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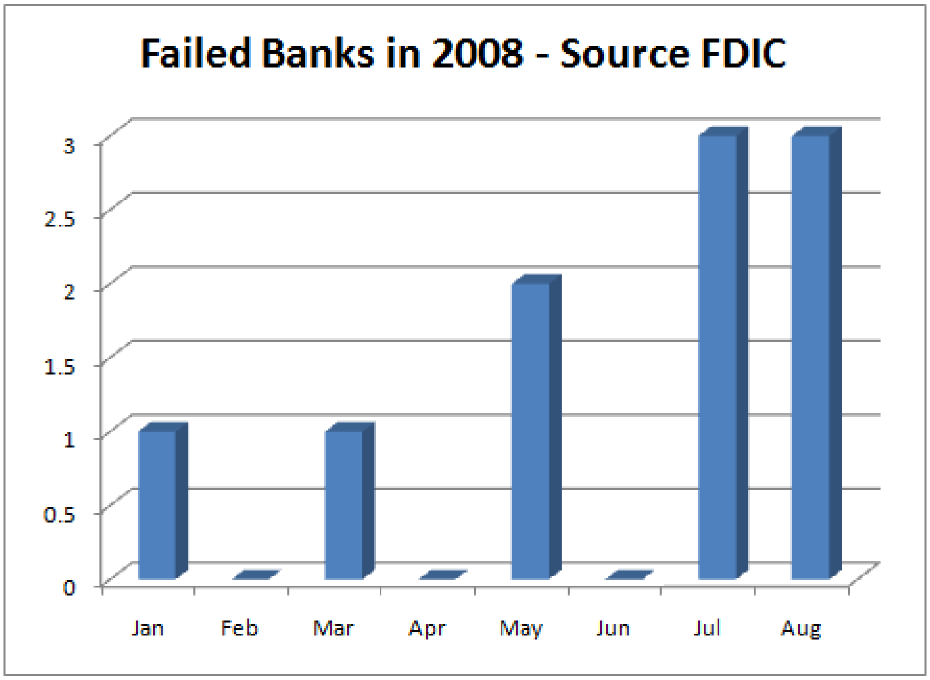
October 7th Watch: *You Know You're In Trouble When...*

While most of the MainStreamMedia hypnotized public was feeding on the pabulum pushed out by the PowersThatBe-owned 'state media' there were numerous indications going on Sunday afternoon that news events were being pushed as much by the actual events surrounding Gustav, as the need for the PTB to keep things from falling part for two more weeks. Fortunately, having access to the predictive linguistics reports out of HalfPastHuman.com, I already expect *relative* order until September 15th because shortly thereafter, and centered around October 7th, we're due to start The Big Slide to Transformation which will happen between now and March of next year. Still, there was almost a sense of either panic, (Or, was it disbelief?) as my broker called to say "*There's a special Sunday trading session in energy due to the hurricane...*" I know, you're thinking to yourself, "hmmm...that's odd..." Yup, sure was...yet here's the story bigger than life. And close on the heels of the change in margin requirements installed Friday (oh, what a coincidence, eh?) With the Dollar on life support (and a hit of meth lately) it shouldn't come as a surprise.. My broker had never heard of a special Sunday session before, but then again, he's only been in the game 20-some years. But not to worry, seems we're not the only ones worried about the end of the month and then October 7th-ish events to follow.

Prequels to Prequels

That the US markets are in a world of hurt doesn't presactly take a brain scientist to figure out. The failure of the apparently misnamed "Integrity Bank" on Friday brought the number of bank failures this year to 10, but the real news is not that this bank failed, it's what happens when I put the YTD data into a spreadsheet and project what's ahead.



So brace yourself because as I look at the numbers, seeing 8 (or more) banks fail in September is not out of the cards, although we might have a low September and then a horrific October or November.

A lot of readers are sending me questions about how to deal with what could become a banking collapse contagion with questions like this one:

> "George:
>
> I have a telephone company credit union account. Do credit unions have the same potential to collapse as does banks?
>
> Also, is it a good idea to go ahead and transfer most of one's money to the Treasury Account as you had suggested previously?
>
> Thanks in advance,"

I think credit unions, savings and loans, and small nationally chartered banks are all decent operations, especially if you keep each account under $100,000 - like any of us regular folks have to worry about that limit, right?

