

Second Wave of Financial Tsunami likely to HIT in 2010

by Matthias Chang via reed - Future Fast Forward *Sunday, Nov 22 2009, 5:07pm*

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Global Economy Slammed between First and Second Quarter of 2010. Count On It!

"The policy-makers of these countries faced with the total collapse of the international financial architecture have concluded that the solution, the only solution is *quantitative easing* (i.e. massive injection of liquidity) to salvage the "too big to fail" banks and (re)inflate their depressed economies. This is best reflected in Bernanke's candid remark that, "the US government has a technology, called the printing press (or today, its electronic equivalent), that allows it to produce as many US dollars as it wishes at essentially no cost".

This is the crux of the problem!"

Many of my friends who have been receiving my e-mail alerts over the last two years have lamented that in recent weeks I have not commented on the state of the global economy. I appreciate their anxiety but they forget that I am not a stock market analyst who is paid to write articles to lure investors back into the market. My website is free and I do not sell a financial newsletter so there is no need for me to churn out daily forecasts or analysis.

However, when the data is compelling and supports an inevitable trend, it is time for another review. This Red Alert is to enable visitors to my website to take appropriate actions to safeguard their wealth and welfare of their families in the coming months.

Since the last quarter of 2008, unrelenting currency warfare has been waged by the key global economies and while this competition thus far has been non-antagonistic, it will soon be antagonistic because the inherent differences are irreconcilable. The consequences to the global economy will be devastating and for the ordinary people, massive unemployment and social unrest are assured.

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The Irreconcilable Differences

Some two decades ago, it was decided by the global financial elites that the framework for the global economy shall consist of:

1) A global derivative-based financial system, controlled by the US Federal Reserve Bank and its associate global banks in the developed countries.

2) The re-location from the West to the East in the production of goods, principally to China and India to “feed” the developed economies.

The entire system was built on a simple principle, that of a FED-controlled global reserve currency which will be the engine for growth for the global economy. It is essentially an imperialist economic principle.

Once we grasp this fundamental truth, Bernanke’s boast that the “US can produce as many US dollars as it wishes at no cost” takes on a different dimension.

I have talked to so many economists and when asked what is the crux of the present financial problem, they all respond in unison, “it is the global imbalances... the West consumes too much while the East saves too much and consumes not enough”. This is exemplified by the huge US trade deficits on the one part and China’s massive surpluses on the other.

Incredible wisdom and almost everyone echoes this mantra. The recent concluded APEC Summit was no different. This mantra was repeated as well as the call for freer trade between trading nations.

This is a grand hoax. All the current leaders on the world’s stage are corrupted to the rotten core and as such have no interest to call a spade a spade and expose the inherent contradictions within the existing financial system.

The call for a multi-polar world is meaningless when the entire global financial system is based on the unipolar US dollar reserve currency. This is the inherent contradiction within the present system and the problems associated with it cannot be resolved by another global reserve currency based on the IMF’s Special Drawing Rights as advocated by some countries. It was stillborn, the very moment it was conceived!

The leaders of China, Japan and the oil producing countries of the Middle East are all cursing and pissing about the current situation, but they don’t have the courage of their convictions to spell it out to their countrymen that they have been conned by the financial spin masters from the Fed acting on the instructions from Goldman Sachs.

Tell me which leader would dare admit that they have exchanged the nation’s wealth for toilet papers?

The toilet paper currency pantomime continues.

We have now reached a stalemate in the current currency war, not unlike the situation of the Cold War between the NATO pact countries and the Warsaw pact countries. Both sides were deterred by the MAD (Mutually Assured Destruction) doctrine of nuclear wars. The costs to both sides were horrendous and it was only when the Soviet Union could not continue with the pace and cost of maintaining a nuclear deterrent and was forced into bankruptcy that the balance tilted in favour of the NATO alliance.

But it was a pyrrhic victory for the US and its allies. What kept the ability of the US to maintain its military might and outspend the Soviet Union was the right to print toilet paper currency and the acceptance of the US dollar by her allies as the world’s reserve currency.

But why did the countries allied to the US during the Cold War accepted the status quo?

Simple! They were all conned into believing that without the protection of Big Brother and its military outreach, they would be swallowed up by the communist menace. They agreed to march to the tune of the US Pied-Piper.

The next big question – why did the so-called “liberated” former communist allies of the Soviet bloc jump on the bandwagon?

Simple! They all believed in the illusion that was fostered by the global banks, led by Goldman Sachs that trading and selling their goods and services for the toilet paper US reserve currency would ensure untold wealth and prosperity.

But the biggest game in town was the Asia gambit. Japan, after a decade of recession following the burst of her property bubble did not have the means and the capacity to bring the game to the next level as envisaged by the financial architects in Goldman Sachs.

And China was the biggest beneficiary. The senior management of Goldman Sachs brokered a secret pact with China’s leaders that in exchange for orchestrating the most massive injection of US dollar capital and wholesale re-location of manufacturing capacity in the history of the global economy, China would recycle their hard-earned US toilet paper reserve currency wealth into US treasuries and other US debt instruments.

