



Fake Views (Part II)

“There are thirty-two ways to write a story, and I've used every one, but there is only one plot – things are not as they seem.”

- Jim Thompson

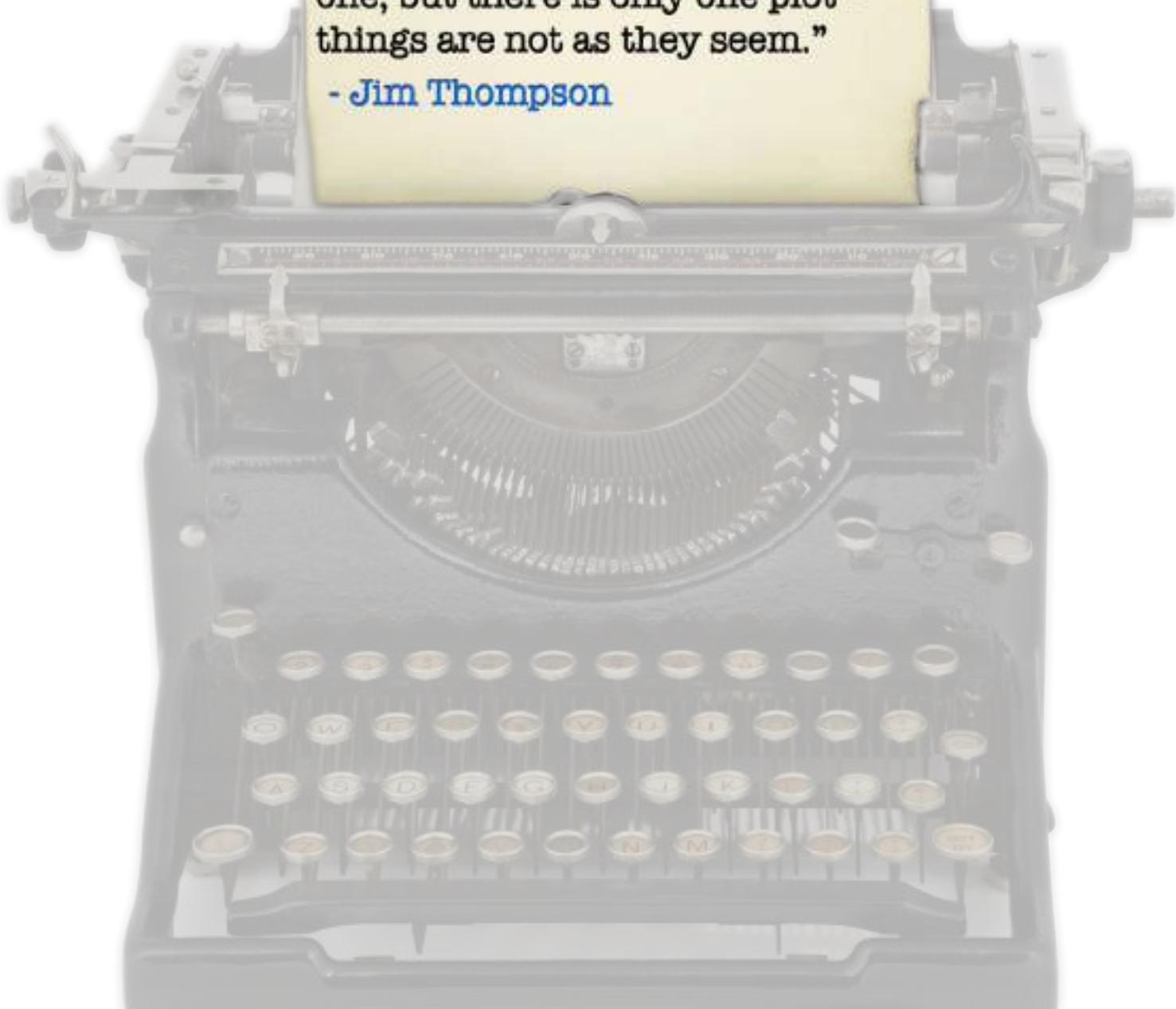


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THINGS THAT MAKE YOU GO HMMM...



FAKE VIEWS (PART II)

There are very few professions in this world for which there is a universally-accepted 'bible' — one which all those wishing to make that particular profession their chosen vocation are encouraged to read in order to gain the requisite knowledge to be successful.

One such profession is screenwriting and the bible for that particular profession is Blake Snyder's *Save the Cat!*.

Snyder was named one of Hollywood's most successful 'spec' screenwriters — selling several of his scripts to major studios who would go on to turn them into multi-million dollar-grossing movies and giving a series of standing room-only lectures on the art of screenwriting to rapt audiences around the world.

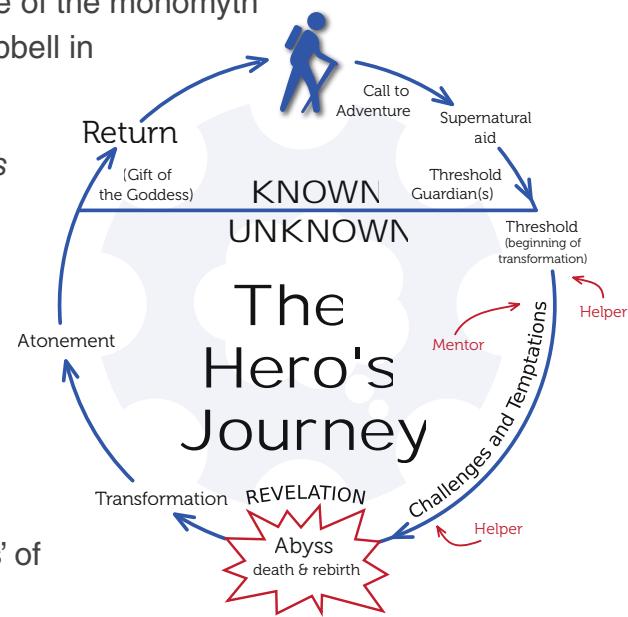
In 2005, Snyder published *Save the Cat! The Last Book on Screenwriting You'll Ever Need* and the book became a gigantic hit. It is now on its 24th printing and has (somewhat at odds with the title) spawned not one, but two sequels: *Save the Cat! Goes to the Movies: The Screenwriter's Guide to Every Story Ever Told* and *Save the Cat! Strikes Back: More Trouble for Screenwriters to Get Into... And Out Of* which were published in 2007 and 2009 respectively. Tragically, Snyder died suddenly of a suspected pulmonary embolism shortly after the publication of his third book.

The original *Save the Cat!* book describes in detail the structure of the monomyth or 'hero's journey' — a concept first introduced by Joseph Campbell in 1949's *The Hero with a Thousand Faces*.

Campbell, taking the monomyth from James Joyce's *Finnegan's Wake*, had described the basic narrative as follows:

A hero ventures forth from the world of common day into a region of supernatural wonder: fabulous forces are there encountered and a decisive victory is won: the hero comes back from this mysterious adventure with the power to bestow boons on his fellow man.

Campbell broke the Hero's Journey down into some seventeen stages which can be simplified into the more familiar three 'acts' of most stories and nearly all movies of today:



- I) Departure
- II) Initiation
- III) Return

Snyder coined the phrase *Save the Cat!* to describe a moment, typically early in a movie, which establishes the main protagonist as someone the audience will root for — particularly effective when the ‘hero’ is a character for whom we would normally have little sympathy (think Aladdin, the common street thief, or Al Pacino’s bank robber, Sonny Wortzik in *Dog Day Afternoon*). The inspiration for the book’s title came from the 1979 movie *Alien* in which Sigourney Weaver’s intergalactic badass *Ripley* literally saves the cat (*Jonesy*) from the creature that gave the movie its title.

As if to prove the validity of Snyder’s premise that, having the hero (or heroine) ‘save the cat’ would put the audience firmly behind them, I came across this little exchange on a movie discussion forum while researching this week’s *Things That Make You Go Hmmm...* (oh the places you’ll go):

Q: What's the meaning of the cat during the first movie?? why is so important for Ripley to keep the cat alive with her??? are there any deep meanings of the whole cat role during the movie??

A: I don't know for sure but I have thought about this often. What I think is that none of the characters on the Nostromo are particularly likeable. What sets Ripley apart, and indeed more so in the sequel Aliens, is her caring nature. I think in making the selfless effort to save the cat (and Newt in the sequel) we as viewers actually care about what happens to HER. Also, unlike the very money-hungry characters on the Nostromo, the cat is an innocent, there by circumstance and not choice. Much suspense is created in the final stages of the film where even though we are fairly sure Ripley is going to survive there is still the will she/won't she save the cat question...There may be some deeper meaning of the cat but this is what I think.



Bingo!

In *Save the Cat!*, Snyder places great emphasis on a movie’s structure and introduces the reader to his *Beat Sheet*, a document which contains the 15 essential plot points Snyder felt every story should contain and, while it’s not necessarily heart-warming for we movie buffs to think about how every one of those two-hour escapes we take into an imagined (or real) past, present or future, you can see the similarities in the structure of most movies very easily as soon as you stop suspending disbelief and cast a critical eye over such things.



Snyder's system is applicable to romantic comedies, thrillers, musicals, dystopian road movies and biographies alike and is an excellent place to lay blame for those of you who feel that Hollywood movies of today lack originality.

However, as ruthlessly as Snyder boiled down the structure of every single story ever told to just 15 points, Jim Thompson, another accomplished screenwriter and the author of such crime classics as *The Killer Inside Me*, *After Dark My Sweet*, *The Getaway* and *The Grifters* took things just about as minimalist as they could go.

As the quote on the cover of this week's *Things That Make You Go Hmmm...* makes abundantly clear, Thompson believed there to be thirty-two stories but just one plot common to them all, no matter the genre, and try as I might, I can find no better example of the accuracy of both Thompson's claim and the nature of his single plot than today's financial markets and the fake views being put forward by those who would have us believe that things are not only exactly what they seem, but that we should invest accordingly.

Things are most definitely *not* what they seem.

Down the path today's political and monetary overlords have decided to take lies trouble because, as every writer worth his salt knows, the whole point about building a story around things not being as they seem is that the denouement involves the uncovering of how things really are.

The twin constructs of fake views which began in Part I of this letter, and this week's continuation around things not being how they seem, are important to understand so let's begin Part II with an extract from a speech delivered by Janet Yellen at the Stanford Institute for Economic Policy Research in late-January:

(Janet Yellen): *“..inflation is likely to move up to 2% over the next couple of years, aided by a strong labor market. In light of the progress that has been achieved towards our employment and inflation objectives and the committee’s assessment of the outlook, the FOMC raised the target rate for the federal funds rate at its December meeting by twenty-five basis points to between fifty and seventy-five basis points. The committee judges however that the stance of monetary policy remains moderately accommodative and so policy should support some further strengthening in labor market conditions and the return of inflation towards our 2% goal.*

With the unemployment rate near its longer-term normal level and likely to move a bit lower this year, the natural question is whether monetary policy has fallen behind the curve.

The short answer, I believe, is no.”





And so, in the wake of her illustrious immediate predecessors, Drs. Greenspan and Bernanke, Janet Yellen once again confirms that, no matter what the evidence to the contrary may be, the delusion which unfortunately *must* sit at the heart of the world's most important central bank is firmly entrenched.

The simple truth, is that the Fed has never been so far behind the curve.

At least, not as measured by the Taylor Rule which, as you can clearly see in the chart (right), is currently in a place it has only ventured once in the last 45 years.

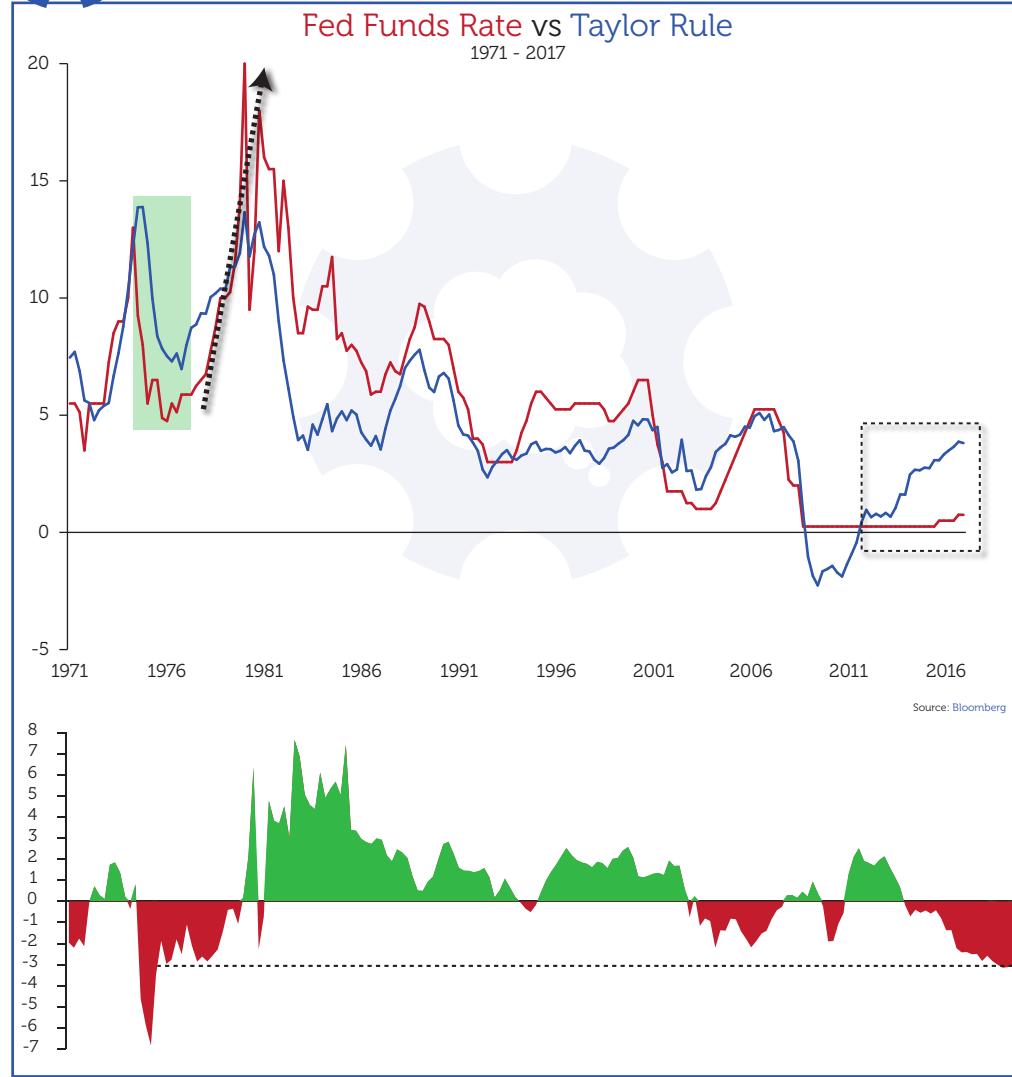
In fact, that one previous time the Fed got behind the curve (as measured by the Taylor Rule) was in the 1970s and, whilst we all no doubt remember how *that* little episode ended, I thought I'd put the dotted black arrow on the chart anyway. Just as a little reminder.

Sorry Janet. Say what you will but you are waaaaay behind the curve, old girl.

Inflation is, of course, ground zero for disingenuity and downright fake views on the part of central banks and governments from Washington to Warsaw and from London to Lisbon and nobody does a better job of tracking and explaining the vagaries of official inflation calculations than John Williams of ShadowStats and I will be leaning heavily on John to help me out here.

(Incidentally, John's ShadowStats service is an incredibly useful one and you can find out more about it by clicking [HERE](#))

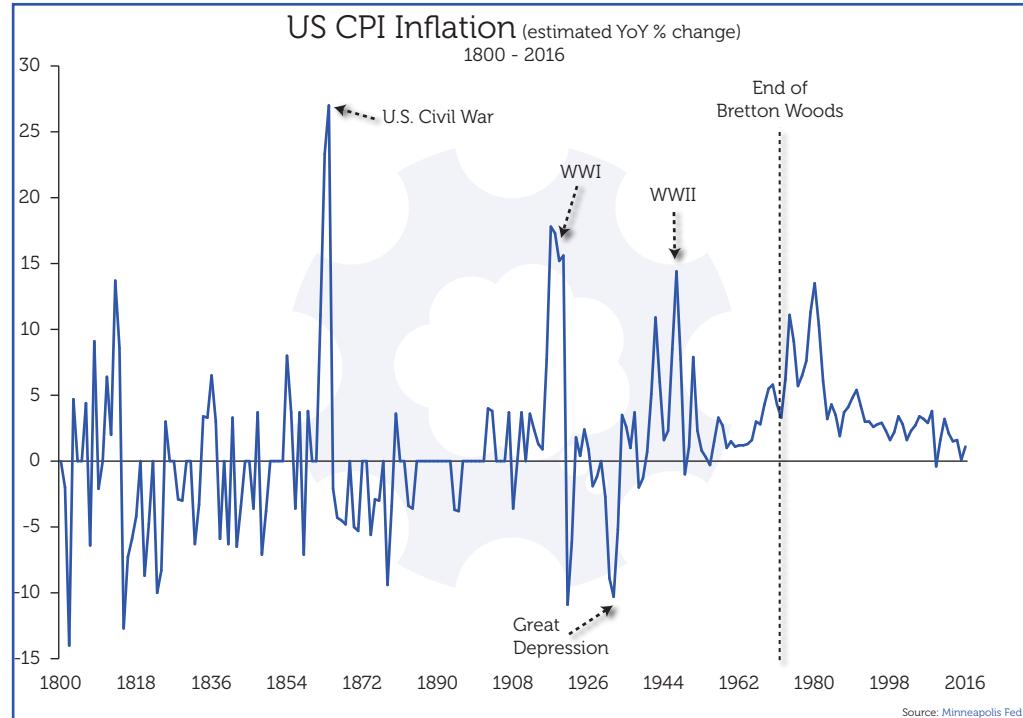
Quite apart from the pressure rising prices places on the average household, so many transfer payments are linked to inflation that it is, of course, in every government's best interests to measure inflation at its lowest possible level. Here's the official description of CPI from the BLS website:



The Consumer Price Indexes (CPI) program produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

That representative basket of goods and services used to be fixed to ensure a consistent evaluation of how easy (or otherwise) it was for the average consumer to maintain a fixed standard of living. Each month it contained the same components at the same fixed weighting so it was easy to calculate the increased income a consumer might have to earn over a given period in order to maintain their standard of living and that same method for calculation was used (according to the BLS themselves) all the way back to the 1700s and, indeed, prior to the end of WWII, the Consumer Price Index was actually called the *Cost of Living Index*.

Here's how the annual rate of change in inflation looks going back to 1800 (as estimated by the Minneapolis Fed using a variety of sources).



As you can see, the annual rate of inflation saw big spikes during the U.S. Civil War and the two World Wars and a big dip immediately after WWI and again during the Great Depression.

