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From: Boris Nikolic
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Subject: FW: China and the Euro Rescue

More on the previous email!

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All of this is unfortunate since a weak Europe/developed world can't fund the foreign aid that Bill is pushing for nearly as well. It is important not to fall into alchemy thinking when assessing the situation and forecasting the future. Magical thinking helps no one in planning.

Sovereign debt is no longer risk free. That's gone... which means financing cost just went in a huge way since: credit = confidence.

The situation in a country like Italy is like someone having a 4% mortgage on their house, and then there is a reset and the interest rate is now 6%+ and headed up. The increased debt service makes you less creditworthy and you have a negative feedback loop.

Unless fiscal control is centralized with monetary control, the euro will lose members or fail. It is just a question of when.

ECB buying bonds of members unable to issue them in credit markets would mean leverage for fiscal central control is gone. PIIS would "party on" about spending. And so it would be Germany that eventually leave the Euro and it would mean the Euro would fail totally. In any event that is moot since Germany is not going to allow it.

If I were Greece, I would default now and default big.

Even if they delay, Greece will be in such a depression economically that it will eventually have no choice since it will be in a negative spiral.

Can the rest of Europe buy time and fix their banks before then? The market thinks not for long given where Italian bond rates are. At least things did not get disorderly last week.

The market will eventually force the issue to a head and hopefully the process will be orderly.

The following is highly edited from: <http://www.zerohedge.com/news/forget-unknown-unknowns-just-known-unknowns-eurozone-crisis-paint-dismal-picture>

The EU leaders have agreed to raise the funds available to the European Finance Stability Facility (EFSF) to 440bn euros, which is not enough to cover the PIIGS' financial obligations in 2012. The rise of the EFSF to 1 trillion euros, loosely agreed on 26 October, would avoid a disorderly default in 2012. The problem, however, is that it is not clear where this extra 560bn euro will come from.

Private money will want a high risk premium if it wants to come in at all. Thus, as has we have noted before, most of the money will need to be printed.

The Bundestag has sent a clear message that it will commit no more than the 211bn that it already has. China is likely to only commit token sums and then only for significant political and business concessions or perhaps physical assets.

The relief of the markets seems to be that a Lehmans style credit-event did not follow the Eurozone leaders meeting of 26 October, but the threat of one clearly remains.

With 61bn euros of debt repayments due in February 2012 alone, Italy will likely have to reschedule.

The forecasting scenario choice is between a managed default and a disorderly recalibration of currencies, liabilities and obligations such as happened after Lehman declared bankruptcy on 14 September 2008.

Leverage' is vague and aspirational. 'Insurance' is not wholly accurate. If the fund only covers the first 20% of defaults then it is simply too small, and calling it insurance does not change that.

Clearly, we are still on the orderly transition pathway in that a credit event did not occur but it remains a credible scenario in the next few months. In both cases, as we have concluded previously, money will be created, debts and assets married up regardless of the history (e.g. bad banks forced on good banks); cash piles like pension funds and corporate cash perhaps forcibly diverted into bonds and so on. In short, there will be a major redistribution of wealth. The second question is after the recalibration, how long will it take to reset the system?