This was the necessary condition precedent for the global financial casino to rise to the next level of play.

Why?

The New Game

The financial architects at Goldman Sachs had a master plan – to dominate the global financial system. The means to achieve this financial power was the Shadow Banking System, the lynchpin being the derivative market and the securitization of assets, real and synthetic. The stakes would be huge, in the hundreds of US\$ trillions and the way to transform the market was through massive leverage at all levels of the financial game.

But there was an inherent weakness in the overall scheme – the threat of inflation, more precisely hyperinflation. Such huge amount of liquidity in the system would invariably trigger the depreciation of the reserve currency and the confidence in the system.

Hence the need for a system to keep in check price inflation and the illusion that the purchasing power of the toilet paper reserve currency could be maintained.

This is where China came in. Once China became the world’s factory, the problem would be resolved. When a suit which previously cost US\$600 could be had for less than US\$100, and a pair of shoes for less than US\$5, the scam masterminds concluded that there would be no foreseeable threat to the largest casino operation in history.

China agreed to the exchange as it has over a billion mouths to feed and jobs for hundreds of millions needed to be secured, without which the system could not be maintained. But China was pragmatic enough to have two “economic systems” – a Yuan based domestic economy and a US\$ based export economy, in the hope that the profits and benefits of the export economy would enable China to transform and establish a viable and dynamic domestic market which in time would replace

the export dependent economy. It was a deal made with the devil, but there were no viable alternative options at the material time, more so after the collapse of the Soviet Union.

The Next Level of the Game

The next level of the game was reached when the toilet paper reserve currency literally went virtual – through the simple operation of a click of the mouse in the computers of the global banks.

The big boys at Goldman Sachs and other global banks were more than content to leave Las Vegas for the mafia and their miserable billions in turnover. The profits were considered dimes when compared to the hundreds of trillions generated by the virtual casino. It was a financial conquest beyond their wildest dreams. They even called themselves, “Master of the Universe”. Creating massive debts was the new game, and the big boys could even leverage more than 40 times capital! Asset values soared with so much liquidity chasing so few good assets.

However, the financial wizards failed to appreciate and or underestimate the amount of financial products that were needed to keep the game in play. They resorted to financial engineering – the securitization of assets. And when real assets were insufficient for securitization, synthetic assets were created. Soon enough, toxic waste was even considered as legitimate instruments for the game so long as it could be unloaded to greedy suckers with no recourse to the originators of these so-called investments.

For a time, it looked as if the financial wizards have solved the problem of how to feed the global casino monster.

Unfortunately, the music stopped and the bubble burst! And as they say the rest is history.

The Goldman Sach’s Remedy

When losses are in the US\$ trillions and whatever assets / capital remaining are in the US\$ billions, we have a huge problem – a financial black-hole.

The preferred remedy by the financial masterminds at Goldman Sachs was to create another hoax – that if the big global banks were to fail triggering a systemic collapse, there would be Armageddon. These “too big to fail” banks must be injected with massive amount of virtual monies to recapitalize and get rid of the toxic assets on their balance sheet. The major central banks in the developed countries in cahoots with Goldman Sachs sang the same tune. All sorts of schemes were conjured to legitimize this bailout.

In essence, what transpired was the mere transfer of monies from the left pocket to the right pocket, with the twist that the banks were in fact helping the Government to overcome the financial crisis.

The Fed and key central banks agreed to lend “virtual monies” to the “too big to fail” global banks at zero or near zero interest rate and these banks in turn would “deposit” these monies with the Fed and other central banks at agreed interest rates. These transactions are all mere book entries. Other “loans” from the Fed and central banks (again at zero or near zero interest rates) are used to purchase government debts, these debts being the stimulus monies needed to revive the real economy and create jobs for the growing unemployed. So in essence, these banks are given “free money” to lend to the government at prior agreed interest rates with no risks at all. It is a hoax!

These “monies” are not even the dollar bills, but mere book entries created out of thin air.

So when the Fed injects US\$ trillions into the banking system, it merely credits the amount in the accounts of the “too big to fail” banks at the Fed.

When the system is applied to international trade, the same *modus operandi* is used to pay for the goods imported from China, Japan etc.

For the rest of the world, when buying goods denominated in US\$, these countries must produce goods and services, sell them for dollars in order to purchase goods needed in their country. Simply put, they have to earn an income to purchase whatever goods and services needed. In contrast, all that the US needs to do is to create monies out of thin air and use them to pay for their imports!

The US can get away with this scam because it has the military muscle to compel and enforce this hoax. As stated earlier, this status quo was accepted especially during the Cold War and with some reluctance post the collapse of the Soviet Union, but with a proviso – that the US agrees to be the consumer of last resort. This arrangement provided some comfort because countries which have sold their goods to the US, can now use the dollars to buy goods from other countries as more than 80 per cent of world trade is denominated in dollars especially crude oil, the lifeline of the global economy.

But with the US in full bankruptcy and its citizens (the largest consumers in the world) being unable to borrow further monies to buy fancy goods from China, Japan and the rest of the world, the demand for dollar has evaporated. The dollar status as a reserve currency and its usefulness is being questioned more vocally.

