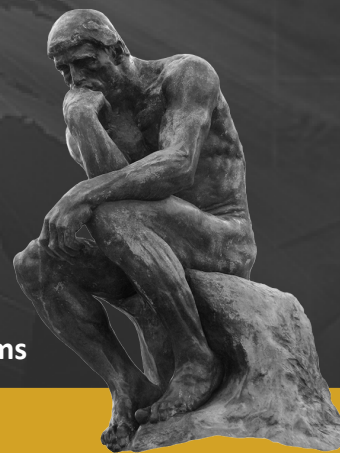


THINGS THAT MAKE YOU GO  
*Hmmm...*

A walk around the fringes of finance

By Grant Williams



27 October 2014

## This Little Piggy Bent The Market

“Never wrestle with a pig. You both get dirty and the pig likes it.”

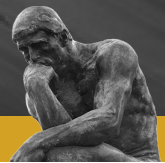
— George Bernard Shaw

“Remember the referendum on the Charlottetown constitutional accord? The more Canada’s political and business elites threatened Canadians that the country would disappear into a black hole if the accord weren’t passed, the more Canadians opposed it.”

— Preston Manning

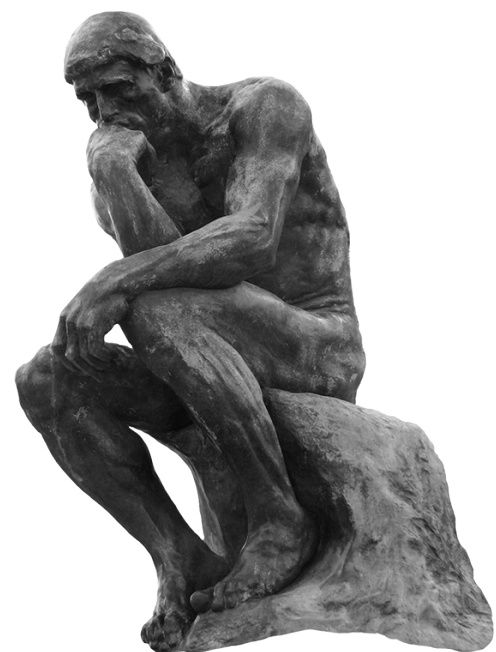
When you’re dealing with Switzerland, Mr. Allon, it’s best to keep one thing in mind. Switzerland is not a real country. It’s a business, and it’s run like a business. It’s a business that is constantly in a defensive posture. It’s been that way for seven hundred years.”

— Daniel Silva, *The English Assassin*



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

About 18 months ago, I had a very pleasant chat with a gentleman by the name of Luzi Stamm.

You may detect some measure of surprise in my words, and the reason for that is quite simple: Luzi Stamm is a politician; and, as regular readers will know, I am no fan of that particular class.

But Herr Stamm was different.

An MP representing the Swiss People's Party, Stamm was spearheading a federal popular initiative which needed 100,000 signatures in order to comply with the Swiss parliamentary system's rigid framework regarding referendums. (OK all you "referenda" people out there, I know, OK? But I'm going with "referendums," so pipe down).

That initiative was one of three being pursued: firstly, a motion to limit immigration into Switzerland to 0.2% per year; secondly, a drive to abolish the flat tax system and for resident, nonworking foreigners to be taxed based instead on their income and their assets; and thirdly, Stamm's initiative... Well, we'll get to that shortly; but before we do, we need to understand a little about how Swiss democracy works.



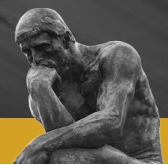
*(Wikipedia): Switzerland's voting system is unique among modern democratic nations in that Switzerland practices direct democracy (also called semi-direct democracy), in which any citizen may challenge any law approved by the parliament or, at any time, propose a modification of the federal Constitution. In addition, in most cantons all votes are cast using paper ballots that are manually counted. At the federal level, voting can be organised for:*

*Elections (election of the Federal Assembly)*

*Mandatory referendums (votation on a modification of the constitution made by the Federal Assembly)*


*Optional referendums (referendum on a law accepted by the Federal Assembly and that collected 50,000 signatures of opponents)*

*Federal popular initiatives (votation on a modification of the constitution made by citizens and that collected 100,000 signatures of supporters)*



*Approximately four times a year, voting occurs over various issues; these include both referendums, where policies are directly voted on by people, and elections, where the populace votes for officials. Federal, cantonal and municipal issues are polled simultaneously, and the majority of people cast their votes by mail. Between January 1995 and June 2005, Swiss citizens voted 31 times, to answer 103 questions (during the same period, French citizens participated in only two referendums)*

In Swiss law, any popular initiative which achieves the milestone of 100,000 signatures MUST be put to the citizens of the country as a referendum, and in a country of just 8,061,516 people (according to the July 2014 count – never let it be said that the Swiss aren't precise), that's a pretty big ask; but the Swiss do love their votes – so much so that, since 1798, there has been a seemingly never-ending procession of issues which the Swiss people have been entrusted by their leaders to decide:

V · T · E	 Elections and referendums in Switzerland <span>[hide]</span>
<b>Parliamentary elections</b>	1848 · 1851 · 1854 · 1857 · 1860 · 1863 · 1866 · 1869 · 1872 · 1875 · 1878 · 1881 · 1884 · 1887 · 1890 · 1893 · 1896 · 1899 · 1902 · 1905 · 1908 · 1911 · 1914 · 1917 · 1919 · 1922 · 1925 · 1928 · 1931 · 1935 · 1939 · 1943 · 1947 · 1951 · 1955 · 1959 · 1963 · 1967 · 1971 · 1975 · 1979 · 1983 · 1987 · 1991 · 1995 · 1999 · 2003 · 2007 · 2011 · 2015
<b>Referendums</b>	1798 · 1802 · 1848 · 1866 · 1872 · 1874 · 1875 · 1876 · 1877 · 1879 · 1880 · 1882 · 1884 · 1885 · 1887 · 1889 · 1890 · 1891 · 1893 · 1894 · 1895 · 1896 · 1897 · 1898 · 1900 · 1902 · 1903 · 1905 · 1906 · 1907 · 1908 · 1910 · 1912 · 1913 · 1914 · 1915 · 1917 · 1918 · 1919 · 1920 · 1921 · 1922 · 1923 · 1924 · 1925 · 1926 · 1927 · 1928 · 1929 · 1930 · 1931 · 1933 · 1934 · 1935 · 1937 · 1938 · 1939 · 1940 · 1941 · 1942 · 1944 · 1945 · 1946 · 1947 · 1948 · 1949 · 1950 · 1951 · 1952 · 1953 · 1954 · 1955 · 1956 · 1957 · 1958 · 1959 · 1960 · 1961 · 1962 · 1963 · 1964 · 1965 · 1966 · 1967 · 1968 · 1969 · 1970 · 1971 · 1972 · 1973 · 1974 · 1975 · 1976 · 1977 · 1978 · 1979 · 1980 · 1981 · 1982 · 1983 · 1984 · 1985 · 1986 · 1987 · 1988 · 1989 · 1990 · 1991 · 1992 · 1993 · 1994 · 1995 · 1996 · 1997 · 1998 · 1999 · 2000 · 2001 · 2002 · 2003 · 2004 · 2005 · 2006 · 2007 · 2008 · 2009 · 2010 · 2011 · 2012 · 2013 · 2014

Source: [Wikipedia](#)

In 2014 alone there have already been three referendums concerning such diverse issues as the minimum wage, abortion, and the financing and development of railway infrastructure. (For those of you just dying to know the outcomes, the abortion referendum, which would have dropped abortion coverage from public health insurance, failed by a large margin, with about 70% of participating voters rejecting the proposal. The railway financing was approved by 62% of the voters, and the motion that would have given Switzerland the highest minimum wage in the world – 22 francs (\$23.29) an hour – was soundly defeated, with 76% of the voters saying “nein.”)

One wonders what the outcome would be of a similar motion to hike the minimum wage to such lofty heights in the US. Or in Great Britain.

The bottom line? The Swiss just think (and, importantly, vote) differently.

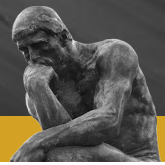
But back to Luzi Stamm and the SPP initiative.

Immigration and taxes aren't uppermost in Stamm's mind. What he IS concerned about is gold.

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When we spoke on the telephone last year, Stamm explained to me that he hadn't really properly understood the part gold played in the Swiss monetary equation until he'd had it explained to him by a friend more versed in finance (Stamm is a lawyer by background but with an economics degree from the University of Zurich); but once he understood how it all worked, Stamm realized that the changes to Swiss monetary prudence which had occurred in just a few short years were (a) potentially disastrous for the country and (b) not remotely understood by his countrymen (and women).

So Stamm decided he ought to do something about it.

The Swiss had accumulated a significant gold reserve the old-fashioned way – through seemingly constant current account surpluses – over many decades, but in May 1992 they finally joined the IMF.

Once THAT little genie was unleashed, things began to change.

In November of 1996, the Swiss Federal Council issued a draft for a new Federal Constitution, and contained within that draft was an amended position on monetary policy (article 89, in case you're wondering) which severed the Swiss franc's link to gold and reaffirmed the SNB's constitutional independence:

*Money and currency are a federal matter. The Confederation shall have the exclusive right to coin money and issue banknotes.*

*As an independent central bank, the Swiss National Bank shall follow a monetary policy which serves the general interest of the country; it shall be administered with the cooperation and under the supervision of the Confederation.*

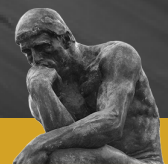
*The Swiss National Bank shall create sufficient monetary reserves from its profits.*

*At least two-thirds of the net profits of the Swiss National Bank shall be credited to the Cantons.*

Spiffy.

In April 1999, the revision of the Federal Constitution was approved (how else than through a referendum?), and it came into effect on January 1, 2000.

Oh... sorry... I almost forgot to mention that in September 1999 – after the revision had been adopted but before it had been officially enacted – the SNB became one of the signatories to the Washington Agreement on Gold Sales, meaning that all that lovely Swiss gold which had been sitting there, steadily accumulating and making the Swiss franc one of the last remaining “hard” currencies on the planet, was eligible to be sold.



A single line in the Swiss National Bank's own history of monetary policy identifies the beginning of the demise of one of the world's great currencies:

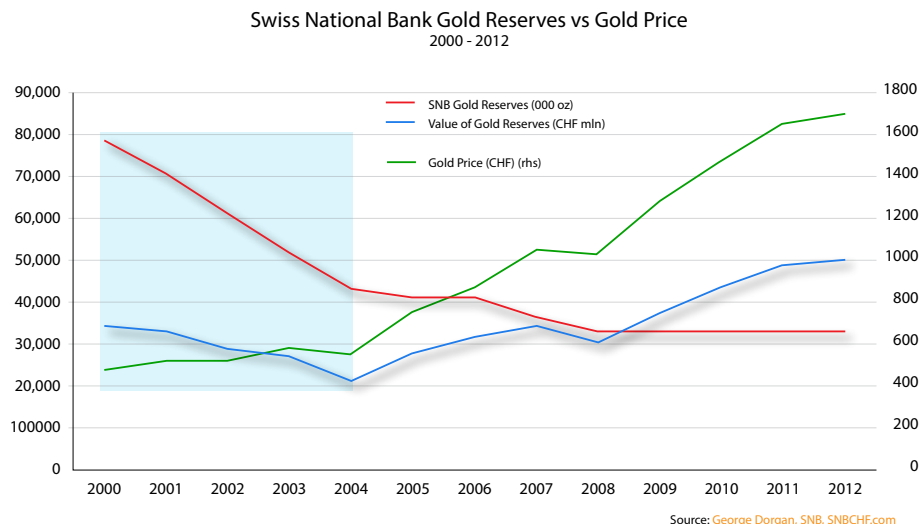
*On 2 May, the SNB begins selling gold holdings no longer required for monetary policy purposes.*

And there you have it. "No longer required for monetary policy purposes."

That's what happens when you finally embrace the beauty of fiat. Not only do you get to sell gold, you get to call the proceeds of those sales "profits."

