



Black Swan Capital

# Currency Currents

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Wednesday 8 July 2009

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## Key News

- [Policy makers on both sides of the Atlantic launched an effort to crack down on what they called speculation in oil markets](#), underscoring concerns that a sharp rise in oil prices could worsen the global economic downturn. (WSJ)
- [A steep drop in exports and corporate investment led to a record economic contraction in the euro zone](#) in the first quarter of 2009, the European Union's statistics office said on Wednesday. (Reuters)
- [Chinese authorities are detaining Rio Tinto Ltd's top iron ore negotiator](#) on suspicion of espionage and stealing state secrets, Australia said on Wednesday, threatening to strain already fraying ties.

Key Reports Due (WSJ):

**7:00 a.m. July 1 Mortgage Refinance Applications:** Previous: -30%.

**10:30 a.m. July 2 U.S. Energy Dept Oil Inventories**

**3:00 p.m. May Consumer Credit:** Expected: -\$7.7B. Previous: -\$15.7B.

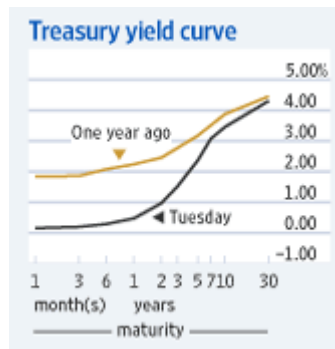
## Quotable

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"We are the cause of all the values that you covet, we who perform the process of thinking, which is the process of defining identity and discovering causal connections. We taught you to know, to speak, to produce, to desire, to love. You who abandon reason-were it not for us who preserve it, you would not be able to fulfill or even to conceive your wishes. You would not be able to desire the clothes that had not been made, the automobile that had not been invented, the money that had not been devised, as exchange for goods that did not exist, the admiration that had not been experienced for men who had achieved nothing, the love that belongs and pertains only to those who preserve their capacity to think, to choose, to value.

"You-who leap like a savage out of the jungle of your feelings to the Fifth Avenue of our New York and proclaim that you want to keep the electric lights, but to destroy the generators-it is our wealth that you use while destroying us, it is our values that you use while damning us, it is our language that you use while denying the mind."

Ayn Rand



Source: WSJ

Above is the yield curve. Notice how far rates in the low-end (left side) of the curve have fallen. This is good for banks but likely bad for us who want to borrow and not too good for those who depend on deposits for income. The spread between the long-end, where banks do lend, and the short-end, where they do borrow, is quite high. It is quite profitable to lend. But it is also quite profitable not to lend because the Fed is paying a nice little interest rate on reserves at the bank. So in effect, the banks can hold reserves and garner a risk free rate of interest from the Fed.

So, if you are a bank and have some bad paper still hanging around, and are still in need of personal healing, it likely makes more sense to grab the risk free rate and let the political chips fall where they may on lending...heck, the US administration has bigger fish to fry, like determining how to dole out socialized medicine to the highest politically connected bidders, fixing executive pay by nasty little bureaucrats who never met a payroll, and making sure there isn't too much profit making in the oil market by those evil speculators who risk their hard earned private capital everyday to make a market liquid and don't complain when they lose. Yes, the US government is far too busy to understand what motivates real profit-seeking players in the real world.

Thus, the Fed has increased reserves by "\$858 billion in the last 12-months ended May. But excess reserves on the books of depository institutions have increased by almost as much, \$842 billion. So, in the 12 months ended May, 98% of the increase in reserves created by the Fed has simply ended up as idle reserves on the books of depository institutions," according to Northern Trust very smart economist Paul Kasriel.

This leads to the following equation (our apologies to real economists and econometricians):

**Deflation** = Massive Government Stimulus (eating private stock of capital) + Increases Money Supply + Plunging Monetary Velocity + Huge Reserves + High Savings + Tight Lending Standards + Private Deleveraging of Bad Paper + Global Tax of Rising Commodities Prices + Rising Unemployment + Obliteration of the Export Model

Prices are falling just about EVERYWHERE in case the inflationist crowd hasn't noticed. Of course our illustrious government has noticed, thus the talk of yet another stimulus to eat away at more private capital and continue to add leverage to solve a problem that was created by leverage.

So let's keep regulating away the ability to make profit so the market won't clear or keep thinking of ways to tax it away to hand over to the moochers or spend it away for political power and then wonder why we are entering a global deflationary spiral?

Who is John Galt?

Jack Crooks

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