You can also see here that, for fully 100 years, during the biggest economic, demographic and technological expansion in the nation's history, deflation was the norm with the citizens of the U.S. spending more time watching their cost of living fall than they did worrying about rising prices as technology rapidly brought down the cost of goods.

WWII saw another understandable spike in inflation which was wrestled to the ground before, again understandably, sharply rising prices returned in the 1970s.

The response to that inflation scare by the Fed Chair at the time, Paul Volcker, was, of course, to jam rates up to 20%. Anybody who has either given but a cursory glance to financial history or spent thirty seconds looking at a long-term chart of the fed funds rate, treasury yields or the gold price is familiar with the policy response, but there was another, far quieter response to the runaway inflation of the 1970s and it came, as these things often do, from the academic community.

Yes, an idea had been brewing amongst the tenured professors of the world that, rather than maintain a consistent 'standard of living', the average consumer would be *much* better off measuring what the academics termed a '*constant level of satisfaction*' — a move which substituted the arbitrary for the calculable and allowed for greater reliance upon that which inhabits the centre of the academic universe; the model.

The way to do this, the academics argued, was to stop calculating the price of a fixed basket of goods which represented a certain standard of living, and start measuring how 'satisfied' an average consumer was.

The best means to measure this, they suggested, was through substitution and, latterly, hedonic adjustment.

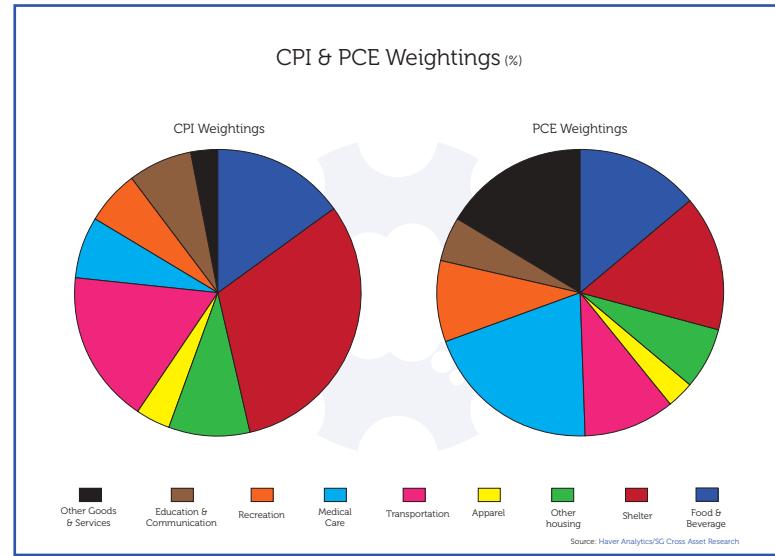
In the case of substitution, the assertion was that a consumer would be more *satisfied* were he (or she — academics are agnostic) able to substitute, for example, hamburger for steak should the price of steak rise to the point of unaffordability. In allowing for this, the satisfaction of the consumer was gauged by his ability to maintain a consistent level of total outlay regardless of the quality of the goods within their basket. How's *that* for stacking the deck when measuring variable expenditure?

Not for them the inconvenience of trying to understand how fast wages needed to rise in order for the working man to be able to put the same roof over his family's head or the same food in his kids' mouths. No. Their system was *better*.

Of course, the first people to endorse the claims of the academic community were those in public office and, as always, their motives were somewhat less than straightforward:

(John Williams): In the early-1990s, political Washington moved to change the nature of the CPI. The contention was that the CPI overstated inflation (it did not allow substitution of less-expensive hamburger for more-expensive steak). Both sides of the aisle and the financial media touted the benefits of a "more-accurate" CPI, one that would allow the substitution of goods and services.

The plan was to reduce cost of living adjustments for government payments to Social Security recipients, etc. The cuts in reported inflation were an effort to reduce the federal deficit without anyone in Congress having to do the politically impossible: to vote against Social Security.



The inflation-calculation changes had the further benefit to government fiscal conditions of pushing taxpayers artificially into higher tax brackets, thus increasing tax revenues. The changes afoot were publicized, albeit under the cover of academic theories. Few in the public paid any attention.

In a 1996 paper, Katharine G. Abraham, Commissioner of the Bureau of Labor Statistics from 1993 through 2001 and a Member of the President's Council of Economic Advisers from 2011 through 2013, explained how The Maestro himself had intervened with yet another preposterous fake view delivered to Congress which was, of course, leapt upon with almost unseemly relish:

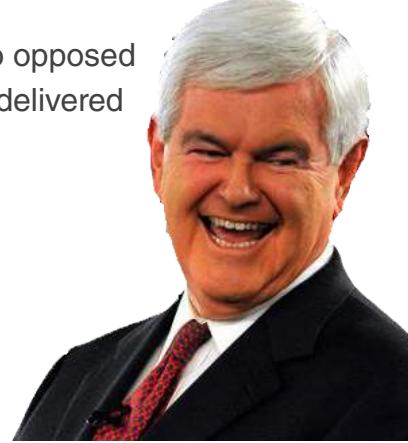
(Katharine G. Abraham): "Back in the early winter of 1995, Federal Reserve Board Chairman Alan Greenspan testified before the Congress that he thought the CPI substantially overstated the rate of growth in the cost of living. His testimony generated a considerable amount of discussion. Soon afterwards, Speaker of the House Newt Gingrich, at a town meeting in Kennesaw, Georgia, was asked about the CPI and responded by saying, 'We have a handful of bureaucrats who, all professional economists agree, have an error in their calculations. If they can't get it right in the next 30 days or so, we zero them out, we transfer the responsibility to either the Federal Reserve or the Treasury and tell them to get it right.'

Gingrich's answer to the question about CPI was stupendous, casting those who opposed any form of reconstitution of the methodology as 'bureaucrats' (a word no doubt delivered with the requisite relish) while those on the side of meddling with the calculation methods were not only labeled as 'economists' but 'professional' ones no less.

Why was Gingrich (and Greenspan) so keen on the adjustments?

Here's John Williams again:

(John Williams): A further comment was noted in a 2008 San Francisco Chronicle article, "In the 1990s, for example, Republicans wanted to make changes in calculating inflation along the lines recommended by a special commission, including more use of quality adjustments. By lowering the official inflation rate, such changes promised to reduce the annual cost-of-living adjustments for Social Security and other federal programs.



"[Katherine] Abraham, the Clinton bureau [of Labor Statistics] commissioner, remembers sitting in Republican House Speaker Newt Gingrich's office:

"He said to me, If you could see your way clear to doing these things, we might have more money for BLS programs."

Federal Reserve Chairman Alan Greenspan and Michael Boskin, then chairman of the Council of Economic Advisors, were very clear as to how changing or “correcting” the CPI calculations would help to reduce the deficit.

As described at the time by Robert Hershey of the New York Times, “Speaker Newt Gingrich, Republican of Georgia, suggested this week that fixing the [CPI] index, with its implications for lower spending [Social Security, etc.] and higher revenue [tax bracket adjustments], would provide maneuvering room for budget negotiators ...”

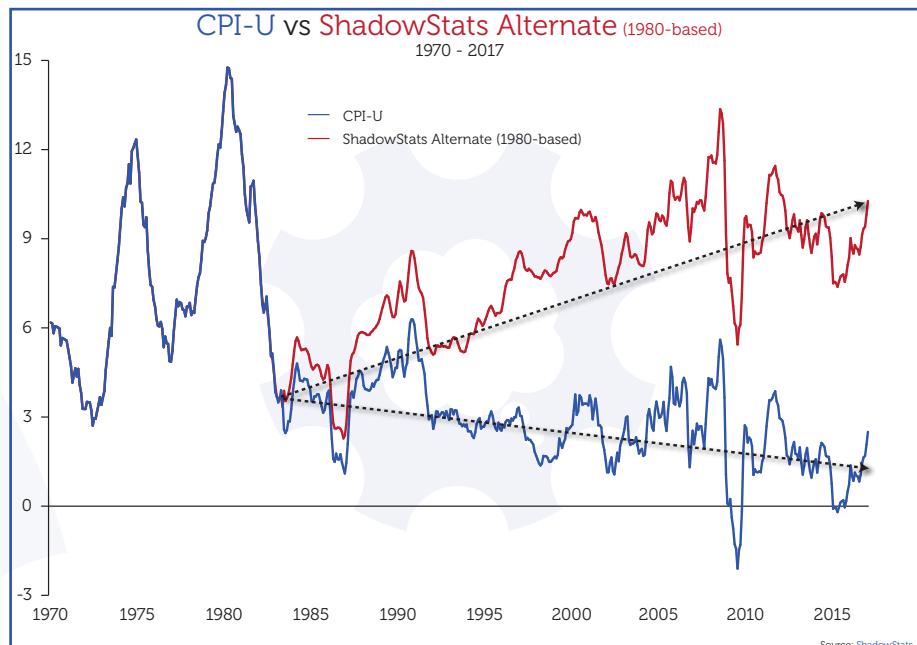
“Alan Greenspan, chairman of the Federal Reserve, is among the other Government officials who have spoken optimistically about financial benefits of a more accurate [CPI] index ...”

“[E]conomists believe one of the most important [CPI upside biases] is when consumers shift their buying patterns in response to changing prices, substituting one product for another. The [CPI] index is based on a fixed market basket of goods and services. But, for example, if the price on an item like steak gets too expensive, consumers may switch to hamburger.”

The Boskin Commission Report, December 4, 1996, actually used steak and chicken for its substitution example. The examples used in arguing for changing the CPI clearly were tied to prices rising and resulting consumer demand shifting to a lower-quality product. Simply put, that was the destruction of the cost-of-maintaining-a-constant-standard-of-living concept and was the primary consideration of those seeking to change the CPI, although other issues would come into play. The drive here was as to get a lower inflation reading, irrespective of whether the data were “more-accurate.”

ShadowStats publishes its own inflation numbers which maintain a constant measurement of the CPI inflation data based on the 1980 methodology and here is what the two different forms of measurement look like when placed alongside each other:

It will come as no surprise to anybody that the new version of calculation produces consistently lower results while the original method heads relentlessly in the opposite direction.



John Williams calculates that the changes currently understate CPI inflation by 5.1%.

Of course, we can't touch on the fake views surrounding CPI inflation without mentioning hedonic adjustments so let's do that briefly with the help of a group called Consumer Price Illusion (emphasis mine):

(Consumer Price Illusion): *Ostensibly, the CPI is a linear combination of the “prices” of things/stuff consumers could actually purchase weighted by a percentage that the “ideal consumer” spends on any particular stuff/thing in his “ideal” basket. The main problem here is that the “prices” used are not the prices a consumer would actually pay; instead the real price for an item is scaled by what the BLS calls a “Hedonic Quality Adjustment (HQA)”. The HQA was designed to solve a real world problem economists face: the market keeps pumping out new and better devices. In practice the HQA is used to artificially depress the prices used in the calculation of the CPI.*

Intuitively, the HQA scales prices by their “perceived” quality. We’re not talking about human perception here, but that of a kitchen sink regression model created by BLS economists. Essentially it throws every quality an item might possess into a linear model and performs a regression of these qualities against the prices found in the market for a given product... The BLS neatly illustrates this effect with an example from their website:

Item A is a television that is no longer available and it has been replaced by a new television, Item B. The characteristics in bold differ between the two TVs. There is a large degree of quality change and there is a very large (400%) difference in the prices of these TVs. Rather than use the 400 percent increase in price between Item A and Item B, the quality adjusted rate of price change is measured by the ratio of the price of Item B in the current period (\$1,250.00) over an estimated price of Item B in the previous period – Item B'.

| Characteristics | Item A | Item B |
|-----------------|---|--|
| Price | \$250.00 | \$1,250.00 |
| Features | 27-inch CRT EDTV S-Video Input Universal remote | 42-inch Plasma HDTV S-Video Input Universal Remote |

Here is an example of a hedonic regression model (including coefficients) for televisions:

$$\ln P = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots + \beta_k X_k + \varepsilon$$

To derive the estimated price of Item B', in our television example, we use the following equation:

$$\begin{aligned}
 P_{B,t+s-1} &= \$250.00 * e^{(\sum(42 * \text{screensize} - 1764 * \text{screensize}^2 + \text{plasma+HDTV}) - \sum(27 * \text{screensize} - 729 * \text{screensize}^2 + \text{EDTV}))} \\
 &= \$250.00 * e^{(\sum(3.50616 - 0.87748 * 0.72483 + 0.34280) - \sum(2.25396 - 0.36263 * 0.12228))} \\
 &= \$1345.02
 \end{aligned}$$

The magic of hedonic adjustment can be seen beautifully in the case of these two television sets. You take a pair of televisions which retail for \$250 and \$1,250, apply a little hedonic adjustment and, hey presto, the one which costs a thousand dollars more is actually 7.1% cheaper.

Don't even bother.

Now, hedonics, like all good government-sponsored model adjustments, is a one-way qualitative street so, for example, while in-flight wifi and free peanuts lower the hedonically-adjusted cost of an airline ticket, the additional misery that travelers have to go through when navigating an airport in the post-9/11 world has absolutely no negative bearing on the cost of air travel.



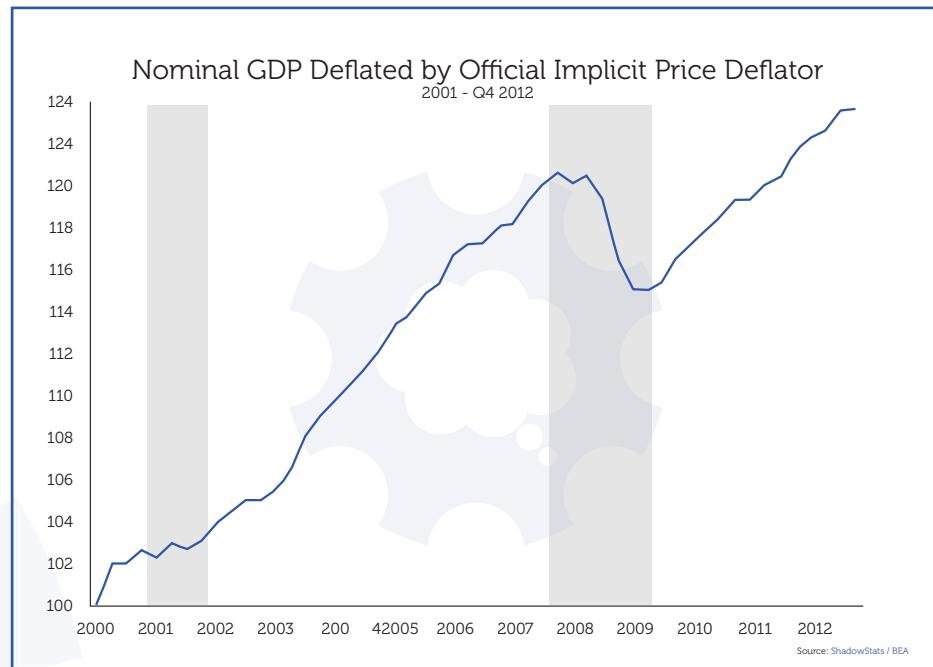
I take plenty of flights and believe me, if I could hedonically adjust the part of my life spent between the time I exit a taxi at the kerbside and the time I finally sit down at the gate, the 'cost' of travel has increased in double digits each year.

But I digress.

The idea espoused by Jim Thompson that there is only one story; things are not as they seem, is not just readily apparent in the inflation numbers, but it fits perfectly with the fake views narrative and bleeds into everything — even the GDP data.

Here's a chart showing headline *real* GDP in the U.S. going back to 2000.

The chart shows nominal GDP deflated by the official GDP price deflator and is seasonally adjusted.



As you can see, the U.S. economy climbed back above its pre-2008 level in 2011 on an official, inflation-adjusted basis. Happy days!

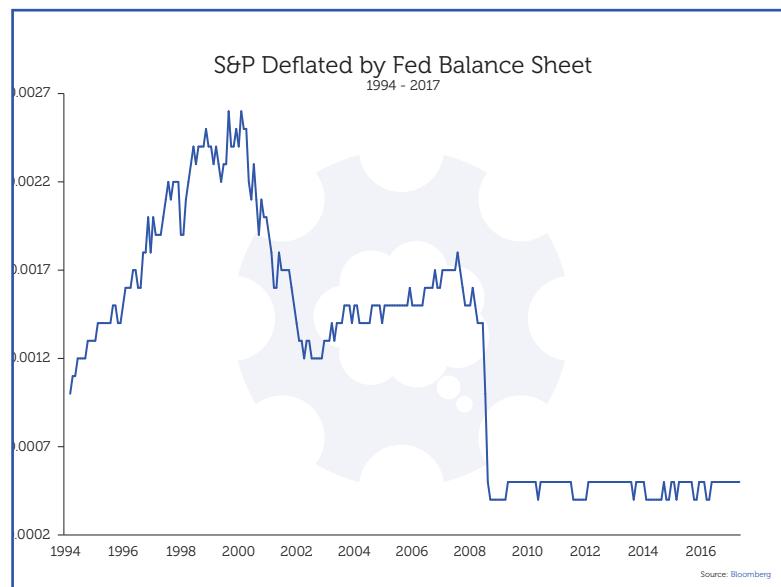
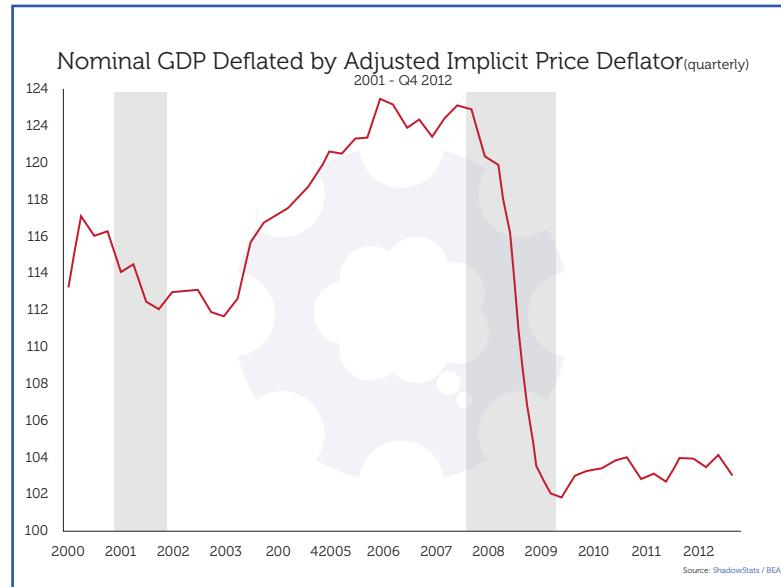
However, there are a couple of glaring anomalies in that first chart. Here's John Williams again:

(ShadowStats): No other major economic series has shown a parallel pattern of full economic recovery and beyond. Either the GDP reporting is wrong, or all other major economic series are wrong. While the GDP is heavily modeled, imputed, theorized and gimmicked, it also encompasses reporting from those various major economic series and private surveys, which attempt to mirror real-world activity. In a related area, the 2001 recession has disappeared from GDP reporting, contrary to other major economic series. Flaws in the GDP inflation methodologies have created the “recovery” and erased the previous recession.

