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"No problem"

"..Brian Lenihan, Ireland's finance minister, told Irish radio early on Wednesday the banks had "no funding difficulties."

- The Financial Times, November 18 2010.

The rule of thumb during a banking crisis: trust no-one, least of all the politicians. Peripheral Europe's banks and its governments are now caught like Macbeth's "two spent swimmers that do cling together / And choke their art". Ireland's banking system and its sovereign creditworthiness are now effectively one and the same fragile thing. A comparison with US banks and their Latin American debt adventuring in 1982 is instructive. As Nassim Taleb put it in 'The Black Swan':

"In the summer of 1982, large American banks lost close to all their past earnings (cumulatively), about everything they ever made in the history of American banking – **everything**."

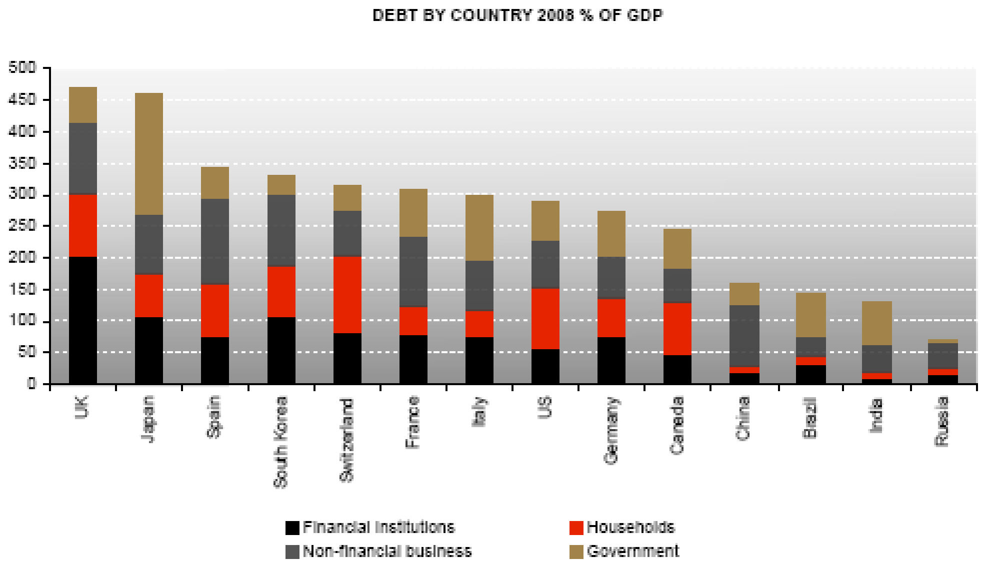
Richard Koo, the Chief Economist of the Nomura Research Institute and author of 'The Holy Grail of Macroeconomics: lessons from Japan's Great Recession' tells it with extraordinary candour at the Centre for Strategic & International Studies website. The presentation gets particularly fruity after roughly 31 minutes. Koo recounts his experience as a syndicated loan desk officer at the New York Fed. Late on a Friday afternoon in August 1982, his job and that of his colleagues was to try and convince the rest of the world, and notably other central banks, that the US banking system was solvent when it was not. The following is taken verbatim from this presentation:

"That was about the worst possible banking crisis in modern US history. [Plus ça change..] Our conclusion was that seven out of eight US money centre banks were actually underwater.. It was so bad because everyone down from Mexico to the southern tip of Chile went bankrupt [or defaulted].. Paul Volcker, the chairman of the Fed, called central banks and ministries of finance all around the world on that critical Friday in August 1982.. Later a Bank of Japan official who took that telephone call from Paul Volcker told me the exact words he used. He said:

"You better give me Governor Maekawa right away. If you don't give me Governor Maekawa there might not be any US banks left on Monday."

"What we at the New York Fed had to do was arrange for all the foreign banks to keep credit lines open to the American banks, ***knowing fully well that all these American banks were actually bankrupt***. And we also could not tell the outside world about the situation because if you go out and say 'American banks are bankrupt' – the next day they ***will*** be bankrupt. And so we had to come up with these stories that 'well, there are some Latin American problems, but they're all good debt, not bad debt,' and we had to lengthen the clean-up process; it was a very difficult period for US central bankers and bank regulators in general.. So by keeping this myth going, that everything is fine.. we had to do that for a very long time.. ***the whole process took about 13 years..***"

The credit bubble was a long time inflating, so it will doubtless take a long time to properly deflate. Meanwhile we get the surreal experience of one of the most indebted countries in the world – the UK – considering lending billions of pounds to help its heavily indebted Irish neighbour. Hinde Capital shows the extent of our own folly, with the UK suffering from a debt problem "much worse than the US'. We are the most leveraged country in the world per capita":



Source: McKinsey Global Institute

Since we're deploying graphics, the following table (Morgan Stanley via FT Alphaville) shows the ugly 'secret' behind whatever bailout Ireland will ultimately get – in that it will actually constitute a stealth loan designed to keep imprudent lenders like France's Credit Agricole, Belgium's Dexia and, with tiresome inevitability, the UK's RBS afloat.