The absurdity borders on breathtaking.

At the beginning of 2000, the Swiss National Bank (SNB) held roughly 2,600 tonnes of gold in its reserves. That equated to approximately 8% of total global central bank gold reserves. After the revised constitution became law, the Washington Agreement took over and... Bingo!:

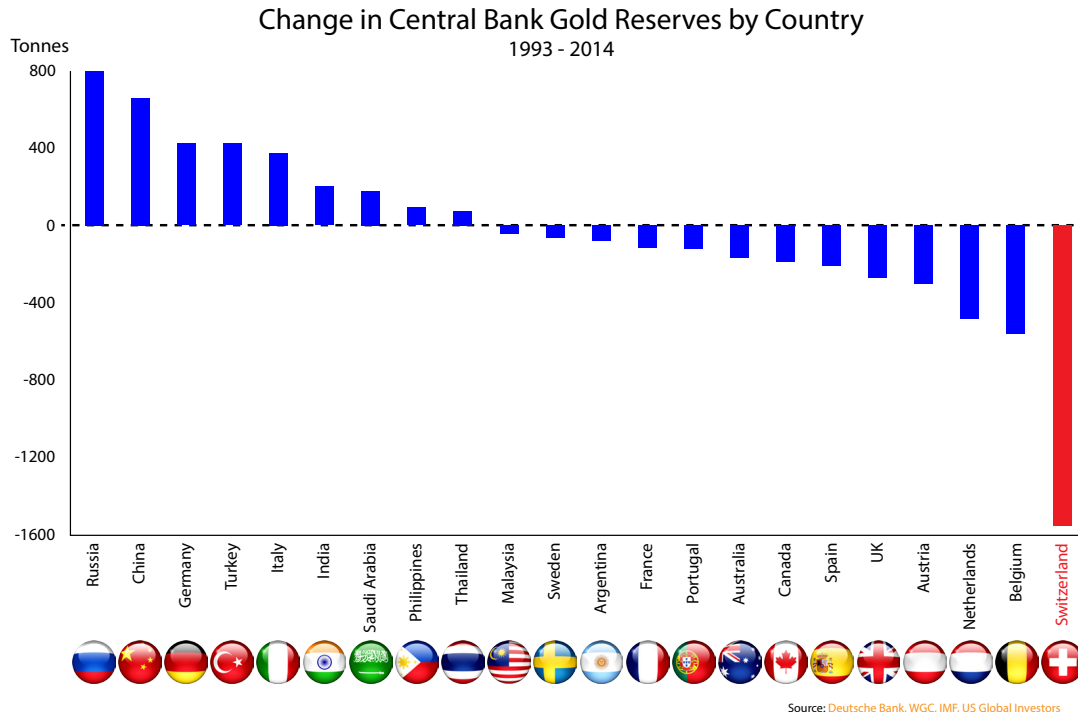


Swiss gold reserves were ~~plundered~~ gently sold in line with the Washington Agreement, and the "profits" (the language used by the SNB themselves) were distributed amongst the Swiss cantons; so everybody in a position to raise questions ended up getting a nice, fat slug of "profit" to ~~keep them quiet~~ help their Canton pay the bills.

Now, does anyone notice anything particular about the period when the Swiss gold sales were at their highest? Yessss... that's right (as with the UK's sales), the bulk of Swiss sales were made at the lows in the gold price (between \$300 and \$500 per ounce – blue shaded area).

To look at it another way, the Swiss National Bank went from being one of the soundest central banking institutions on Earth to just another in the **morass** of apologist financial institutions that lost sight of their mandates while grasping for a Keynesian free lunch, egged on by a new breed of politicians who knew nothing of the principles of sound money or, if they did, were happy to put them to the back of their minds as they extended their hands.

Sadly, as went the soundness of the SNB, so went the soundness of the Swiss franc itself.



As you can see from the chart above, the SNB has, over the last two decades, oustripped its nearest rival in gold sales by a factor of three.

Adding to the fun and games was the decision in September 2011, at the height of the euro crisis, to peg the Swiss franc to the euro (something that obviously couldn't have been done prior to breaking the gold peg) in order to stop it appreciating.

How? Why through literally unlimited printing of Swiss francs to stop the exchange rate breaking 1.20.

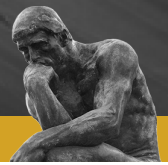
At the time, the SNB was unequivocal:

*The current massive overvaluation of the Swiss franc poses an acute threat to the Swiss economy and carries the risk of a deflationary development. The Swiss National Bank is therefore aiming for a substantial and sustained weakening of the Swiss franc.*

All this talk of "massive overvaluation of the Swiss franc" is utter bollocks a little disingenuous. ("Surely not!" I hear you cry.)

Between 1970 and 2008, the strength of the Swiss franc was legendary. During that time, it appreciated by 330% against the US dollar and by 57% versus the Deutsche mark/euro. Consequently, a strong currency went hand-in-hand with a strong economy. How awful.

The problem was NOT in the OVERvaluation of the Swiss franc, as the SNB would have you believe, but rather in the UNDERvaluation of the competition; and the only thing the SNB could do was to join in the great devaluation race.

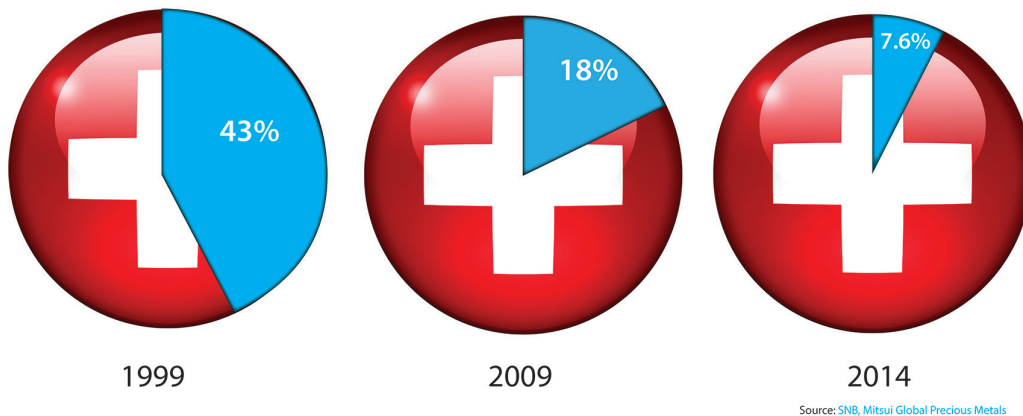


That move weakened the currency by about 9% in 15 minutes, and the immediate effect on the SNB's balance sheet was obvious:

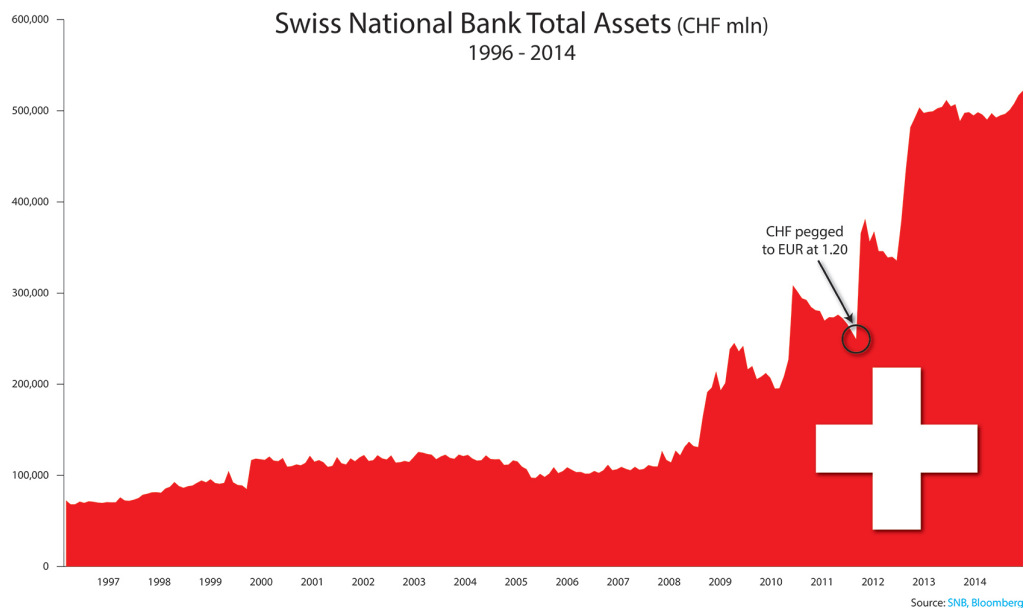
*(Mitsui Global Precious Metals): As late as the end of 2009, the SNB held 38.1 billion CHF in gold out of total reserves of 207.3 billion CHF, with gold representing a touch over 18 per cent of all its reserves. At the end of July 2014, it owned 39.1 billion Swiss Francs in gold (or 1,040 tonnes) from total reserves of 517.3 billion CHF, meaning that roughly 7.6 per cent of its assets were in the form of the yellow metal.*

Note that the rise in value of Swiss gold by CHF 1 billion wasn't enough to counter the destructive nature of overt and unchecked money printing.

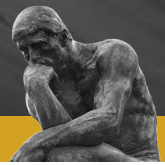
Gold as % of Total Swiss Reserves  
1999 vs 2009 vs 2014



Like the Fed, the BoJ, and the BoE before them, the SNB became, at a stroke, another previously sound institution that unhesitatingly ripped its balance sheet to shreds:







Since 2009, the SNB has quintupled its balance sheet, making it (on a relative basis) the most prolific of the central bank printing machines. Not bad for the world's 96th-largest nation.

Since the EUR peg was instituted just three years ago, the SNB's balance sheet has more than doubled.

So, with the Swiss franc's soundness under attack from within its own borders, Luzi Stamm decided to try to use the Swiss love for referendums and the rigidity of the Swiss political process to try to reinstate the Swiss franc as a sound currency.

To that end, Stamm proposed the Swiss Gold Initiative ("Save Our Swiss Gold").

Funnily enough, the proposal was rejected by lawmakers, but Stamm gathered three like-minded MPs and, more importantly, enough signatures on his petition (100,000) to ensure that a referendum on the proposal would take place; and that vote will happen on November 30th – six weeks from now.

Stamm pulled off a masterstroke in securing the involvement in the Swiss Gold Initiative of Egon von Greyerz who, along with being one of the most highly respected figures in the gold industry, happens to be one of the world's nicest human beings.

We'll get to Egon's involvement shortly, but first let's take a look at the motions that make up the Swiss Gold Initiative, which are threefold:

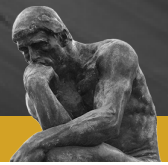
1. *The gold of the Swiss National Bank must be stored physically in Switzerland.*
2. *The Swiss National Bank does not have the right to sell its gold reserves.*
3. *The Swiss National Bank must hold at least 20% of its total assets in gold.*

*(NB. Before we get to the part of this story where the SNB tell us how big a nightmare it would be to force them to hold 20% of their reserves in gold (come on, you KNEW that was coming), I'd point you back to the chart on page 8. Remember? The one that showed the Swiss held 18% of their reserves in gold just five short years ago?)*

Addressing the motions in order, let's begin with number 1, that all Swiss gold be physically stored in Switzerland.

Switzerland has made its name over centuries as being one of the safest places on the planet to store gold. That reputation has been good enough to convince people from all over the world to entrust their gold to the Swiss for safe-keeping. However, like many other central banks, the SNB stores a certain proportion of its gold overseas. How much? We don't know. Where exactly is it held? We have no idea (other than "in the UK & Canada"). In fact, when the finance minister was asked, in parliament, where Switzerland's gold was stored, his answer was something of a head scratcher:

*Where this gold exactly is stored, I cannot say, because I do not know, because I do not need to know, and because I do not want to know.*



Riiiiight... Call me old-fashioned, but if I were a Swiss national I'd want a better answer than that.