The second graph plots the GDP corrected for the inflation understatement inherent the GDP deflator of roughly two-percentage points of annual inflation. That inflation understatement resulted from hedonic-quality adjustments, again, as discussed in Hyperinflation 2012.

Note that the 2001 recession is back, and that the “2007” recession really started in 2006, consistent with the downturn in the housing market. The economy plunged through 2008 into 2009. Instead of rebounding to full recovery, as seen in the headline GDP, however, the corrected real GDP has been bottom-bouncing, stagnant at a low level of activity. It now is turning down again. The corrected version appears to be much closer to the reality of common experience.

This chart is remarkably similar to another featured in these pages before; that of the S&P deflated by QE in the shape of the Federal Reserve's balance sheet:



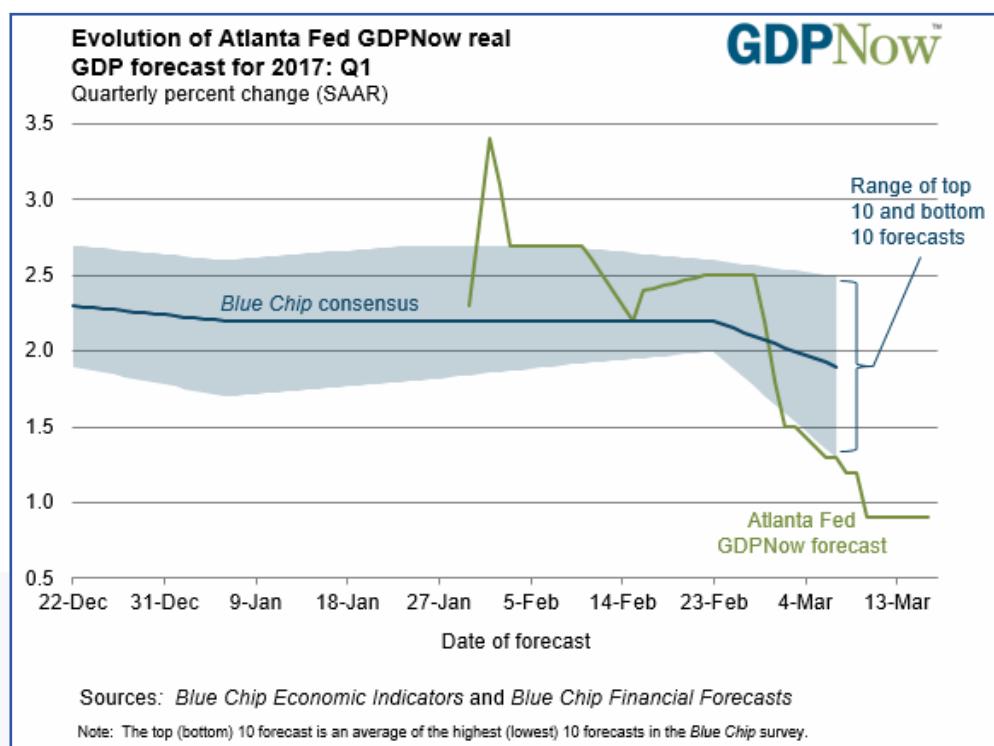
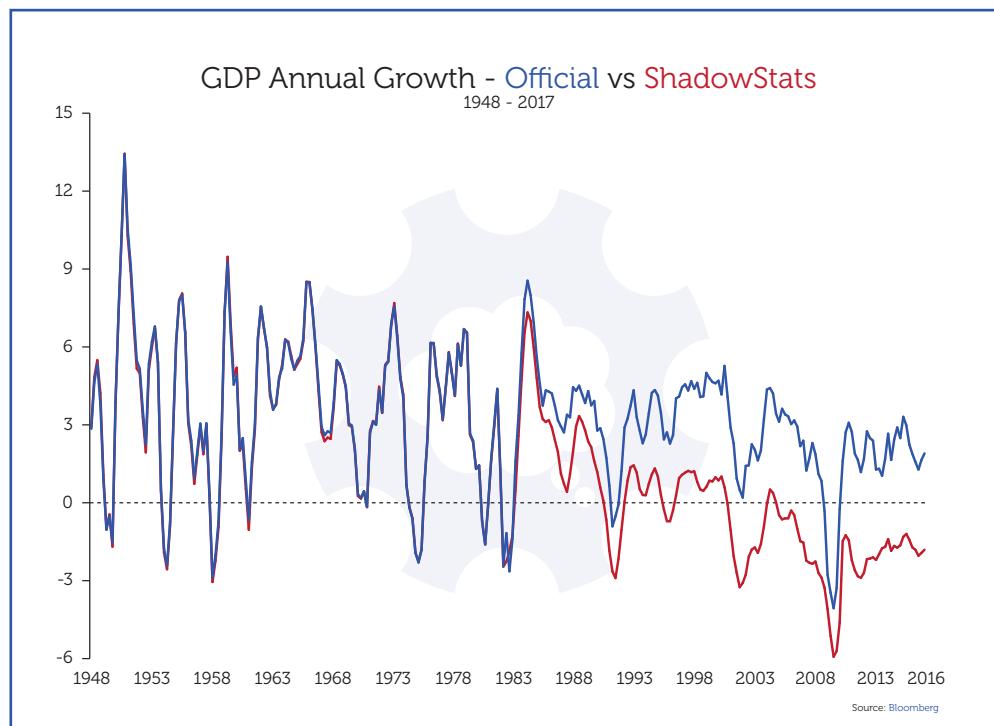
And, as you can see over time, the manipulation of inflation numbers has a profound optical effect on the strength of the U.S. economy.

Why does this matter? Well, given the events of this week, the fake views of the latest incumbent of the chair of the Federal Open Markets Committee in terms of the strength (or otherwise) of the U.S. economy are highly likely to become problematic.

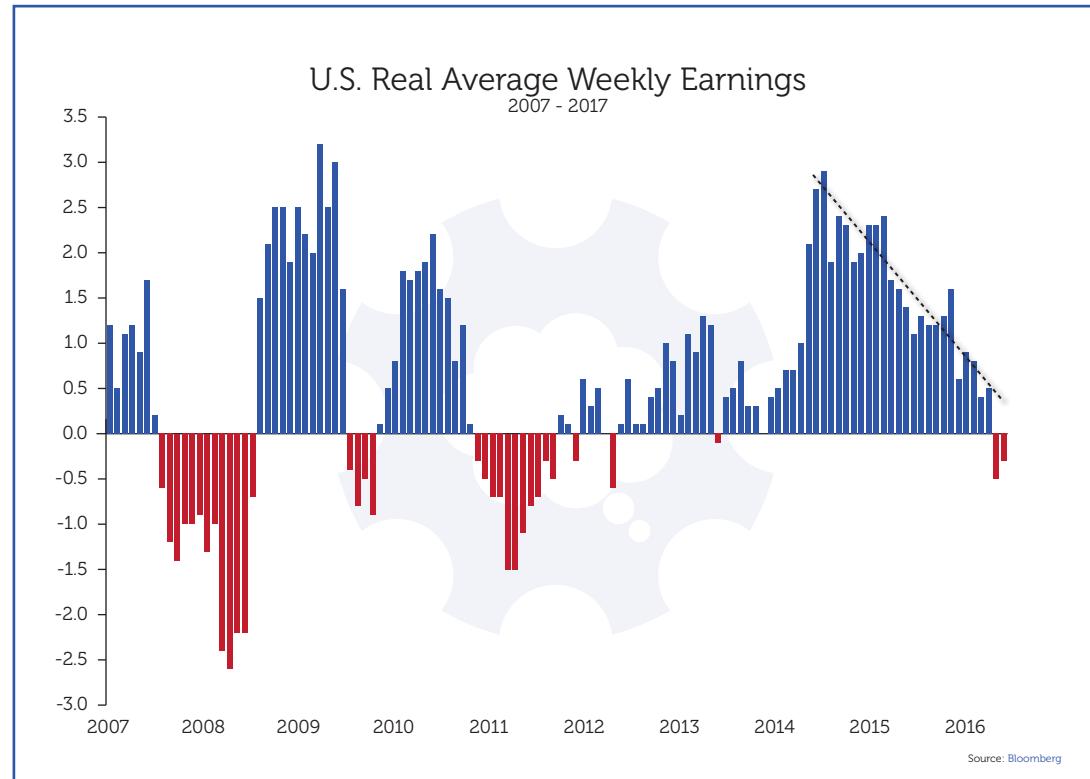
In raising rates another 25 basis points on March 15th, Janet Yellen took the step for which she had been preparing the markets for some considerable time. Going into Wednesday's press conference she and the rest of her colleagues on the FOMC must have been delighted to see expectations for a 25bp hike as close to 100% as they are ever going to get. Translation? We can raise without the market starting to wobble.

Unfortunately, the very day Janet finally took the upper bound of the federal funds rate back up to 1%, the Atlanta Fed GDPNow tracker pulled the rug out from under her feet, falling to sub-1% after having reached 3.4% just a few weeks ago.

Hardly helping matters is real average weekly earnings growth which has been negative for the last two months, continuing a downtrend which has been in place since the data peaked way back in February 2015.



Of course, at this point, just like The Maestro and The Bearded Wonder before her, Yellen has no choice but to continue offering fake views from the most important pulpit in the world because to admit the truth would be a disaster. However, at her press conference on Wednesday, the Chair faced something altogether unusual — awkward questions, particularly from Bloomberg's Kathleen Hays:



(Kathleen Hays):

What happened

between December and March? GDP is tracking very low. Measures of labor compensation are not threatening to boost inflation any time fast. The consumer is not picking up very much. Fiscal policy, we don't know what's going to happen with Donald Trump. And yet, you have to raise rates now. So what is the — what is the motivation here? The economy is so far from your forecast in terms of GDP, why does the Fed have to move now? What does this signal, then, about the rest of the year?"

Yellen's answer was... 'wishy-washy' to say the least but Hays remained undaunted and pressed on, daring to bring up the question usually on everybody's lips — at least until they get a chance to put it directly to the fed chair: "what if you're wrong?":

"So following on that, you expect it to move, but what if it doesn't? What if GDP doesn't pick up? What if you don't see wage measures rising? What if you don't — what if, what if the core PCE gets stuck at 1.7 percent?"

Too far down the road paved by her predecessors to do anything but forge ahead, Yellen muttered something about the data being 'noisy' and policy not being 'set in stone' but there is a world of difference in reading her answers and watching her deliver them so I would recommend you take the time to see for yourselves [HERE](#).

Yahoo Finance, in just three lines, identified precisely what the chair of the FOMC wanted needed to get across during her press conference:

(Yahoo Finance): Chairwoman Janet Yellen sought to justify the Federal Reserve's interest hike on Wednesday during a press conference in which she said the decision sends a "simple message" to consumers that the economy is "doing well."

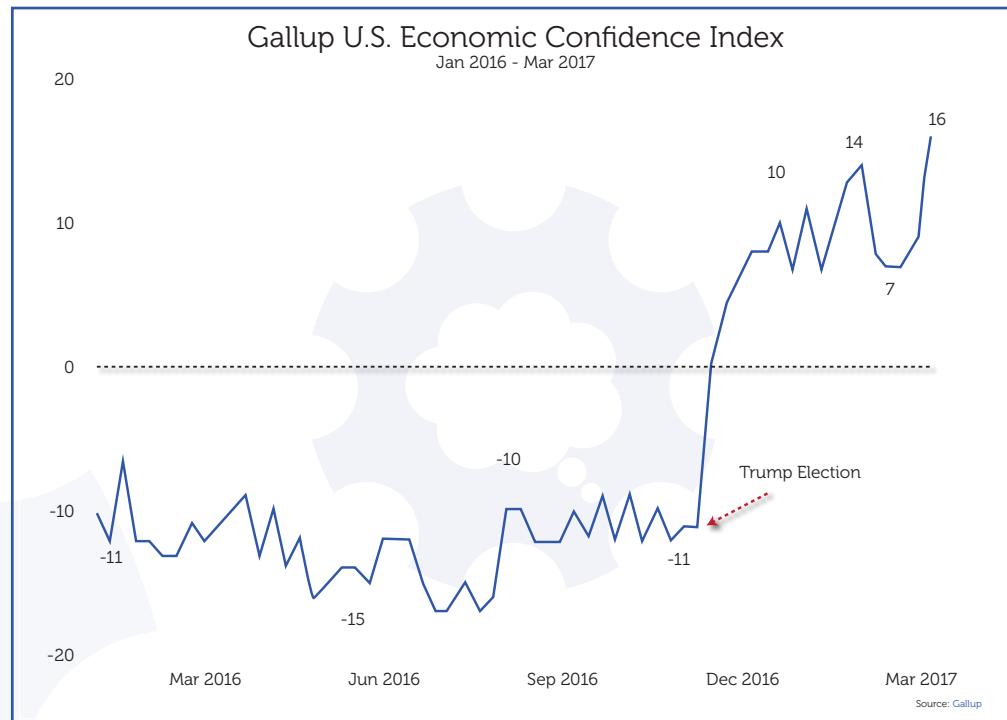
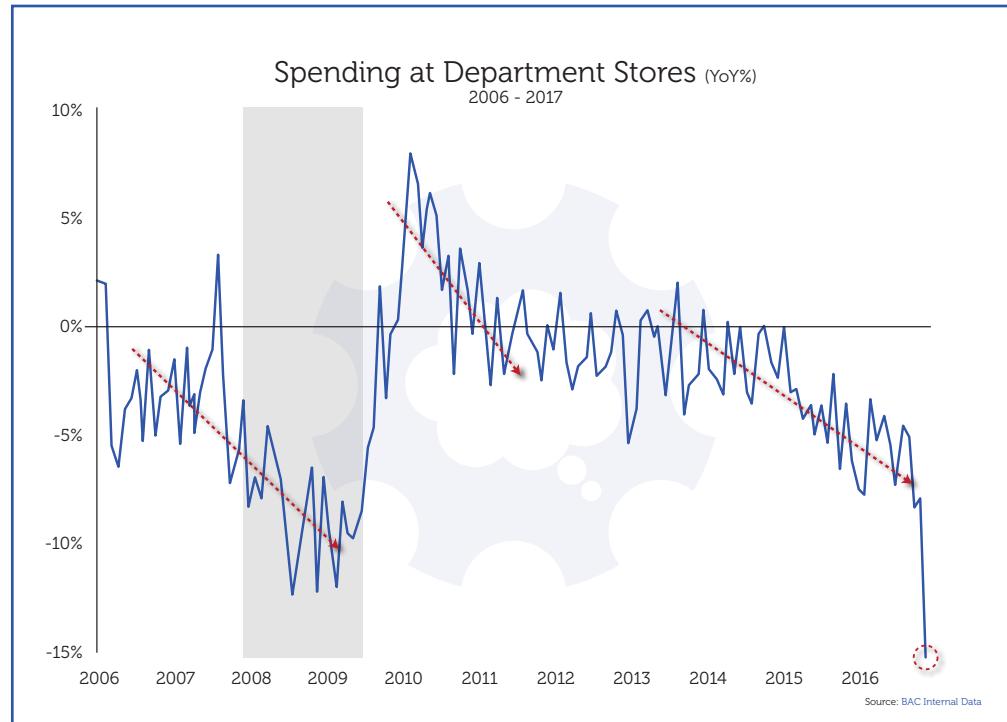
Unfortunately, a slew of recent data would seem to not only contradict the fake views of Ms. Yellen, but also to highlight just how desperate she has become to project and instill confidence.

Why?

Exhibit A: Department store spending YoY has plunged to levels below even those seen at the nadir of the Credit Crisis and which, absent periods of excessive stimulus, have essentially been in a downtrend for a decade.

Yes, the rise of online shopping has something to do with this phenomenon but the most recent data is most certainly *not* due to a sudden discovery by the consumer of a new website called Amazon.com.

We've discussed the state of the consumer before in these pages but it's safe to say that things are not getting any better, however, you wouldn't know that from the level of confidence on display (see Exhibit B, chart, bottom right).



(Gallup): Many Americans either gained or regained economic optimism last week, as Gallup's U.S. Economic Confidence Index soared seven points to hit +16. This marks the highest weekly average in Gallup's nine-year trend. The index has recovered the ground it lost over the week of Jan. 30-Feb. 5, when it fell from the previous record high of +14 to +8 and languished at that lower level for the next three weeks.

“...gained or regained confidence **last WEEK**”???

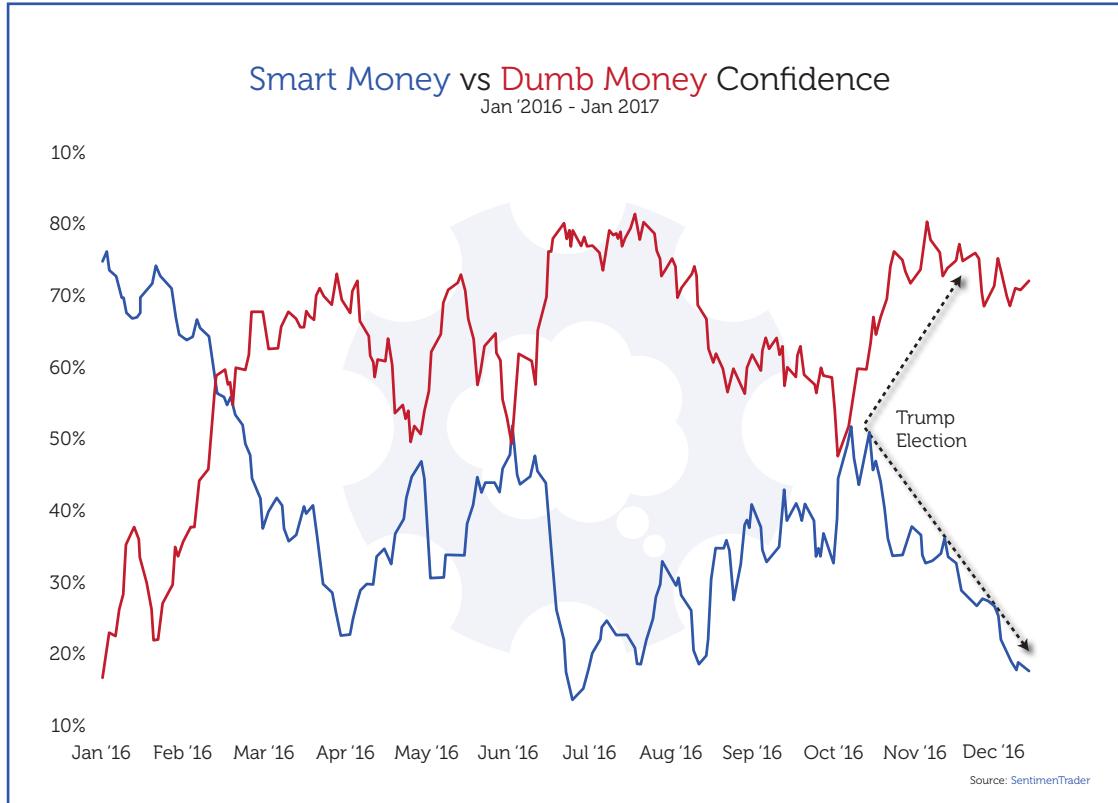
Apparently that was due to President Trump’s address to the joint session of Congress and the reason confidence ‘soared’ was simply due to the fact that he didn’t go off-piste, attack the press for reporting fake news and stuck to the teleprompter.

