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GLOBAL REPORT

CAN'T EARN A LIVING? BORROW!

The Federal Reserve just released their flow of funds data for the second quarter. At 14.2%, the (annualized) growth rate of home mortgage debt was the highest since 1979. In dollar terms, US households added \$US 397.6 Billion of debt through mortgages and another \$US 40 Billion in revolving credit during the quarter.

Multiply by four and get annual borrowings of \$US 1.75 TRILLION.

The net worth of US households (and non-profit organizations) has increased by 3.7% annually since 1997. Their debt has grown at an 8.8% annual rate. Obviously, borrowing to keep up is required, but it is not working, as can be seen from the latest report from the US Bureau of Labor Statistics which states that in 2000, US families spent 44% less on household appliances than families did in 1973 (note that year). They also spent 22% less on food and 21% less on clothing. In hard concrete economic terms, that is a real fall in the standard of living.

All this is bad enough, but now the clincher, the fact that brought together the sum of economic facts, has been found. A report from the US Center for Economic Policy Research has found that the median US real wage was the same in 2000 as it was in 1973. In real economic terms, this means that the living standard of Americans, as measured in the broadest terms available, has stood still since 1973.

What happened in 1973? Eighteen months after the last tie between the US Dollar and Gold was severed by President Nixon, the US Dollar and all other world currencies "floated".

The Money Lender (The Bank) - Versus - The Money

Earners:

From 1944 to August 1971, the US Dollar had been connected to Gold (for international institutional transactions) at a fixed ratio of \$US 35 to one ounce of Gold. Between August 1971 and March 1973, with this last "tie" to Gold broken, the global financial system was in chaos. Then, in 1973, a cascade of currencies, up to and including the US Dollar, "floated" against each other with no fixed ratio anywhere. For the first time in history, NO nation's currency maintained any connection to man's historic money - Gold (and Silver). All circulating currencies had become coloured pieces of paper (or plastic) residing inside the accounts of the commercial banks. The commercial banks, unfettered from any fixed ratio between Dollars and Gold, were presented with the ability to increase the amount of "money" in their accounts by the simple means of increasing customer loans and "crediting" the sum lent. The money or wage earner could only earn his or her money out of the total stock of pre-existing money. The bank could now "earn" its money by lending it into existence.

A NECESSARY Concept - The Pre-Existing Stock Of Money:

The industrial or transport wage earner is the son of the Industrial Revolution which began in Britain back in 1760. Prior to that, the Western World was haunted by the Malthusian spectre of over-population. The only safety valve was either immigration to near empty lands such as North America or outright transportation of the surplus population, again to North America and especially to Australia. This transportation was directed at what were then called sturdy beggars who haunted the highways, byways and cities of the English economic landscape. But by the time that the Industrial Revolution had gained a solid foothold, there were suddenly places to go where work could be done for a money wage. This wage was at least sufficient to live on. An almost new market appeared, a market for simple and cheap consumer goods which the wage earners could all now afford to buy. It is no wonder, as valid economic research shows clearly, that it was the cheap goods which were being mass produced back then, goods which the upper classes looked upon with scorn.

But there was another factor at work, and that was SOUND money. Back in the early/mid 1800s, money was a fixed weight of Gold and Silver coinage and it was in general circulation. Only the upper classes used banks or had accounts in banks. Sound money has an additional economic quality attached to it. Its total quantity is not easily expanded. That had further consequences. As the newly arrived industrial wage earner swung into action, he stood as a producer of either brand new goods or goods in vastly higher quantities than had ever been produced before. He also stood as a new consumer of this vastly increased supply of goods. As a consequence, the whole British structure of plant and equipment changed to meet this new demand. Real industrialisation took off with a huge blast.

Historically, this was the situation which existed from 1760 to about 1910-14. The industrial revolution spread first across the English-speaking world and then in fits and starts, around the rest of the world.

Then - The Foundation Was Ripped Away:

The first cannon shot of WW I in August 1914 blasted the West's monetary foundation to pieces. Governments tore Gold away and replaced the Gold with paper money. The connection between SOUND money, the men and women who earned it, and the industrialisation which would have been impossible without their efforts, was broken. It has not been repaired to this day. Ever since August 1914 and the start of WW I, an unholy alliance has been formed between most governments and the bankers which can supply governments with new "money" at the stroke of an account entry. Suddenly, it was as if there were two parallel monetary systems, one where SOUND money had once existed and one where money was a bookkeeping entry. Over time, "money" as a bookkeeping entry has conquered the world. Since 1944, at its global centre has stood the US paper and credit DOLLAR.

