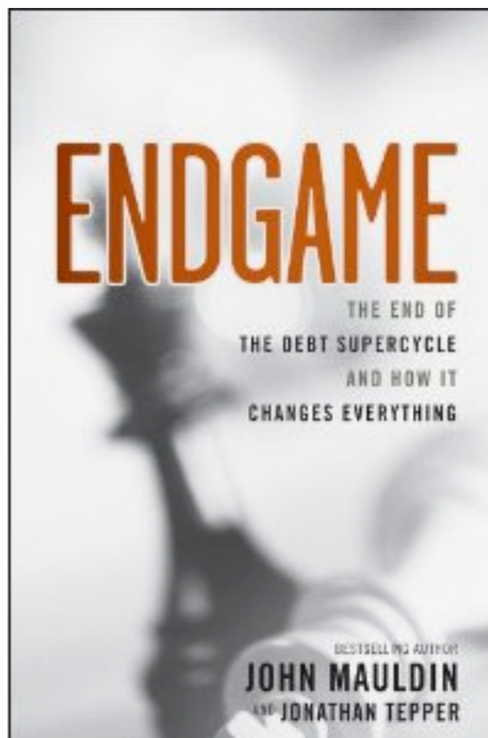
When Irish Eyes Are Voting
An Extra "15 Million" Homes
Some Thoughts on the Middle East
Tokyo, Oregon, and Dallas

By John Mauldin

When Irish eyes are smiling,
Sure, 'tis like the morn in Spring.
In the lilt of Irish laughter
You can hear the angels sing.
When Irish hearts are happy,
All the world seems bright and gay.
And when Irish eyes are smiling,
Sure, they steal your heart away.

Just when I've begun saying it's safe to get back in the water, we get some shark sightings. They are a still a long ways off, but we need to keep our eyes on the deep waters and stay close to shore. This week we will look at a variety of data points and see what conclusions we can come to.

But first, I need some help from a few of you. Official publication date for my new book, *Endgame: The End of the Debt Supercycle and How it Changes Everything,* is March 8. I will be looking to do as much press as possible. If you are official press, drop me a note and we will get you a copy. Radio? TV? Call me.



Second, I want you to mark your calendars for April 28-30, when I will host, along with my partners at Altegris Investments, what I think will be the single best investment conference of the year. It will be the 8th annual Strategic Investment Conference in La Jolla. Let me give you the Killer's Row line-up of speakers, in alphabetical order: Martin Barnes *(Bank Credit Analyst),* Marc Faber, Niall Ferguson (author and Harvard professor), George Friedman of Stratfor, Louis-Vincent Gave of GaveKal, Neil Howe *(The Fourth Turning),* Paul McCulley (if he ever surfaces from his fishing vacation), David Rosenberg, Dr. Gary Shilling, Jon Sundt (of Altegris) and, of course, your humble analyst. I mean, really. Most conferences have one or two top-tier headliners. We have nothing but the best. These guys are all great speakers, but getting them on panels together? Way cool. Plus some of the best hedge-fund managers (personal opinion) show up to give you their thoughts. And maybe a surprise last-minute guest or two. If this conference lineup were a baseball team, they would sweep the World Series. Oh, and the best part? Your fellow conference attendees. The interaction among them is what truly makes this conference the best.

We (well actually, Altegris) will soon start sending out invitations, but you can register today at http://hedge-fund-conference.com/2011/invitation.aspx?ref=mauldin. Sadly, the conference is limited to accredited investors with a net worth of more than $2 million, as there are funds presenting that require that minimum (and some even more). Those are the rules we have to live with, whether I like them nor not (I don't, as long-time readers know). But we follow them religiously.

Every year the conference sells out. Every year some of you wait to the last minute, thinking we can "always take one more." We can't. There is a limit to the space. If you have attended in the past, call your Altegris representative and make sure you get on the list. Do not procrastinate.

Now more than ever you need to consider the place for alternative investing in your portfolio. I work with partners around the world for both accredited and non-accredited investors. If you would like to know more, then go to www.johnmauldin.com and click on The Mauldin Circle, register there, and someone will call you. Seriously, the teams at Altegris (for US accredited investors), CMG (for those with net worth less than $2 million in the US), ARP (Europe), and others have some very innovative and interesting funds and managers on their platforms that really deserve a look. Even if you can't make the conference, your portfolio will thank you for finding some alternative investments that make sense in these times. Now, to the letter. (In this regard, I am president of and a registered representative of Millennium Wave Securities, LLC, member FINRA.)

When Irish Eyes Are Voting

Most of the world is focused on the Middle East and Libya, and rightly so. We will look at that in a minute. (Sidebar: the White House spelled the country "Lybia" in a recent tweet. Can you imagine what the liberal media would have done to poor Dan Quail if that tweet was from

him? Just saying.) And I agree the Middle East is important. But my eyes are focused on what I think is the far more important event of the day, and that is the election going on in Ireland.

I have written about Ireland before, but we need to once again focus on what are not smiling Irish eyes. Ireland was once the envy of Europe, with one of the highest growth rates in the world. It was not long ago that Ireland could borrow money at lower rates than Germany. Now rates are 6% and likely to rise with the new government. Let's look at a few data points from a brilliantly written article by Michael Lewis, who ranks as one of my favorite writers. When he writes, I read it just for the education on what great writing should look like, as well as for the always fascinating information. The article is at http://www.vanityfair.com/business/features/2011/03/michael-lewis-ireland-201103 .

