

Instability in the Oil and Currency Markets: Petro-Dollars and the Oil Bourse

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Several years ago free trade, globalization, offshoring and outsourcing were discussed in the major media. As time wore on the issues disappeared and now it is not easy to find discussions of these policies virtually anywhere as the drain of jobs and companies leave the third world.

Not only have the better paying jobs been leaving, but the destruction of economic independence and sovereignty has been a victim as well, something few professionals, never mind the public, thinks about. If America is to ever have an economic recovery there will have to be trade legislation with tariffs on goods and services.

Over in Europe in December the ECB received a \$1 trillion illegal loan from the Fed. 523 banks quickly borrowed \$650 billion and late in February and they will borrow another \$850 billion. Yes, they'll borrow it all and then some, if available you might arbitrarily add 03% to the 1% cost to cover shortcomings of collateral. That isn't all that bad because the average yield on senior unsecured bank debts are 4.3%. If invested that way that is a 3% return with little risk. They call this a license to steal. We the public don't get these kinds of offers. That is \$1.5 trillion and if fractionalized at 9 to 1 is more than \$14 trillion. In a similar situation the Fed lent to Goldman Sachs, JPM and Morgan Stanley and they made \$13 billion borrowing from the Fed, so you can see the tremendous profits that are going to be gleaned by European banks. We'd call this a subsidy or better yet a bailout.

It is the wish of the ECB and the Fed that the banks purchase domestic sovereign debt, which will push down borrowing costs for governments and reduce the risk that countries in trouble default. In addition, loans made to small and medium sized companies would boost the economy and create jobs. Having \$1.5 trillion, banks will assist in purchasing part of the \$800 billion of sovereign debt maturing in 2012. Unfortunately, we believe only about 5% of the funds will go into loans, some 55% to refinancing maturing debt and the remainder to buy sovereign debt. What is very interesting is that the ECB is strongly encouraging all banks to participate in the upcoming second auction. The borrowing from auctions 1 and 2 could aggregate \$1.6 trillion.

This has encouraged the UK government to lend more as well. RBS, previously received \$72 billion, borrowed another \$78.4 billion from the ECB in December. The savings from borrowing from the ECB at 1%, rather than from the British Government, represents a savings of almost \$776 million. The beat goes on. Add this \$1.6 trillion to the Fed's US spending of more than a trillion a year followed by QE 3 and the western world is engulfed in a sea of money and credit crated out of thin air, which will certainly accelerate inflation, perhaps in a big way.

The flip side of this lending, if only 5% reaches into the economies of the US, UK and Europe over the next 1-1/2 to 2 years, that represents business loans of \$10 billion, at a minimum. This is super charged money and will affect these economies starting in the second or third quarter. That is why all these economies are going to do better than almost all analysts and economists had predicted. They do not understand the strength of this volume of money and credit in turning these economies around. The players all know of the inflationary implications but believe them to be preferential to deflationary depression. It is easy for the Fed to create money and credit, so they have chosen this way, the only way short of deflationary depression, to bail out the financial system over and over again. This infusion of money and credit will continue as inflation climbs. When hyperinflation of 30% to 50% becomes reality the game is over. The big question is how long will it take? We do not think anyone has that answer at this juncture, but we can assure you that with this kind of aggregate creation is certainly going to bring about hyperinflation.

The stock market could well reach its old high of 14,700 with such tremendous amounts of money at banker's disposal, although it could trade at 10,500 due to other underlying problems. A very hard call at this point. There is one thing for certain all currencies will continue to depreciate more than 20% annually versus currencies as they have in 11 of the past 12 years. This is why you don't want to be in any currencies unless you have to be. They are all guaranteed losers. All are fiat with no backing except for some bankrupt government or privately owned central bank that wants you to believe they are worth something when they are not.

We are convinced Iran is a very good poker player. They did not go for the trap set up six weeks ago by the US and Europe. It turned out to be another non-event. Iran knows they are not as yet ready for war. The Iranian oil bourse will start trading oil in currencies other than dollars starting on March 20th. Beware the Ides of March. This is a blatant attempt to challenge the US domination of oil markets and to try to lessen the influence of the petrodollar on the world economy. This is what is at the heart of this conflict.

The foolish charade of the US to use a dispute over Iran's nuclear program is ridiculous. It is all about the powers controlling the US attempts to protect the US dollar as the world's reserve currency. It should be noted that the oil bourse has been opened since 2008. Iran has the 3rd largest oil reserves in the world and trading oil in other currencies is a major challenge to the US. In March oil will begin to trade in other major currencies, such as the yen, yuan, euro and rupee. As you know India is already negotiating for oil in rupees and gold. Iran would use their rupees to purchase goods from India ending in a fairly balanced trade. The final objection for India is its own tax structure. Indian businesses cannot pay for Iranian oil imports with rupees unless the finance ministry exempted such payments from a withholding tax. We are sure this will be overcome. About 45% of payments will be in rupees and the remainder in other currencies and gold. The India-Iranian oil trade is worth about \$12 billion a year.

On July 1st, the EU will ban Iranian oil imports. The bourse will have been operating in multiple currencies for 3-1/2 months and if successful this will prove to be a headache for Europe. We hear nothing out of Europe so we wonder if the Continent is preparing? They have to replace 500,000 barrels of oil a day. What happens if Iran shuts off their oil early? That would be chaos and oil being disrupted could climb to much higher prices. As you can see it is going to be a very interesting spring and early summer.

When England joined the EU one of the main issues was Britain's almost fully funded pension plan. It is reality time. Proposed new rules, promulgated by Brussels bureaucrats would force more funds to be held in reserve and to invest in less risky assets. In other words Brussels wants to dictate British investment decisions when European results and funding have been fair at best. All European investments in pensions are under funded and some are badly under funded.

This discussion is very important, because it points out that the unnatural association, known as the European Union, has essentially become dictatorial. The proposal would kill off 19% of final salary pensions, which are based on earnings and length of service. It would also push many businesses into insolvency, leading to job losses. It would cost firms about \$950 billion.

The idea of the bureaucrats is to force the pensions to buy government bonds. That is to fund government profligacy and looting on the Continent. If such a proposal were to be passed it would be catastrophic for European financial markets. Can you imagine the market impact of a switch of \$4 trillion in shares and bonds into government bonds? These bureaucrats at the EU have to be totally out of their minds to pursue such a proposal.

Later this year and into next year consumer debt is going to become a major problem. It may boost retail sales in the first half of the year, but it should slow sales in the second half unless real employment increases, and we do not expect that to happen

In November revolving and credit card debt rose 10%. We do not expect a recovery just a sideways to slightly upward movement such as an increase of 1-1/2 to 2 percent of GDP. Even though the growth will be there it will cost about \$1.3 trillion to accomplish. More or less what it cost the past two times. That will consist of higher Treasury purchases by foreigners looking for an alternative to the euro; the Fed's program of selling the short end of the treasury market and buying the long end; the ongoing net purchases of Treasuries and QE 3, which we predicted would be the purchase of toxic waste bonds from banks, so that those tied up funds could be used to buy Treasuries, shares and to increase business loans to small and medium sized companies.

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