Since we're talking contingencies here, this is my personal operating plan for the next month and a week:

- Balance of September: Continue stocking up on food, supplies, and so forth while things we might need are relatively available. If you have a need for anything from overseas and it will store OK, don't be shy about getting a couple of months worth stored up - and maybe six months to a year for indispensable items like coffee.
- Get all your dental work done - I'm going in for a crown next week - although it may be rescheduled if the hurricane is worse than a 3 and/or if power goes out.
- Refresh your home supply of stored water.
- (If you're me...finish getting the solar power system and the new well in!)

- If you work for an employer, try to think of how you could help them with a 'contingency plan' which could be enacted if anything goes seriously wrong. You talking points might include:
    - What economic conditions got us to the current mess.
    - An analysis of the company's operating cash requirements.
    - Ways the company can continue to operate at minimal cost. Or, if the economy melts down this fall, you have to ask the really really unthinkable questions like "In a survival-oriented world, is there really a market for what our company does?" Example: Cosmetics sales become really questionable. Power, energy, ag, basic supplies, those are all indispensable, bt who is going to have money to pay?
    - Come up with a work-share proposal to have in your back pocket.
    - If you company depends on either credit cards ors the internet, ask yourself "How would we fund transactions in the event the internet or the credit card clearing centers were attached?"

  [Start of a draft letter to employer is toward the end of this week's report.]
- After you get your quarterly taxes done (if you file quarterly) come up with a plan for how to operate over the next six months or year under each of the following possible conditions:
    - The banks are closed, or there are runs on banks
    - The ATM's and credit card processing centers are down.
    - The Internet is down
    - There is no power.
    - There is no phone system.
    - You can't call the cops.
    - You have a medical emergency...
    - Stores are out of stock on most goods
- So while you can, get at least 6-months of medicines stored up.
- Buy some canned beans - you may not like them, but a couple of cases of Ranch Style beans and a 50 pound sack of rice *bought now - not after events* - is a wonderful insurance policy. Got a water filter? Matches? Ever do any campcraft? Do you even own a survival book? (Have you read a book in the last year???)
- Stock up on toiletries: toilet paper, toothpaste, antacids, Band-Aids, Neosporin or clones, have a first-class first aid kit at the ready.
- When you get your mid-month money (if you have any coming in) get a little cash set aside. Do you have enough cash to eat for 2-months without going to a bank?
- How do you pay your bills if there is a massive banking failure?

I realize it may give you a headache to even consider how you would be able to live without a bank, a couple of credit cards, and ACH transfers to pay bills and such, but believe me, that's a distinct *possibility* that I think any prudent person has to give at least some amount of head-space and planning toward. You do realize that most people will be S.O.L. (definition link if you live that sheltered a life that you don't know this one).