The Shift Of The "Centre" To The New System:

It is an historical fact going back centuries. Bankers were virulently hated by both wage earners and farmers. An immense popular literature as well as countless valid economic essays (especially from the "Currency School") abounds with tales of the perfidy of bankers, all of whom wanted to get the hard earned money from wage earners and replace it with paper which they could and did print at next to no costs to themselves. Nefarious as this truly was, it was fundamentally the least of the real problems. As bankers expanded their reach, their emissions of paper money and "money" on account acted to change the STRUCTURE of production. The wage earners and farmers were no longer the ones who provided the demand in the marketplace with the SOUND money they earned through productive work. There was also a fast increasing, new and additional monetary demand coming into the marketplace. This demand came from the new loans which the banks pushed at anyone who was prepared to borrow. Here began a competition between the producers standing with their **earned** money in hand and the borrowers who stood with **borrowed** money in hand. From that point onwards, both flows of monetary demand met in the market competing for the same economic goods.

A “Service” Economy Is NOT An Economy:

An “economy” which consists of nothing but “services” is flat perfect economic nonsense. In such an economy there are no consumer goods because there is no capital plant and equipment with which to produce them. Services, as such, arrive naturally as a consequence of the division of labour. As an economy accumulates more plant and equipment, new and better services always follow as a consequence of the expanding wealth generated by the PRODUCTIVE economy.

In economic terms, neither Disneyland nor Hollywood nor Pizza Hut nor “Joe’s Lawn Mowing” could exist for long on their own. They only exist because there is a real productive economy around them.

With the “modern” bankers adding to monetary demand through their climbing emission of loans, it was this second stream of additional (borrowed) monetary demand which accelerated the advance of the now huge service industries. By the way, “service industries” is a contradiction in terms. It is true that wage earners too benefited from this artificial increase in monetary demand, but when these same wage earners showed up in the market place to buy, they found no additional GOODS.

They did not find goods which they or their fellows had produced. What they DID find was that their domestic market had been flooded with imports, all drawn in by the second stream of money which had not been earned or saved but had been lent into existence by the bankers.

It’s A Mean Economic Outcome:

As stated at the beginning of this report, the **median** US real wage was the same in 2000 as it was in 1973. Wage earners in the US today must know this, even though they don’t know what happened to them. The “median” real wage is the point which half the wage earners are above and the other half below. This, not the “average” wage, is the one which has not moved for 30 years - since 1973.

The root economic cause for this situation is the fact that President Nixon closed the Gold window on August 15, 1971. That led, inevitably to the floating of the US Dollar in early 1973. These two actions removed the US banking system from any hard connection to economic reality. It allowed them to engage in all the consequent credit expansions with their associated market and economic booms and busts. The wage earner simply cannot compete with the bankers’ ability to lend new additional money into circulation. The result is that whatever nominal wage increase he has achieved since 1973, the hard facts stand to the fore. His median wage has NOT increased over the past 30 years. He has to EARN his money before he can spend it. The borrower does NOT have to do that, he just borrows and then spends.

To All Those Who Have Not Yet Understood The Situation:

Today, China is re-enacting a version of “olde England”. Sturdy beggars are rolling towards the new industrial zones to look for a wage earning job where none existed before. For the industrial North American wage earner, this is a near disaster. His new Chinese counterpart is fully prepared to work 10 to 12 hour days for the equivalent of \$US 1 or \$US 2 or \$US 5. Not only that, this Chinese wage earner is prepared to save around 30% of this meagre wage. He knows that he has NO “welfare system” behind him. Here is the real fundamental economic problem. As this Chinese wage earner works and saves, his Central Bank is taking the savings which he is piling up in China’s third world banks and sending a multiple of these saving savings back as loans to the US.

Right here is one of history’s most nefarious money loops. The US expands credit and part of the new money lent out goes overseas to China. Chinese exports flow into the US economy, forcing all US industry and their own wage earners to the side. After this cycle, the US money which stormed out to China now storms right back into the US banking and financial system as loans from China. And what do the American banks do with this money? They lend it into the hands of the American consumers.

Where The World's Money Flows Meet:

Overwhelmingly, the world's money flows meet in the USA. There are other nations which run current account deficits (like the UK and Australia), but the US is the epicentre. This can be easily seen from the annualised borrowing pace of US households - an ASTRONOMICAL \$US 1.75 TRILLION. That amount of borrowing is a full 16-17% of TOTAL US GDP.