Anyway, the ~~spurious~~ reason commonly given by central bankers for storing gold in places like London or New York is to have it “close to the marketplace should sales be necessary.” Obviously, if the Swiss are forbidden from selling their gold and are bound to hold a minimum of 20% of their gold reserves in gold, that argument becomes moot anyway, so shipping it home should be nice and straightforward. Just find out where “in the UK and Canada” it is (I'm sure they gave you a receipt), call them up, and tell them you'd like it back. Now that you've sold more than 50% of the gold, it shouldn't take too long to physically move the rest home. Surely?

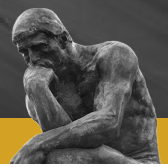
Number 2 on the initiative's wishlist is that the SNB be prohibited from selling their gold reserves. Now, THAT might be a problem for the SNB in times to come in the “ordinary conduct of monetary policy,” but as we are some ways away from a world in which “ordinary” features in any way, shape, or form where monetary policy is concerned, I don't think this prohibition is going to matter much. However, if you think this initiative isn't being taken seriously, you just have to look at an excerpt from a speech given by the governor of the SNB, Thomas Jordan, a matter of days after the Swiss Gold Initiative achieved the 100,000 signatures it required to qualify as a referendum.

If you lean in real close, you can smell the fear:

*(Thomas Jordan, speech to general meeting of shareholders of the Swiss National Bank, 26 April 2013): The SNB does not generally comment on any political initiatives. However, the gold initiative has a very direct impact on the SNB's capacity to act. This is why we are taking the opportunity today to present our viewpoint for the first time on the demands of the initiative.*

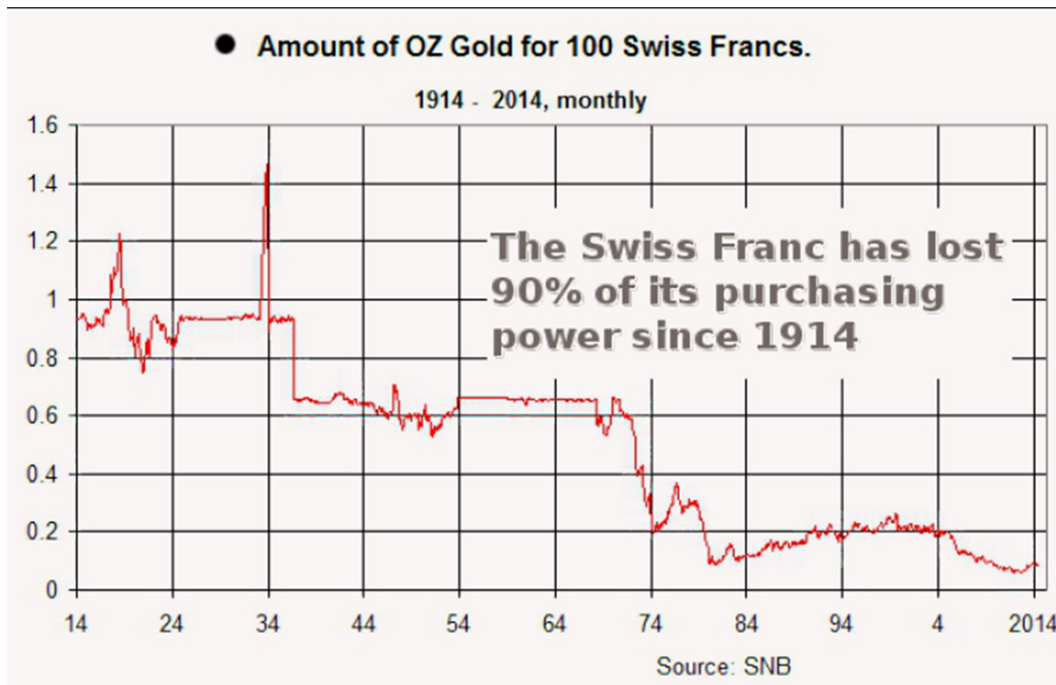
*The initiators see a high level of gold reserves as a guarantee for currency stability. They fear that the Swiss franc will decline in value and that price stability will be threatened if a large proportion of the balance sheet does not consist of gold holdings. They are also concerned that the SNB's gold reserves held abroad are not secure and will not be accessible in critical situations.*

*We share the objectives the initiators put forward, such as maintaining currency and price stability and ensuring both the SNB's capacity to act and its independence. However, the measures proposed to this effect are not suitable; in fact, they are even counterproductive. Instead, they are based on misunderstandings about the importance of gold in monetary policy and would compromise the SNB's capacity to act in pursuing its monetary policy, which would run counter to the objectives envisaged. In other words, these measures would, in certain situations, considerably hinder the SNB in fulfilling its monetary policy mandate and be detrimental to Switzerland. We therefore consider it our duty to point out the serious disadvantages of the initiative already at an early stage.*



Thomas, if I may?

The SNB's desire to "maintain currency and price stability" can be summed up by this chart, which will be all too familiar to those who have studied the fiat currencies of the world, but it obviously needs trotting out one more time:



As for the SNB's capacity to act in "pursuing monetary policy," what the Gold Initiative will do is effectively stop them from printing unlimited amounts of Swiss francs in order to keep the once-mighty Swiss franc pegged to a potentially obsolete currency like the euro.

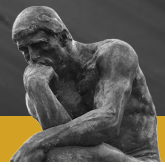
Now, I am simplifying here in the interest of expediency, and I am well aware of the restrictions that any kind of gold standard places on a central bank's operational capability, but it's important to understand that the Swiss franc functioned perfectly well as a partially gold-backed currency up until 1999, and the desire of the SNB to have *carte blanche* to ~~debase the Swiss franc~~ at will more flexibility in their monetary policy comes down to their wanting to employ the same tactics being resorted to by the world's other major central banks.

If you can't beat 'em, join 'em.

All of which leads us to perhaps the most fascinating part of the Swiss Gold Initiative: the motion to ensure that the SNB immediately acquires enough gold to back 20% of its reserves (a threshold which it must then maintain as a minimum — at a level, you know, about where they were in 2009).

Now, the numbers around this little piece of the puzzle are interesting.

In order to reach the 20% threshold, the SNB has two options open to them: they can either reduce the size of their balance sheet or buy gold.



In life, there are many limbs out onto which one should never venture, but I'm prepared to dance out onto this one like Billy Elliot:

***The SNB will NOT reduce the size of their balance sheet in order to meet the 20% mandate should the motion be passed.***

There. Quote me on that.

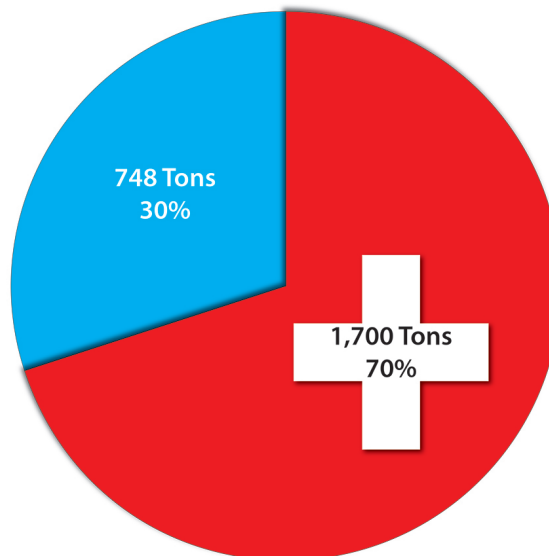
And we all know what THAT leaves, don't we boys and girls?

Yes, in order to meet the regulations should the Gold Initiative pass, the SNB will need to buy 1,700 tons of gold at the market (assuming, of course, that they don't expand their balance sheet further in the meantime – something that, with the increasingly weak euro, is doubtful in the extreme). That equates to roughly \$70 billion or CHF 67 billion.

And we are talking physical gold. Not futures contracts or complex derivatives but the metal itself.

Put another way, 1,700 tons of gold is roughly 70% of total annual gold production.

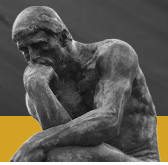
Swiss Gold Initiative Requirement  
as % of Annual Global Gold Production



Source: WGC, SNB, SGI

Now, the SNB will have five years in which to reach the required 20% limit, but they will essentially need to get started immediately, because with the floor such a big buyer will put under the price and the constant expansion of their balance sheet due to that pesky euro peg, the longer they wait, the more gold they will have to buy and the less they will get for their money.





Catch Zweiundzwanzig.

How's your attention? Grabbed yet?

OK, good.

Until now, the whole idea of this hokey little referendum has been written off as inconsequential and largely ignored by all but the most buggy of gold bugs. It was written off when Luzi Stamm announced it. It was written off when they needed to get 100,000 signatures; and, amazingly, it was ignored even once they HAD reached the magic number; but recently a number of things have happened which are making some serious waves and causing considerable unease amongst the Swiss banking establishment.

While in San Antonio recently, I was fortunate enough to chat with a displaced fellow Brit who came to meet me at the Casey Summit to talk about the Swiss Gold Initiative, and what he had to say fascinated me.

The gentleman explained a few of the nuances surrounding the framework within which the vote on the Gold Initiative will be conducted, and as I listened I realised that this little vote could potentially become a very big vote indeed.

Firstly, he noted the fact that there isn't any "no" campaign running against the initiative. Not one that actively campaigns, at least. There will be no billboards, posters, or leaflets distributed making the case for a vote *against* the SGI. Thus, it's basically up to the organizers of the initiative to get the word out and educate the Swiss public about the importance of what they're trying to do in a vacuum.

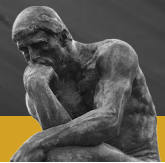
That, of course, requires money.

During these campaigns, there is no TV or radio advertising allowed, only an old-fashioned leaflet/poster/billboard campaign (how very Swiss), which is an expensive operation to have to finance.

However, a curious quirk of Swiss politics allows anybody (and I mean ANYBODY) to make a donation to campaigns such as these from anywhere in the world – with 100% anonymity.

As our conversation continued, I learned that the initiative plans to blanket the country with billboards, posters, and leaflets and to conduct a comprehensive social media campaign to engage the vital 18-44 demographic – a strategy completely new to the somewhat antiquated world of Swiss politics.

All this felt like it was going to be rather expensive for such a small campaign, but with the donation system certainly helping their chances, Stamm & friends embarked upon their fundraising venture; and, as I mentioned previously, their first move was a masterstroke.



Over the past several years, I have been extremely fortunate, through regular encounters around the world, to have found myself in a position to call Egon von Greyerz my friend.

Egon is a wonderful man with a keen intellect, a great sense of humour, and a code of ethics which is utterly above reproach. He is also now the “face” of the Swiss Gold Initiative to the gold industry.

I recently chatted with Egon about the progress being made, and what he had to say was fascinating:

*Switzerland now has the opportunity to be the first country in the world with official partial gold backing of its currency. A currency backed by gold means the government and the central bank cannot manipulate the currency at will and print worthless pieces of paper that they call money. This would stabilise the real value or purchasing power of the Swiss franc. A currency with stable purchasing power leads to stable prices and promotes savings and investment rather than spending and credit. Officially Switzerland, like most countries, has a low inflation rate; but for the average person, consumer prices in the shops for food and other necessities continue to rise.*



*Even though the official Swiss inflation is low, there is massive inflation in some sectors like housing and financial assets. The money printing in Switzerland combined with artificially low interest rates have led to a major housing bubble.*

*Swiss housing prices are now unaffordable for most Swiss and in relation to income prices are now in an unsustainable bubble. An increase of Swiss mortgage rates from current 1-2% per annum to a more normal 4% could lead to major mortgage defaults and a housing collapse.*

*The Swiss have a history [of] putting some of their savings into the Vreneli, the Swiss 20 franc gold coin. In recent times, as spending on credit rather than savings has been the norm, the Swiss have bought less gold, but in spite of that they have more affinity with gold than most Western nations. The Swiss gold industry is also very significant, since Swiss refiners produce nearly 70% of the world's gold bars.*

*The most prolific savers in gold are of course the Indians, mainly by buying jewelry. But in the last few years China has been the biggest buyer of gold. There is a constant flow of gold going from the West to the East. This has created a shortage of gold in the West.*

*The government and SNB will be very concerned about the poll results and will intensify their propaganda concerning how bad this would be for Switzerland. But as you know, the Swiss are an independent lot and don't like the government telling them what to do. It will be extremely interesting.*



Interesting indeed.