If nothing else, you have to admire the way Trump has reset the hurdle he has to clear to seem Presidential.

If that doesn’t highlight just what an ephemeral construct confidence is then nothing will and, of course, that works in both directions.

What’s also fascinating to watch unfold is the difference in confidence levels amongst the supposed ‘smart money’ vs the alleged ‘dumb money’.

As this great chart from [SentimenTrader](#) shows, the confidence levels of smart and dumb money went in completely different directions after the election and the faith being shown by the financial wizarding community has carried on heading lower.



The very nature of this chart helps explain why bubbles occur and to coin a phrase first used last year by a certain candidate for office, the stock market is a big, fat, juicy bubble — something which makes it all the more important that the fake views of Chair Yellen continue to be propagated.

Most important, however, has been the market reaction to the latest move by the FOMC — a reaction that caught none other than Jan Hatzius of Goldman Sachs by complete surprise:

(ZeroHedge): ...in a note by Goldman's Jan Hatzius, the chief economist warns that the market is overinterpreting the Fed's statement, and Yellen's presser, and cautions that it was not meant to be the "dovish surprise" the market took it to be.

Specifically, he says that while the FOMC delivered the expected 25bp hike, with only minor changes to its projections. "surprisingly, financial markets took the meeting as a large dovish surprise—the third-largest at an FOMC meeting since 2000 outside the financial crisis, based on the co-movement of different asset prices."

Even more surprising is that according to Goldman, its financial conditions index, "eased sharply, by the equivalent of almost one full cut in the federal funds rate."

In other words, the Fed's 0.25% rate hike had the same effect as a 0.25% rate cut!

The importance of the reaction can't be overstated because it essentially means that something I have been talking about as a key signal that the Golden Age of the Central Banker* is coming to its inevitable end has started to happen. The fed is losing control of the market:

(Jan Hatzius): The committee may have worried that a rate hike—especially a rate hike that was not priced in the markets or predicted by most forecasters as recently as three weeks ago—might lead to a large adverse reaction on the day, and wanted to avoid such an outcome by erring slightly on the dovish side. But we feel quite confident that they were not aiming for a large easing in financial conditions. After all, the primary point of hiking rates is to tighten financial conditions, perhaps not suddenly but at least gradually over time. And even before today's meeting, at least our own FCI was already fairly close to the easiest levels of the past two years and this was likely one reason why the committee decided to go for another hike just three months after the last one.

This loss of faith/loss of trust (call it what you will) is both striking and dangerous in a low-growth world which is teetering on the brink of a protectionist wave, as a recent OECD survey pointed out:

(Bloomberg): The global economy may not be strong enough to withstand risks from increased trade barriers, overblown stock markets or potential currency volatility, according to the Organization for Economic Cooperation and Development.

While forecasting a pickup in growth this year and next, it said the pace is still too slow and warned there's much that could derail it.

* © Dr. Ben Hunt

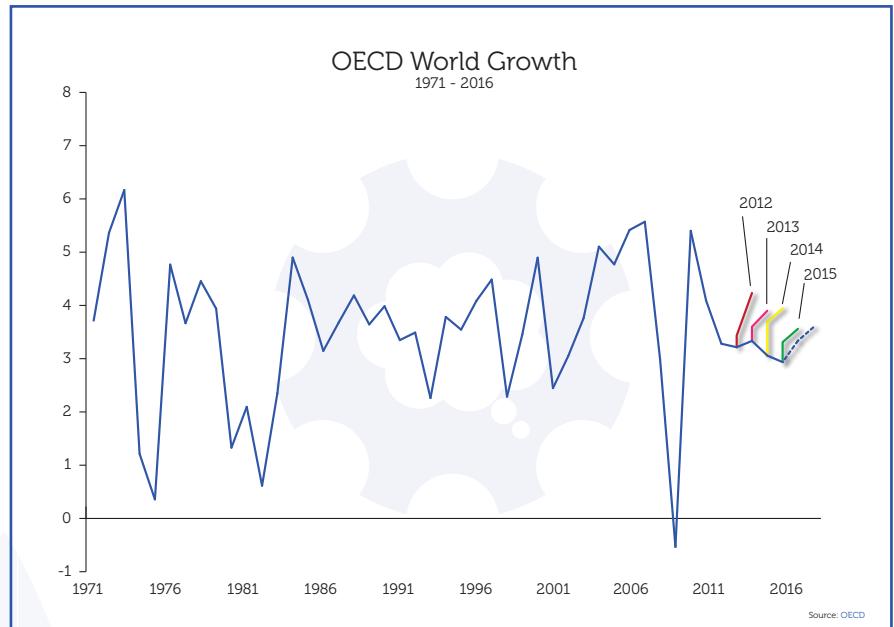
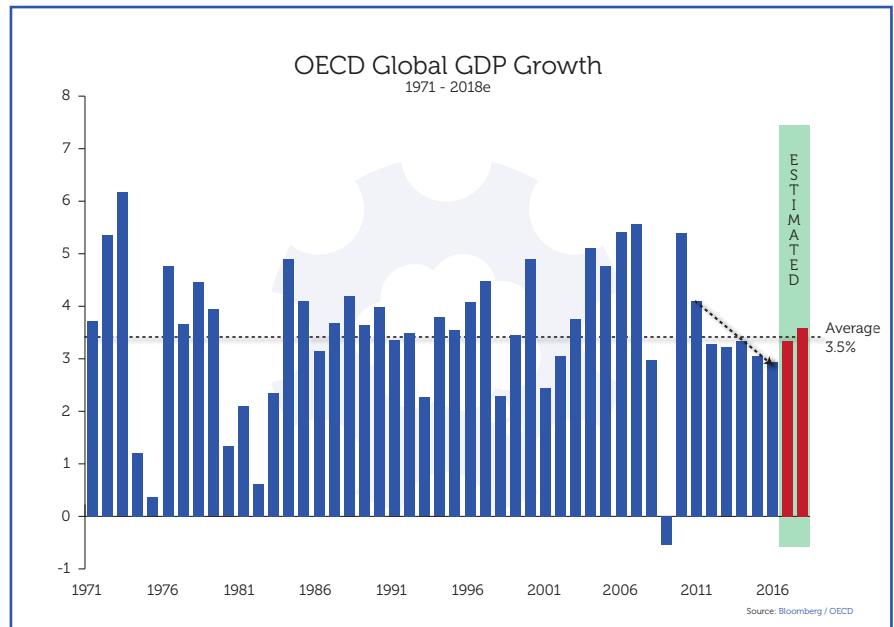
The OECD expects global expansion to reach 3.3 percent this year, up from 3 percent in 2016, and pick up again in 2018. But the pace will remain short of its average in the two decades before the financial crisis because of weak investment and productivity gains.

"We have acceleration but I'm concerned about this really soft foundation to the recovery," OECD Chief Economist Catherine Mann said in an interview. "We still have this slow, sluggish productivity growth and persistent inequality. Put those together and it's hard to see the robust consumption and investment profile you need to really get things going."

Yes, of course the OECD see growth higher next year. That will come as no surprise to anybody and, as you can see here, after five consecutive years of below-average growth, they are once again confident that starting *next year*, things will once again be on the up.

A look at the second chart shows once again the relentless optimism of yet another official body whose models (upon which we mere mortals are supposed to blindly rely) continuously overestimate the future.

Call me a cynic but when you have august bodies such as the OECD and the Federal reserve who hold the integrity of their models sacrosanct and, indeed, build their entire functionality around them, surely, if there was nothing remotely disingenuous going on they would by now have tweaked an input here or there to ensure that the forecasts were more accurate — but, by '*more accurate*' I of course mean '*lower*' so is it any wonder tweaks of *that* nature (unlike those which lowered the CPI) haven't been made? Of course not.





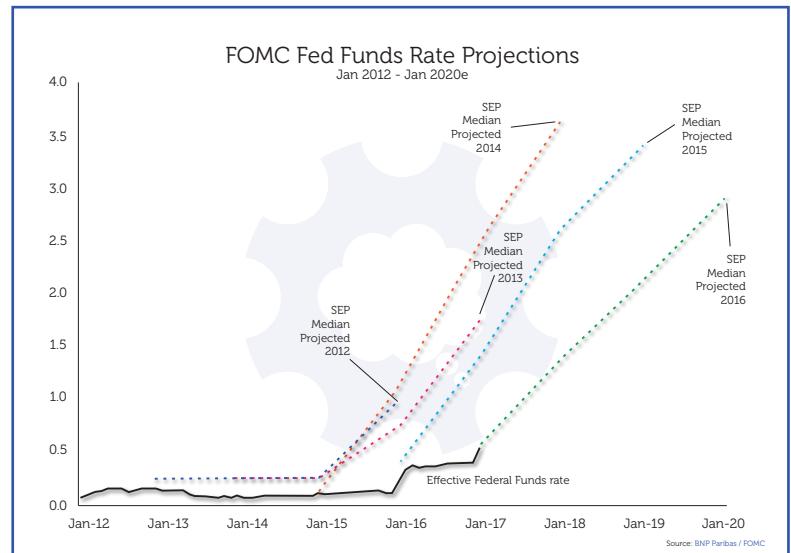
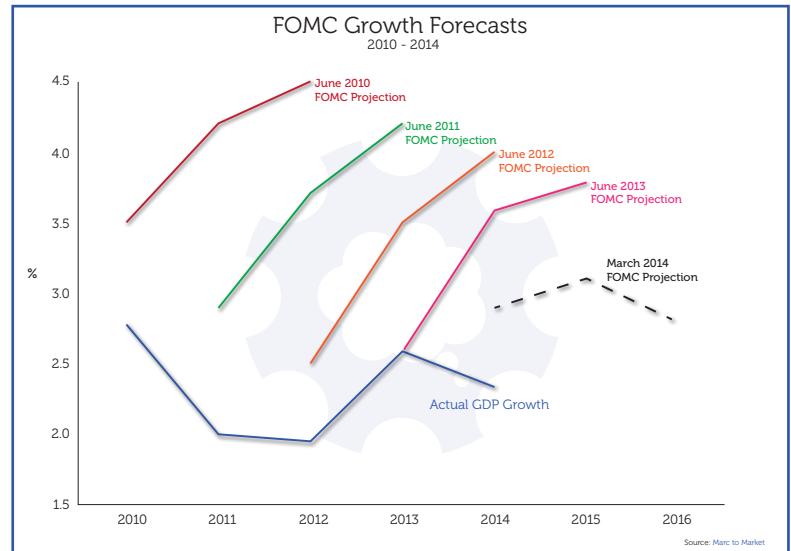
The Fed have missed growth estimates every year since 2010 — and by an almost unfathomably wide margin each time.

Similarly, their forecasts for the fed funds rate have been so far off beam as to raise doubts as to why *any* serious investor would take what they say at face value.

That lack of any real credibility hasn't hurt them thus far because it has resulted in ascending asset prices so investors can sit back, listen to the fake views, chuckle and carry on buying the dips safe in the knowledge that the fed don't have the balls to raise rates meaningfully and, should anything untoward happen like.. oh, I don't know... maybe a 1% correction? The fed will step in with more accommodation.

You see, that's the trouble with fake views; you start off uttering them to drive a chosen narrative but you end up being forced to maintain and defend them with both your reputation and your credibility on the line should you fail.

Mere mortals such as you and I don't have the luxury of being able to defend any fake views of our own with the full faith and credit of the United States government or, God forbid, the blank cheque that an electronic printing press offers, but these people do and they are shameless.



Charlie Bilello @charliebilello · 18h

S&P 500: 108 trading days w/o a 1% down move, longest since 1995. If no 1% down day next week, longest since 1965.

| S&P 500: Longest Periods Without a 1% Down Day (1950 - 2017) | | | |
|--|--------------|------------|----------------|
| Rank | Streak Start | Streak End | # Trading Days |
| 1 | 3/1/1963 | 10/8/1963 | 154 |
| 2 | 7/21/1965 | 2/28/1966 | 154 |
| 3 | 11/12/1953 | 6/7/1954 | 142 |
| 4 | 11/26/1963 | 6/3/1964 | 131 |
| 5 | 10/25/1960 | 4/17/1961 | 119 |
| 6 | 2/12/1957 | 7/26/1957 | 115 |
| 7 | 1/3/1985 | 6/12/1985 | 112 |
| 8 | 12/9/1994 | 5/17/1995 | 110 |
| 9 | 10/12/2016 | 3/17/2017 | 108 |
| 10 | 7/20/1995 | 12/15/1995 | 105 |
| 11 | 6/6/1967 | 10/30/1967 | 103 |
| 12 | 12/18/1957 | 5/13/1958 | 102 |
| 13 | 6/21/1993 | 11/2/1993 | 95 |
| 14 | 7/14/2006 | 11/24/2006 | 94 |
| 15 | 10/12/1992 | 2/12/1993 | 87 |
| 16 | 4/16/1952 | 8/15/1952 | 86 |
| 17 | 7/26/1968 | 12/20/1968 | 85 |
| 18 | 5/8/1979 | 8/31/1979 | 82 |
| 19 | 8/5/1964 | 11/30/1964 | 81 |
| 20 | 2/15/1950 | 6/2/1950 | 75 |

Pension Partners @CharlieBilello

Charlie Bilello @charliebilello · 18h

S&P 500: 63 straight days w/o a 1% intraday move, the most peaceful market in history. \$SPX pensionpartners.com/the-most-peace...

S&P 500: # Consecutive Trading Days Without a 1% Intraday Move (1962 - 2017)

#Consecutive Trading Days Without a 1% Intraday Move (1962 - 2017)

Pension Partners



Ultimately, however, Thompson's single plot will emerge and things will be shown to be decidedly not what they seem.

This very week, alongside the claims of an economy which is robust enough to stand another round of tightening, the latest U.S. Industrial Production print was announced and, as we have shown in this publication previously, this is just about as concrete a barometer for an upcoming recession as any investor could wish for.

Assuming Thompson is correct and things are not what they seem, we can join several dots as it would naturally follow that assets are understandably being priced to a narrative which has been deliberately built around a series of fake views. Namely; the economy is doing well, equities are not over-valued, the fed is not behind the curve, the dollar is going to the moon, volatility is dead, deflation is dead but inflation is under control, the debt ceiling will be raised without issue and President Trump will get his tax cuts and his infrastructure spend passed by Congress but not suffer any problems with higher interest rates putting the squeeze on the now-\$20 trillion dollars the United States owes the rest of the world.

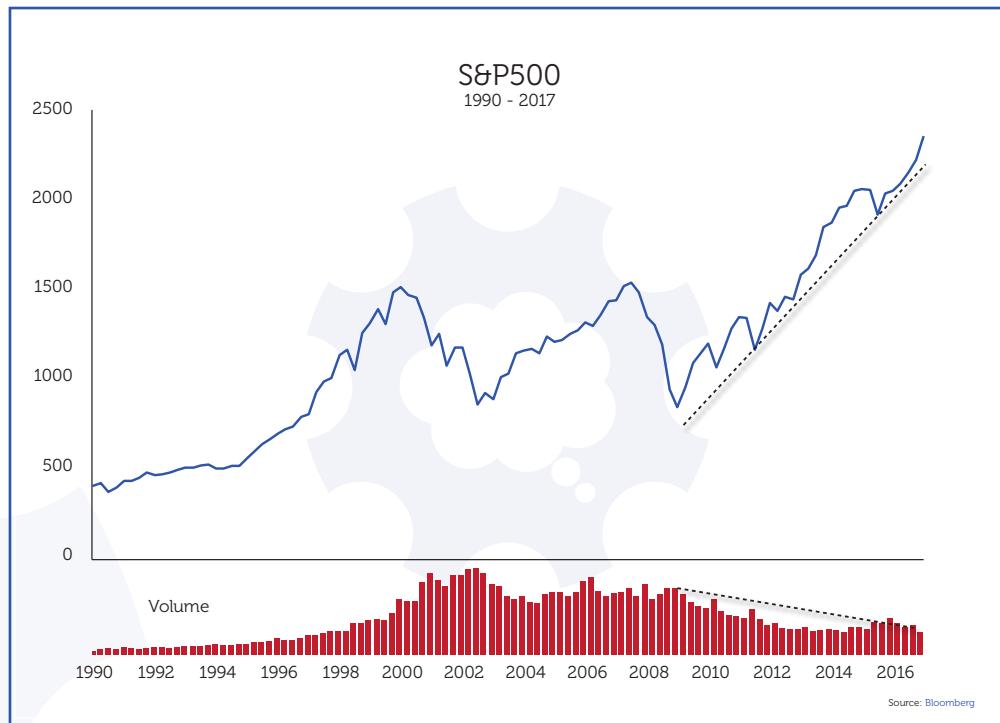
So, all this being said, we need to ask ourselves one crucial question; if such views are fake and things are *not* as they seem then what should we, as investors, do about it?

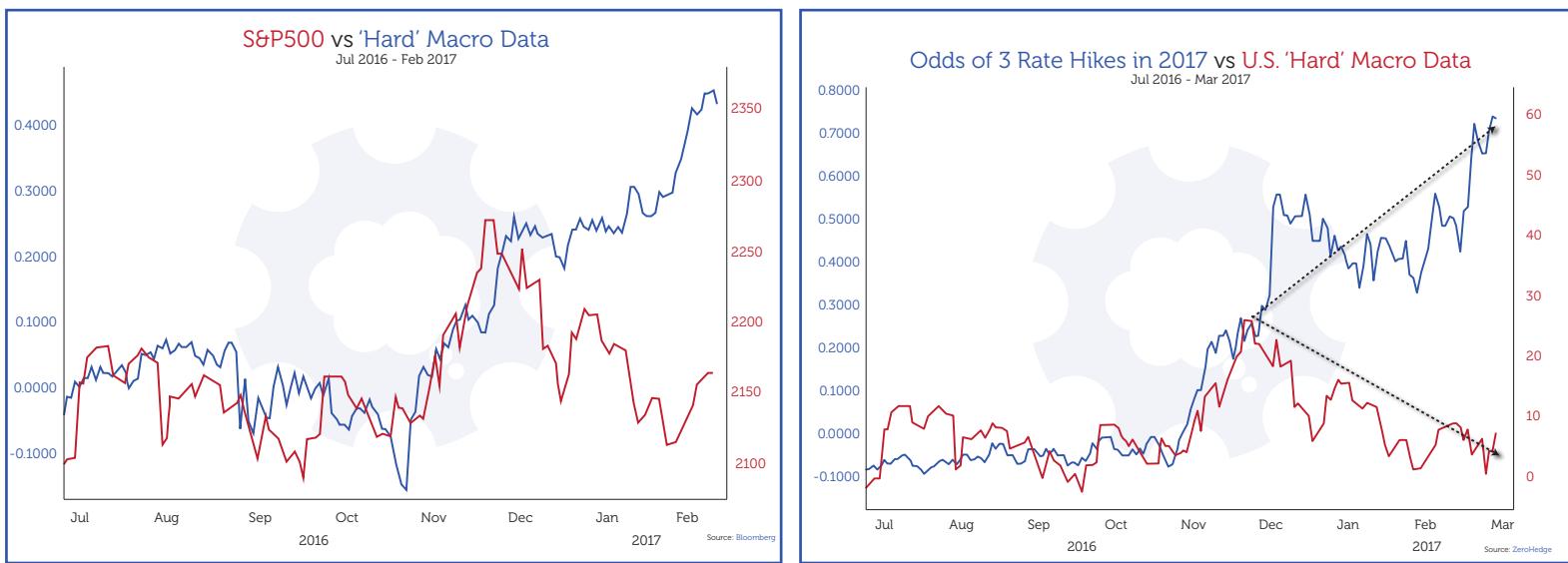
This is the perfect set-up for the contrarian investor — overvaluations as far as the eye can see, a clearly false (or, in this case, fake) narrative and universal buy-in to same on the part of market participants.