That is a HUGE proportion of the size of the world's largest economy. The truly hair raising aspect of this global situation is that if the Bush regime suddenly (on purpose or under duress) acted to balance its books to tax revenues being received, 6% of the US GDP disappears. That would cause an instant economic recession inside the US economy.

A genuine US federal government balanced budget would be "bad" enough. But contemplate what would happen if all the presently unstoppable American borrowers and consumers decided to "stabilise" their current debts. If that happened, a full 16-17% of the US GDP disappears. Were THAT to happen, the US economy would face an instant and outright DEPRESSION.

The Global Effects Of Such a US Re-Balancing:

The combination (even in theory) of such a double re-balancing of the US economy - a federal budget limited to taxes currently received, combined with US households acting to stabilise the current level of their debts - would erase a GIGANTIC 22-23% of US GDP.

Any nation across the rest of the world which currently stands with a trade surplus against the US would promptly see its export industries fall flat on their faces. Their main export market would be gone.

Across these nations which are dependent on their exports to the US, stock markets would crash followed by large parts of their own internal banking and financial systems. Where the currencies of these nations would go on the international currency floors is anybody's wild guess.

But no matter where the currencies of these other nations went, it would be the level of the US Dollar which would be the centre of global attention.

This much is certain - all the rest of the world combined CANNOT save the US Dollar. Whether the rest of the world can save themselves remains to be seen.

From The Hypothetical To The Actual:

The hypothetical situation described above deals only with the best possible future outcome. To look at an actual outcome which has not yet happened, economic history comes to the fore. As all of economic history shows, a "re-stabilisation" of debt as outlined above has NEVER worked! Always, if past history of like instances is to be taken into account, the end result has been a financial/economic CRASH. Economic history shows that a crash ALWAYS overshoots, that is, it falls to a point below (often far below) where a simple and controlled "re-stabilisation" would have taken an economy. This outlook is bad enough, but economic history has never had an example of a credit bubble anything like as large as the one which the US banking and financial system has blown up in the near decade since the mid 1990s.

Like Empty Drums Rolling Downhill:

It is vital to take ALL official statements about the global or national economic outlook, from whatever source derived, as propaganda, flummery, SPIN. The global name of the game is to try to take the US Dollar down in easy stages, with pauses and rallies along the way. There is only one problem. Such a course of action has NEVER worked in economic history.

It All Depends - On Two Factors:

At present, and in truly global terms, the world economy depends upon two main financial factors. The first is whether US households can keep up an annual rate of borrowing and spending, amounting to 16-17% of the US GDP. If (when) that borrowing rate contracts by any amount, after a short delay, so will the money outflow from the US economy. This will quickly impact on any nation reliant on their exports to the US - mainly the Asian nations. A reduction in US household borrowing and spending will lead directly to lower exports to the US. That will lead directly to a crisis in Asia which will put the Asian Crisis of the late 1990s totally in the shade.

The other item on which the world economy depends is the direction of the current money flow of the US Dollars being earned by the nations running trade surpluses with the US. The main players here are again in Asia, notably Japan and China. At present, the Dollars earned by these nations in return for their exports to the US are turning right around and going back to the US as foreign loans, notably in US Treasuries. Any ebb in this money flow would push US market interest rates UP. What would American households do then? They would decrease their borrowings, and that in turn would further diminish the importing power of the US economy.

If (When) Either Of These Happens, What Can The US Do?:

If US households either cut down on their borrowing or go further and start to REPAY existing debt, the only thing that the US could do to compensate is to blow out the federal budget deficit even further. The budget deficit is already more than 6% of US GDP. To compensate fully for the elimination of household borrowing would take a federal budget deficit of 22-23% of present US GDP. That would equate to annual deficits of \$US 2.2-2.4 TRILLION. And THAT cannot happen. Before US budget deficits got anywhere near that level, US interest rates would surge and the US Dollar would be blown apart.

The Asian exporters to the US certainly know about this potential scenario. So, what if they and the rest of the Asians decided to send less of the money they earn from their US exports back to the US? What if they find other and potentially safer and/or more lucrative investments? That would lessen the demand for US debt instruments, and rates would start to climb. The only way to prevent this would be for the Fed to storm into the breach and lend even larger sums of money into internal US circulation.