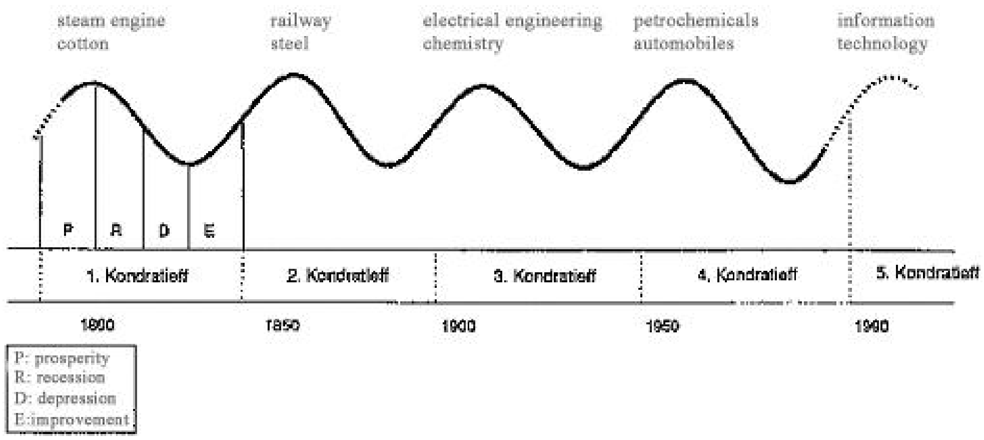
Off to the Lockup

The game of interest starts innocently enough, which is why back in Biblical days, there were Jubilee Years every 50 years when all debts were forgiven. Seven times Seven Years was about all the longer an economic cycle based on interest can work - and it could be argued that beyond 50-years the length of an economic cycle can only be extended via ever-increasing amounts of exploitation or regular folks by the uber rich. The Wkipedia entry on Jubilee years is most instructive:

> "The Jubilee (Hebrew Yovel יובל) year, is the year at the end of a seven cycles of Sabbatical years (Hebrew Shmita), and according to Biblical regulations had a special impact on the ownership and management of land, in the territory of the kingdoms of Israel and of Judah; there is some debate whether it was the 49th year (the last year of seven sabbatical cycles),

> or whether it was the following 50th year. The English term Jubilee derives from the Hebrew term yobel (via Latin: Jubilaeus), which in turn derives from yobhel, meaning ram [1]; the Jubilee year was announced by a blast on an instrument made from a ram's horn, during that year's Yom Kippur[2]. The biblical rules concerning Sabbatical years (shmita) are still observed by many religious Jews in the State of Israel, but the regulations for the Jubilee year have not been observed for many centuries. "

And yes, the regular 50-80 year swings in the economy which are collectively called the Kondratiev Wave seem to closely fit the Biblical Jubilee years:



While some of us academic/cynical/studious/argumentative types are still debating whether the end of the wave is fixed by astronomical/astrological/sun cycles, economic cycles on the one hand, or are simply driven by a sequencing of generations (sort of along the lines of Strauss and Howe, but more really I think in keeping with life extension processes and such) is hotly debated by people who have become entwined in the argument.

Although I'm extremely guilty of being ensnared by the discussion I'm quickly trying to meditate/work my way out of it because the problem with such idly speculations is that even if you know the 100% correct answer down to 5-decimal points of precision, knowing the answer doesn't buy you anything.

In other words, it's about as futile as coming up with a great and foolproof was to make money in the paper markets - it may seem extremely appealing but when you 'win' the game you get a pile of paper and unless you convert those into things of intrinsic value, there's nothing saying that paper will always be fungible (e.g. convertible to other things of value).

Pondering the predictive linguistics as we do around here, one of the persistent features in the reports/and underlying data of late has been this whole worrisome notion of 'financial lockup'. We can follow the *drivers* by reading the headlines, easy enough, just follow the bank failures and don't be misled into caring about the politics. Sure, there are some tantalizing headlines:

McCain Picks Palin - a good decision and although the media seem bent on making headlines like "Sarah Palin: The Deer Mama" I was impressed that McCain made a decision *not* to go with a real Washington hard core 'insider' like Joe Biden. Keeping in mind that the VP is only a 'heartbeat away from being President" I ask myself, who would I rather see as President? Joe Biden or Sarah Palin. That doesn't even require thought...Juneau is about as far from the Beltway as you can get...But then we have the 'investigations rumor" and the 'where'd all her campaign money come from?' Is anything MSM believable? I mean besides the plane ride stories which gets us to...

Dick Cheney is going to Georgia which is, to our way of thinking, just upping the ante another level in the continuing tit-for-tat escalation of the conflict. "Cheney's Georgia trip brings message to Russia "says one headline, but on the internet headlines like "Russian sleeper agents begin 'Day X" attack in US" are starting to appear. Want to be what day this "day x" might be?

I'm hoping Cheney puts country above energy and special interest groups, but that's maybe expecting more than he can deliver. A NYT piece making its appearance account the country this weekend says "Cheney contemplates legacy..." Presumably, they mean more than his hunting trip where he winged a lawyer. Out of season, too, as I haven't been able to find an open season on lawyers in this area. Would one more 'war of liberation' do it?