I know, I know... I've banged this drum before but take a look at these charts through the prism of things being not as they seem and tell me; what would you do?

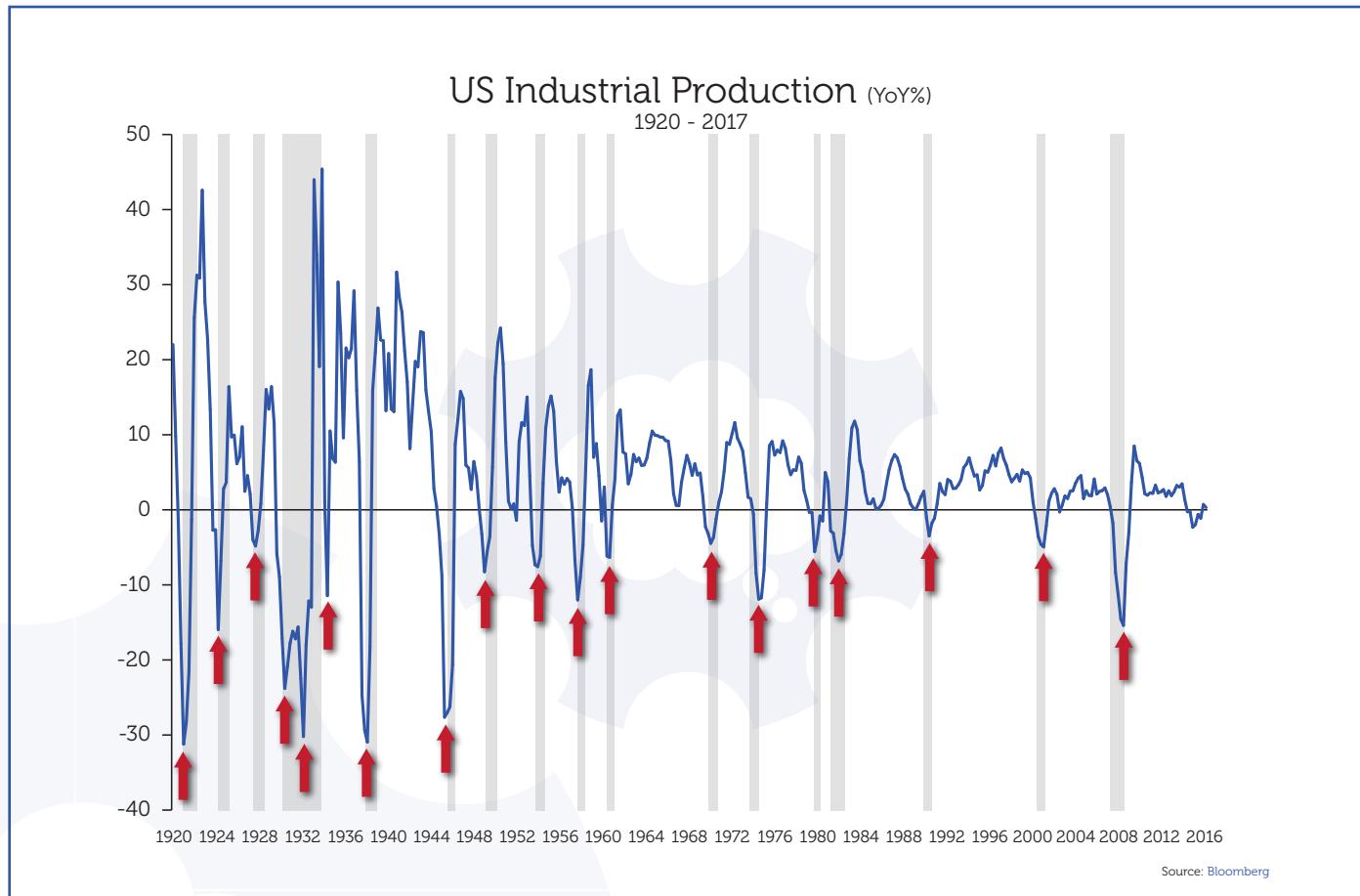
First up, the S&P500 which has skyrocketed to record highs by an unfathomable magnitude with the volume declining and the economic data simply failing to offer any justification for the move.

As the 'hard' macro data has deteriorated so the S&P Index *and* the odds on three rate hikes by the Yellen Fed have soared.

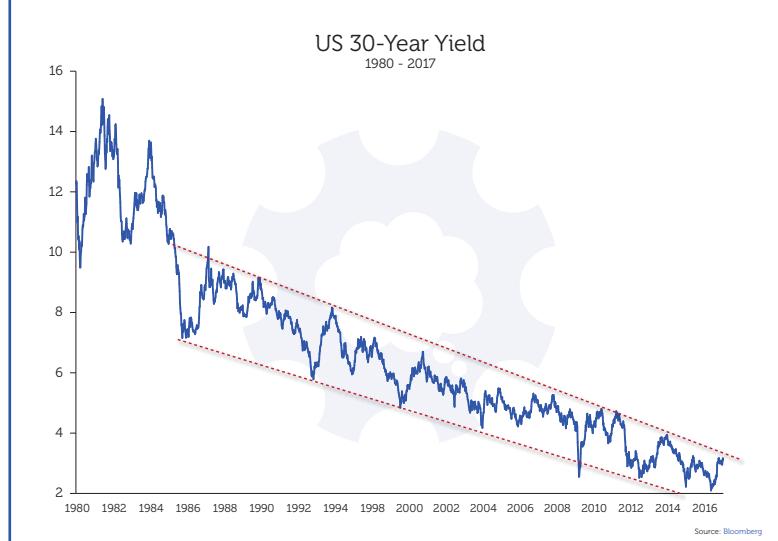




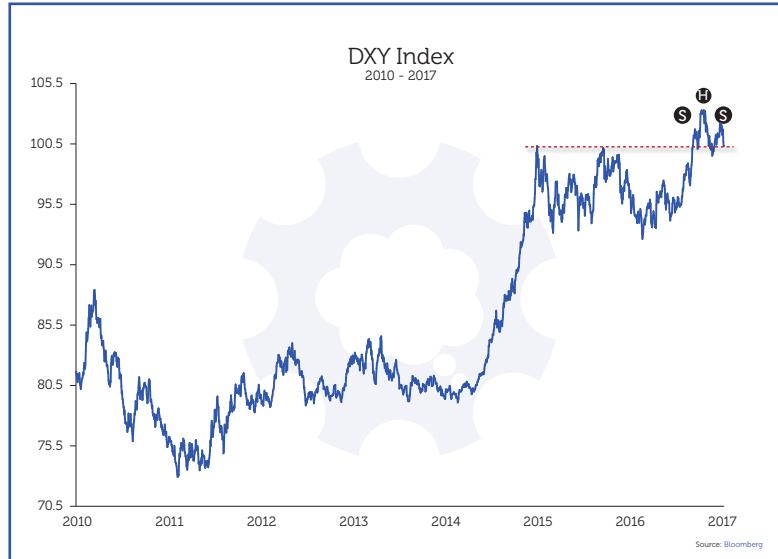
Meanwhile, amongst that hard data, the most recent 'miss', Industrial Production, (an almost flawless waning signal for an impending recession) continues to scream out a warning:



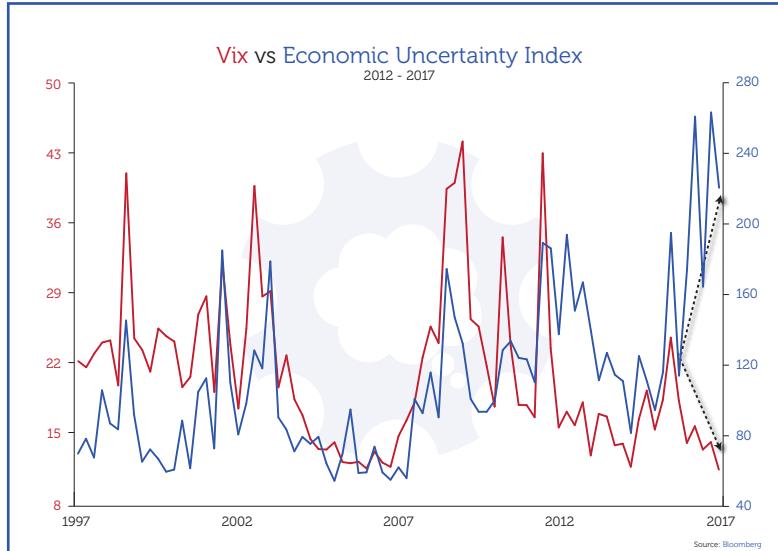
The treasury market can seemingly find no love anywhere — even though it refuses to break out of its long-term trend....:



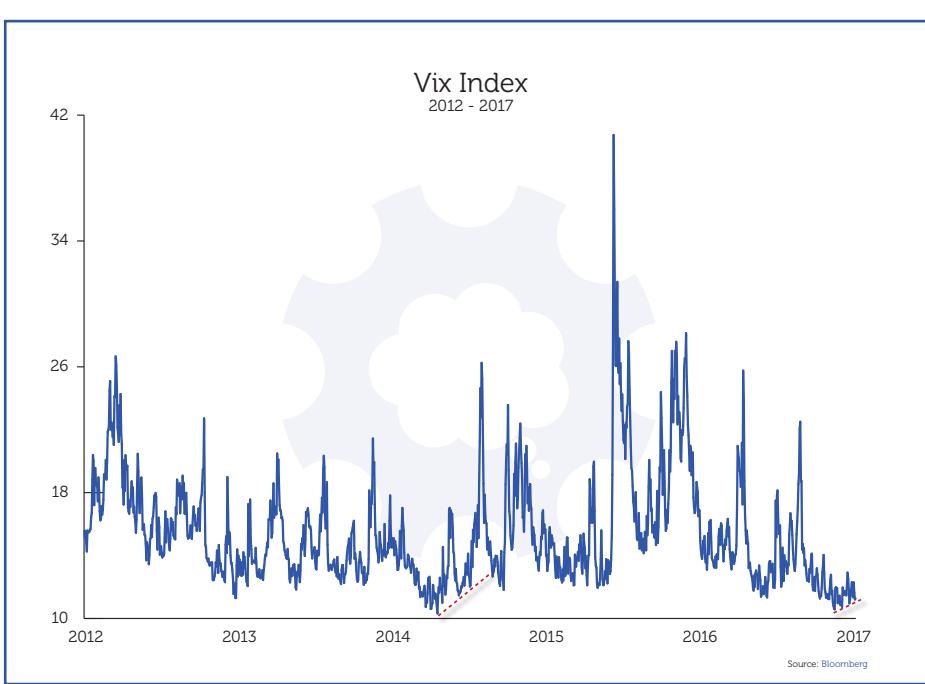
...and everybody's favourite consensus long, the U.S. Dollar wages a pitched battle that has every technical analyst in the world on red alert.



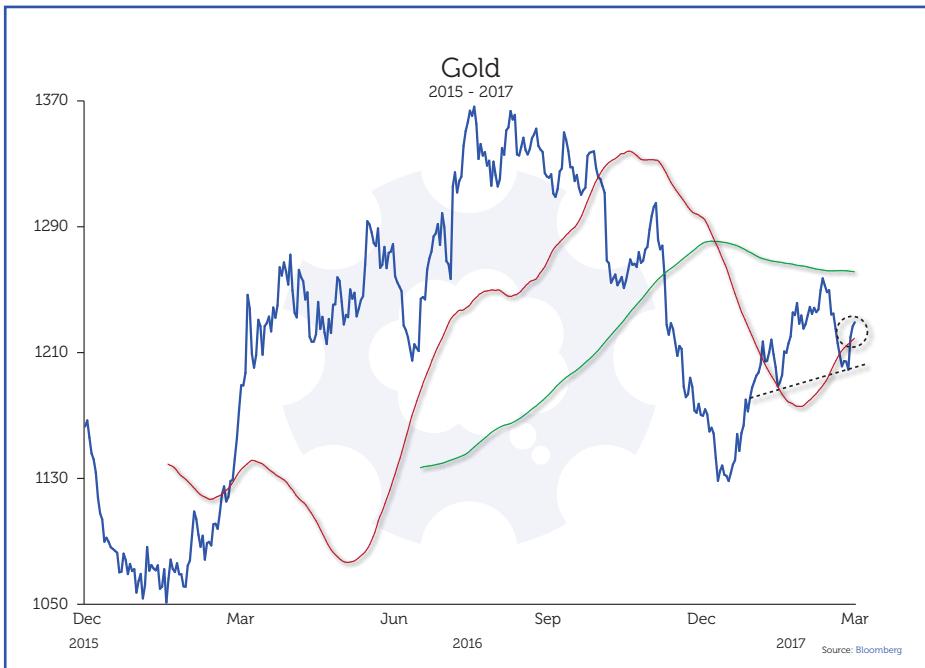
But... even though the VIX Index has also diverged from reality when viewed against global political uncertainty...



...the first signs of a rise in volatility can be seen in the bottom-right hand corner of the chart... iiiiiif you look closely enough.



While elsewhere, that other early warning sign, gold, has crossed above its 50-day moving average, perhaps sensing trouble ahead...



The news is fake, the views are fake and the evidence is everywhere that those responsible for disseminating both have a very clear motive for what they are doing.

Don't be fooled.

As Jim Thompson so clearly articulated; there may be 32 stories but there is only one plot.

Things are not as they seem.



OK, so after all that talk of fake views, it's time to move on to some of the realities of today's world and we begin in Hong Kong — a place famous for its spectacular skyline which offers views that are anything but fake. This week, however, we take a look beneath the surface — literally — as we explore an unseen side of the Fragrant Harbour.

From there our journey takes us to Uttar Pradesh in India, where Narendra Modi scores a decisive victory, to The Netherlands, where Mark Rutte does likewise and to South America where we find out how to be a gold smuggler.

Europe may be broken but the FT thinks we shouldn't count her out, Ambrose Evans-Pritchard explains why the Fed has a tiger by the tail, Robert Shiller has déjà-vu all over again as he contemplates Wall Street's reaction to President Trump and Peter Zeihan walks us through three new wars (as if we didn't have enough to think about already).

In Venezuela, the solution to a bread shortage is distinctly... Venezuelan, and finally, in keeping with the subject of this week's *Things That Make You Go Hmmm...*, we hear why economics is the 'wrongest' profession.

Our charts include a series which encapsulates the French economy ahead of the May election, New Zealand's crazy house prices and Albert Edwards tells us to Mind the GAAP.

Lastly, we hear from David Stockman, Jonathan Tepper and there is a chance to hear the new Real Vision podcast, Adventures in Finance so please do give that a listen and subscribe/review/tell your friends/all of the above.

Lastly, a little Housekeeping.

I will be moderating my friend Dave Floyd's **Round Table at the Ranch** event which will take place May 4th-6th at the beautiful Brasada Ranch in Central Oregon.

Joining us will be an excellent group of speakers including Andrew Baptiste, James Cutting, Michael Oliver and my good friend Jesse Felder.

You can find out more about the event by clicking [HERE](#) and hopefully I'll see some of you there.

UNTIL NEXT TIME...



INSIDE HONG KONG'S ABANDONED MINES: SCMP

Exploration geologist Jackie Chu Chun-tak splashes through cold, ankle-deep water as he progresses further into the gloom of the dark, narrow tunnel, carved out of solid granite. This abandoned mine is not for the claustrophobic and it's potentially dangerous for those who don't know what to look out for.

Chu admits he rarely allows groups under his direction to venture this far beyond Portal 8, for safety reasons, but Post Magazine has been afforded special access to the underground secrets of the Needle Hill tungsten mine.

The tunnel is an adit, a horizontal passage, about 1.5 metres high and two metres wide, which connects the partially sealed portal, and the outside world, to the quartz vein that extends vertically through the mine and contains the valuable wolframite ore, from which tungsten is extracted. This adit has not been worked for some 50 years and the only remnants of a once-thriving industry are rotting ladders, disappearing trolley tracks and porcelain guides for wire telephone lines protruding from the jagged walls.

"We won't go any further, it's not safe," says Chu, as the beam from his powerful torch illuminates a pile of granite boulders the size of large suitcases, which have fallen from the collapsed roof.

While working for a mining consultancy in Kazakhstan, Chu and a colleague, Jacky Chan Sik-lap, decided to write a book titled *Hong Kong Mining History* (2015). It was a labour of love rather than a commercial venture but they have sold more than 1,500 copies and the weekend group tours to disused mines Chu leads are usually oversubscribed.

Above Chu's head, the large gap where the quartz vein once was rises to the upper reaches of a network of adits and shafts that extends for more than 3km, through Needle Hill, adjacent to the Lower Shing Mun Reservoir. The Shing Mun Tunnel Road passes within a metre of the bottom of the extensive mine network.

On this cold winter's day, it is surprisingly warm and humid this far inside the mine. Chu says it remains about 18 to 20 degrees Celsius all year round as he searches for some of the dark grey wolframite mineral embedded in the mine walls, near the site of the quartz vein. Apart from Chu's echoing voice, there is only the sound of dripping water.

"Yes, that's it," he says, shining his torch about 20cm from the adit ceiling as the mineral glints in the light.

During its operational peak, in the 1950s, when tungsten was in high demand for the armour-piercing munitions used in the Korean war, the mine employed more than 2,000 men. About 222 tonnes of wolframite concentrate was extracted annually.

On exiting the adit into blinding daylight, Chu points out the concrete shells of what were once ore-processing sheds, accommodation blocks and a canteen, now being reclaimed by vegetation. There was a good road here, too, which linked Needle Hill with Tsuen Wan, so that ore concentrate could be transported by truck for export.