That would dampen down a climb in US interest rates - BUT - it would put even more pressure on the US Dollar while the already horrendous internal credit expansion would accelerate even faster. The US would keep sending these Dollars overseas to buy imports, but with the Asian exporting nations now not as keen to "recycle" the Dollars into US debt instruments, some of these Dollars would NOT come back. Instead, they would be sold for other currencies to take advantage of non US investment opportunities.

With this would come a situation in which the US trade deficit was NOT being "financed" by recycled Dollars and the US budget deficit was NOT being carried by foreign investment in Treasury debt paper. The result would be an inexorable upward pressure exerted on BOTH US interest rates AND on US internal prices, ALL internal US prices, including prices for consumer goods.

Here, either US households will be forced to cut back on their borrowing and spending and/or US exporters will decide not to "recycle" all the Dollars they receive in return for their exports. Whichever happens first, the other is sure to follow. The only uncertainty left is of the timing, and the US response.

The Only Caveat Is WAR:

If war was to break out across the Middle East, or in Korea, with the US fully involved - then all bets are off. In such a situation, the only individual safety lies in a personal cash hoard held in hand to last for 2-3 months AND a personal (and very private) holding of about 10-20% of total wealth in GOLD coin.

INSIDE THE UNITED STATES

THE ALL CONSUMING STATES OF AMERICA

The US now produces only 45% of the manufactured goods it consumes. In September, manufacturing jobs declined for the 38th month in a row. US weekly earnings dropped for the first time in 14 years.

Borrow To Buy The Difference:

On September 30, the US federal government reached the end of its sad fiscal year. To make the year more palatable, the Treasury reduced its debt (<http://www.publicdebt.treas.gov/opd/opdpenny.htm>) by \$US 20 Billion on that last day, posting a total of \$US 6 TRILLION, 783 Billion. The official increase in debt for the 2003 fiscal year was \$US 555 Billion. On the first day of fiscal 2004, October 1, the debt to the penny went up by \$US 21.3 Billion. On the latest figures, as of October 9, the debt was listed at \$US 6 TRILLION, 818 Billion. That's a rise of 35 Billion in just over a week. So, the federal government borrowed \$US 555 Billion in 2003 to which can be added the \$US 1 TRILLION 750 Billion borrowed and spent by US consumers. On top of that was the huge borrowings by US State governments and by US corporations. In sum, 2003 was one of world history's biggest borrowing orgies.

As a counterpoint, the S&P 500 is currently selling at 29 times trailing earnings. That is higher than it was just prior to the October 1987 crash.

The REAL US Economy:

The US Commerce Department said factory orders dropped a larger-than-expected 0.8% in August, led by a 2.3% drop in transportation-related orders. The August decline was the first since April, when orders slid 2.6%, and was steeper than Wall Street forecasts for a 0.2% decline. This, sadly, shows that the US capital plant and industrial machine park cannot yet find any traction and get going.

US employment research firm *Challenger, Gray & Christmas* reported that planned layoffs at US firms slipped only slightly in September, to 76,506 from 79,925 in August. That came on top of 872,080 jobs cut so far this year. This shows that real US unemployment is being woefully under-reported.

Monetary note: The US Federal Reserve has increased the US money supply since 1995 by an amount that is greater than the entire existing 1977 money supply.

Credit expansion note: Total US outstanding debts rose from \$US 13 TRILLION in 1990 to \$US 16 TRILLION in 1998 to \$US 32 TRILLION by the end of 2002.

David M Walker, the US Comptroller General of the United States, said that he projects annual US budget deficits of between \$US 566 Billion and \$US 644 Billion over the next two years. These deficits will be added to the already outstanding US Treasury debts mentioned earlier on this page.

Even When Seen, It Is Still UN-Believable:

In the teeth of this debt orgy by ALL sectors of the US economy, President Bush has appealed to the American people and the Congress for a colossal \$US 87 Billion - almost three times the annual Gross Domestic Product of Iraq under Saddam Hussein - to rebuild that country.

Bush described the US financial commitment to the Iraqi nation of 25 million people as "*the greatest financial commitment of its kind since the Marshall Plan*". This is said by a President whose Patriot Act asks Americans to throw out the first, fourth, fifth, sixth, fourteenth and fifteenth amendments to the Constitution. Washington has clearly lost the plot, and is hoping that the American people don't rebel.