The poll that Egon refers to is the next of those things that are making waves.

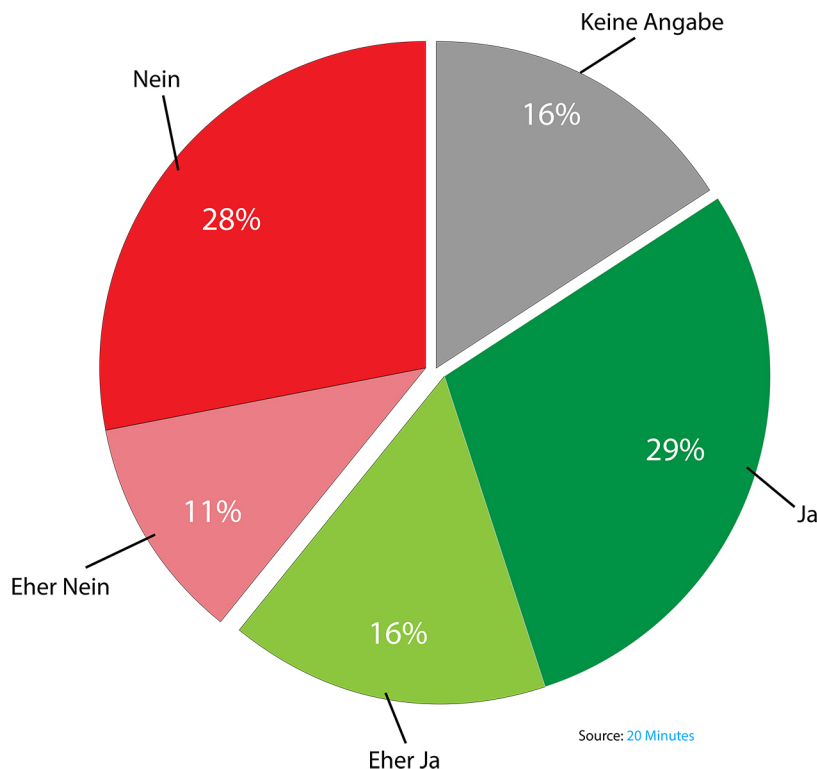
The official press launch of the SGI campaign was held this past week, with Luzi and his committee and Egon speaking to the Swiss media; but AHEAD of that launch, a poll was conducted in *20 Minutes*, a popular German-language free daily newspaper published both in print and online.

The question asked was simple: “How will you vote in the upcoming Save Our Swiss Gold referendum?”

The results were a surprise to just about everybody – including Luzi and Egon.

A total of 13,397 people were polled from all across Switzerland on October 15, and the poll clearly demonstrated that already – without any campaigning – there is a solid block of voters inclined to vote FOR the initiative:

### 20 Minutes Poll on Swiss Gold Initiative

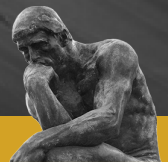


“How will you vote in the Save Our Swiss Gold referendum?”

#### Handy Swiss/English Translator:

Ja	=	Yes
Eher Ja	=	Probably Yes
Nein	=	No
Eher Nein	=	Probably No
Keine Angabe	=	Undecided

With the establishment being unable to actively campaign AGAINST the Initiative, all has been quiet for many months (which is why you probably haven’t heard anything about the SGI); but with the dawning awareness that this little campaign might actually grow some legs, a few members of that establishment have been getting a little antsy.



Firstly, last year when the proposal was tabled in parliament, we had this reaction:

*(Centralbanking.com): Switzerland's upper house gave the thumbs down to a controversial proposal yesterday that would force the Swiss National Bank (SNB) to more than double its gold holdings by requiring the bank to permanently hold 20% of its assets in bullion – but the rule could still ultimately become law in a popular referendum later this year.*

*The “gold initiative”, the brainchild of the right-wing Swiss People's Party (SVP), which also calls for SNB gold to be repatriated to Switzerland – much of it is currently stored in London, New York, and Canada – is slated for a public referendum after the SVP secured 100,000 signatures in support of the measures last year.*

*Switzerland's political establishment, however, remains vehemently opposed, fearing a gold quota would severely undermine the SNB's ability to carry out its mandate – and their case has been helped by the poor performance of the metal over the past year.*

*Speaking before the upper house yesterday, finance minister Eveline Widmer-Schlumpf warned the “credibility of monetary policy” would be “greatly impaired” if the floor was introduced. She also described gold as “among the most volatile” and “riskiest investments” on the central bank's books. The SNB took a \$16 billion loss on its gold holdings last year as prices fell 30% – contributing significantly to a Sfr9.1 billion loss on total assets, as shown by data released by the bank today.*

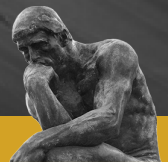


*SNB governor Thomas Jordan has also slammed the idea, arguing it would severely restrain the SNB's policy choices by restricting the flexibility of its balance sheet. In a worst-case scenario, he warned last April, the assets side of the SNB's balance sheet would over time be largely comprised of unsellable gold, which could force the bank to turn to money creation to finance its expenses.*

*“For the SNB to fulfil its mandate at all times, its capacity to act in monetary policy matters must not be compromised by rigid rules on the composition of its balance sheet,” Jordan stressed.*

It's laughable, actually.





No word from the finance minister on the huge potential **gains** which were foregone when the SNB sold their gold at the lows (gains which, at today's prices, would have been in the region of CHF 27.5 bn). No. We won't mention those. Nor will we even bother to go anywhere near Jordan's fears that the SNB might be "forced" to (GASP!) "turn to money creation to finance its expenses."

No. We'll leave those well alone and instead visit a "dossier" opened by the SNB on its website a couple of weeks ago as the realization dawned upon them that the SGI won't just "go away" if they don't talk about it:

*(Centralbanking.com): ...Now, with less than two months until the vote, the central bank is intensifying its communication. It opened a "dossier" on its website yesterday where it will post materials outlining why it "reject[s] the initiative".*

*"Monetary policy transactions directly change our balance sheet. Restrictions on the composition of the balance sheet therefore restrict our monetary policy options," [SNB Vice-chairman Jean-Pierre] Danthine explained.*

*"A telling example is our decision to implement the exchange rate floor vis-à-vis the euro... with the initiative's legal limitation in place, we would have been forced during our defence of the minimum exchange rate not only to buy euros but also to buy gold in large quantities.*

*"Our defence of the minimum exchange rate would thus have involved huge costs, which would almost certainly have caused foreign exchange markets to doubt our resolve to enforce the rate by all means."*

Sometimes I think these people are completely delusional.

So, let me get this straight: gold is a relic which restricts your ability to do such vital things as... oh, I dunno, promise to print unlimited amounts of your currency in order to peg it to another, failing currency and thereby debase it by 9% in 15 minutes? Or it might mean the market doesn't have complete faith that you might be completely relied upon to do really smart things like that?

Disaster!

Somebody. Please? Make it stop.

The Swiss establishment has been reliant upon the public's ignorance in these matters, but now they are up against a formidable opponent in Egon von Greyerz. Not only that, but they can clearly see that, as elsewhere around the world, the public is fast becoming disenchanted with the status quo; and that is potentially very dangerous for these people.



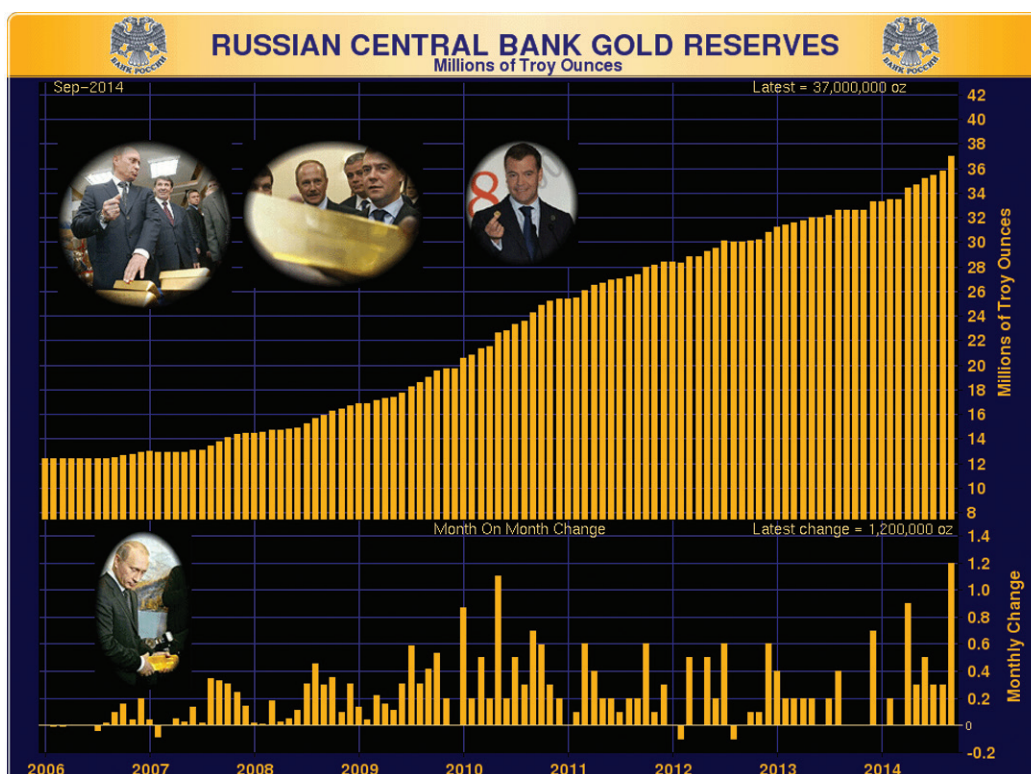
What is important to understand here is that if the initiative passes it will be part of the Swiss constitution IMMEDIATELY – not in two years, as many blogs and websites are suggesting. This means that the government and parliament cannot touch it. Only another referendum can change it. This is proper democracy for you.

The closer we get to the vote on November 30, the bigger this story is going to become, and the bigger it becomes, the higher the chance that the yes vote wins.

Should that happen, it will undoubtedly set off alarm bells throughout the gold market, as yet more physical gold will need to be repatriated and another sizeable, price-insensitive buyer will enter the marketplace.

Curiously, as awareness of this initiative has risen in the last month or so, two strange things have happened in the gold markets, one in the murky world of central bank gold operations, the other in the equally murky world of China's Shanghai Gold Exchange.

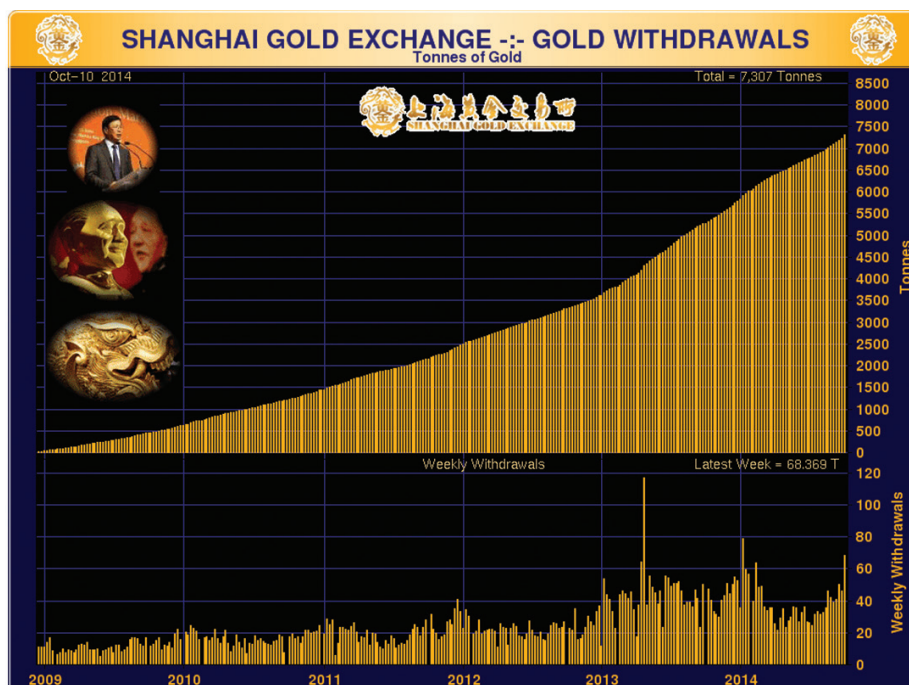
Firstly, the Russian central bank (which, unlike its Western counterparts, happily publishes its dealings in the gold market for the entire world to see) made its biggest monthly purchase in 15 years in September when they purchased 1.2 million ounces:



Source: [www.sharelynx.com](http://www.sharelynx.com)



While in China, withdrawals from the Shanghai Gold Exchange suddenly spiked to 68.4 tonnes (the third-highest level on record):



Do either of these moves have anything to do with pre-positioning ahead of the Swiss referendum outcome? I have absolutely no idea.