Records show that the first mining permit for Needle Hill was issued in 1917 and a South China Morning Post report in June 1920 stated that, “The output from the Needle Hill mine averaged about 30 piculs [a unit of weight defined as a ‘shoulder load’] of wolfram ore per month [in 1919].”

Mining was sporadic during the 20s, because of unstable prices, and was restricted to traditional methods – shallow surface cuts and short adits – due to ventilation problems.

In 1935, while the Shing Mun Reservoir was under construction, resident engineer Gordon Gifford Hull spent a lunch break panning in a stream. He recognised wolframite-rich placer deposits (the accumulation of minerals formed by gravity separation during sedimentary processes) in sediment being excavated from the Upper Shing Mun River. This was of a higher grade than the wolframite that had so far been mined in the area and he traced the mineralisation to the quartz veins on Needle Hill.

“The agreement with the Hongkong Government which Mr J. H. Marsman signed on Monday grants to Marsman Investments Ltd a 21-years’ lease, on a royalty basis, to develop the wolfram deposits over an area of approximately 540 acres near Needle Hill and the Shing Mun River,” reads a May 13, 1936 Post report.

Jan Hendrik Marsman was a Dutch engineer and entrepreneur who had extensive business interests in the Philippines. He successfully ran the Needle Hill mine until the Japanese invasion, in 1941. According to anecdotes from the time, Marsman missed his early morning call at the Peninsula hotel and thus the last Pan Am Clipper out of Hong Kong before the Japanese army arrived. He later escaped to the United States and wrote a book about his exploits.

Perhaps Marsman himself walked in this part of the mine during a tour of inspection, Chu suggests, pointing to a flooded shaft full of limpid water as a bat flutters past his head.



The Japanese worked the mine but left it in a state of acute disrepair. Marsman Hong Kong (China) was wound up in 1952. According to the Post report on the company's demise, more mechanisation had been considered for Needle Hill, then dismissed "in view of the declining price of wolfram ore".

The company had also been working the Castle Peak Mine, but that had been made untenable by an obstacle that has scuppered many a Hong Kong venture: uncooperative neighbours.

"Negotiations were entered into with the owners of the adjoining property to permit the passage of wheeled vehicles over their lots to gain access to the mine," read the report. But the owners' demands were "out of reason" and it was decided to defer any further capital expenditure...

HOW TO BECOME AN INTERNATIONAL GOLD SMUGGLER: BLOOMBERG

AS the minutes ticked by on the afternoon of April 28, 2015, Harold Vilches watched stoically while customs officers at Santiago's international airport scrutinized his carry-on. Inside the roller bag was 44 pounds of solid gold, worth almost \$800,000, and all the baby-faced, 21-year-old college student wanted was clearance to get on a red-eye to Miami. Vilches had arrived at the airport six hours early because he thought there might be some trouble—he'd heard that customs had recently seized shipments from competing smugglers. But Vilches had done this run, or sent people to do it, more than a dozen times, and he'd prepared his falsified export paperwork with extra care. He was pretty sure he wouldn't have any trouble. While he waited, he texted his contacts in Florida, telling them he'd already cleared customs.

The plan was to hand off the gold at the Miami airport to a pair of guards, who would load it into an armored truck for the short trip to NTR Metals Miami LLC, a company that buys gold in quantities large and small and sells it into the global supply chain. The modesty of its shabby office, where a receptionist sits behind an inch-thick acrylic barrier, belies the amount of business that goes on inside. U.S. Department of Justice investigators believe NTR Metals Miami has bought at least \$3 billion in South American gold in the past four years, much of it from illegal mining operations, people familiar with the investigation say.

Vilches didn't need this headache. In just two years he had rapidly risen in the ranks of Latin American gold smugglers. Although he was barely old enough to order a beer in Miami, he'd won a \$101 million contract to supply a gold dealer in Dubai. That hadn't exactly worked out—the Dubai company was after him for \$5.2 million it says he misappropriated—but still, in a brief career he'd acquired and then resold more than 4,000 lb. of gold, according to Chilean prosecutors. U.S. investigators and Chilean prosecutors suspect almost all of it was contraband.



That evening at the airport, Vilches employed his standard cover story, saying that the gold came from coins acquired from customers and recast as ingots. The customs officers weren't buying it. The laboratory Vilches had used to vouch for the gold wasn't government-certified, they said, and they doubted his claims that the gold had come from coins. Vilches was irate. He couldn't believe it when the man behind the desk called his boss and then relayed orders from above: If it's Vilches's gold, seize it.

Investigators with the Policía de Investigaciones, Chile's equivalent of the FBI, had been monitoring Vilches for months, intercepting his phone calls and scouring the export papers he'd submitted. The kid was clever, they agreed, but who was he working for? "I thought there was someone behind him, always," says José Luis Pérez, a Chilean prosecutor on the case.

After the airport officials confiscated Vilches's gold, they let him go. For the next 15 months, Chilean authorities allowed Vilches to bring illegal gold in and ship it out as they built a case, searching for associates and those above him. They listened in on various telephones, read Vilches's text messages, and followed couriers. They watched as smugglers brought gold south from Peru, across remote stretches of desert and through valleys in the Andes Mountains, or west from Argentina, driving over the snowy mountain pass in the shadow of 22,800-foot-high Aconcagua, then down to Santiago and Vilches's headquarters, a place police nicknamed "The Bunker." Inside, Vilches assayed, weighed, and paid for the gold. He melted it down and recast it as ingots, then flew it, or used a family member to fly it, to Miami.

To their growing amazement, the police never found the larger organization they presumed was supporting and protecting Vilches. There was, as far as they could determine, no bigger fish. Finally, in August 2016, they arrested him. Investigators say they have documented \$80 million in gold shipments that moved through his hands via eight shell companies he established in Chile and Miami—and they think there was much more. They charged Vilches and four associates, including his wife and her father, with racketeering, smuggling, customs fraud, and money laundering. None of them have been tried, and the case remains open. Vilches's wife and father-in-law declined through their lawyer to comment. Today, Vilches lives with his wife in an apartment in a rundown part of Santiago; he's under house arrest from 10 p.m. to 6 a.m.

In exchange for his release from jail, Vilches provided extensive testimony that has allowed Chilean prosecutors and the U.S. Department of Justice to try to build a huge, multinational gold smuggling case. Interviews with police and prosecutors in Chile and the U.S. and hundreds of pages of police files describe Vilches's part in a black market that adds literally tons of illegally mined and contraband gold to the international economy every year.

In the past decade and a half, global gold consumption has risen by almost 1,000 tons a year, to about 4,300 tons, according to the World Gold Council, a London-based industry group.

Legal mining operations haven't kept up with demand, so illegal mines controlled by criminal gangs, from the Amazon to central Africa, help cover the deficit, according to Verité, a nonprofit group in Amherst, Mass., that's researched the illegal gold trade. A 2016 Verité study found that five countries in Latin America shipped 40 tons of gold from illegal mines to the U.S. in one year, almost twice the legal exports from those countries. South America's illegal gold mines, most of them in the Amazon basin, are toxic pits in which mobs of laborers use fire hoses and mercury to extract nearly pure gold nuggets from the red earth. According to a finding by the United Nations, the industry thrives on child labor, devastates the environment, and enables prostitution at ramshackle camps around the mines. The gold moves from smuggler to smuggler, then into a network of refiners and traders, all feeding the world's voracious demand...

[THREE NEW WARS; Q&A WITH PETER ZEIHAN, PART 2:](#) GAVEKAL

We recently met with geopolitical strategist Peter Zeihanto discuss world events since the American election and his new book, "The Absent Superpower: The Shale Revolution and a World without America." In the book, Peter credits energy and resource innovations with reshaping the global geopolitical environment.

We covered so much ground in our visit with Peter that we decided to break it into two reports. Last month in [part 1](#), we covered the broad impact of the Shale Revolution, which he calls, "the greatest evolution of the American industrial space since 1970," and which he expects to accelerate the breakdown of the global order as we know it. Today, in part 2, we examine the major global shifts in geopolitics that will result as the US moves into energy independence. Peter believes this will reshape global geopolitics, leading to three major conflicts. It is these conflicts we asked him to discuss in greater detail. We hope you enjoy the discussion.

GAVEKAL CAPITAL: We last left off discussing how the oil export ban could be rescinded if global geopolitical issues flare up. What are you on the lookout for?

PETER ZEIHAN: *There are three big conflicts I see that could cause a major schism between what the US pays for oil and what the rest of the world pays for it. I'm talking about a potential global oil price of around \$150 per barrel while the US pays only \$50 per barrel thanks to shale oil in the US and a resumption of the ban on oil exports. The break-even cost in the United States is around \$40. If you put the embargo back in place, you've got a functional ceiling on how high the price can be domestically. If shale overproduces and you can't export the crude, then it's a question of refining capacity which can't be built out that quickly.*



War number one is Russia vs Europe. The Russian demographic situation is already untenable and it's moving into catastrophic. By the time we get to about 2020-2022, the size of the Russian army will be less than half of what it was last year. The post-Soviet Union baby bust was that sharp, so if they are going to use their military in an attempt to re-shape their world, they have to do it now. And in many ways they already are. Depending on which scenario plays out -I list several in my book -anywhere from two to seven million barrels per day of crude in the market goes offline. Former Soviet Union oil shipments are in danger in Estonia, Latvia, Lithuania, Eastern Poland, Belarus, Moldova, Ukraine, Northeast Romania, Azerbaijan, Armenia, and Georgia. That list is the entirety of Russia's western energy exports. The Russians will either use oil as a political tool, or the targeted folks will say, "You're not going to sell crude through us while you're conquering us." Either way it's going offline. And because Russian energy production is in the permafrost it can't be shut in safely. If you turn off the wells, they freeze solid and you have to re-drill them, so from the point that the Russians stop production in a field, it's 10 years minimum to bring it back online.

One of the biggest mistakes I think people make when analyzing Russia is they don't realize that the Russians are not thinking about money right now. The general consensus is that the Russians won't do anything to disrupt the flow of oil because they need the oil income. That's not how the Russians are thinking at all. Their current borders are completely unsustainable, and they only have a short window to do something about it. The Russians see the end of their country on the horizon, and they'd rather have that be 60 years from now than five years from now. There's no route for withdrawal: they've got to get through to the Carpathians, the Caucasus and they've got to get to the Polish gap and the Baltic Sea. I believe Russia's move to extend its border is going to fail, but if I were Putin right now, I wouldn't have a better plan. And that will take, based on which scenario goes down, between two million and nine million barrels of crude offline, and five BCF and 12 BCF of natural gas.

GC:What do you think of the relationship between Trump and Putin?

PZ:For two men with egos as large and as fragile as Trump and Putin, I can't imagine they're going to get along for long. However, for 2017 both of them have a lot reasons to focus on other issues, so burying the hatchet for the moment makes a lot of sense. Also, the United States has no long-term rationale to get involved in a ground war with a nuclear-armed power who's a shell of its former self, with nothing to lose and who is invading countries that aren't even defending themselves.

I expect the rhetoric to pick back up, but for 2017, I think it's going to be pretty calm in bilateral relations. This will free up Russia to act more aggressively regionally. That means Ukraine is even more in play. That means breaking up the European Union. That means consolidating the former Soviet space. All of that is going to go into high gear this year and next.

GC:What's Russia's interest in breaking up Europe?

PZ:If the Europeans are squabbling --and it's not a difficult task to get the Europeans to squabble --they can't form a common front against the Russians unless they're American-led. So if the Americans step back for their own reasons, and you can keep the Europeans at each other's rhetorical throats, Russia can take advantage. 2

GC:What would be the bell that would ring that would announce to the world that Russia is on the move?

PZ:We have the French nationalists saying that the Russians are intervening in French national elections just like they did in the US. So the bells are ringing left, right and center. It's happening. We've already had civil discontent in Latvia and Estonia caused by Russian efforts.

GC:Who goes to bat for these countries?

PZ:Well, if it's not the United States, if you're the Baltic countries, it's Sweden. And I think they will. But Sweden can't roll back the Russians by themselves. They can make it hurt like hell. For Poland, it's Germany. The Poles just get the bad end of every stick throughout history, and they're about to get another one. For Romania and the Caucasus, it might be Turkey. Although the Russians are doing everything they can to make sure that the Turks don't want to get involved, and so far it's working. Poland, plus Germany, plus the Scandinavians, plus the Brits are sufficient to roll the Russians back...



THE PARTY OF NARENDRA MODI WINS A DECISIVE VICTORY IN UTTAR PRADESH: ECONOMIST

One television channel calls it a TsuNaMo. The term, playing on the initials of India's prime minister, Narendra Modi, is apt. In the most politically critical of five state elections whose result was announced on March 11th, Mr Modi's Bharatiya Janata Party (BJP) all but drowned its rivals in a tide of its trademark orange.

The capture of some 312 out of 403 seats in the state assembly of Uttar Pradesh was not merely a result of harder work, superior organisation and a more aggressive message. Indian pundits, a normally quarrelsome bunch, are virtually unanimous in crediting Mr Modi himself as the biggest vote-getter. Having won power in 2014 on a wave of hope for change, Mr Modi's government had begun to lose momentum and the prime minister himself his aura of invincibility. In particular his abrupt move in November to scrap higher-denomination currency notes, which caused widespread hardship for little evident gain, raised doubts about Mr Modi's competence. But now his hawa, meaning wind—as in a political tail-wind—is back. From one end of the Britain-sized state to another, voters proudly declared confidence that Modi-ji is the man to sort out India's myriad woes.

Uttar Pradesh is only one of 29 states and 7 “union territories” but with 220m people it is by far the most populous. It happens also to spread eastwards from the suburbs of Delhi, India's capital, and to straddle the Hindi-speaking heartlands that tend to set the national agenda. In the 2014 general election that brought the BJP to power at the centre, the party had also swept the state. But as those pundits are fond of saying, local politics is different: the party held barely 10% of seats in Uttar Pradesh's own assembly.

For the past decade two local parties, each with roots in different caste groups, have dominated the state's confoundingly complex politics. In the run-up to this last election, which was held in seven phases in February and March, both parties projected outright victory for themselves. They disdained to follow the example set in 2015 in the neighbouring state of Bihar, where rival local groups successfully joined in a coalition to trounce the BJP. So even though the two parties (along with Congress, the fading national party associated with the Gandhi political dynasty that had joined one of them in electoral alliance), together won more than half the votes, India's first-past-the-post system allowed the BJP to romp home with a 39.7% vote share.

For many this is good news. Across UP—as the state is often abbreviated—revellers turned the victory into an excuse for starting early with the carnival antics of the spring festival of Holi, which officially falls on March 13th. In the business world many are pleased for more sober reasons, hoping that Mr Modi's government may now have renewed confidence to pursue market-opening reforms.

But for some the BJP's win is bad news. Perhaps most obviously, it is discomforting to UP's 40m Muslims. Not only did the Hindu-nationalist BJP not field a single Muslim candidate. Subtly in the case of Mr Modi himself, and not-so-subtly in the case of lower-ranking lieutenants, party spokesmen rubbed salt in perceived sectarian wounds. They insinuated, for instance, that other parties had showered particular favours on Muslim voters—who in fact are generally worse off than their Hindu compatriots. Social media, meanwhile, spread messages that called on Hindus to ignore their caste differences and vote for “our” interests.

More immediately, the shock loss in UP was a particularly brutal blow to Congress, the perennial rival of the BJP in national politics. Congress's current scion, Rahul Gandhi, had hoped to turn a strong showing for its UP alliance into a springboard for the 2019 general election. Congress suffered other poor results on March 11th, losing control of the mountainous northern state of Uttarakhand, failing to keep a majority of seats in Manipur to the east, and falling short of an outright win in Goa to the south despite a poor showing by the incumbent BJP. Its only consolation was that these are all relatively tiny states, and that Congress did win a resounding triumph over allies of the BJP in Punjab, a relatively rich state with 30m people. But in the context of a national map that now glows mostly orange from the Himalayas to the Indian Ocean, that looks more like a toehold than a springboard...

WALL STREET'S BUZZ OVER 'GREAT LEADER' TRUMP GIVES SHILLER DOT-COM DEJA VU: BLOOMBERG

The last time Robert Shiller heard stock-market investors talk like this in 2000, it didn't end well for the bulls.

Back then, the Nobel Prize-winning economist says, traders were captivated by a “new era story” of technological transformation: The Internet had re-defined American business and made traditional gauges of equity-market value obsolete. Today, the game changer everyone's buzzing about is political: Donald Trump and his bold plans to slash regulations, cut taxes and turbocharge economic growth with a trillion-dollar infrastructure boom.

“They’re both revolutionary eras,” says Shiller, who’s famous for his warnings about the dot-com mania and housing-market excesses that led to the global financial crisis. “This time a ‘Great Leader’ has appeared. The idea is, everything is different.”

For Shiller, the power of a new-era narrative helps answer one of the most hotly debated questions on Wall Street as stocks set one high after another this year: Why are traders so fixated on the upsides of a Trump presidency when the downside risks seem just as big? For all his pro-business promises, the former reality TV star’s confrontational foreign policy and haphazard management style have bred uncertainty -- the one thing investors are supposed to hate most.

Charts illustrating the conundrum have been making the rounds on trading floors. One, called “the most worrying chart we know” by Societe Generale SA at the end of last year, shows a surging index of global economic policy uncertainty severing its historical link with credit spreads, which have declined in recent months along with other measures of investor fear. The VIX index, a popular gauge of anxiety in the U.S. stock market, has dropped more than 30 percent since Trump’s election.

“I don’t generally call the entire market wrong -- investors are very smart, highly motivated individuals -- but I find it hard to say why stock markets are so un-volatile right now,” says Nicholas Bloom, a Stanford University economist who co-designed the uncertainty gauge with colleagues from the University of Chicago and Northwestern University.



The simplest explanation may be that share prices have less to do with Trump than with tangible improvements in the economy and corporate earnings. With the U.S. unemployment rate well below 5 percent and S&P 500 Index profits projected to reach all-time highs this year, perhaps it shouldn’t be surprising that equities are doing so well.

But there’s more to the market’s resilience than just numbers, according to Ethan Harris, Bank of America Merrill Lynch’s global economist in New York. Like the fable of the boy who cried wolf, Harris says pessimistic forecasters have so badly over-estimated the consequences of big events -- the rolling European debt crisis since 2010, the U.S. debt-ceiling standoff in 2011, Brexit in 2016 -- that traders have become conditioned to ignore them. Even when bears are right, the past eight years have shown that central banks are more than willing to save the day when markets fall.

“It’s been a period of repeated shocks, and I think people get toughened against that,” Harris says. “It seems like uncertainty is the new norm, so you just learn to live with it.”



For Hersh Shefrin, a finance professor at Santa Clara University and author of a 2007 book on the role of psychology in markets, the rally is just another example of investors' remarkable penchant for tunnel vision. Shefrin has a favorite analogy to illustrate his point: the great tulip-mania of 17th century Holland.