OK, so these are the kinds of stories that are pushing current events (plus some weather here and there, like Gustav. But let's put aside the drivers and get down to the practical coping and doing part.

I asked a friend who is in the banking sector "How does it break?" and he gave me a whole laundry list of 'possibles' to consider (abbreviated somewhat...)

> "As the de facto risk manager at my bank, I ponder this frequently. My response will be limited to my understanding of how we (small bank) are connected to bigger banks (not necessarily money-center). I do not have a wide/firm grasp of how the bigger banks we touch are connected to the money-center banks.
>
> In no particular order, here are a few things that could happen/stop happening:
>
> 1. Incoming (to us) international wires must enter the U.S. through a bank big enough to have its own SWIFT code. We are not big enough. Our primary correspondent bank isn't, either. If the sending (foreign) bank doesn't have a preference as to which U.S. bank to use as a gateway, we give them info for Wachovia in NYC. If Wachovia goes down, our customers can't get incoming foreign wires unless the sending bank knows the SWIFT code of a large-enough bank. We would contact our correspondent bank or Fed to get SWIFT codes for alternative gateway banks.
>
> 2. For some reason, Wachovia clears some checks for Fed, at least in some capacity. On occasion, our customers will deposit a check drawn on a bank in the same Federal Reserve district. So, the check should go from us to Fed to the drawee bank, and the credit should go from the drawee bank to Fed to us. Sometimes, Wachovia's stamp appears on the back of the check, and not as the drawee bank.
>
> In those cases/clearing relationships, Wachovia could gum up the clearing unless they could be bypassed (I think). So, our customers could have denied/delayed availability of the checks they deposit that pass through Wachovia. (detail edited)
>
> 3. We receive our customers' direct deposits and ACH debits through our correspondent bank. If this bank went down, we would have to contact Fed to re-route the transactions through another correspondent. That could take a couple of days to get the agreements signed and implement.
>
> 4. We send our outgoing wire transfers through the same correspondent - same consequence. Also, this correspondent bank lends out overnight/longer-term excess funs on deposit by banks like us (normally, we do have excess funds on deposit). However, repayment of those funds is dependent upon the condition of the banks to whom our correspondent lends. The loan quality measures (of loans the correspondent has made to the borrowing banks) of the correspondent have been declining for several quarters.

> Consequently, the correspondent's loan loss reserves have increased, driving down its not-so-robust profitability.
>
> --- (more technical explanations of failure linking) ---
>
> 8. There is a possibility that our Fed account balance being drawn down could restrict how much cash we can order from Fed. We are located in a cash-oriented rural area, so our not being able to get as much cash as we needed could cause us to restrict cash withdrawals.
>
> 9. We deal primarily in domestic, $-denominated transactions, so the Herstatt scenario in Wikipedia is a less likely impact for us (unless I'm missing something).
>
> [G: Yes. The Herstatt scenario could seize up maybe a French bank, then a Chinese bank, and then Wachovia, and then you're stuck...it's ugly because it propagates depending on the size of failure, counterparty risk can go systemic is my understanding. Cross your fingers?]
>
> 10. Our primary assets are mortgages and investments in government agency bonds (cue the howling wolves). Of course any loan is dependent on the borrower's ability to repay. If their payroll direct deposits or deposited checks get bottled up, they won't be able to make their payments. Short-term, our delinquency rates would rise from their current negligible levels. Longer-term, we would probably have to write down the book value of the loans. Even if they had enough deposits in our bank to make the payments, that process would cause corresponding decreases in assets (loans) and liabilities (deposits). Banks have inverted balance sheets - that's why we call debt "credit" ;-)
>
> 11. I would guess that some banks might start canceling their debit cards in order to slow down the outflow of funds. The resulting increase in checks clearing might find bottlenecks where the larger banks have a role in check clearing (see #2 above). The resulting reduction in velocity of funds circulating could cause seize-up.

And you know how you spell velocity of money going to zero, right? d-e-p-r-e-s-s-i-o-n.