INSIDE JAPAN - AND CHINA

ASIA IS WORKING TO HOLD THE US DOLLAR - UP

Japan's Finance Ministry has spent 4.46 TRILLION Yen (or \$US 36.2 Billion) over just the past MONTH intervening in currency markets, adding to the record 13.5 TRILLION Yen it has spent this year. All of this is being politely called an aggressive Yen weakening campaign. What it is in fact is a HUGE US Dollar support operation. Showing the actual magnitude of this Japanese US Dollar support is most easily done by adding the Japanese report that Japan's financial institutions and banks still hold 44.5 TRILLION Yen (\$US 397 Billion) in bad loans. If the money being spent to support US Dollars was being spent to get bad loans off the books, the Japanese banks could emerge from under its pile of bad loans in just three years.

Japan was the largest external holder of US Treasury notes and bonds in July, owning \$US 443.8 Billion.

SAVING CHINA:

Chinese household savings increased by 19% in August from August 2002. They may reach 90% of China's GDP (10.3 TRILLION Renmimbi) this year, compared with 68% in 1998 and 45% in 1992.

Global Economic Point - Counterpoint:

The lead point is the fact that as long as the US Greenspan Federal Reserve facilitates lending by US commercial banks and others, the US will inundate the world with its US Dollar outflow. Anybody selling to the US internal market will be the recipient of these new US Dollars.

The counterpoint is this Fed Dollar creation results in the piling up of ever greater stacks of additional new US Dollars in the Central Banks of the recipient nations. If these Central Banks want to avoid this, they have only the hard option of lending these US Dollars right back to the US, receiving debts in return.

This global money loop will stay in place as long as the US keeps its credit-expansion rolling, with the US piling up ever greater external debts.

The ONLY Way To Stop This:

If the US Greenspan led credit expansion is not slowed and then stopped by the US itself, the only other way is for Asia (i.e. China and Japan) to step aside and allow a massive fall in value of the US Dollar against their own national currencies. That would stop the ongoing outflow of US Dollars fast. Suddenly, Americans would have to pay much higher prices for all their Asian consumer goods.

The problem here, of course, is that stopping the ever accelerating borrowing by American consumers would also stop most of the export industries in Japan and China.

The Hard Choice Before Asia:

The choice is whether to keep selling its produced economic goods to the US to keep its own export industries running while, at the same time, lending the US the money with which to buy the economic goods produced by these industries. The prospect is that Asia will, in the end, hold nothing but debt paper as the result for all the work done. The other choice is to stop doing this at some point at the cost of a massive contraction of their export industries. In reality, Asia has NO other valid choices.

The global fate of the US Dollar is now in the hands of the Asian nations. Their decision will decide the arrival time of the coming GLOBAL recession.

INSIDE THE EUROPEAN UNION

WAITING FOR THE FALL

European Central Bank (ECB) President Wim Duisenberg, who is stepping out of his position as the head of the ECB, said in his departure interview that a decline in the US Dollar is “*unavoidable*” because of a record deficit in the US current account. Mr Duisenberg told the Spanish newspaper *Expansion* that the US has a: “*Huge current-account deficit so sooner or later there will have to be an adjustment in its currency.*” And then came his expression of both hope and deep apprehension:

“We'll do everything possible so that this adjustment is gradual.”

Letting The US Dollar Down Gently:

Let there be no mistake in regard to this. The job will be the near equivalent of trying to defuse a fat nuclear bomb in the dark with a pair of pliers. If it blows up, it will blow apart the world's reserve currency as well as the world's main trade currency. Only the twelve Euro nations will be able to stand somewhat apart from this potential debacle, simply because the Euro is itself a reserve currency.

As the US Dollar descends, it will not descend at a uniform speed against all the other currencies, but at a higher speed against some and a slower speed against others. That, in turn, sets up cross currents that will suddenly make some new trade appear profitable while other world trade, previously profitable, will no longer be so. Trade patterns will change. That means changes in the exports of the nations affected.

Some new trade possibilities will open up, others will be closed off, and that will cause internal economic changes right across the world's economic and financial landscape. Most affected, of course, will be the American people. As the US Dollar falls at various speeds against most other nations' currencies, the exporters in these nations will initially try to maintain their markets inside the US by letting their profit margins fall. But when they have fallen far enough to cause losses, these exporters will have to raise their US selling prices. When that starts to happen across a broad front inside the US, the Fed will no longer have to worry about “deflation” (which it mis-identifies as falling prices). Instead, it will be internally climbing prices that will be seen across the US. That will, of course, be identified as inflation, and in short order, money lenders will have to raise their interest rates on new loans and bonds will start falling in value on the US bond market to reflect the now declining purchasing power of the US Dollar. That is what will actually be happening and will be reflected in rising consumer prices.

