided two quarters of negative growth, which by international convention is the signature of a real recession.

Talk about the “*Lucky Country*”. Nonetheless, a total of 1,700 jobs were lost in May. Unemployment rose to a seasonally-adjusted 5.7 percent from 5.5 percent in April, the Australian Bureau of Statistics said on June 11. Aussies were so happy about these results that consumer confidence and retail sales have actually climbed. The Reserve Bank of Australia (RBA) has stood pat at its 3.00 percent rate.

#### **Looking Offshore At Foreign Customers:**

There can't be much doubt that the rest of the world where Australia's customers live are in the grip of a tightening deflation. In regard to what Australia sells internationally, the CRB Index of 19 raw materials including oil and copper is now down about 39 percent from a year ago, although it has more recently climbed about 14 percent. Set side by side with the Baltic (shipping) Index, the combination shows that Aussie resource exporters can expect a torrid second half of this calendar year with falling prices and declining volumes. Since manufacturing only accounts for about 10 percent of the Aussie economy, it will not be able to assist on the export side. The economic result is that Australia will once again fall into an international trade deficit just as the Rudd government tries to borrow \$A 200 Billion!

#### **Closer To The Ground - On The State Level:**

Queensland and NSW are now in recession after their economies contracted for two consecutive quarters. Victoria and Western Australia also contracted sharply as private investment plummeted in the March quarter. No wonder. The financial pressure is on. The yield on Aussie ten-year notes was 4.88 percent in mid-May. It is now 5.67 percent. This shows that credit is tightening inside Australia. Over the second half of 2009, that will affect the entire economy, especially the thousands of businesses large and small who provide employment. As these higher funding costs hit, they will also hit the broader economy.

As the state economies go, so goes the national economy. It is only as a result of statistical flukes that Australia has avoided two quarters of economic contraction.

#### **When The Aussie Recession Arrives:**

The real economic results of Prime Minister Rudd's borrowing and failing external markets will start to show up in the third calendar quarter. The tightening of Australia's internal credit markets will, at that point, tighten even further as local lenders shy away from lending more. What now counts on the local scene is not the return on capital but the return OF capital. Credit deflations are insidious in the sense that they initially take place inside the accounts and balance sheets of the major lenders.

Next to nothing is seen on main street because major lenders in increasing trouble are loath to talk about it - right up until they storm into the arms of governments to be rescued at taxpayers' expense. At that point, the situation becomes visible. At present, with the world covered by “rescue plans” and “stimulus packages”, people are holding off making major decisions in the vain hope that all of this will work.

The place to look is NOT at the “stimulus”. The real economic place to look is towards what will happen when these packages come to an end. They will have to be stopped before Treasuries go bankrupt. If they are not stopped, the Treasuries WILL go bankrupt and all “stimuloi” will hit the wall. The worst lies ahead. It will arrive when all these rescue attempts - in Australia and almost everywhere else - fail.

## THE GLOBAL MARKET REPORT

### IN THE LAST DITCH ON THE US DOLLAR FRONT

*The US Dollar's position as the world's reserve currency isn't under threat. Our trust in US Treasuries is absolutely unshakable."*

Japanese Finance Minister Kaoru Yosano - June 10, 2009

*(Russia) "does not see any changes in our policy with regards to dollar-denominated paper over the next year or more."*

Russian Finance Minister Alexei Kudrin - June 12, 2009

On top of those two, German Finance Minister Peer Steinbrueck was reported to "*not be concerned*" with the Euro's value against the US Dollar and IMF Managing Director Dominique Strauss-Kahn "*doesn't see a weak US Dollar*".

We must invoke here nineteenth century German Chancellor Otto von Bismark's "law" - "*Never believe anything in politics until it has been officially denied three times*". There's four for you, and there were undoubtedly many more during the G-8 Finance Ministers' meeting in Italy. Admittedly, they are all from different sources, but the meaning is clear enough.

#### **Of Silk Purses and Sow's Ears:**

As the G-8 Finance Ministers sat down in Italy, US Treasury debt and the US Dollar suddenly became sacrosanct. On top of that, a new found "fiscal responsibility" has surfaced in the US in recent days and is now spreading, courtesy of onset of these G-8 meetings which will culminate in a Heads of State meeting next month. The reason behind all the talk about "winding down" the current avalanche of (mainly US) deficit spending is clear. One look at the HUGE leap in yields on two-years or longer Treasury debt paper since the Fed announced its program of direct Treasury buying in March will suffice.