What I DO know, though, is this:

Most people have written the SGI off as a sideshow of little consequence. Most people assume that it won't get passed. Most people assume that, if it IS passed, it won't make any real waves.

I think most people are wrong.

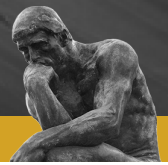
I think there is a VERY good chance the motion will get passed; and I think that, when it does, it will spark calls for similar actions in neighbouring countries such as Austria, for example, or maybe the Netherlands.

I also think that the physical gold market is far too tight to be able to handle any sudden widespread demand for large-scale repatriations of gold.

This story is going to be getting more attention in the coming weeks. Already, Rick Santelli has spoken about it on CNBC, and so has Eric King in a tremendous interview (which you can listen to [here](#)), and this is only the beginning. More polls will follow, as will increasingly desperate rhetoric from the SNB.

Amidst it all, calm and confident will be my friend Egon and the tenacious Herr Stamm.

Don't bet against them.



The official website for the Swiss Gold Initiative is [here](#):

And if you'd like to make a completely anonymous donation in any amount to help the initiative fund their campaign to restore sound money at the heart of Europe, then click [HERE](#).

At the top of the page, you'll see a button marked "Donate." (I've done it and it's easy — oops, there goes my anonymity.)



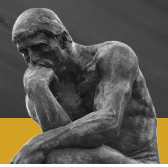
Oftentimes, it's movements like the Swiss Gold Initiative that cause ripples which change things for the better, and I have a feeling that the time is ripe for an unexpected outcome.

Either way, I think you'll be seeing a lot more of this little piggy in the days and weeks to come.



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**OK** ... well, that went on longer than I'd planned, I'm afraid, but I think it's an important story for you to keep an eye on. It's not, however, the only one.

Greece is back and it's the most unwelcome return of that word since Michelle Pfeiffer and Adrian Zmed took over from Olivia Newton-John and John Travolta. This is a movie we've seen before, and last time it had an extremely unhappy ending.

The German economy is starting to stall, which is leading to a few calls for "something" to be done (OK); we look at the run-up to what is turning into a very closely fought election in Brazil (the results should be coming in as this week's TTMVGH hits your inbox); and Jim Chanos shares a lesson he learned in 1987 that has stood him in good stead ever since.

Cliff Asness brilliantly takes Paul Krugman to task over inflation (the line about the skunk and the tennis racket is worth the price of admission on its own); Liam Halligan explains why panic moneyprinting cannot save the euro; and in China we find that the housing market is starting to cause the kind of concern reserved for times when prices in 69 of 70 cities drop simultaneously.

Pater Tenebrarum answers the question of whether Ebola is a black swan; the brilliant Worth Wray lays out "A Scary Story for Emerging Markets" just in time for Halloween; and we have charts of Chinese ghost towns and Chinese red tape as well as an interview with Egon von Greyerz about the SGI, a statement read to the Swiss parliament by MP Lukas Reimann, and a word on the madness of today's markets by Bill Fleckenstein.

## Until Next Time...

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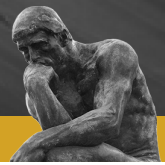
## Greece's latest woes signal next stage of the eurozone crisis

If Greece is the canary in the coal mine, then we are all in trouble. Interest rates on Greek debt have jumped in recent days, rocketing to around 9pc on 10-year bonds, an unsustainable financing cost for such a troubled government.

The last time this sort of thing happened, in 2010, the eurozone was soon plunged into near-fatal crisis. Four years later, the debt crisis in the eurozone's periphery was meant to be over, so Greece's sudden relapse is one reason why so many equity, bond and commodity investors are running for the hills.

Unlike last time, no hidden debt has been discovered, and Greece's budget deficit has actually fallen significantly.

While not quite a model student, Greece had at least been trying to mend its ways. The proximate trigger for the surge in bond yields is that the Athens government had been over-exuberant since the start of the year, hoping to leave the bail-out programme early, partly for the wrong, anti-austerity reasons.



None of this will now happen, and the European Central Bank has promised to help out, which may temporarily calm matters down.

The stark reality is that Greece is not out of the woods, contrary to what many had claimed — yet its crisis is containable. Its economy is too small; even under a worst-case scenario it would not be able to take down the whole of the eurozone.

But what this latest flare-up confirms is that merely reducing budget deficits is not enough. Having an excessive national debt remains a major problem, especially now that economists are slashing their growth forecasts for the eurozone as a whole and continent-wide deflation is looming. In such a Japanese-style scenario, the traditional debt-eroding mechanisms of inflation and growth no longer apply.

Falling prices — caused by a defective, one-size-fits-all monetary policy, and thus insufficient demand — will push up debt ratios as a share of GDP, especially when economic output is stagnating at best. As Capital Economics points out, any eurozone country with high and rising debt ratios is vulnerable; Italy and Portugal, which both have debt to GDP ratios of about 130pc, could be next in the firing line. Once again, excess debt is the problem — though this time, burdens are rising for partly different reasons.

The euro has seen its value slide by 5pc against a trade-weighted basket of currencies since March, with Citigroup predicting that the total depreciation will hit 10pc over the next 12 months. In the past, this would have generated a 5pc boost to exports, translating to a 1pc rise in GDP over three years.

Sadly, the impact this time around is likely to be far more muted. Demand for the sorts of goods the eurozone exports has weakened significantly. A greater share of the value of the region's exports is in turn made up of imported components or raw materials, limiting the beneficial impact of the weaker euro, Citigroup correctly points out.

Firms will most likely make use of the weaker euro to increase their margins whenever possible, as their Japanese counterparts did recently when the yen lost some of its value....

\*\*\* ALLISTER HEATH / [LINK](#)

## A nail-biter

BY THE time Brazilians pick their president on October 26th they will have few nails left to bite. Three polls published on the eve of the tightest and tetchiest election Brazil has ever seen suggest the race will go to a photo-finish. After trailing Aécio Neves, of the centre-right Party of Brazilian Social Democracy (PSDB), by a whisker, the left-wing incumbent, Dilma Rousseff this week opened up a sizeable six-to-eight point lead. But on the final straight Mr Neves has picked up pace. He still trails by four and six points in surveys by two most reputable pollsters, IBOPE and Datafolha, respectively. But momentum seems once again to be with him.



Mr Neves (whom The Economist has endorsed in this election) has shown a knack for confounding expectations. As Marina Silva, a charismatic centrist, soared in the polls, he looked out of the running. Then, in an unprecedented surge days before the first round on October 5th, propelled by an assured performance in an important televised debate and the PSDB's tireless canvassing, he leapt past Ms Silva and into the run-off. On polling day he notched up 34%, eight points less than Ms Rousseff, even though polls had him trailing by 18 on the eve of the election. Next, he emerged ahead in early run-off simulations, the first time a runner-up in the first round has managed this feat in Brazilian electoral history.

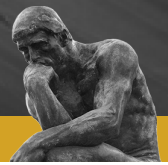
This prompted Ms Rousseff's Workers' Party (PT) to pull out all the stops. First, it baselessly accused the market-friendly Mr Neves of wanting to cut social programmes and govern solely for the rich elite. Then it plucked facts out of context to bash his record as governor of Minas Gerais, a big state where Ms Rousseff beat him in the first round (mainly because Ms Silva took some of the opposition votes), neglecting to mention that whenever Mr Neves himself stood for elected office there he romped to victory.

When those tactics proved insufficient to dent Mr Neves's lead, the PT resorted to dirtier tricks. It used an acrimonious TV debate on October 16th, when rivals traded charges of nepotism and party corruption, to paint Mr Neves's criticism of the president as sexist. The move was a not-so-subtle allusion to a rumour circulating since 2009 that he had hit his then girlfriend, and now wife (which both deny). Mr Neves's support among female voters dipped from 52% to 45% in a week.

Mr Neves, for his part, has repeatedly accused Ms Rousseff of tolerating graft, citing leaked testimonies from an ongoing probe into an alleged bribes-for-votes scheme at Petrobras, the state-controlled oil giant, implicating the PT and some of its coalition allies. On October 23rd *Veja*, Brazil's biggest, rabidly anti-PT weekly, published unsubstantiated claims that one deposition had revealed Ms Rousseff and her popular predecessor and patron, Luiz Inácio Lula da Silva, knew all about the kickbacks. Ms Rousseff, whose personal probity few doubt, accused *Veja* of "electoral terrorism" and secured an injunction to stop it from publicising the edition (though not to halt its sale). Both she and Lula strenuously deny any knowledge of the supposed scheme.

Earlier Petrobras revelations did not dent Ms Rousseff's polling numbers. *Veja's* bombshell is therefore unlikely to sway the remaining handful of undecided voters, who are less concerned with graft and more with increasingly uncertain prospects as Brazil's economy stalls, inflation stays stubbornly high and public services remain shoddy. Several such individuals, picked by IBOPE, the pollster, got a chance to grill Ms Rousseff and Mr Neves during their final televised showdown on Brazil's most-watched network. One asked about corruption; the rest wanted to know how to tackle rising costs of living, spruce up poor schools or find good jobs. The chummy Mr Neves outshone Ms Rousseff, who came across as wooden, seemingly clinging to a prepared script and failing to sound convincing in her responses to voter concerns....

\*\*\* THE ECONOMIST / [LINK](#)



## Out of Balance? Criticism of Germany Grows as Economy Stalls

It doesn't take much these days to rile German Finance Minister Wolfgang Schäuble. Last Thursday, as he made his way to the stage at George Washington University in the US capital, for example, a steward stretched his arm out to guide Schäuble to the stage. "Yes, yes, I can see," Schäuble grumbled irritably as he pushed his wheelchair forward.

His tetchiness is understandable. Schäuble this autumn is on the defensive to an extent not seen in some time. During his appearance on the panel, he faced repeated demands from other speakers, including Italian Finance Minister Pier Carlo Padoan and former US Treasury Secretary Larry Summers, for Germany to take action to spark economic growth in Europe. He sought to counteract them with his usual mantra, according to which Germany remains the motor driving the entire European economy.

The problem, though, is that Europe's motor is losing steam, with a slew of bad news about the German economy in recent weeks. The latest business climate index published by the respected Munich economic think tank Ifo, which is considered to be a reliable early indicator, fell for the fifth straight month in September to its lowest level in almost a year and a half.

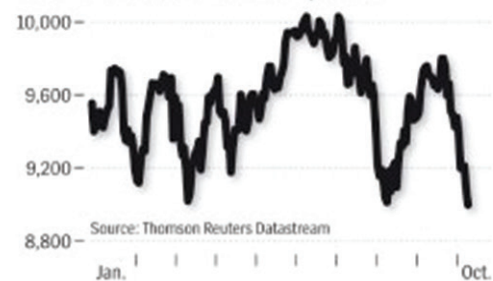
Furthermore, German factory orders are down and exports are collapsing. And last week, the country's leading economic research institutes issued downward revisions of their economic forecasts for this year and next.