The falling purchasing power of a currency affects ALL paper denominated in that currency, bonds, mortgages, the whole array of loan and debt instruments. In principle, to simply hold on to such financial instruments is to set oneself up for ongoing losses. As holders realise this, the selling starts.

Nobody Knowingly Holds On To A Losing Proposition:

That general and accelerating selling of US debt paper and other financial instruments is the danger point. Such selling causes the market prices of such financial paper to fall even faster and further.

It is this event which the now former Head of the ECB, Mr Duisenberg, fears more than anything else. If such loss-avoidance selling gains momentum, then the sum total of the world's Central Banks stand with insufficient means with which to stand in the breach to counter it. If they were to try to counter such global mass selling by buying the US debt paper as it was being sold, then they would have to create such enormous amounts of their own national currencies, as to destroy them.

This is the global danger point which lies ahead for the world. Wim Duisenberg knows it. So also do the worldwide *Privateer* subscribers.

AUSTRALIAN REPORT

AUSSIES ONLY BORROWED \$A 7 BILLION IN JULY!

They borrowed most of this sum of money to invest in property. Annualise that July number and one can see a local credit expansion of stupendous proportions - by Aussie standards. After all, borrowing at an annual rate of \$A 84 Billion is not bad going for a nation of only about 19 million people. Now, go one step further and place this vast sum of borrowed and then “invested” money, against the economic fact that the Aussie economy could only manage a rate of “growth” (over the June quarter) of 0.1%, the lowest in two and one-half years.

\$A 84 Billion is being borrowed on an annualised basis and spent into the economy, and all it can do is stand still. Just imagine what would happen if that borrowed money infusion suddenly came to an abrupt end and was no longer being spent into the local economy. That’s right, the Aussie economy would be going backwards at a rate of knots. In such a case, the only main economic “stimulus” left for the Aussie economy would be things like Aussie credit card purchases, which in the single month of June hit \$A 11.6 Billion. This amount is close to the annual records which are usually set in the lead up to Christmas.

Borrowing Is Scary - When It Stops It’s DEADLY:

Right now, all across Australia, there are many businesses large, small, and even huge - all of which are working flat out producing and then delivering economic goods or rendering services. If any of these businesses have failed to understand that all this activity is being financed with borrowed money and go out and expand the size of their business, when the borrowing surge finally ends, that business will go broke. When this credit expansion borrowing surge does end, and they all do, it will be businesses like this which will suddenly see less cash (20-30-40% less cash) roll across their counters. With that, they will no longer be able to meet their now larger fixed costs, and then bankruptcy stares them in the face.

An Old Economic Adage:

Back in olde London town, when early capitalism was taking off, huge booms and busts followed in an irregular sequence as the commercial bankers lent a boom into existence and then later had hard economic law pull the boom right out from under them.

Back then, based simply upon experience alone, this adage was formed: It is during hard times, the Dickensian name for recessions and depressions, when real property RETURNS to its rightful owners.

There was even a basic business rule formed upon this principle. Taking for granted the fact that a smart businessman could recognise a boom powered ahead by ever greater amounts of borrowed money, the rule was that a business should take advantage of the boom to make money, but under NO circumstances should it expand its operations.

The rule was to make and to accumulate money and pile it up for the future. It was fully recognised that at some point ahead would lie the end of the boom. It was further recognised that when the boom ends, wait, and when the recession/depression seems to be ending, then there are bargain priced opportunities littering the landscape. THAT is the time to expand the business.

Enormous family fortunes were made throughout the nineteenth century by those following the above rules. They were money makers during the upswing, they pulled their horns in during the bust, and they became capital investors once they recognised that the bust was near or at an end.

Around the bottom of the approaching global recession there will be new fortunes to be made by those few who made money during the false upswing and held onto it during the economic washout.

THE GLOBAL MARKET REPORT

OH SAY CAN'T YOU SEE?

In the anthem, it is "*in the dawn's early light*". A banner can be seen by those who do not refuse to see and who are fiercely searching for it - in any light - however dim. But when the eyes and the mind are closed off by conscious effort, then one can neither see one's hand in front of one's face, nor can one understand the simplest of situations when one is making every effort NOT to understand it. This does not, of course, describe a *Privateer* subscriber. But it does describe far too many people, in all walks of life and in all parts of the world. In a financial system in boom times, ignorance can be bliss, for a while. Who cares why it's going up - get aboard! When the bust comes, though, and it always does, ignorance is very detrimental to one's financial health. Booms are one thing, busts another. But a situation of the nature of the one now facing the global system is a rare historical event. It is so big that it can be seen in its entirety only with the full exercise of every perceptive power, and the willingness to follow a chain of reasoning through to its conclusion, no matter how unpalatable that conclusion might be.