The End Game

The present fallout can be summarized in simple terms:

Should a bankrupt (the US) be allowed to use money created out of thin air to pay for goods produced with the sweat and tears of hardworking citizens of exporting countries? Adding insult to injury, the same dollars are now purchasing a lot less than before. So what is the use of being paid in a currency that is losing rapidly its value?

On the other hand, the US is telling the whole world, especially the Chinese that if they are not happy with the status quo, there is nothing to stop them from selling to the other countries and accepting their currencies. But if they want to sell to the mighty USA, they must accept US toilet paper reserve currency and its right to create monies out of thin air!

This is the ultimate poker game and whosoever blinks first loses and will suffer irreparable financial consequences. But who has the winning hand?

The US does not have the winning hand. Neither has China the winning hand.

This state of affairs cannot continue for long, for whatever cards the US or China may be contemplating to throw at the table to gain strategic advantage, any short term gains will be pyrrhic, for it will not be able to address the underlying antagonistic contradictions.

When the survival of the system is dependent on the availability of credit (i.e. accumulating more debts) it is only a matter of time before both the debtor and creditor come to the inevitable conclusion that the debt will never be paid. And unless the creditor is willing to write off the debt, resorting to drastic means to collect the outstanding debt is inevitable.

It would be naïve to think that the US would quietly allow itself to be foreclosed! When we reach that stage, war will be inevitable. It will be the US-UK-Israel Axis against the rest of the world.

The Prelude to the End Game

The US economy will be spiraling out of control in the coming months and will reach critical point by the end of the 1st quarter 2010 and implode by the 2nd quarter.

The massive US\$ trillions of dollars stimulus has failed to turn the economy around. The massive blood transfusion may have kept the patient alive, but there are numerous signs of multi-organ failure.

There will be another wave of foreclosures of residential and more importantly commercial properties by end December and early 2010. And the foreclosed properties in 2009 will lead to depressed prices once they come through the pipeline. Home and commercial property values will plunge. Banks' balance sheets will turn ugly and whatever "record profits" in the last two quarters of 2009 will not cover the additional red ink.

Given the above situation, will the Fed continue to buy mortgage-backed securities to prop up the markets? The Fed has already spent trillions buying Fannie Mae and Freddie Mac mortgages with no potential substitute buyer in sight. Therefore, the Fed's balance sheet is as toxic as the "too big to fail" banks that it rescued.

In the circumstances, it makes no sense for anyone to assert that the worst is over and that the global economy is on the road to recovery.

And the surest sign that all is not well with the big banks is the recent speech by the President of the Federal Reserve Bank of New York, William Dudley at Princeton, New Jersey when he said that the Fed would curtail the risk of future liquidity crisis by providing a "backstop" to solvent firms with sufficient collateral.

This warning and assurance deserves further consideration. Firstly, it is a contradiction to state that a solvent firm with sufficient collateral would in fact encounter a liquidity crisis to warrant the need for a fall back on the Fed. It is in fact an admission that banks are not sufficiently capitalized and when the second wave of the tsunami hits them again, confidence will be sorely lacking.

Dudley actually said that, "the central bank could commit to being the lender of last resort... [and this would reduce] the risk of panics sparked by uncertainty among lenders about what other creditors think".

To put it bluntly what he is saying is that the Fed will endeavour to avoid the repeat of the collapse of Bear Stearns, Lehman Bros and AIG. It is also an indication that the remaining big banks are in trouble.

It is interesting to note that a Bloomberg report in early November revealed that Citigroup Inc and JP Morgan Chase have been hoarding cash. The former has almost doubled its cash holdings to US\$244.2 billion. In the case of the latter, the cash hoard amounted to US\$453.6 billion. Yet, given this hoarding by the leading banks, the New York Federal Reserve Bank had to reassure the financial community that it is ready to inject massive liquidity to prop up the system.

It should come as no surprise that the value of the dollar is heading south.

When currencies are being debased, volatility in the stock market increases. But the gains are not worth the risks and if anyone is still in the market, they will be wiped out by the 1st quarter of 2010. The S&P may have shot up since the beginning of the year by over 25 per cent but it has been outperformed by gold. The gains have also lagged behind the official US inflation rate. It has in fact delivered a total return after inflation of approximately minus 25 per cent. When Meredith Whitney remarked that, "I don't know what's going on in the market right now, because it makes no sense to me", it is time to get out of the market fast.

In a report to its clients, Soci  t   G  n  ral warned that public debt would be massive in the next two years - 105 per cent of GDP in the UK, 125 per cent in the US and in Europe and 270 per cent in Japan. Global debt would reach US\$45 trillion.

At some point in time, all these debts must be repaid. How will these debts be repaid?

If we go by what Bernanke has been preaching and practising, it means more toilet paper currency will be created to repay the debts.

As a result, debasement of currencies will continue and this will further aggravate existing tensions between the competing economies. And when creditors have enough of this toilet paper scam, expect violent reactions!

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