The German government on Tuesday followed suit. Economics Minister Sigmar Gabriel in Berlin announced that growth is now expected to be 1.2% in 2014 and 1.3% in 2015. Previously, the government had forecast 1.8% growth this year and 2.0 % in 2015.

### Gloomy Prospects

German Economic Developments in 2014

**Dax 30** index of German blue chip stocks



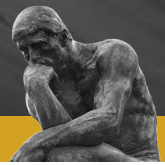
**Ifo Business Climate Index** 2005 = 100



**Production Index (Industry)** 2010 = 100







The course correction has created a dilemma for Schäuble. His draft federal budget for 2015 is based on the higher growth predictions. A conservative with Chancellor Angela Merkel's conservative Christian Democratic Union (CDU), Schäuble is hoping to become the first finance minister since 1969 to present a balanced budget free of new debt. Indeed, it has become Schäuble's ultimate career goal. But weakening growth translates to lower tax revenues and the finance minister's dream may now be washed away in a flood of red ink.

The rule of thumb in Germany holds that growth loss of half a percentage point leads to a shortfall in the federal budget of around €4 billion (\$5.07 billion), half of which must be absorbed by the government. "It's always possible to drum up €2 billion in a budget of €300 billion in order to stay in the black," a sanguine Schäuble confidant says. Beyond that, though, the wiggle room disappears.

At the same time, Schäuble would also like to do more to spur growth if he can do so without jeopardizing his goal of a balanced budget. He wants to restructure the budget, moving away from consumptive expenditures and focusing instead on investment. Given that his draft budget is still the subject of preliminary consultations in German parliament, he still has plenty of time to shift funds around.

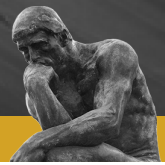
Schäuble has hinted to parliamentarians where money might be found. Germany's social security funds are currently operating with large surpluses and they could get by, for a time at least, with reduced allowances from the federal budget. The funding this would free up — somewhere between a few hundred million euros and a little over €1 billion — could be invested in road construction.

German Finance Minister Wolfgang Schäuble has been facing criticism at home and abroad over his conservative fiscal policy. Zoom

German Finance Minister Wolfgang Schäuble has been facing criticism at home and abroad over his conservative fiscal policy.

Still, the finance minister is aware that simply relabeling funds may not be enough to quiet critics, so he has another trick up his sleeve. He wants to win over private investors earlier than previously planned to pump capital into repairs of ramshackle bridges, building roads and other infrastructure projects. It's an idea Schäuble busily peddled at the fall meeting of the International Monetary Fund and the World Bank in Washington over the weekend.

He didn't find very many supporters. Indeed, it would seem that many in Europe and further abroad would like to see more than a bit of numbers juggling from Germany. "What's happening in Europe is not working," Summers said at the IMF meeting. "The monolithic focus on the financial deficit to the exclusion of the investment deficit, which causes growth deficit, has been a very substantial error." He also warned that Europe could find itself on a path of Japanese-style stagnation and deflation.



In comments clearly directed at Germany, Summers argued in favor of “self-financed infrastructure projects” by governments. He noted that no one can currently borrow money cheaper than governments can. Through higher growth, he argued, “public infrastructure payments can pay for themselves.”

The chorus of Germany critics is large at the moment. “We are rather concerned about cooling in Germany,” IMF Europe expert Mahmood Pradhan said last Friday...

\*\*\* DER SPIEGEL / [LINK](#)

## China Home-Price Drop Spreads as Easing Doesn't Halt Fall

China's new-home prices fell in all but one city monitored by the government last month as the easing of property curbs failed to stem a market downturn amid tight credit.

Prices dropped in 69 of the 70 cities in September from August, the National Bureau of Statistics said in a statement today, the most since January 2011 when the government changed the way it compiles the data. They fell in 68 cities in August.

The central bank on Sept. 30 eased mortgage rules for homebuyers that have paid off existing loans, reversing course after a four-year campaign to contain home prices as Premier Li Keqiang seeks to prevent economic growth from drifting too far below the government's 7.5 percent annual target. Home sales slumped 11 percent in the first nine months of this year.

“Prices will continue the downtrend for the rest of the year,” said Donald Yu, Shenzhen-based analyst at Guotai Junan Securities Co. “If sales in the fourth quarter fail to clear inventories as developers want, more price cuts are still likely in the first quarter of next year.”

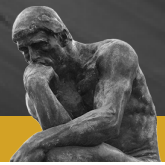
All but five of the 46 cities that imposed limits on home ownership since 2010 have removed or relaxed such restrictions amid the property downturn that has dented local revenues from land sales.

The Shanghai Stock Exchange Property Index, which tracks developers listed on the city's exchange, rose 0.3 percent as of 10:21 a.m. local time.

Developers will keep prices attractive as they open more projects toward the end of the year to meet sales targets, boosting supply and increasing competition, Ping An Securities Co. Shenzhen-based analyst Yang Kan wrote in an Oct. 14 report.

New-home prices fell 0.7 percent from August in Beijing and 0.9 percent in Shanghai, according to the government. The port city of Xiamen in southern Fujian province was the only city where prices didn't fall, remaining unchanged from the previous month.

Prices in Shanghai fell 0.8 percent from a year earlier, the first annual decline since December 2012, compared to a 17.5 percent jump in January this year. Hangzhou, the capital of southeastern Zhejiang province, had the biggest decline among all cities, with 7.6 percent.



The average new-home price in 100 cities tracked by SouFun Holdings Ltd. fell 0.9 percent in September from August, dropping for the fifth consecutive month. The price rose 1.1 percent from a year earlier, narrowing for a ninth month in a row, China's biggest real estate website owner said.

The People's Bank of China's new rules give homeowners who have paid off their mortgages and want a second property the same advantages as first-time buyers, including a 30 percent minimum down payment, compared to at least 60 percent previously, and interest-rate discounts of as much as 30 off the central bank's benchmark. The PBOC also eased a ban on mortgages for people without home loan debt who want to buy a third home, allowing banks determine down payments and rates.

Sales in 32 cities tracked by Barclays Plc rose to the highest level so far in 2014 last week, "with the primary driving force from the combination of accelerating new launches and improving homebuyers' sentiment," the bank's Hong Kong-based property analysts led by Alvin Wong wrote in a Oct. 20 report.

Home sales in September jumped 40 percent from August, the biggest increase this year, according to Bloomberg News calculations, based on a government report earlier this week.

\*\*\* BLOOMBERG / [LINK](#)

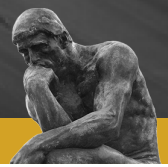
## Chanos: "The Lesson That Shaped My Understanding of How Fragile the System Is"

Tell me about the back half of 1987. Did you do well in the stock market crash?

Yes, we did extremely well in 1987. But people forget that the market ended flat for the year. It had a big rally for eight months and then peaked at the end of August. The stock market crash was the end of the move, not the beginning. I remember vividly being at my brother's wedding in Wisconsin the weekend it peaked, thinking that the market would never go down.

By September my performance was back to flat on the year and the October crash put us up. What really scared me in October of 1987 was that after Monday's crash, on the Tuesday and Wednesday of that fateful week, there was a lot of concern about not getting paid, that brokerage firms would have to liquidate. That was a wake-up call that really helped us to protect ourselves later during the crisis in 2008.

It was my first lesson in the fact that if you do not watch your balance sheet correctly as a short seller, you are an unsecured creditor of a brokerage firm. It was a quick education in the importance of prime broker and credit relationships and how, for example, it was preferable to be in the US rather than London from this perspective.



That lesson also shaped my understanding of how fragile the system was. I believe the system was much closer to going down in two days in 1987 than at any point in 2008. People think I am crazy when I say that. But people who remember those two days remember that we were worried that the clearing system was not going to work and that people were not going to get paid. I was worried that I was not going to get paid our profits.

\*\*\* STEVEN DROBNY VIA ZEROHEDGE / [LINK](#)

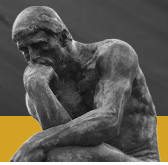
## The Ebola Outbreak — A Black Swan

A friend recently asked us whether the massive Ebola outbreak in West Africa could be regarded as a “black swan” in the sense of Nassim Taleb’s definition of the term. After thinking it over, we concluded that yes, it can definitely be characterized as one. Evidently, something is very different about this year’s outbreak compared to previous ones, and a number of unexpected developments have occurred. Chief among them is that a hitherto firmly held belief had to be abandoned. It was thought that the very thing that makes the illness rather terrifying, namely its high mortality rate, helped in containing outbreaks.

We can definitely state that the current outbreak is anything but “well contained”. Below is a statistical table that shows all Ebola outbreaks since the discovery of the disease in 1976. Note that this graphic is already dated by now — the 2014 event has literally “gone off the chart” in the meantime. Even so, this graphic gives a good impression of how small the previous incidences of Ebola outbreaks were by comparison.







From a statistical viewpoint, the 2014 outbreak definitely must be regarded as a “black swan” — it was hitherto held to be impossible for the illness to propagate in such fashion (source: news.au.com)

Another way of looking at the “black swan” quality of the current outbreak is its geographical spread. All previous Ebola outbreaks were confined to a few isolated locations at most, mainly because they occurred in remote villages in the bush. As a result sick (and therefore infectious) people simply didn’t manage to reach any other villages to spread the virus further. Moreover, since also many of those who catch the illness quickly die, the virus was thought not to propagate very easily. Death is obviously the ultimate impediment to mobility (the dead do however remain infectious for quite some time).

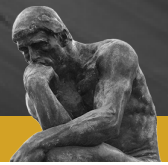
The fact that the outbreak already has “black swan” qualities makes it more likely that a few other strongly held beliefs could also turn out to be wrong. There is already an intense debate over how the virus actually moves from person to person. Given that it is present in sputum, a number of virologists have stated that if one were for instance bathed in a gentle spray of saliva emitted by a coughing and sneezing person that has been infected, one will probably catch it. In fact, a recent warning issued by the Center for Infectious Disease Research and Policy is mainly noteworthy for its admission regarding the uncertainties about possible transmission vectors. It recommends that health care workers be fitted out with proper respirators to ward off infection via aerosol particles.

Before hearing about this, we remarked as follows in a recent email conversation: Even considering the low standards of hygiene and certain cultural idiosyncracies that make it more likely for the disease to spread in African countries, it seems not as difficult to get infected as was generally held. One must also keep in mind that the official numbers almost certainly understate the number of infected people by a fairly big margin — many people reportedly get infected and simply die without ever making it into the statistics.

The progression of the outbreak shows that many hitherto widely accepted nostrums about Ebola and the likelihood of it spreading beyond a fairly small group of people have proved wrong. There is therefore possibly one more article of faith that may prove wrong as well, namely that there is no reason to worry that it could spread in developed countries.

What if it did?...

\*\*\* ACTING MAN / [LINK](#)



## The Inflation Imputation

In 2010, I co-signed an open letter warning that the Fed's experiment with an unprecedented level of loose monetary policy — in amount, and in unorthodox method — created a risk of serious inflation. Sporadically journalists and others have noted that this risk has not come to pass, particularly in consumer prices. Recently there has been an article surveying each of us as to why; seeming to relish in, when provided, our various rationales, presumably as they sounded like excuses.

It seems none of the responses provided what the authors clearly wanted, a blanket admission of error. I did not comment for that article, continuing my life long attempt not to help reporters who've already made up their mind to make fun of me — I help them enough through my everyday actions, they don't need more!

More articles of similar bent keep showing up. The authors seem to find it amusing that four years of CPI data wouldn't get people to change their economic views, while ignoring that 80 years of overwhelming evidence has not dissuaded Keynesians from the belief that this time, if they could only run everything, not just most things, they'd really get it right.

Focusing my attention, as was predestined, Paul Krugman lived up to his lifelong motto of “stay classy” with a piece on the subject entitled *Knaves, Fools, and Quantitative Easing*. Some lesser lights of the Keynesian firmament have also jumped in (collectivists, of course, excel at sharing a meme). Responding to Krugman is as productive as smacking a skunk with a tennis racket. But, sometimes, like many unpleasant tasks, it's necessary. I will, at least partially, make that error here, while mostly trying to deal with the original issue separate from Paul's screeds (though one wonders if CPI inflation had risen in the last four years if Paul would be admitting his entire economic framework was wrong — ok, one doesn't really wonder — and those things never happen to Paul anyway, just ask him).