In my case, the amount of money I will be moving out of the banking system and into the Treasury Direct system is mighty small ($200? OK, a bit more then...). Still, that's something that I will do as soon as I get a bead on income for the quarter. It MIGHT be safer than having an account in a conventional bank. But, remember this is all going to be 'whole new territory' stuff, so no telling what the 'perfect moves' will be. Which is why I am putting as much as I can into *consumables and means to produce goods*.

A couple of months of goat food? Some metalworking machinery? Solar panels to run things? A couple of new wells? Spares of everything? Exercise, fitness, good teeth? Yes, these will be hard to produce after the fact is the linguistics are right. Besides, if they are not, I will be in the best shape I have been in in 20-years come the other side of "whatever" this fall.

So how does the actual 'recovery' work?

> "Recoverability? My imagination possibly envisions local currencies, such as the Berkshares (see E.F. Schumacher Society). I'd be willing to sell some of my precious metals to my bank in exchange for them canceling my mortgage balance. If enough others could do so (unlikely, since not many people have as low a mortgage balance), the bullion could form the new capital basis for the bank to issue its own currency or script, at least for local transactions. Even if that could work for us (only one location), I don't see how larger,

> more geographically dispersed banks could follow suit.
>
> If there are any other specific situations you want me to address, let me know. I suspect the scope of what you're after may exceed my knowledge. Derivatives - I don't even know what I don't know. I'm just a little country banker who reads a newsletter by a nutjob in East Texas."

I have to tell you, I was downright impressed with the deep thinking my banker-friend has put into this. Apparently, I'm not the only one losing some sleep over systemic risk and what's on the other side.

Backing Up to the Future

You caught, I hope, the mention of BerkShares? You really need to read up on them because this could be the new currency that steps in to fill the trading gap if we have problems galore with the US dollar, or if the banking system has a protracted systemic failure.

If you click over to the BerkShares site you can find a good explanation of how BerkShares work:

> **How does the 10% discount work? Where does that 10% go?**
>
> The ten percent discount is part of the exchange rate, not a discount given at the point-of-sale. That 10% doesn't "go" anywhere - no one is making a percentage on BerkShares transactions. To explain more clearly, let's follow 100 BerkShares through a common transaction:
>
> One day, you decide to go out for a nice dinner. You go to the bank to purchase BerkShares to spend at a local restaurant. You go in with 90 federal dollars and exchange them for 100 BerkShares. You go to dinner, and the total cost comes to $100. The restaurant accepts BerkShares in full, so you pay entirely in BerkShares. Therefore, you've spent 90 federal dollars and received a $100 meal - a ten percent discount for you. The owner of the restaurant now has 100 BerkShares. They decide that they need to deposit them for federal dollars and return them to the bank. When they bring them to the bank, the banker deposits the 100 BerkShares you spent on dinner and gives the restaurant $90 federal dollars, the same 90 dollars that you had originally exchanged for BerkShares. The end result? You receive a ten percent discount because of the initial exchange, but the same $90 you originally traded for BerkShares all goes to the business where you spent those BerkShares.

The organizers of BerkShares make it very clear that....

> "BerkShares will not, and are not intended to, replace federal currency. Their use will help strengthen the regional economy, favoring locally owned enterprises, local manufacturing, and local jobs, and reducing the region's dependence on an unpredictable global economy."

Sounds pretty workable, huh? Especially instead of exchanging US Federal Reserve Notes (FeRN's) you could deposit gold into an account.

I can see it now: Someone will put up a hand and ask "Hey! Wouldn't this be a cool way to beat the IRS?" Well, no, not really. You see, when IRS says they want money, they mean whatever you get in the way of income.

That's the big difference between being a business (favored by tax laws) and being a private citizen (distinctly disfavored by tax laws).

In a business, there are generally small taxes on the gross sales of a business, like a 'business and occupation tax' but the Fed's go for taxes on the profits. So the formula in a business is Sales, less cost of goods sold gives gross profit, and from there you back out expenses, and if there's any net profit left, then that's taxed.