For months, Russia and China (and more recently the other members of the "BRIC" nations - see *Inside China And Japan* in this issue) have been regularly warning about the fragility of the US Dollar and the US Dollar "centric" global financial system. Japan has certainly not come out in opposition to these warnings - until June 12, see above. Neither has Europe or the IMF. As recently as June 10, all four of the BRIC nations were announcing their intentions of switching some of their HUGE foreign reserve holdings from Treasury bonds to "IMF bonds". The problem here is that IMF bonds do not exist as yet.

The World Bank does issue bonds which are traded on the open market. The IMF has never issued bonds, although discussions aimed towards such issuance have been recurring on an irregular basis ever since the early 1980s. Only very recently have they been taken seriously, although at present there is no word from the IMF about when such bonds will be issued. The proposal is to base the bonds on the basket of currencies which make up the IMF's version of a "reserve currency", the SDR or Special Drawing Right. If and when such bonds were to be issued, the proposal further states that they will NOT trade on the open markets and will be reserved for holdings by central banks only. Not marketable - no price - handy that.

Very handy. Consider the fact that in the US in particular, rational economics and the sanctity of commercial law and contract has been swept aside in order to make sure that the "toxic waste" which has threatened to destroy banks all over the world is NOT priced or valued on any type of open market. No effort has been spared in this endeavour. Official interest rates in all major economies are at zero or closer to zero than they have ever been before. Government deficit spending has blown out everywhere. Blanket "guarantees" on bank deposits are universal. "Stimulus packages" rain down like confetti.

The US has taken the lead in ALL these endeavours. And all of a sudden, the US Dollar is "sound" ??

## The Great - And Temporary - Deliverance:

The sudden seeming global allegiance to the US Dollar and the global foreign exchange reserves for which it stands (or falls out from under) has been quite startling. Over the week just ended, the US Treasury faced a series of debt auctions and regular sales totalling \$US 130 Billion. Events on the Treasury markets in the lead up to these auctions were daunting, to put it mildly. As already analysed in the *Global Report* in this issue, not only were yields blowing out, but this ratcheting up of yields was reaching the shorter end of the curve. On June 5 and 8, the yield on Treasury two-year paper exploded upward by almost FIFTY PERCENT - from 0.95 to 1.41 percent. That is unprecedented in magnitude.

By June 10, Treasury ten-year yields had touched 4.00 percent (they were 2.50 percent three months ago). The thirty-year bond yield was closing in on 5.00 percent, reaching a high of 4.83 percent on the day (it was 3.50 percent three months ago). The US Dollar was gyrating wildly either side of the vital 80.00 level on the trade-weighted US Dollar Index (USDIX). The spread between the yield on Treasury ten-year paper and German paper of a similar maturity reached its highest level since late 2007 - the US yield being higher, of course. And don't forget, the European Central Bank (ECB), unlike the Fed, still has an official interest rate, albeit only 1.00 percent.

That was as high as Treasury yields got - note the date of the quote from Japanese Finance Minister Yosano at the start of this section. By the time that the auction on thirty-year paper was held, yields were once again falling as reported foreign (read foreign central bank) participation in the auction reached its highest level since the Treasury resumed selling the 30-year bond back in 2006. The USDIX made it safely back to a level above 80.00 in time for the G-8 Finance Ministers meeting. And Gold, which had been quiet all week, suddenly dived almost \$US 22.00. Even more startling, the Gold sell-off on June 12 did NOT take place in the US, it took place in Asia and Europe. By the time the Gold futures markets opened in New York on the day, Gold had already shed \$US 20.00 from its US close on the previous day. This is HIGHLY unusual. As a rule, Friday Gold "hits" take place in the US after the other markets have closed for the weekend. But this weekend was different - it was the start of the G-8 meetings in Italy.