Let me say up front that this essay will satisfy nobody. Those looking for a blanket admission of error will get part of what they want; a small part. Those hoping I hold the line denying any misstep will also be disappointed. I believe truth, as is often the case in similar situations, lies in the middle of these and I prefer truth, as I see it, to any reader walking away sated.

We indeed warned about the risks of inflation in 2010 and the CPI has been, to put it mildly, benign since then. First, to give the baying crowd just a bit of what it wants (I will take some of it back soon), our bad (I say “our” but obviously I speak only for myself). When you warn of a risk and it doesn't come to pass I do think you owe the world this admission, even if you later explain what it means to warn of a risk not a certainty, and offer good reasons why despite reasonable worry this particular risk didn't come to pass. I, and many other signatories, live in the world of economic or political prognostication, in my case money management, where if you get a bit more than half your calls right you are doing quite well, more than a bit more than half, you're doing fabulously. I'll put our collective record up against Krugman's (and the Krug-Tone back-up dancers) any day of the week and twice on days he publishes.



Let's start with the big one. We did not make a prediction, something we certainly know how to do and have collectively done many times. We warned of a risk. That's a very specific choice people like the open letter writers, and Paul, have to make all the time, and he knows this, but that doesn't deter him. Rather, Paul engages in the old debating trick of mentioning this argument himself and dismissing it. This technique worked for Eminem at the end of Eight Mile. But let's not be fooled by chicanery (silly Paul, you are no Rabbit).

If I had wanted to make a prediction, I would have made one. I didn't, nor did my fellow signatories. Frankly, if there are any economists, aside from those never-uncertain-but-usually-wrong like Paul, who did not think such unprecedented Fed action represented at least a heightened risk, I think it was malpractice on their part. An honest Paul Krugman (we will use this term again below but this is something called a "counter-factual") would have agreed with our letter but qualified that while heightened, he still didn't think this risk would come to fruition and that he thought it was a risk worth running. Still, I will give the critics half credit here, accept half blame, and issue a *demi mea culpa*. By writing the letter we clearly thought this risk was higher than others did, and wished to stress it, and it has not (as most commonly measured) as of now come to bear. Our, and my, (half) bad. I hope that makes the critics (half) happy and they can stop copying each other's articles over and over again....

\*\*\* CLIFF ASNESS (VIA JOHN MAULDIN) / [LINK](#)

## Panic money-printing won't save the eurozone

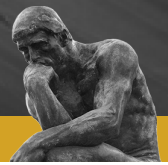
"It sounds far-fetched, I know," I wrote in this column in December 2007. "But the ultimate victim of this subprime crisis could be nothing less than the single currency's existence".

Reading it today, the above statement seems pretty reasonable. Many mainstream analysts now recognise the huge stresses imposed by the ongoing credit crunch could yet see monetary union break up, with at least one country leaving. To argue otherwise, certainly in Anglo-Saxon company, is to risk appearing in denial.

After the eurozone's successive summer bond crises of 2011 and 2012, it's no longer particularly controversial to accept what we sceptics have been warning about for years; that the "irreversibility" of monetary union is merely a political slogan.

A peripheral member-state could indeed leave of its own accord, or be forced out, so escaping the straitjacket of a vastly overvalued currency. Another may then opt, or be asked, to follow. Saying so is now part of reasonable economic discourse, not necessarily the start of a row.

The first time I wrote the words that begin this article, though, getting on for seven years ago, the situation was rather different. Back then, only "xenophobes" "cranks" and "nutters" argued the eurozone might not survive. The subprime meltdown, moreover, was seen as "America's crisis", for most French, German (and even British) observers a problem most definitely made on Wall Street.



It seemed weird, then, to suggest back in December 2007 that the most spectacular fallout from subprime — not only a severe market dip and related economic downturn, but something even more catastrophic, the forced break-up of vastly symbolic supranational structures — could actually happen in Europe.

It doesn't seem weird now. Last week's turmoil on global markets, which saw Greek bond yields pushed above an eye-watering 9pc, mean the eurozone crisis is back. As sovereign borrowing costs across several member states spiralled — not just Spain, Portugal and Italy, but France too — yields on 10-year German bunds plunged to an all-time low of 0.72pc, as panicked investors searched for safety.

This sharpening divide, or “yield-divergence” in the jargon, means that vast multibillion euro sums are being bet, once again, on the prospect of a eurozone break-up.

It strikes me that Europe's initially smug response to “America's crisis” was always blinkered, jingoistic nonsense. Eurozone banks were also extremely top-heavy back in 2007, in many cases more so than their US counterparts. Traders across Western Europe, we now know, had similarly gorged themselves on derivatives backed only by extremely shaky mortgages and other dysfunctional consumer loans.

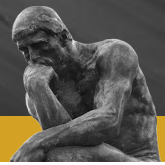
Long before 2007, it was clear to anyone with a reasonable knowledge of failed monetary unions throughout the ages, that the eurozone suffered from a deeply-ingrained flaw. A single currency shared by separate national democracies can only hold together with regular and substantial fiscal transfers between member states. And such transfers will only be remotely legitimate if the ultimate aim is to unite and become one country.

“Ever closer union” is at the heart of the European Union's articles of association, of course. It's the Eurocrat's ultimate dream. On the ground, though, the single currency's incoherence, is tearing Europe apart. Unemployment in Spain is 25pc (and a heartbreaking 50pc among youngsters). France has stalled, averaging just 0.5pc growth over the last four years — with voters increasingly blaming the euro.

Germans are increasingly wondering why they should bail out profligate “Club Med” nations, while peripheral countries that have taken the pain of tough budgetary reforms now openly complain about “core” countries that use their political clout to refuse.

Marine Le Pen's Front National attracted 26pc in the latest opinion polls. Le Pen — who openly advocates eurozone exit — would beat incumbent President François Hollande in a two-headed run-off for the Elysee. Even in Germany, where a sense of obligation to the “European project” runs deepest, the anti-euro Alternative für Deutschland (AfD) won 7 of the 96 seats in the European elections in May. In the tight coalition politics of Germany, the entry of AfD into the Bundestag, which seems inevitable, will seriously complicate Berlin's Parliamentary arithmetic.





It's clear that last week's pyrotechnics on global markets were most definitely "made in Europe". News that eurozone inflation hit a five-year low in September spooked traders, with weak spending continuing to plague hopes of a meaningful European recovery. Amid such deflationary fears, separate data showed a sharp 3.1pc drop in eurozone imports, another sign of falling domestic demand.

There were growing concerns that the Syriza party, which opposes bail-outs and any form of adherence to related fiscal discipline, could soon come to power in Greece. The markets were also unnerved by a warning from the International Monetary Fund that less than a third of the eurozone's banks have balance sheets strong enough to rebuild their reserves and boost lending; a sign that the "stress tests" scheduled for later this month could hold some nasty surprises.

Unlike previous eurozone crises, of course, there are clear signs that Germany is suffering. Having grown 0.7pc during the first three months of 2014, German GDP shrank 0.2pc in the second quarter. The eurozone's powerhouse is on the brink of recession. Industrial production dropped 4pc in August, the biggest monthly fall since early 2009. Exports were down 5.8pc – again, the steepest drop since the Lehman collapse.

Just a month ago, eurozone stocks were trading at their highest level in almost six years, with optimism spreading that quantitative easing would soon be forthcoming from the European Central Bank. Yet last week, Europe led a rout that saw some \$5 trillion (£3.1 trillion) wiped off the value of equities worldwide, even including Friday's partial recovery.

The Western world is clearly locked in a deep deflationary trend. The 10-year US Treasury yield, like its German equivalent, is on the floor, hitting 2.04pc last week and down almost 100bp since the start of the year. But that doesn't mean QE is the answer....

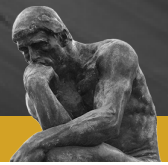
\*\*\* LIAM HALLIGAN / [LINK](#)

## A Scary Story for Emerging Markets

In the autumn of 2009, Kyle Bass told me a scary story that I did not understand until the first "Taper Tantrum" in May 2013.

He said that – in addition to a likely string of sovereign defaults in Europe and an outright currency collapse in Japan – the global debt drama would end with an epic US Dollar rally, a dramatic reversal in capital flows, and an absolute bloodbath for emerging markets.

Extending on that shared outlook, my friends Mark Hart and Raoul Pal, warned that China – seen then by many as the world's rising power and the most resilient economy in the wake of the global crisis – would face an outright economic collapse, epic currency crisis, or both such events in the process.



All that seemed almost counterintuitive five years ago when the United States seemed like the biggest basket case among the major economies and emerging markets appeared far more resilient than their “submerging” advanced economy peers. But Kyle Bass, Mark Hart, and Raoul Pal are not your typical “macro tourists” that pile into common knowledge trades and react with the herd. They are exceptionally talented macroeconomic thinkers with an eye for developing trends and the second and third order consequences of major policy shifts. In addition to their wildly successful bets against the US supprime crisis and the European sovereign debt crisis, it appears they saw an even bigger macro trend that the whole world and (most of the macro community) has missed until very recently: policy divergence.

Their common macro vision looks not only likely; not only probable; but **IMMINENT** today as the widening gap in economic activity between the United States, mainland Europe, and Japan is starting to demand a dangerous divergence in monetary policy.

In a CNBC interview earlier this week from his Barefoot Economit Summit (“Fed Tapers to Zero Next Week”), Kyle Bass explains that this divergence is set to accelerate in the next couple of weeks as the Fed will likely taper its QE3 purchases to zero. Two days later, Kyle explains, the odds are high that the Bank of Japan make a Halloween day announcement to expand its own asset purchases that could shake the world... and over time, it only increases the pressure on Mario Draghi and the ECB to pursue “overt QE” of its own.

Such a shift, if it continues to play out, is capable of fueling a 1990s-style US dollar rally with even scarier results for emerging markets and far more dangerous implications for a highly levered, highly integrated global financial system.

As Raoul Pal points out in his latest issue of *The Global Macro Investor*, “the [US] dollar has now broken out of the massive inverse head-and-shoulders low created over the last ten years, and is about to test the trendline of the world’s biggest wedge pattern.”



(US Dollar Index, 1967 – 2014)

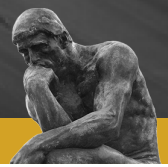


For readers who are unfamiliar with technical analysis, breaking out from a wedge pattern often signals a complete reversal in the trend encompassed within the wedge over a number of years. As you can see in the chart above, the US Dollar Index has been stuck in a falling wedge pattern for nearly thirty years with all of its fluctuations contained between a sharply falling upward resistance line and a much flatter lower resistance line.