Even the most casual students of financial history are familiar with the frenzy, during which a rare tulip bulb was worth enough money to buy a mansion. What often gets overlooked, though, is that the mania happened during an outbreak of bubonic plague.

"People were dying left and right," Shefrin says. "So here you have financial markets sending signals completely at odds with the social mood of the time, with the degree of fear at the time."

Shiller says when markets are as buoyant as they are now, resisting the urge to pile in is hard regardless of what else might be happening in society.

"I was tempted to do it, too," he says. "Trump keeps talking about a new spirit for America and so you could (A) believe that or (B) you could believe that other investors believe that."

On whether stocks are nearing a top, Shiller can't say with any certainty. He's loathe to make short-term forecasts.

Despite the well-timed publication of his book "Irrational Exuberance" just as the dot-com bubble peaked in early 2000, the Yale University economist had warned (with caveats) that shares might be overvalued as early as 1996. Investors who bought and held an S&P 500 fund in the middle of that year made about 8 percent annually over the next decade, while those who invested at the start of 2000 lost money. The index sank 49 percent from its high in March 2000 through a bottom in October 2002...

VENEZUELA HAS A BREAD SHORTAGE. THE GOVERNMENT HAS DECIDED BAKERS ARE THE PROBLEM: *MIAMI HERALD*

Facing a bread shortage that is spawning massive lines and souring the national mood, the Venezuelan government is responding this week by detaining bakers and seizing establishments.

In a press release, the National Superintendent for the Defense of Socioeconomic Rights said it had charged four people and temporarily seized two bakeries as the socialist administration accused bakers of being part of a broad "economic war" aimed at destabilizing the country.

In a statement, the government said the bakers had been selling underweight bread and were using price-regulated flour to illegally make specialty items, like sweet rolls and croissants.



The government said bakeries are only allowed to produce French bread and white loaves, or pan canilla, with government-imported flour. However, in a tweet on Thursday, price control czar William Contreras said only 90 percent of baked goods had to be price-controlled products.

Two bakeries were also seized for 90 days for breaking a number of rules, including selling overpriced bread.

Juan Crespo, the president of the Industrial Flour Union called Sintra-Harina, which represents 9,000 bakeries nationwide, said the government's heavy hand isn't going to solve the problem.

"The government isn't importing enough wheat," he said. "If you don't have wheat, you don't have flour, and if you don't have flour, you don't have bread."

He said the country needs four, 30-ton boats of wheat every month to cover basic demand.

The notion that bread could become an issue in Venezuela is one more indictment of an economic system gone bust. The country boasts the world's largest oil reserves but it has to import just about everything else. Facing a cash crunch, the government has dramatically cut back imports, sparking shortages, massive lines and fueling triple-digit inflation.

Earlier this week, President Nicolás Maduro launched "Plan 700" against what he called a "bread war," ordering officials to do spot checks of bakeries nationwide. In the plan, the government said it would not allow people to stand in line for bread but it's unclear how it might enforce the order.

"The government is doing everything in its power to end the bread lines," Crespo said, "but they're looking at the whole thing backwards."

Crespo said he'd been in touch with several union members in Caracas and that most said they'd passed the inspection by simply opening their pantries.

"The bakeries are showing the authorities that they have no bread inventory," he said. "The government has to see the reality...."

BROKEN EUROPE IS DOWN BUT NOT OUT : FT

AS she prepares for her 60th birthday party in Rome next weekend, Europa is in bad shape. A recent medical check-up revealed one hand about to be amputated (gangraena brexitosa), one foot terribly inflamed (putinisma ukrainica), a skin disease across many body parts compounded by a dangerous allergic reaction (xenophobia populistica), an ulcer eating away her stomach (eurozonitis), as well as logorrhoea and memory loss.

The doctor also fears that her heart may soon go into cardiac arrest (arrhythmogenic Le Pen syndrome). When Europa was in her thirties, back in the hope-filled years after 1989, Ukrainians and Moldovans, Turks and Egyptians would turn their heads when this magnetically attractive woman walked into the room; now they take no notice. And to cap it all, her partner of many years has gone off his rocker (egomania narcissistica trumpica).

The image of Europa as a woman is probably as old as the word itself. Readers will recall that the Angelina Jolie of ancient Greek mythology was carried off by a repeat sex offender called Zeus, who disguised himself as a bull. But the EU — today's "Europa" — more resembles the 16th-century cartographer Sebastian Münster's wonderful image of Europa regina, queen Europe, her body composed of many European countries and regions. Munster's Europa is a rather stately lady, with crown, orb and sceptre, but also has many distinct parts. For Europe as a single nation, nation Europa, is a figment of federalist dream and Eurosceptic nightmare, not the reality.

And here begins the problem with some of the prescriptions produced by Brussels doctors. Take the distinguished Luxembourgish gastroenterologist Jean-Claude Juncker's recent European Commission white paper, interestingly subtitled "reflections and scenarios for the EU27 by 2025" (no more enlargement, then?). It helpfully lays out five pithily titled scenarios: "carrying on," "nothing but the single market," "those who want more do more," "doing less more efficiently" and "doing much more together".

But it takes off into cloud cuckoo land with the idea that a broad popular debate across Europe will culminate in what Mr Juncker modestly calls "my State of the Union speech in September 2017", and then onward to "a course of action to be rolled out in time for the European Parliament elections in June 2019". As if the whole continent were waiting with bated breath for Mr Juncker's speech, as Americans wait for their president's State of the Union.

This is politics with the politics left out. A more realistic timetable looks something like this: following the good example of Dutch voters, who this week saw off the populist challenge of Geert Wilders' Freedom party, French voters rally round in the second round of their presidential election, on May 7, to avoid a Le-Pen-shaped heart attack for the whole EU; the issue of Greek debt is somehow fudged until after the German general election on September 24; an Italian banking and/or political crisis is avoided. If all this muddling-through works, and that's a big "if", then maybe a coalition of willing national leaders, working with the EU's three "presidents" and their institutions (council, commission and parliament), can chart a recovery for the EU from 2018 on.

The complicated truth is that Europa needs an array of treatments, each based on a careful diagnosis of the particular problem, be it Brexit, populism, the eurozone, Russian interference in Ukraine, the plight of refugees from our near abroad, the looming dictatorship in Turkey, or how to live with Donald Trump.

Some of the treatments entail action at the EU level, as well as in other groupings: on the external border of the Schengen area, for example, or through Nato when it comes to defending the Baltic states against the hybrid threat from Vladimir Putin's Russia. So far as the internal workings of the EU are concerned, the best way forward must be some combination of Mr Juncker's third and fourth scenarios: "those who want more do more" and "doing less more efficiently". But the struggle for Europa will be won or lost in the national and regional politics of her many parts, with their diverse languages and styles.

It is up to French, German and Italian politicians, intellectuals, teachers and business leaders to make the case at home, in their own domestic idioms, for continuing and reforming the EU — and likewise for the Walloon and Flemish, Polish, Spanish, Catalan, Irish and, yes, English...

THE US FEDERAL RESERVE IS RIDING A TIGER BY RAISING INTEREST RATES : AMBROSE EVANS-PRITCHARD

On three separate occasions since 2013 the US Federal Reserve sent shock waves through the global financial system when it tried to tighten monetary policy, and each time it was forced into partial retreat to halt the mayhem.

The Fed has since come to terms with its unwelcome role as the world's central bank, a monetary superpower that cannot set liquidity conditions for the US alone. The international blow-back into the US economy from any mistake is instant and brutal.

Over recent months the Federal Open Market Committee has been careful to take the global pulse before acting. It now hopes the coast is clear. Today's quarter point rise in the federal funds rate to 1pc has been so loudly signalled in advance that investors have already adjusted.

Emerging markets seem better prepared, so far able to shrug it off. China has restored confidence in its exchange rate regime. Capital flight appears to be under control. Europe's shift towards bond tapering reduces the risk of a rocketing dollar. "We're not overly worried about downside shocks," said Janet Yellen, the Fed chairman.

Yet nobody really knows whether the world can handle a total of six rate rises over the course of 2017 and 2018 as sketched in the Fed's 'dot plots' scenario.

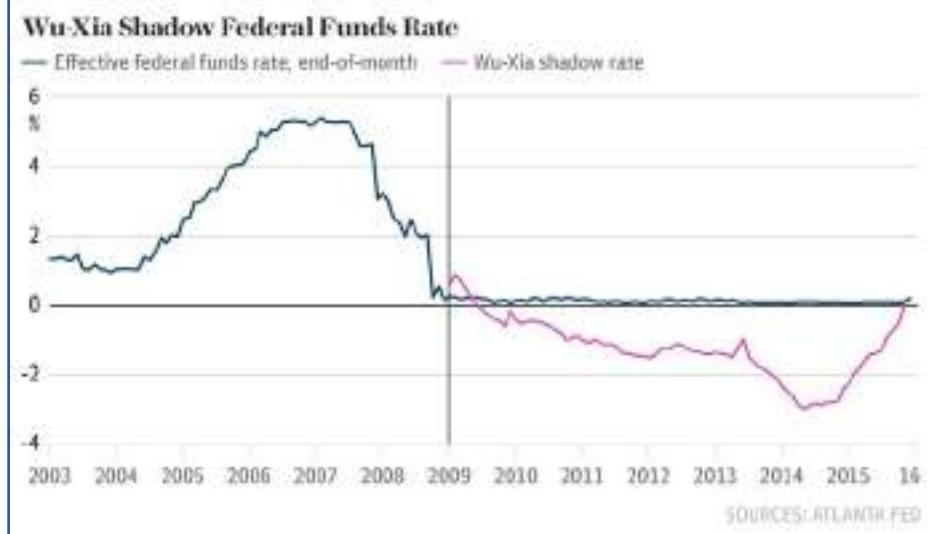
"Our highly levered financial system is like a truckload of nitroglycerin on a bumpy road. Don't be allured by the Trump mirage of 3pc to 4pc growth and the magical benefits of tax cuts and deregulation," says bond guru Bill Gross from Janus. This is a year to hold onto your money, he tells clients, not to seek a return on money.

On the face of it, a 1pc rate is risibly low a full eight years into the economic expansion. It is deeply negative in real terms. Savings are being whittled away.

But we are not dealing with normal circumstances. The Atlanta Fed's Wu-Xia 'shadow rate' suggests that the combined tightening so far this cycle is equivalent to thirteen rate rises, once you include the withdrawal of stimulus from quantitative easing and dovish forward guidance. If so, we may be near the end-game.

The Wu-Xia model and others like it show a relentless fall in the natural rate of interest over the decades. Each peak and each trough is lower. It is the deflationary consequence of a deformed world of over-capacity (China), under-consumption (Europe), excess savings (inequality), and lack of demand.

Former US treasury secretary Larry Summers thinks the natural rate has dropped to minus 3pc in his grim vision of secular stagnation. Is he wrong? Have we put this episode behind us at last? We don't know.



Mrs Yellen said tonight that the long-term neutral rate has dropped to 1pc in real terms but could be zero at the moment as the economy battles the lingering headwinds of the financial crisis. "It reflects slowing population and productivity growth," she said.

What we do know is that the post-War world has never been so leveraged to the dollar or so sensitive to US borrowing costs. Offshore dollar debt in US currency has risen fivefold to \$10 trillion since 2002.

This is the fruit of globalisation and the Fed's own policies of zero rates and QE, which unleashed a flood of cheap and irresistible dollar liquidity into emerging markets and lured them into the West's debt experiment. This Faustian Pact has closed in on the Fed. The institution cannot easily extract itself.

When the Lehman crisis hit, China and emerging markets were able to buffer the global economy. Today they too face varying degrees of credit exhaustion. Debt-to-GDP ratios have risen by 41 percentage points in the developing countries since 2008, and risen by 33 points in the rich countries.

This leverage is an accident waiting to happen. Analysis from Bank for International Settlements suggests that the potential trigger is a strong dollar, which automatically causes a contraction of bank balance sheets through the structure of hedging contracts. The Fed must move with extreme care.

What is striking about this rate rise is that the US economy itself appears to be slowing already. If you are bearish, you can find plenty of warning signals. Commercial bank loans have contracted over the last three months. The Atlanta Fed's instant GDP tracker has abruptly dropped to an annual growth rate of 0.9pc for the first quarter. "GDP is a pretty noisy indicator," said a slightly nettled Mrs Yellen when taxed on this point.

The broad M3 money supply has been trending down steadily to a 55-month low and is starting to flag late-cycle fragility. The inventory-to-sales ratio for cars has reached 3.0, a level rarely seen over the last twenty years. "The last thing they should be doing is thinking about rate hikes," said Patrick Perret-Green from AD Macro...

DUTCH ELECTION SLOWS EUROPE'S POPULISTS: *DER SPIEGEL*

Mark Rutte is the most successful liberal politician in Europe. Although his party will lose about one-quarter of its seats in the House of Representatives in The Hague, the prime minister of the Netherlands is this biggest winner in Wednesday's election. For the third time in a row, his right-wing liberal VVD party has emerged as the strongest force in the Dutch parliament, with a comfortable lead.

Just a few weeks ago, it looked like right-wing populist Geert Wilders would win. Only a few days ago, six parties had at least an outsider's chance of coming in first place. But now Rutte has come out ahead by a clear margin because two populists wouldn't stop insulting him.

Why Did Rutte Win?

Rutte's election win had a Turkish father: Recep Tayyip Erdogan. The more rudely the despot from Ankara insulted the Netherlands, the more the Dutch stood behind their prime minister. Rutte managed the crisis in a highly professional manner: He drew a red line by, first of all, denying entry to Turkey's foreign minister and then having Turkey's family affairs minister escorted out of the country in a polite but determined manner. And after the scandal, Rutte portrayed himself as a conciliator. Instead of responding to Erdogan's attacks in the same way, he invited Erdogan's Prime Minister Binali Yildrim to share a meal. And he agreed.



In the TV debate with Wilders on Monday, Rutte then pushed his opponent against the wall. When the far right politician called for the Turkish ambassador to be thrown out of the country, Rutte coolly answered: "That is the difference between tweeting from a bench and governing a country." The Dutch also place a great deal of value on Rutte's pragmatism. In the last few days before they went to the polls, Rutte won the crucial votes he needed in order to get a clear lead on Wilders. Previously, Rutte had profited more from the slackening support of his rival than from his own strength.

Rutte broke some election promises in the past years, and as a result his party also lost about one-quarter of its seats, but he delivered on his core theme. The Dutch economy is booming again after a long crisis, with growth rates of 2 percent and an unemployment level sinking towards the 5 percent threshold. It has its extreme levels of interconnection to the outside world to thank for this: The small country, with its mere 17 million inhabitants, exports more goods into the world than the United Kingdom or Italy.

What Happens Now?

Rutte needs to forge a completely new coalition because his coalition partners up to this point, the Social Democrats (PVDA), have disappeared into the political abyss as a result of serious discontent over the government's social reforms. Rutte now needs at least three coalition partners, but he can choose from among four centrist parties: the Christian Democrats, the left-wing liberal D66, the strong Greens as well as the Social Democrats. He can then play them against one another and won't have to worry about having to make too many concessions. In Germany, Chancellor Angela Merkel can rejoice over the fact that Rutte is staying in office. On many issues, he has been her most important ally in the EU.

Who Is Responsible for Wilders' Failure?

Wilders himself. For months he led in the polls, but now he has apparently lost even second place to the Christian Democrats (CDA). Early results Wednesday indicated his one-man Party for Freedom (PVV) wouldn't even attain its 2010 election result. As the party's only official member, Wilders has only himself to blame.

"PVV was invisible during the election," says Amsterdam-based political researcher Tom van der Meer. Wilders had stayed away from almost all TV debates and only rarely made public appearances during the election. But that's precisely where the "normal Dutch people," whose voice the man with the Mozart haircut so badly wanted to be, are. No important Dutch politician has as little direct contact to everyday citizens as the self-proclaimed tribune of the people, who has been under protection 24 hours a day for the past 12 years. Wilders has conducted almost his entire campaign via his mobile phone. He tweeted as cleverly and radically as his role model, Donald Trump. But the American president didn't just use Twitter: He also got people excited at his election rallies, which provided celebratory photos of his supporters.



Wilders' public admiration for Trump was ultimately his downfall because the American's radical, chaotic policies go too far even for his own most loyal followers -- not to mention the many swing voters who had sympathized with him. Rutte recognized this -- and summarized it with one sentence: "Geert Wilders is chaos."

What Happens to Wilders Now?

He will keep going. For the Venlo native, this election outcome is the most bitter defeat of his political career. But give up? No way. Who could replace him? He's PVV's only member. And what else should the 53-year-old do for the rest of his life?

According to his brother Paul, he barely has any friends left, and he has fallen out with parts of his family. Sooner or later, Wilders hopes, his time will come again. A new refugee crisis, a wave of violence carried out by foreigners, a terror attack or simply dissatisfaction with the new government would be sufficient to drive his poll numbers back up. Besides, the role of top opposition figure is tailor-made for him. And he doesn't necessarily need to be in the government in order to implement parts of his political agenda. "Wilders has once again pushed Rutte and the Christian Democrats a little further to the right," says van der Meer, the political scientist...

Dutch Election Results

Preliminary results (as of 11:30 a.m.), in percent



Photos show the lead candidates of the parties, source: NOS

THE WRONGEST PROFESSION: DEAN BAKER

Over the past two decades, the economics profession has compiled an impressive track record of getting almost all the big calls wrong. In the mid-1990s, all the great minds in the field agreed that the unemployment rate could not fall much below 6 percent without triggering spiraling inflation. It turns out that the unemployment rate could fall to 4 percent as a year-round average in 2000, with no visible uptick in the inflation rate.

As the stock bubble that drove the late 1990s boom was already collapsing, leading lights in Washington were debating whether we risked paying off the national debt too quickly. The recession following the collapse of the stock bubble took care of this problem, as the gigantic projected surpluses quickly turned to deficits. The labor market pain from the collapse of this bubble was both unpredicted and largely overlooked, even in retrospect.



While the recession officially ended in November 2001, we didn't start creating jobs again until the fall of 2003. And we didn't get back the jobs we lost in the downturn until January 2005. At the time, it was the longest period without net job creation since the Great Depression.

When the labor market did finally begin to recover, it was on the back of the housing bubble. Even though the evidence of a bubble in the housing sector was plainly visible, as were the junk loans that fueled it, folks like me who warned of an impending housing collapse were laughed at for not appreciating the wonders of modern finance. After the bubble burst and the financial crisis shook the banking system to its foundations, the great minds of the profession were near unanimous in predicting a robust recovery. Stimulus was at best an accelerant for the impatient, most mainstream economists agreed—not an essential ingredient of a lasting recovery.

While the banks got all manner of subsidies in the form of loans and guarantees at below-market interest rates, all in the name of avoiding a second Great Depression, underwater homeowners were treated no better than the workers waiting for a labor market recovery. The Obama administration felt it was important for homeowners, unlike the bankers, to suffer the consequences of their actions. In fact, white-collar criminals got a holiday in honor of the financial crisis; on the watch of the Obama Justice Department, only a piddling number of bankers would face prosecution for criminal actions connected with the bubble.