On the other hand, if you grow enough tomatoes to get noticed, Uncle will want some portion of the revenue as though it were 'income'. Sell 100 tomatoes? Uncle wants to see the books. And yes, S&H Green Stamps are considered income too, as I understand it, so getting paid in anything seems to be problematic. Even BerkShares. That's *if* there's an IRS in 6-months able to worry about such trivialities.

In the Argentina experience, a lot of public servants just stopped going to work when the money stopped flowing. Ditto the experience of the late Soviet Union. Services are nice, but figure how to do on your own...

You Say You Want a Revolution?

One other item this weekend is the British Defence Report which my source in Geneva at the UN has put up on his personal site. It's a draft, yet not widely circulated 2006 report (running about 7.32 MB in PDF form, so be patient loading it...get a beer or something) and it looks into the possible future of the world from the British perspective.

The reason this is that the UK's DCDC (Development Concepts and Doctrine Center, a Directorate General within the UK Ministry of Defence (MOD) is a pretty reliable unofficial source of what's going on in the minds of those who rule and worry about the perpetuity of their rule.

This is a little dated (2006) but some of the trend analysis seems to be hanging together and getting to the same kind of outcomes as the predictive linguistics work.

To prepare yourself for what's ahead, just skip ahead to page 76 (of the report, it's also page 92 in my PDF reader) and read the whole section on Strategic Shocks.

What's eerie is that the descriptors here are very much like those which have popped out of the predictive linguistics work and which sound like they could have been written by the time monks.

Take this part on Global Economic Collapse, just for example:

> "Globalization will result in critical interdependencies that will link members of a globalized society that includes a small super-rich elite and a substantial underclass of slum and subsistence dwellers, who will make up 20% of the world population in 2020. A severe pricing shock, possibly caused by an energy spike or a series of harvest failures, could trigger a domino effect involving the collapse of key international markets across a range of sectors. The impacts of this collapse could be transmitted throughout the globalized economy, possibly resulting in a breakdown of the international political system, as states attempt to respond to domestic crises and the local effects of wider economic collapse. Sophisticated societies that depend on complex, transnational networks for the supply of basic human needs, such as food that cannot be provided indigenously, are likely to face severe infrastructure failure, collapse of public services and societal conflict." (p.79/pdf 94)

Or more worrisome, this view of the Middle Class:

> "The middle classes could become a revolutionary class, taking the role envisaged for the proletariat by Marx. The globalization of labour markets and reducing levels of national

> welfare provision and employment could reduce peoples' attachment to particular states. The growing gap between themselves and a small number of highly visible super-rich individuals might fuel disillusion with meritocracy, while the growing urban under-classes are likely to pose an increasing threat to social order and stability, as the burden of acquired debt and the failure of pension provision begins to bite. Faced by these twin challenges, the world's middle-classes might unite, using access to knowledge, resources and skills to shape transnational processes in their own class interest." (p.81 / pdf 96)

I feel I should be walking through the streets of the big cities of America yelling "August 31st and all is well..."

But keep a sharp eye to weather over this first week of October, it promises to be unlike any Oktoberfest *ever.*

Oh, in that special Sunday session on energies, prices were up and strong...can't have it rattling the markets when things are this fragile now. Price fixing? Oh! It's for everyone's own good...

That Letter for Work

Here's what I was thinking about sending out to a client this coming week - may not do it though - they may not be open to my kind of radical planning ideas:

Major Financial Failure Contingency Plan

General expectations

> A number of press reports over the past several weeks have indicated that a 'catastrophic' bank failure is possible within the next 90-days.
>
> Should such an event occur, the *whole world could experience a* 'lock-up' of all global financial systems as the initial problem propagates throughout the financial system. Although it seem 'unthinkable' it's far from just a pipe dream; it has already nearly happened once.
>
> The entire global system had a 'near-miss' with such a propagating disaster in 1974 when a relatively small German bank, Bankhaus Herstatt, renounced some of its derivatives commitments. As a result of this *one failure*, other banks – in cascading fashion – which were depending on Herstatt payments to trigger follow-on transactions which depended on its cash flow – seized up.
>
> Although U.S. regulators have managed to shield the continuing sequential failure of smaller American banks out of the mainstream media, and while timing of news remains confined to 'after market hours' (witness last Friday's failure of Topeka-based Columbia Bank and Trust), the propagative nature of the problem is unlikely to remained confined to 'covenient' hours of announcement much longer.
>
> Further, the Bank of International Settlements is making comments about the need to assure itself of the integrity of America's financial condition.
>
> As a Financial Times article noted:

> "What has made this upheaval so shocking is not simply its scale and duration but the fact that almost all western policymakers and bankers were caught unawares. "If you had said a year ago that America could suffer a banking crisis on the scale of Japan, people would have laughed," one former senior US regulator admits.
>
> Or as the Bank for International Settlements, which groups central banks, observes in its latest annual report: "The duration of the turmoil, its scope and the growing evidence of effects on the real economy have come as a great surprise to most commentators, private as well as public. "

Dollar revaluation

Although the impact on the U.S. dollar is not presently clear, as there is concerted central bank support globally for the dollar, the impact one the dollar may be expected to be decidedly negative once any projected meltdown of a U.S. money center bank begins in earnest.

What's presently masked is that central banks are presently *buying* dollars in order to maintain its value for purely market-driven reasons.

A recent Euro Money story noted that:

> "A majority of them (central banks) believe the chances (of intervention) will increase if there is a disorderly move in the Eurodollar above 1.60."

A relatively new science, predictive linguistics, projects a three-times doubling of the publics emotional affinity for gold and silver over coming months, along with extremely adverse events for the present U.S. dollar. The linguistics work may simply presage actual events by a few months, although the new currency regime has been in linguistics outlooks for several years.

Impact on foreign trade

A further predictive linguistics expectation is reference to the archetypical imagery which would be associated with 'ships bound for America, laden with goods for the U.S. market being *turned around* while at sea and returning to previous ports, as uncertainty of payment for the goods makes their delivery untenable.'

Although this development verges on far-fetched, especially in light of the mid-summer rally in the U.S. dollar, nevertheless, the *possibility* deserves at least cursory consideration by chief executives and policymakers.

Domestic Impacts

Domestic impacts that could accompany a sudden global loss of confidence in the U.S. dollar's ability to fulfill its role as the world's reserve currency are many and varied.

From the U.S. consumer standpoint, the collapse of the dollar could quite literally triple or quadruple the price of imported goods over a matter of only a week or two. This would include commodities such as oil, which in turn would drive gasoline prices up three-fold to around $7 to $8 per gallon.

The largest agricultural costs are energy-related, and thus a tripling of energy prices would immediately double farm-level costs. Add to this the cost of transpiration, and rapid wage inflation to keep pace with pricing and we can see a scenario where food prices going up by a factor of two or three times comes into view as the energy price impacts propagate through the economy, a process estimated to take 60-months to complete.

In addition to simple price increases, there would likely be mandatory curtailment of energy use. This might mean something as simple as an odd-even license plate regimen, which worked during the 1970's gas crisis, or it may evolve to something more strict and expand into consumer goods such as food and clothing, depending on the severity of the problems.

From a predictive linguistics standpoint, the risk period begins October 7th and once in place, will continue in a downward spiral as living standards decline all the way into February or March of 2009. This will include occasional electricity outages, a lack of access to funds in banks and ATM's, as well as numerous other displacements, such as internet service disruptions because of power quality issues.

Major Drop In Sales

In the event these admittedly dire predictions are even close to the events coming this fall, (company name) should develop a strategic plan to avert financial disaster for the company and for its owners.

(Budget checkpoints)

Reduction in R&D budgets

Reduced workweeks

Declining inventory levels

Operating Expectations

Estimating size of decline

Extrapolation to (company name)

Basic budget profile

Estimated monthly cash flow deficits

Contingency cash conservation plan

Maybe your company doesn't deserve the heads-up...besides we could be completely wrong. I just wouldn't be taking a BIG bet against us...

Write when you get rich!

George

Click here for this week's Chart Pack.