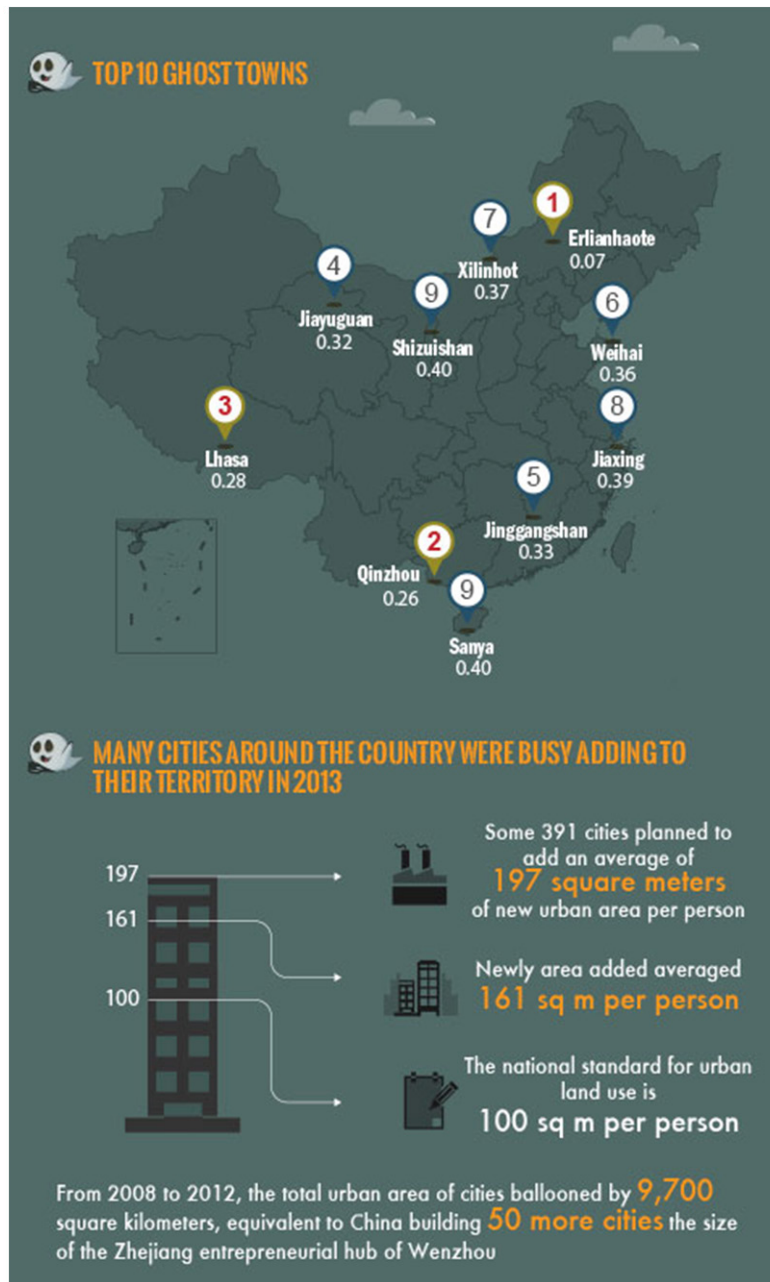
Any break-out beyond the upward resistance shown above is an incredibly bullish sign for the US dollar and an incredibly bearish sign for carry trades around the world that have been funded in US dollars. It's a clear sign that we may be on the verge of the next wave of the global financial crisis, where financial repression finally backfires and forces all the QE-induced easy money sloshing around the world to come rushing back into safe havens.

Let me explain...

\*\*\* WORTH WRAY / [LINK](#)



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

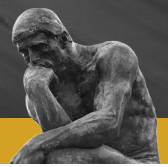


Source: Caixin

A Beijing newspaper has devised its own “ghost towns” index. Remember Ordos, the poster child in the West for such places? Well it doesn’t even make the list. Step forward, Erlianhaote.

\*\*\* CAIXIN / [LINK](#)



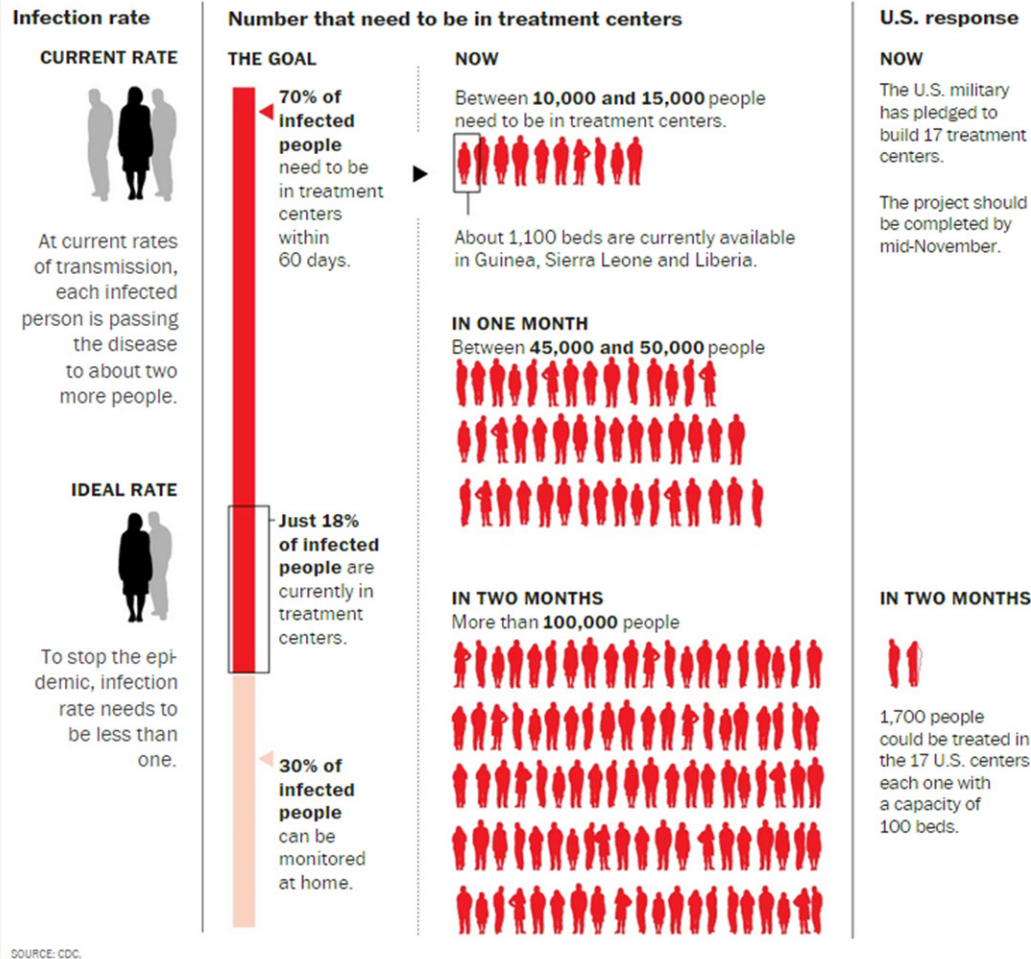


## Ebola in the West

### Containing Ebola: What it would take

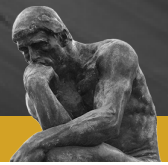
By Patterson Clark, Published: Oct. 9, 2014

To halt the spread of Ebola, many more people need to be isolated in treatment centers, according to CDC models. [Read related article](#)



The Washington Post put together a graphic highlighting the problem facing the West should Ebola need to be contained, and even though the story is being given the full media scaremonger special treatment, behind the hyperbole lie some extremely concerning possibilities.

\*\*\* WASHINGTON POST (VIA PATER TENEBRARUM) / [LINK](#)



**This week senior** Chinese officials are meeting in Beijing to resolve the sorts of problems the EU can't seem to fix, let alone acknowledge. On the chopping block are regulations – hundreds of them. According to Premier Li Keqiang, 416 lines of red tape have allegedly either been abolished or eased in order to facilitate business growth in important sectors such as transportation, logistics and telecommunications. In June, Li vowed to slash an additional 200 measures.

The Chinese government also plans to relax oversight of key areas such as utilities and natural resources, land and the pricing mechanism of money. Gone is the government's control over shale gas, coal bed methane and imported liquefied natural gas (LNG). The mining sector's tax code has been reformed. And for the first time, private companies have been granted the license to ship crude oil.

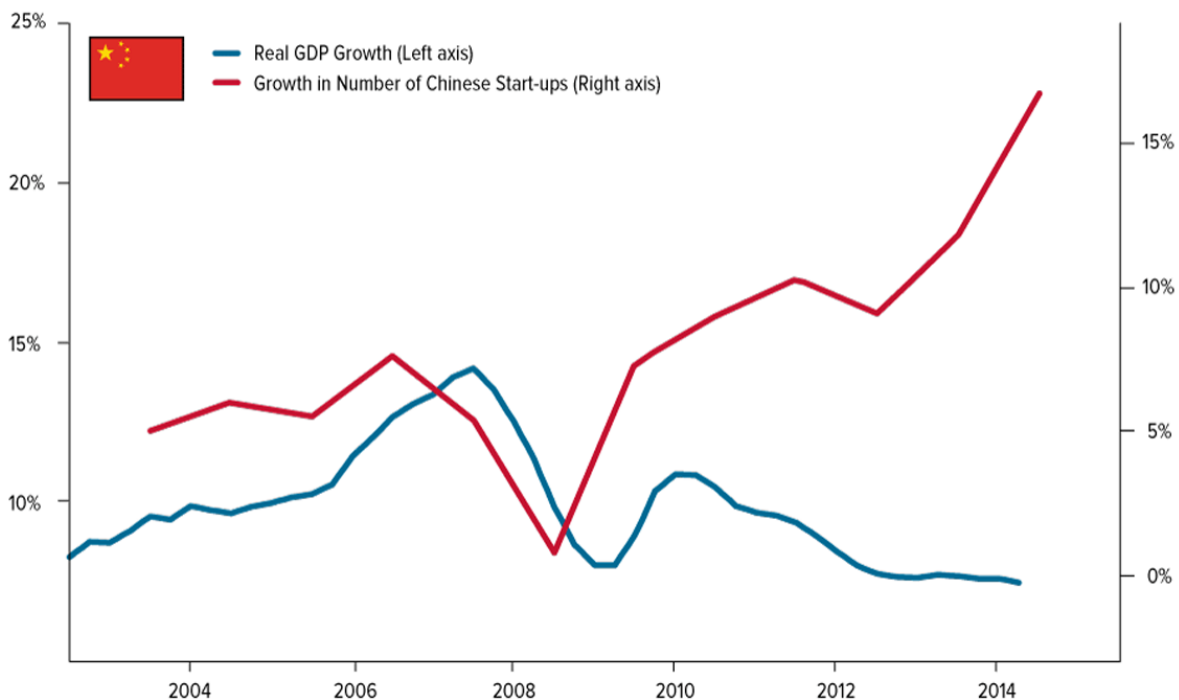
It appears as if China is starting to see the light. They're introducing competition back into their capital markets instead of strangling it, as the eurozone is fond of doing. Between January and September, 10.97 million new jobs were created in China, exceeding the government's goal of 10 million in 2014 and beating the benchmark by an entire quarter, according to China's National Bureau of Statistics (NBS).

As you can see below, new business start-ups in China have skyrocketed....

\*\*\* US GLOBAL INVESTORS / [LINK](#)

## China's Reduction of Red Tape Has Increased Business Start-ups, Despite Slowing Growth

Annual Percentage Change



Source: BCA Research, China State Administration for Industry & Commerce, U.S. Global Investors



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



[CLICK TO WATCH](#)

**At the risk** of flogging a dead horse, I bring you Swiss MP Lukas Reimann, who recently addressed the Swiss parliament on the subject of the soundness of the Swiss franc in the context of the SGI and demonstrated at a stroke that the Swiss establishment are up against some smart and engaged opposition.

This will be very interesting indeed.

**Want to hear** Egon von Greyerz talk about this week's topic? Well, here he speaks with Dan Popescu about the SGI, the possible ramifications of a "yes" vote for the gold price, and central bank policy worldwide, as well as the recent poll that revealed the Swiss public's predisposal towards the cause and China's strategies in the physical gold market.

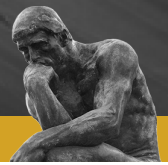


[CLICK TO WATCH](#)



[CLICK TO LISTEN](#)

**Regular readers know** the high regard in which I hold Bill Fleckenstein and here is another great example of why as he talks to Eric King about the 'sea of madness' in which markets find themselves right now. As always, clear-eyed analysis and much-needed pragmatism from Bill.



*and finally...*

**This incredible video** from the American Museum of Natural History takes viewers from the Himalayas through our atmosphere and into the inky black of space, right out to the afterglow of the Big Bang. Every star, planet, and quasar seen in the film is possible because of the world's most complete four-dimensional map of the universe, the Digital Universe Atlas, which is maintained and updated by astrophysicists at the American Museum of Natural History.

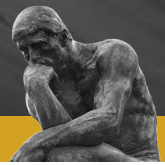
*If you don't feel small after taking this journey, then you may have a major ego problem!*



[CLICK HERE TO WATCH VIDEO](#)

*Hmmm...*





## Grant Williams

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

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

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



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

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

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