The entire situation has been summed up in one small story about the "reconstruction" of Iraq.

Instant Financial System - Just Add Paper And Stir:

US Treasury Undersecretary John B Taylor said on Friday, October 10 that his Treasury "team" had reached the culmination of months of effort striving to get Iraq's banking system back in operation. The culmination will come on Wednesday, October 15. On that day, "several" Boeing 747's will land in Iraq. On board will be 2,300 TONS of brand new paper money (without Saddam's portrait on it) which have been printed in facilities throughout the world. This "money" will then be delivered by convoy to 250 "distribution points", most of them banks, throughout Iraq.

Presto, instant financial and banking system. What could be simpler?

Well, let's see. 2,300 TONS is 4,600,000 pounds or 73,600,000 ounces of paper. There are about 25 million people in Iraq. At that ratio, each Iraqi - man, woman, and child - will get just under 3 ounces of paper money - that's about 85 grams for our non American readers.

What is the point? Well, there is no difference - IN PRINCIPLE - between this brand new Iraqi "financial system" and any other financial system now operating in the world. The difference is one of degree and sophistication. Most modern financial systems in "advanced" economies don't have much use for cash anymore. They mainly use credit instruments and immense databases and spreadsheets housed in banks of computers. But strip away the "sophistication" and the high tech finery and one is left with a printing press and a "legal tender" law as the foundation upon which EVERY national financial system rests.

A Selection Of Examples of Monetary "Sophistication":

September 30 having come and gone, the OFFICIAL US federal deficit for fiscal 2003 is out. It comes in at \$US 374 Billion - surpassing the previous deficit record of \$US 290 Billion set in 1991 by \$84 Billion or 29%. The Treasury also runs a daily report on the increase in Treasury debt. In fiscal 2003, Treasury debt climbed from \$US 6,228 Billion to \$US 6,783 Billion. That's a rise of \$US 555 Billion - \$US 181 Billion or 48.4% MORE than the official deficit of \$US 373 Billion. How is this done? By way of smoke, mirrors, "off budget items", and Social Security "surpluses". Every year, the discrepancy between the official deficit and the increase in Treasury debt gets bigger, but nobody looks.

If you think that's funny, here's something even funnier. In August, the Congressional Budget Office (CBO) projected cumulative budget deficits for the decade from 2004 through 2013 at a cumulative \$US 1,400 Billion. Having now announced the official 2003 deficit, they are standing by that projection.

Contradictions Writ Large:

In our previous issue (#485), *The Privateer* referred to the old “banking rule” formulated by the Classical economists back in the first half of the 1800s. The rule goes like this: “*Where the banks have lent the most over recent years, that is the sector where the future and certain economic BUST will take place.*” Using this rule, which has never been contradicted, the obvious areas of future economic bust are in the area of consumer lending in general and real estate lending in particular. In Australia, where “consumers” have similar borrowing predilections to the ones in the US, there are already many warning voices being raised about the future potential for a crisis for mortgage lenders and borrowers alike.

Now, consider the fact that in modern “economic speak”, a “boom” is not a “boom”, it is merely an episode of robust economic “growth”. Where is the area in which everyone from the government to the banking system is counting on to fuel the longed for economic “growth” of the future? It is in business, specifically in new business borrowing and recapitalisation.

Unfortunately, US businesses are refusing to borrow. In the last week of September, the Dollar value of all commercial and industrial loans fell to \$US 907.3 Billion, its lowest level in the five years since August 1998. Worse, this was in the face of a weighted average interest rate for all business loans of 3.15%, the lowest such rate since the Fed began tracking it back in 1986.

This refusal by business to borrow and expand is impacting the US federal government severely. Led by a swan dive in corporate tax receipts, total US federal tax receipts have now fallen for three successive years, a phenomenon not seen since the 1930s. Leading the way has been a swan dive in corporate tax receipts which fell 11.1% in the year just ended. The total was 1.2% of US GDP, the lowest level since 1983 and the second lowest since 1936.

The contradiction is simply this. Financial and economic commentators the length and breadth of the US are all trumpeting the “fact” that a robust expansion is once again well underway. The only thing that is “expanding” is the US external debt position, deficit spending by government, and borrowing for consumption - a house, no matter how palatial, is NOT a production good - it is a CONSUMPTION good.