There was a similar story outside the United States, as the International Monetary Fund, along with the European Central Bank and the European Union, imposed austerity when stimulus was clearly needed. As a result, southern Europe is still far from recovery. Even after another decade on their current course, many southern European countries will fall short of their 2007 levels of income. The situation looks even worse for the bottom half of the income distribution in Greece, Spain, and Portugal.

Even the great progress for the world's poor touted in the famous "elephant graph" turns out to be largely illusory. If China is removed from the sample, the performance of the rest of the developing world since 1988 looks rather mediocre. While the pain of working people in wealthy countries is acute, they are not alone. Outside of China, people in the developing world have little to show for the economic growth of the last three and a half decades. As for China itself, the gains of its huge population are real, but the country certainly did not follow Washington's model of deficit-slashing, bubble-driven policies for developing countries.

In this economic climate, it's not surprising that a racist, xenophobic, misogynist demagogue like Donald Trump could succeed in politics, as right-wing populists have throughout the wealthy world. While his platform may be incoherent, Trump at least promised the return of good-paying jobs. Insofar as Clinton and other Democrats offered an agenda for economic progress for American workers, hardly anyone heard it. And to those who did, it sounded like more of the same.



To get a clearer fix on how deeply our economics establishment is entrenched within its own counter-empirical worldview, let's home in on what is undoubtedly the most consequential article of faith in its catechism: the gospel of the deficit hawk.

Here's one handy way to break down the real-world costs of deficit hawkery. The cries for fiscal prudence that come from folks like Timothy Geithner and Paul Ryan, which are echoed in the media by the Washington Post and other major outlets, are costing us almost \$2 trillion a year in annual output. This amount comes to more than \$6,000 per person per year or \$24,000 for an average family of four. These deficit hawks are ensuring that our children and grandchildren will live in poverty.

Yes, I'm inverting the traditional alarms raised by deficit hawks about the calamities of intergenerational indebtedness and throwing them in their faces, precisely so we can catalog the ways in which they've been spreading nonsense to push bad economic policies for decades. These bad policies have steep and lasting costs, especially following the collapse of the housing bubble and the Great Recession. The constant fear-mongering of the deficit hawks prevented the government from spending the money required to push the economy back to full employment. There was nothing to replace the construction and consumption spending that had been driven by the bubble.

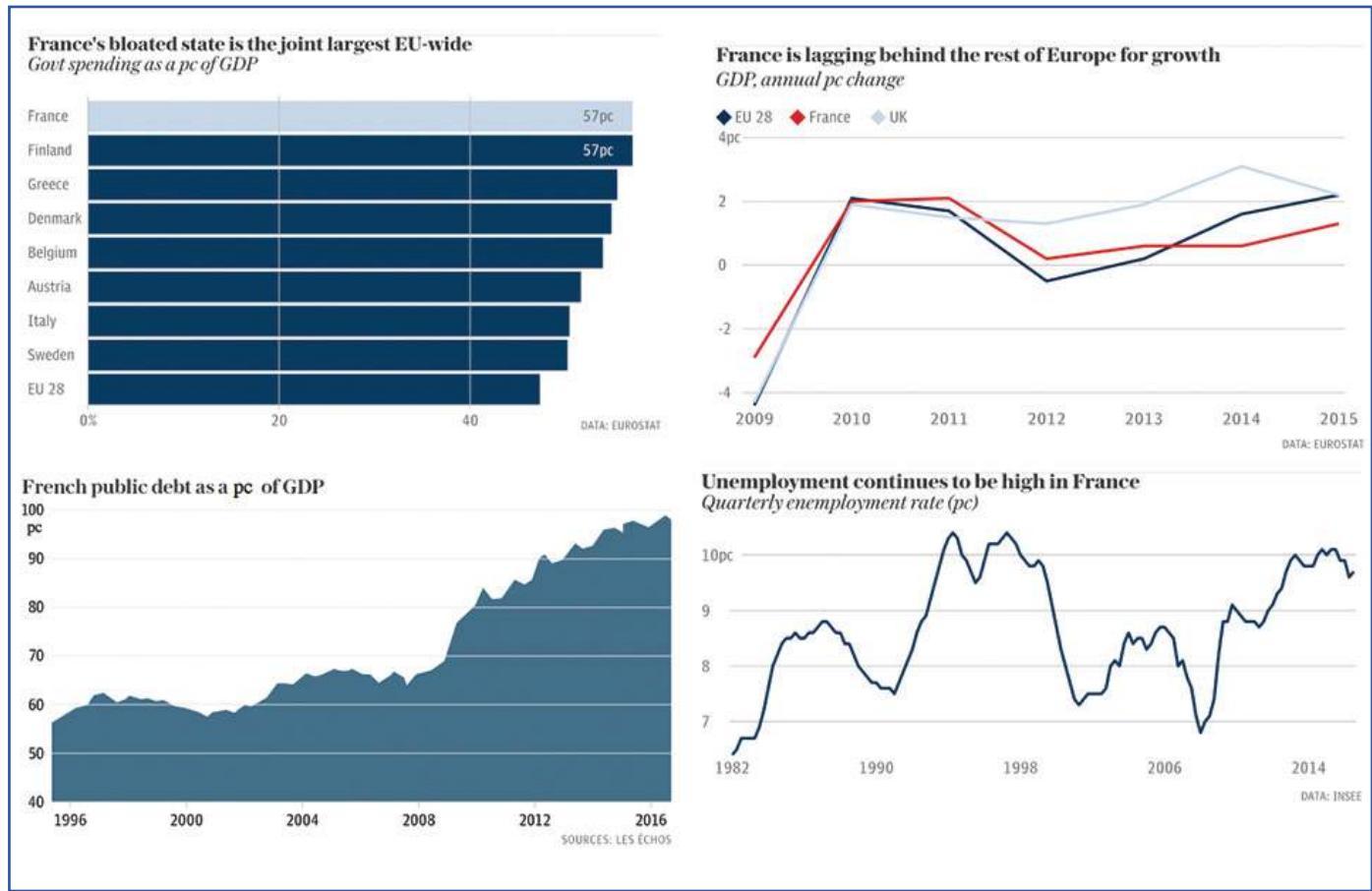
The practice of expressing budget numbers in dollar terms that virtually no one understands is inexcusable.

As a result, the economy has operated well below its potential level of output since the recession began almost ten years ago. Not only has this meant needless unemployment, causing hardships for families with one or more unemployed worker; it has also produced long-term damage to the economy. Millions of workers have dropped out of the labor force. Some will never work again. In addition, when companies see weak demand, they invest less than they would have otherwise. The drop in investment slows the rate of productivity growth.

The combined impact of fewer workers and lower productivity is enormous. In 2008, before the true extent of the recession was known, the Congressional Budget Office (CBO) projected that by 2017 the economy's potential would be 29 percent larger than it had been in 2007. In its most recent report, the CBO puts the economy's potential for 2017 at just 16 percent more than its 2007 level. This difference of 13 percentage points translates into more than \$2 trillion a year in today's economy...



CHARTS THAT MAKE YOU GO HMMM...



With high levels of public debt, slow growth and huge levels of government spending, France's economy is in dire need of a shot in the arm.

If current opinion polling is to be believed, the country looks set to get it, with France on the brink of making a historic decision in the first round of its presidential elections...

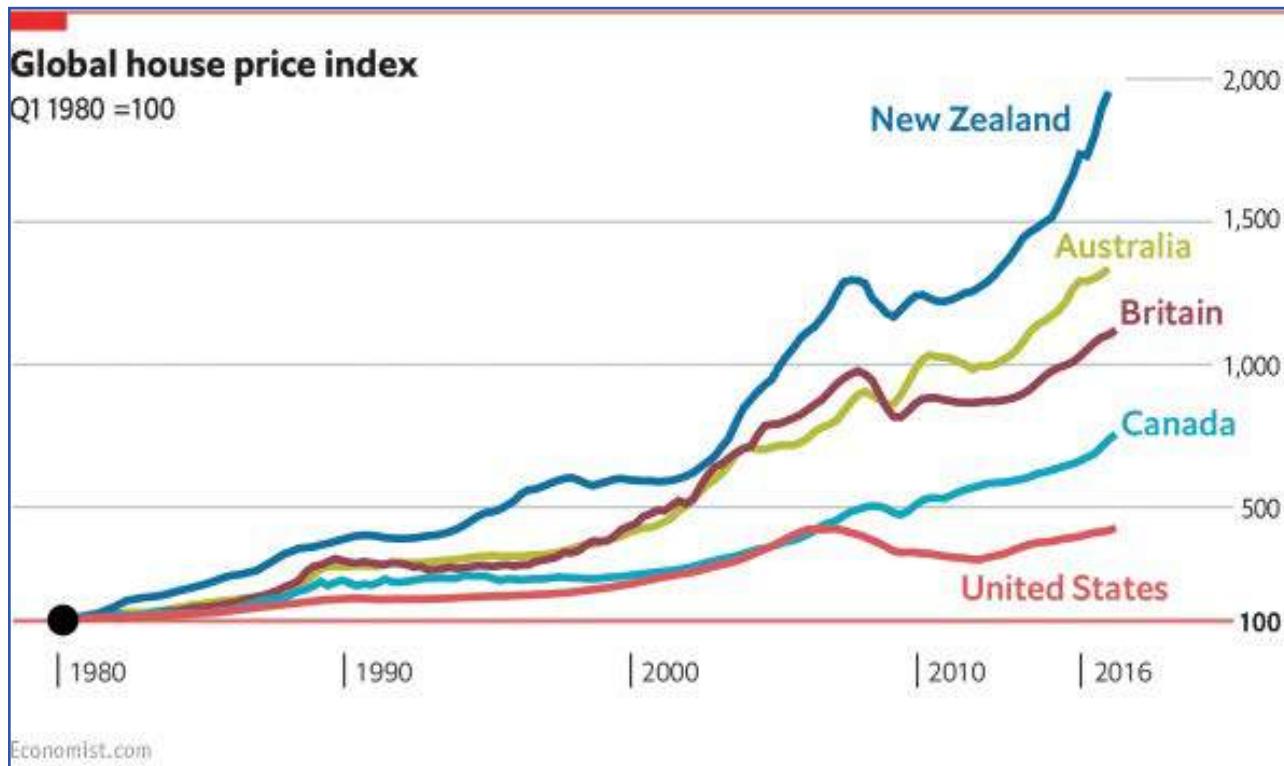
Neither of two favourites to progress to the second round - Marine Le Pen of Front National and Emmanuel Macron of En Marche - represent parties with pedigree when it comes to governing, and both offer extremely different visions of France...

On the one hand Le Pen promises to curb immigration and withdraw France from the EU, while Macron wants to see a more economically outward facing France with lower taxes for corporations.

Both candidates seek to shake up France's establishment and propel the country's sluggish economy out of its current stupor. So what exactly is happening to France's economy?

[LINK](#)





Presented without comment — from me at least. If you DO want a comment, my buddy Chris Mackintosh (who happens to live in New Zealand) is the man to see... just click on the link:

Ever since anyone can remember, global real estate prices have been going up. Pretty much doesn't matter which country you're from (unless, of course, it's Syria, or Iraq... or Fuhggedistan): if you bought something in the last 2 to 3 decades, it's like the ceilings were insulated with helium. Even when the 2008 crisis hit and we had Captain Clever ensuring the world that things were just peachy:

"At this juncture, however, the impact on the broader economy and financial markets of the problems in the subprime market seems likely to be contained. In particular, mortgages to prime borrowers and fixed-rate mortgages to all classes of borrowers continue to perform well, with low rates of delinquency." — Ben Bernanke, March 28, 2007

Even with that setback real estate has marched upward. The US, of course, took a decent breather and is only today back to where it was pre the GFC.

But the US isn't the world, so let's look at what everyone else has been up to.

[LINK](#)

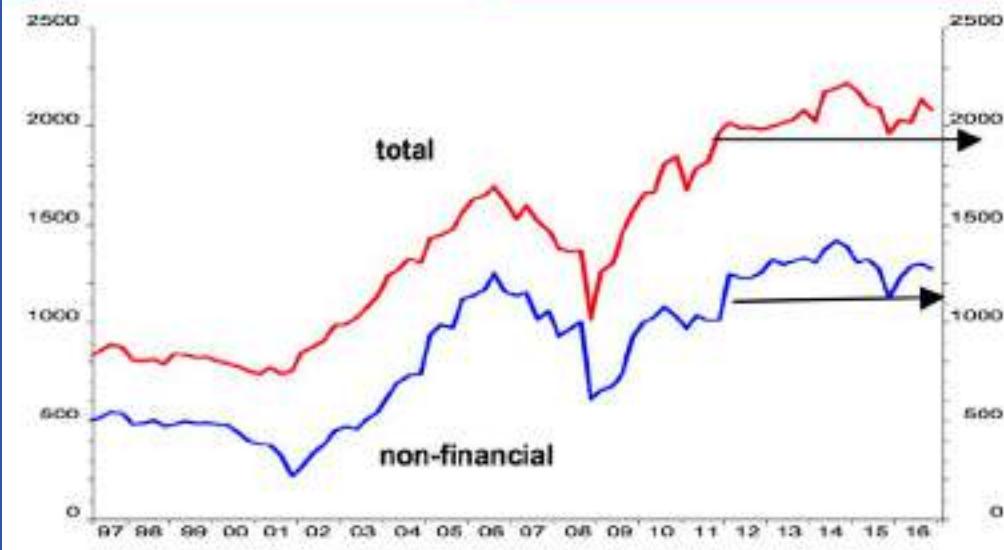
It is at this point in the cycle that the US whole economy profits measure gives a more 'truthful' representation of companies underlying profit conditions the data comes from the IRS and companies don't tend to lie to the IRS. The whole economy profits data is not so timely as the stockmarket data as the IRS and the Bureau of Economic Analysis have to give the data a good scrub. Hence the Q4 whole economy profits data will only be released with the 3rd estimate of Q4 GDP on 30 March. But we can get a sneak preview buried deep in the recently released Fed Z1 Flow of Funds release (you have to be a real geek to know this stuff).

To that end we show the latest Q4 whole economy profits measures below. Much against expectations, whole economy measures slipped again in Q4 in line with unit labour cost data that show corporate margins are being squeezed.

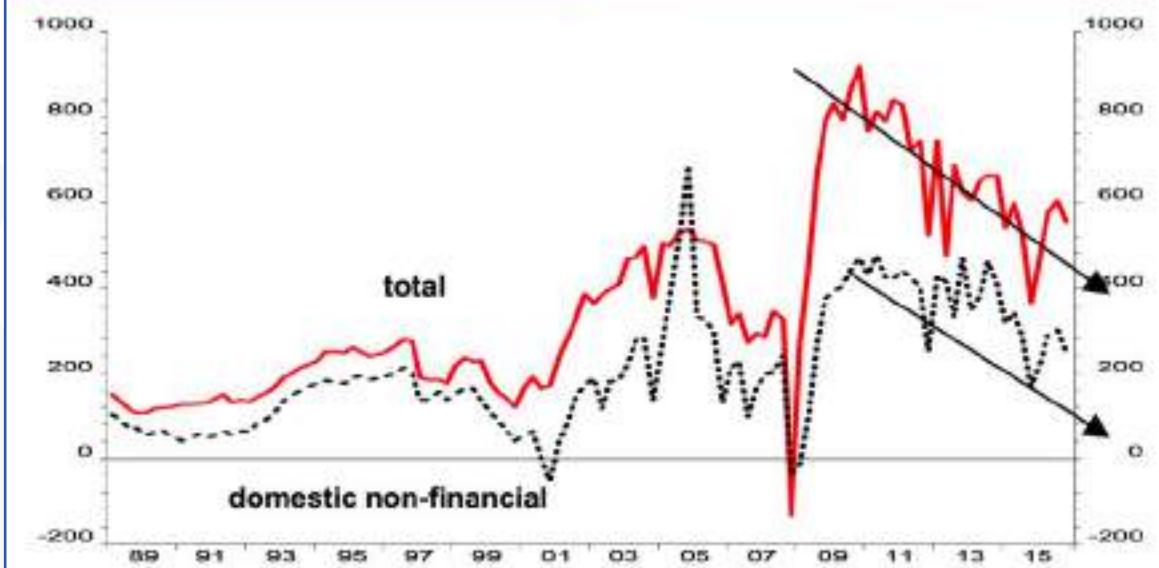
This is in contrast to the heavily massaged stockmarket measures which have been recovering briskly. We've seen this divergence before at the end of the cycle and I know which I believe...

[LINK](#)

**US whole economy corporate profits
(pre-tax with IVA and CC adjusted)**



**US undistributed profits
(post-tax profits less dividend payments with IVA and CC adj)**





WORDS THAT MAKE YOU GO HMMM...

Fast forward 2 minutes and listen to the wisdom of David Stockman, author of *The Great Deformation* as he talks to Robert Kiyosaki about why the next crash will be the worst one yet, why President Trump is not the second coming of Ronald Reagan and why he will be unable to stop the impending debt-fueled train crash...



[CLICK TO LISTEN](#)



Jonathan Tepper is one of my favourite analysts. He's whip smart, acutely insightful and possesses the driest sense of humour you'll find this side of the Sahara desert..

This week Jonathan joined hedge fund manager Erik Townsend on MacroVoices to talk about a subject he's been discussing for some time - the Aussie property bubble — as well as the issue at the heart of this week's *Things That Make You Go Hmmm...*, namely inflation.

Enjoy...

[CLICK TO LISTEN](#)



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At long last, the Real Vision podcast is up and running. Each week, Aaron Chan and I will take you on a journey through some of the fascinating interviews we've featured on Real Vision and you'll also find a series of mini-documentaries plus special guests from the world of Real Vision.

Please subscribe, review and enjoy...oh, and spread the word!!



AND FINALLY...

and finally



[CLICK TO WATCH](#)

“We’ve all seen actors playing doubt in fiction films, but we have few true images of the feeling in documentaries. To make them, we decided to put people in a situation powerful enough not to need any classic narrative framework. A high dive seemed like the perfect scenario...”

A fascinating short study of fear, bravery and the galvanising effect of social pressure (thanks Brent!).





Things that make you go
hmmm

About The Author

Much to his chagrin, Grant Williams has reached 30 years in finance.

Over that period, he has held senior positions at a number of investment banks and brokers including Robert Fleming, UBS, Banc of America and Credit Suisse in locations as diverse as London, Tokyo, New York, Hong Kong, Sydney and Singapore.

From humble beginnings in 2009, *Things That Make You Go Hmmm...* has grown to become one of the most popular and widely-read financial publications in the world.

Grant is a senior advisor to Vulpes Investment Management in Singapore and also one of the founders of *Real Vision Television*—an online, on-demand TV channel featuring in-depth interviews with the brightest minds in finance.

A regular speaker at investment conferences across the globe, Grant blends history and humour with keen financial insight to produce unique presentations which have been enthusiastically received by audiences wherever he has traveled.



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