Exhibit 15

European Banks Exposure to the Periphery (€m)

Bank	Sovereign Periphery Exposure	Periphery Loan Exposure	Periphery TOTAL	TNAV 2011	Sovereign Periphery Exposure as % of TNAV 2011	Total Exposure as % of TNAV 2011
Credit Agricole	3,261	31,825	35,086	28,612	11%	123%
Dexia	6,713	3,894	10,607	8,905	75%	119%
RBS	3,533	73,857	77,390	68,752	5%	113%
Danske Bank	89	11,086	11,175	12,103	1%	92%
Santander	5,173	33,342	38,515	51,530	10%	75%
Lloyds BG	169	31,451	31,619	52,223	0%	61%
Barclays	1,838	20,728	22,566	53,781	3%	42%
Intesa SPI	794	9,362	10,156	29,866	3%	34%
SocGen	5,093	4,830	9,923	34,149	15%	29%
BNP Paribas	8,090	3,500	11,590	59,675	14%	19%
Natixis	716	576	1,292	12,776	6%	10%
HSBC	2,517	-	2,517	91,456	3%	3%
UniCredit	1,066	-	1,066	49,946	2%	2%
Banco Popolare	89	-	89	5,165	2%	2%
Deutsche Bank	700	-	700	40,701	2%	2%
Monte dei Paschi	131	-	131	9,705	1%	1%
Nordea	102	-	102	24,233	0%	0%
SEB	16	-	16	8,054	0%	0%
Credit Suisse	-	-	-	23,056	0%	0%
UBS	-	-	-	34,155	0%	0%
Handelsbanken	-	-	-	8,826	0%	0%
TOTAL	77,773	269,669	347,442			

Source: CEBS, company data, Morgan Stanley Research

In a narrow sense we are living through a protracted banking crisis. But in a much broader sense the crisis is political – not least as any nominal distinctions between central banks and national treasuries are fast eroding, and because at this scale, banks that are too-big-to-fail now represent what is effectively sovereign – because sovereign underwritten – risk. The crisis is also political because the workings of a free market have been trampled by political actors desperate to keep the show on the road; it's not ***their*** money they're casually recycling through an insolvent system.

Ignoring for a moment any value judgment as to whether perhaps a sizeable number of the 'have-nots' got that way through their own greed and stupidity, in the words of WH Hutt in 'Politically Impossible' (hat-tip to Sean Corrigan and Jonathan Escott):

"The efforts at power-acquisition by politicians who promise exploitation of the 'haves' are facilitated by the patent sincerity of a mass of disinterested supporters. But their campaigns are universally accompanied by grotesque factual distortion, reliance on the ignorance and indoctrination of those led and (in the USA, at least) the deliberate engendering of envy and violent feelings. Their appeals are basically effective, however, because, in the short run, it is obviously possible for some 'have-nots' to benefit through expropriation of the 'haves' via income transfers. And relatively few among the classes believed to benefit are much concerned with the long run, while the consequences are not apparent to the generous-hearted acquiescent citizens who are not beneficiaries. Under universal suffrage, if the improvident are in the majority, or if they constitute a determining 'swing vote', they are in the position ultimately to pauperize a nation as long as politicians can rise to wealth and power through outbidding one another in generosity at the taxpayers' expense."

We get no particular pleasure from discussing politics when we could otherwise be profitably discussing "pure" investment. But the investment problems of today are precisely political ones, which is one reason why they've become so intractable. One could plausibly argue that democracy sows the seeds of its own destruction when it allows swathes of the electorate to vote for their own enrichment, leading politicians to indulge in a race to the bottom, in fiscal terms, that can ultimately only lead to ever-increasing monetary inflation and currency debauchery *en route* to sovereign bankruptcy. In both asset and currency terms, the only practical solution to the current mass insanity and denial on the part of western politicians is to entrust one's monies to those regimes and territories that still practice some form of fiscal discipline. Gold and silver, of course, as the ultimate expression of the stateless asset, are beholden to no politician or arbitrary law.

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