Meanwhile, the business sector of the US economy, especially the genuinely productive manufacturing sector, is CONTRACTING at rates seldom seen in the past century. Companies are contracting both their capacities and their employment. Business executives have been selling into a rising stock market for months. Those whose business it is to PRODUCE wealth know full well that the present economic climate is not conducive to what they do. This leads to the obvious question: How is an economy in which productive capacity is shrinking at record speed going to generate genuine economic growth?

The answer is that it isn't - as a cursory glance at the real state of the US economy will amply confirm.

Checking Up On US Markets:

All three major US market indices, the Dow, the S&P 500, and the Nasdaq, hit new 2003 highs over the past week (Oct. 6-10). One of the major factors in this ongoing “strength” has been an explosion in new margin debt. Two months ago, at the end of July, total margin debt on the Nasdaq had reached an all time high of \$US Billion. A full 27% of this debt (\$US 7 Billion) had been added in the three months since May 2003. At its top in March 2000, margin debt on the Nasdaq was \$US 21.9 Billion. At its present level of 1915, the Nasdaq is still 62% below its March 2000 peak of 5048.

Looking further, we find that for US stock markets as a whole, price/earnings (p/e) ratios (using trailing reported earnings) are at levels only equalled at the 1929 and 1987 peaks. Using national accounts estimates of corporate profits, market p/e is at its highest level ever, by far. Finally, cash dividend yields are less than half historical averages and MUCH lower than those in Europe.

Monetary “Progress”:

In Iraq, the plan is to resuscitate a national financial system by flying in a fleet of jumbo jets loaded to the roof with paper. That, given the actions of government and financial officials everywhere, seems to be the plan everywhere else too. The difference is that in modern and sophisticated economies, plane loads of paper are no longer necessary. All that is deemed necessary is a sufficiently indemnified lender (courtesy of the Fed and the other Central Banks) catering to an adequate supply of gullible borrowers.

The Roman Emperors debased the currency by reducing the amount of Gold or Silver in it and/or by adding base metals to the mix. The Medieval alchemists strove to make this unnecessary by looking for a way of “transmuting” base metals into Gold. When this failed, the idea of “paper money” was discovered in China by Marco Polo and brought back to the Western world. By the late nineteenth and early twentieth century, the use of checks and bank notes had filtered down to the man in the street.

In 1913, the US got an income tax AND a Central Bank. In 1971, the Dollar was divorced from Gold. The rest is history, documented in these pages, in the writings of many great economists and historians, and on steadily increasing numbers of websites. Those who WILL see WON’T get fooled again.

Recent Events:

As already stated, all major US stock market indices hit new annual highs over the past week. Having become past masters of selective vision, Wall Street will latch onto ANY piece of data, no matter how tenuous, which feeds their mantra that the US economy is “recovering”. This time it was the employment statistics - 57,000 net new jobs were created. The fact that almost all of them were very low paying jobs was ignored, as, of course, was the fact that manufacturing employment continues to fall.

But the BIG event concerned the \$US index, which has been falling steadily for six straight weeks now. This week, it finally breached its 2003 lows. Up until October 6, the 2003 low closing level for the \$US Index had been 92.25, set on June 13. On October 7, the \$US index closed at 92.18. By the end of the week on October 10, it was down to 91.79. Two months ago, it was reported that the Bank of Japan had spent the equivalent of \$US 80 Billion propping up the Dollar by the end of July. It has now been reported that in September alone, the Bank of Japan spent almost \$US 39 Billion in a similarly fruitless exercise. Japan’s total expenditure this year selling Yen for Dollars is now put at \$US 119 Billion.

Gold:

For the latest on Gold (including charts) please see our Gold This Week (GTW) pages online: <http://www.the-privateer.com/subs/goldcomm/gold.html>

What’s Next?:

The US is in the midst of a long weekend, Monday, October 13 is Columbus Day. On Wednesday, October 15, President Bush departs for his Asia trip, where his first port of call will be a two-day visit to Tokyo. Mr Bush will be wading into the middle of a Japanese federal election, set to take place on November 9. This bodes ill for any substantial agreements he might wish to make with Mr Koizumi.

Mr Bush then visits the Phillippines, Bangkok for the annual ASEAN meeting, Singapore, Indonesia, and finally Australia on October 22-23.

Mr Bush leaves behind him a growing political unrest. The number of Americans who want to replace Mr Bush at the Presidential elections a year from now has grown to 50%, according to the latest polls.