Black Swan Capital
Currency Currents
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Key News

- BEIJING, Jan 12 (Reuters) - China took its strongest step towards tightening monetary policy on Tuesday as the world's third-largest economy roars ahead, surprising investors with an increase in banks' required reserves that rocked global financial markets.
- Greece condemned for falsifying data (Financial Times)
- Insight: Lift rates and think about the savers (Financial Times)

Quotable

“Meanwhile, the rest of the world has to wonder whether it is learning the lessons from Japan’s fall from economic grace. Japan’s experience strongly suggests that even sustained fiscal deficits, zero interest rates and quantitative easing will not lead to soaring inflation in post-bubble economies suffering from excess capacity and a balance-sheet overhang, such as the US. It also suggests that unwinding from such excesses is a long-term process.

“Yet Japan’s experience also has a lesson for quite a different economy. It indicates that when very fast growth begins to slow in a catch-up economy with very high corporate savings and comparably high fixed investment, demand may well prove extremely difficult to manage. This is particularly true if the deliberate promotion of credit growth and asset price bubbles has been part of the mechanism used to sustain demand. And who needs to learn this vital lesson now? The answer is: China.”

Martin Wolf, Financial Times

FX Trading – Lessons to be learned.

Martin Wolf of the *Financial Times* (quoted above) brings back the common comparison to Japan’s lost decade ... in hopes of conveying the similarities between Japan *then* and the US *now*.

Yes, the comparison is not new. Several months ago in an issue of *The International Economy* magazine, I read several responses from economic minds across the globe to the question: Will the US suffer a lost decade?

But even many months before that, when deleveraging dominated markets, the idea had begun circulating. Admittedly, deflation was a bigger concern on the minds of investors one year ago relative to today. Maybe, though, we shouldn't shrug off the Japan scenario just yet.

On Monday I mentioned attending a discussion on economics and markets hosted by CB3 Financial Group. One of the other attendees mentioned a recent guest on *PBS News Hour* with Jim Lehrer. The guest basically talked about how the financial system was getting back to business as usual.

And in this case "business as usual" did not mean operating efficiency or normalization, per se, but rather back to the old practices that got everyone into trouble in the first place. You know: the type of stuff that's prompted cries of much-needed financial regulation.

Robert Reich seems to agree. This article from the Financial Times is making a similar case for financial regulation, suggesting the government needs to come down hard on Wall Street.

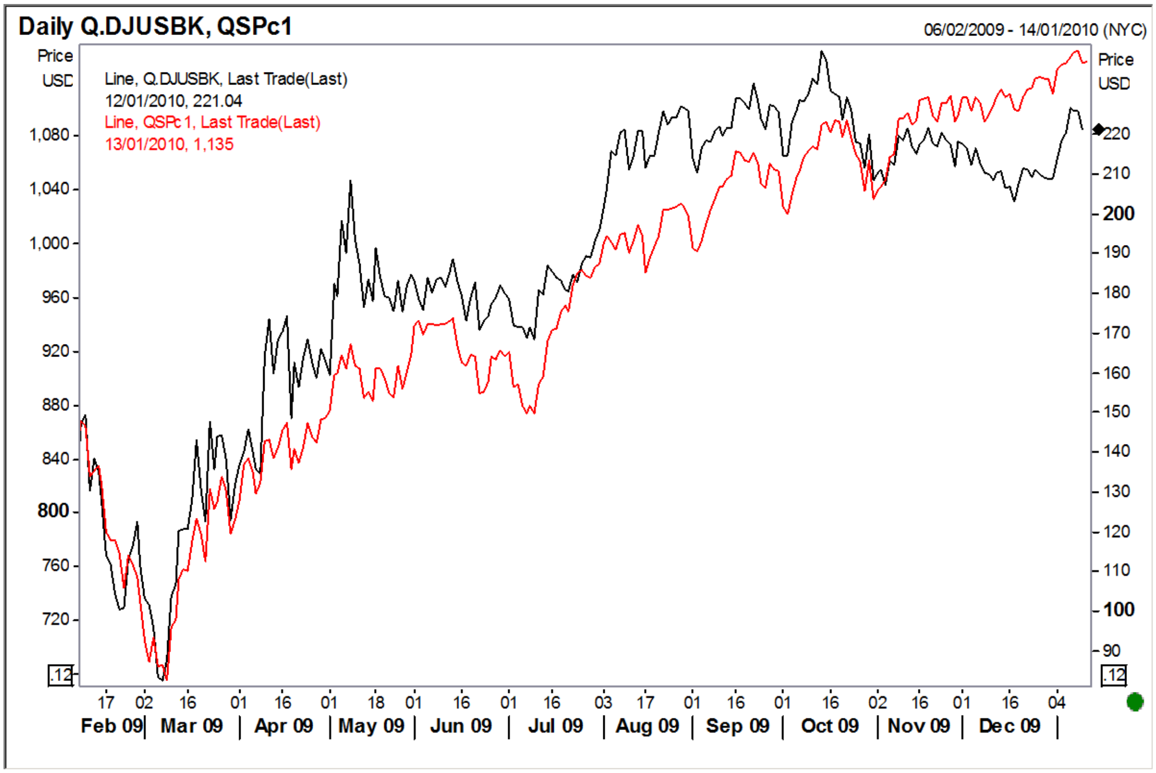
Now, are we really that unstable in this nascent, market-led recovery? Well, it's obvious the economy has not come as far along as the markets. Let's think about that. Something comes to mind ...

Heavy on the newswires today is talk about how the Obama administration plans to slap a $120 billion fee on TARP-assisted companies. Yeah, the whole mess is too ridiculous to even want to discuss in full. I'll try to lay out the ideas real quick:

- The government took steps to keep the banks from failing
- The public mostly opposed the TARP
- The government talked up the need, and eventual "success", of TARP
- The public became sick over resurgent banker bonuses
- The TARP will actually turn a loss
- The government must levy a fee to recoup some of the taxpayer-funded bailout

Ok, somewhere along the line the market became reassured that this is a decent enough attempt at fixing the problems and enough of a reason to buy bank stocks. What's ensued since has been a solid-looking recovery for the stock markets.

Dow Jones Bank Stock Index (black) vs. S&P 500 Index (red) Daily: Bank index is now underperforming S&P after leading for many months.



A disconnect between the economy and the market has become obvious, no doubt. Now the big question: how shall the two reunite?

It seems there are two general answers:

1) The economy plays catch-up.
2) The market takes a double-dip.

I'd say the majority is currently betting on numero uno. But if there's really a risk of a lost decade in the US, or if there's really a risk that the financial system is just building itself back up for an encore collapse, then maybe the market does a rethink.

The pressure would really be on China to keep the rest of the world from going belly up. Like Mr. Wolf says, perhaps China, too, can learn a lesson from Japan.

It's like déjà vu all over again.

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Note from David Newman ...

2010 Forecast Issue coming this month … *20+ pages of analysis and charts covering the major and emerging market currency world—key themes and targets.*

Currency Investor presents its annual 2010 Forecast for the coming year. Don't miss this issue as it may be the most important one we write all year.

Our monthly *Currency Investor* newsletter is geared toward newcomers and experienced investors who are looking for a conservative approach to the foreign exchange market, and learning more about how the global economy works.

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Thank you.

All the best,

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