## Oh (Fill In Your Favourite Deity) Give Me Solvency:

***"But don't give it yet!!"*** Two weeks ago, two events took place. First, US Treasury Secretary Geithner was suddenly summoned to Beijing to publicly assure his Chinese hosts that the US Dollar and debt assets denominated in US Dollars were safe and that he like his predecessors remained in favour of a "strong US Dollar" as being in "the national interest". Whose "national interest" - that of China or the US - was not stated at the time. He also was quoted as reassuring his hosts that the blow-out in US Government deficit spending was "strictly temporary" and that he had concrete plans to wind back the deficits as soon as the "green shoots" matured into something which could be pruned. No sooner had Mr Geithner returned to the US than Fed Chairman Bernanke began to tell the US Congress that their levels of deficit spending were "dangerous" and that something would - eventually - have to be done about it.

Forward two weeks to the G-8 Finance Ministers' Summit in Italy. According to the communique, the gathering in Italy: *"discussed the need to prepare appropriate strategies for unwinding the extraordinary policy measures taken to respond to the crisis once the recovery is assured."*

The desired implication of discussing such issues is that the recovery IS assured, why else discuss them? Having assured the world that the recovery is a "done deal", Mr Geithner and his UK counterpart Alistair Darling, were at pains to assert that any fiscal stringency was NOT something to be entered into - just yet.

In the G-8 nations, individuals are shunning new debt, trying to pay down existing debt, and increasing savings. "State" and municipal governments have no choice but to cut spending. The US and UK federal government is looking into the idea, but feels it would be dangerous "at this time". Meanwhile, the rest of the world has come to the rescue of the US Dollar one more time this week.

## One Last Grasp At The Nettle:

At the end of May, the USDX fell below the 80 level - which it had never been below in the nearly four decades between 1971 and September 2007 - for the first time since October 2008. By the end of the first week of June, the \$US Gold price had traded intraday in New York at almost \$US 990 - just short of the \$US 1000 ceiling which has been clamped down on Gold since March 2008. By June 10, US Treasury debt paper was looking at its biggest fall ever from the beginning of the year to date.

Two weeks ago, the expectation was that at the June 23-24 FOMC meeting, the US Fed would announce an increase in its \$US 300 Billion program of buying Treasury paper with newly created US Dollars. Many were urging an increase in this program to "at least" \$US 1 TRILLION - whether the Fed chose to announce it or not. Official US Treasury funded debt is now nearly \$US 11.4 TRILLION and has been rising by an average of about \$US 155 Billion a month since the start of this fiscal year. The Fed has already chewed through more than half of the \$US 300 Billion set aside to purchase Treasuries, an amount which was supposed to last them until the end of the fiscal year on September 30. Were it not for the fact that foreign central banks are still buying, the Fed would have already used up ALL of it.

And what are the chances of the US government (or the UK government for that matter) actually voluntarily reining in their deficit spending? Well, the last time the US government genuinely did that to counteract the effects of previous stimulus plans was in 1920-21. They have not done it since, with the partial exception of Mr Volcker's short-lived "hands off" approach in 1979-81 which saw US rates top 20 percent. The fuse is still burning brightly on the US debt bomb. All that the reassuring talk about the US Dollar and the re-emergence of big foreign buying of Treasury paper late this week has accomplished is to lengthen it - slightly. The longer it burns, the bigger the "bang" when it finally goes off.

## Recent Events:

The one piece of concrete evidence supporting economic "recovery" which the G-8 Finance Ministers have pointed at is the performance since March of world stock markets. In Asia, several stock markets including those of China, India and Indonesia are now up more than 50 percent on the year to date. Given the fact that all these markets were down more than 50 percent last year, they have still made up only about half of their 2008 losses. Other world markets have not even fared as well as that.

Still, as of June 12, almost all world stock markets are now in the "black" for the year and all are certainly a long way above the abysmal lows registered in mid March this year. This week, the last of the major US stock indices, the Dow, regained its levels at the start of 2009. As of its close on June 12, the Dow was sporting a gain on the year of 0.26 percent.

## Gold:

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

## What's Next?:

The G-8 Finance Ministers' meeting is over. Next weekend, it is the turn of the G-8 Foreign Ministers - all this activity laying the "groundwork" for the meeting of the G-8 Heads of State in Italy on July 8-10.

In the meantime, the BRIC nations are meeting in Yekaterinburg, Russia, on Tuesday, June 16. The central topic of discussion will certainly be the US Dollar, with the unpublicised part being what to do AFTER the G-8 meetings have run their course. In the US, the FOMC meets on June 23-24.