The Hedgehog and the Fox

Last week the Fourth European Estate known as the Trade Unions opined that:

"The 25 largest fortunes represent 10% of the Portuguese GDP, which means an increase of 17.8% since 2010".

"If ever there is another troika intervention, it should be less ideological, more skilled at listening and dialogue and exclude the ultra – conservative ideologues from the ECB".

"The implementation of the Troika's austerity programme on Greece is incompatible with social justice, has led to the dismantling of the Welfare State and strengthened extremist and intolerant elements. Nationalism, racism, xenophobia and violence rush in to fill the gap left caused by the non-respect of democratic institutions and by the disintegration of the social fabric".

"The Troika stated that it will only hear the trade unions and will not negotiate with them. The Troika will only negotiate with the government".

There is a clear feeling in countries in the European Periphery, but also increasingly by members of the Core, that the Austerity sanctioned by the central EU power and facilitated by the ECB is undemocratic. The European Project is a hedgehog which is about to be attacked by many democratic foxes. The endangered species of European Hedgehog has taken note of this existential threat; and is now in the process of trying to reform itself after admitting that corruption and waste is endemic.

The next wave of ECB liquidity, is also no forgone conclusion. The ECB leaked very publicly, before the last Council Meeting, its intentions capabilities to refrain from sterilising its OMT bond purchases. The inference is that a future liquidity injection, via OMT, will have the impact of inducing permanent unsterilized liquidity in the system. The clever trader foxes took this as a signal that Unsterilized QE is the ECB's next policy tool. Closer inspection of the ECB's tactical leak however suggests that it was actually done with the intention of enlisting support of the monetary hedgehog, known as the Bundesbank, to endorse this project. The Bundesbank has so far not opined on the issue; however the German legal system has 'suddenly' decided to refer the legality of the ECB's whole OMT programme to the European Court. A clever fox, who was buying the market, would suggest that Germany was complying with EU legal opinion on the OMT; and that said EU legal opinion would rule that the ECB had acted legally. It should however be noted that the ECB's mandate unequivocally precludes it from monetizing the deficits of nations. Furthermore, Germany's constitution expressly forbids deficit monetization. Even if the EU courts rule that the OMT is legal, this only refers to the Sterilized part of the OMT. Unsterilized OMT is unconstitutional in Germany and also by ECB Mandate. It is unlikely that the clever foxes, who are trying to be bulls, have fully understood these finer legal points. A German hedgehog could therefore at any time wound the clever fox by raising the point that Unsterilized QE via the Unsterilized OMT is simply a form of deficit monetization. We believe that Germany has quietly flagged that this issue is to be used at a point and time of Germany's choosing in the future. The sly fox Draghi has been cornered by the German hedgehog. The German hedgehog has regained the initiative.

This German initiative has been seized because the very delicate matter of the next wave of Greek bailouts is currently being negotiated with the Troika behind closed doors. In a report entitled "Beware of Hedge Funds Bearing Gifts", posted on December 13th 2013[iv], we suggested that Greece was in the advanced phase of negotiations. The Greeks were threatening to use their existing primary surplus as a bargaining tool to extract further concessions from the Troika.

A clever fox, from the hedge-fund community, had been enlisted in this exercise with the promise of rich rewards, in the form of capital gains, in the Greek sovereign debt market that it had cornered. Ostensibly the EU part of the Troika has fallen into the Greek trap, by signalling that it may offer to extend the Greek bailout loan to fifty years and reduce the rate of interest by fifty basis points[v]. We would suggest that this "50/50" kicking the down the road is not exactly in the interest of either the Greeks or the clever fox hedge-fund.

Extending the maturity of the loan would signal that Greece will never be able to pay the loan off; and is therefore being put in the same position as an indebted African nation. One remembers what the Spanish Prime Minister said about his nation not being Mozambique. He may soon find cause to repeat this statement. Under the "50/50" scheme, future generations of Greeks will be perpetual debt slaves. The rate of usury will be lowered to make the burden manageable over the long term without ever triggering an outright default.

European destruction and reconstruction of the Twentieth Century was financed by American capital. Alas, America is a deficit nation today; with no capital to export to Europe. Germany is however a capital surplus nation. It therefore seems logical to assume that the strategy of America should be to make Germany finance European reconstruction, whilst at the same time weakening itself relative to the already weakened United States. Germany, thus first has to be blamed for European destruction; as it was at Versailles. Germany however, is reciprocating with alacrity by enforcing austerity.

Another headwind, to justify less "Taper" and more QE, is also being opined and vigorously blown in the media. This headwind is Japan. Abe and Abenomics are now being written off as abject failures. He is being given one last chance in the upcoming wage negotiation round. If salaries are not raised, then swift progress will be made to end his political career. Imported energy inflation removes the ability of Japan Inc. to pay higher wages and preserve its bottom line. If Japan Inc. pays higher wages it will self-destruct, unless energy costs fall rapidly. In order for energy costs to fall, the Yen must strengthen; which then has a negative impact on Japanese exports and Japanese equities.