(I am often asked about how you can become a financial writer by young people who are starting out. I have just two suggestions. Write a lot and then write some more. Writing is no different than the piano or guitar. It takes a lot of practice, and then more practice. You don't start playing concerts on day one, and your writing won't be worth much either, but you will get better. Second, study the great writers and learn from them. Try to copy the styles of the guys you like for practice. Take the best and make it your own style. Lewis is one of the best.)

- Housing prices in Dublin had risen by 500% since 1994. Rents for homes were often 1% of the price of the home. A $1-million-dollar home went for $833 a month. That is a very clear bubble.
- Irish home prices implied an economic growth rate that would leave Ireland, in 25 years, three times as rich as the United States.
- In 1997 the Irish banks were funded entirely by Irish deposits. By 2005 they were getting most of their money from abroad. The small German savers who ultimately supplied the Irish banks with deposits to re-lend in Ireland could take their money back with the click of a computer mouse. Since 2000, lending to construction and real estate had risen from 8 percent of Irish bank lending (the European norm) to 28 percent. One hundred billion euros—or basically the sum total of all Irish public bank deposits—had been handed over to Irish property developers and speculators. By 2007, Irish banks were lending 40 percent more to property developers than they had to the *entire Irish population* seven years earlier.
- As the scope of the Irish losses has grown clearer, private investors have been less and less willing to leave even overnight deposits in Irish banks and are completely uninterested in buying longer-term bonds. The European Central Bank has quietly filled the void: one of the most closely watched numbers in Europe has been the amount the ECB has loaned to the Irish banks. In late 2007, when the markets were still suspending disbelief, the banks borrowed 6.5 billion euros. By December of 2008 the number had jumped to 45 billion. As Burton spoke to [Lewis], the number was still rising from a new high of 86 billion. That is, the Irish banks have borrowed 86 billion euros from the European Central Bank to repay private creditors. In September 2010 the last big chunk of money the Irish banks owed the bondholders, 26 billion euros, came due. Once the bondholders were paid off in full, a window of opportunity for the Irish government closed. A default of the banks now would be a default not to private investors but a bill presented directly to European governments.

- A political investigative blog called Guido Fawkes somehow obtained a list of the Anglo Irish foreign bondholders: German banks, French banks, German investment funds, Goldman Sachs. (Yes! Even the Irish did their bit for Goldman.)
- [And this is the kicker!] "Googling things, **Kelly learned that more than a fifth of the Irish workforce was employed building houses. The Irish construction industry had swollen to become nearly a quarter of the country's G.D.P.—compared with less than 10 percent in a normal economy—and Ireland was building half as many new houses a year as the United Kingdom, which had almost 15 times as many people to house.**" [That makes the US housing bubble look small by comparison.]
- And just for fun: "A few months after the spell was broken, the short-term parking-lot attendants at Dublin Airport noticed that their daily take had fallen. The lot appeared full; they couldn't understand it. Then they noticed the cars never changed. They phoned the Dublin police, who in turn traced the cars to Polish construction workers, who had bought them with money borrowed from Irish banks. The migrant workers had ditched the cars and gone home. Rumor has it that a few months later the Bank of Ireland sent three collectors to Poland to see what they could get back, but they had no luck. The Poles were untraceable: but for their cars in the short-term parking lot, they might never have existed."

Now, let's turn to that repository of all things leftist, the UK *Guardian,* as they write about today's elections.

An Extra "15 Million" Homes

"Though the campaign has shed disappointingly little light on realistic options ahead, the financial numbers are scary. After 2000 the early Celtic Tiger years became a property-led speculative bubble, made worse by weak planning laws and 300,000 too many new homes. The crash saw GDP collapse by 11%, unemployment triple to 13.3% and government debt quadruple to 95%, which will rise to 125% by 2014 on IMF estimates."

Let's think about that for a moment and compare it to the US. We built somewhere between 2 and 3 million too many homes in our bubble, depending on whom you ask. Total Irish population (including Northern Ireland) is 6 million people. If the US had built the same number of excess homes, there would have been 15 million of them! And the banks just kept lending!

Irish taxpayers are being asked to pay French, German, and British bond banks and the ECB, which bought that debt. It is 30% of their GDP, along with the rest of the debt. At 6% interest, that means it will take 10% of their national income just to pay the interest. It guarantees that Ireland will be in a poverty cycle for decades. The ECB and the IMF seem to think the solution for too much debt is more debt. And in order to pay the ECB, the Irish must take on an austerity program that guarantees even worse recessions and higher unemployment.

The government that agreed to take on the bank debts is going to be voted out in spectacular fashion today. Whether one party can win or has to form a coalition government is not yet clear, but the mandate is to renegotiate the Irish debt. Both the ECB and the Germans have said that is not possible, that deals have been made. But asking Irish voters, you don't get the sense they feel the same obligation.

Even the venerable Martin Wolf of the *Financial Times* agrees. Writing last week:

"So what might a new government seek to do? Its degrees of freedom are, alas, limited. Even excluding recapitalisation of the banks, the primary fiscal deficit (before interest payments) was close to 10 per cent of GDP last year. Under the IMF programme, this is to be turned into a surplus of 1.5 per cent of GDP by 2015. Given the lack of access to private markets, the deficit would have to be eliminated even more quickly without the official assistance. Again, the debt overhang would be huge, under any plausible assumptions. Ireland is doomed to fiscal stringency for decades, given its poor growth prospects, at least in comparison with its Tiger years.

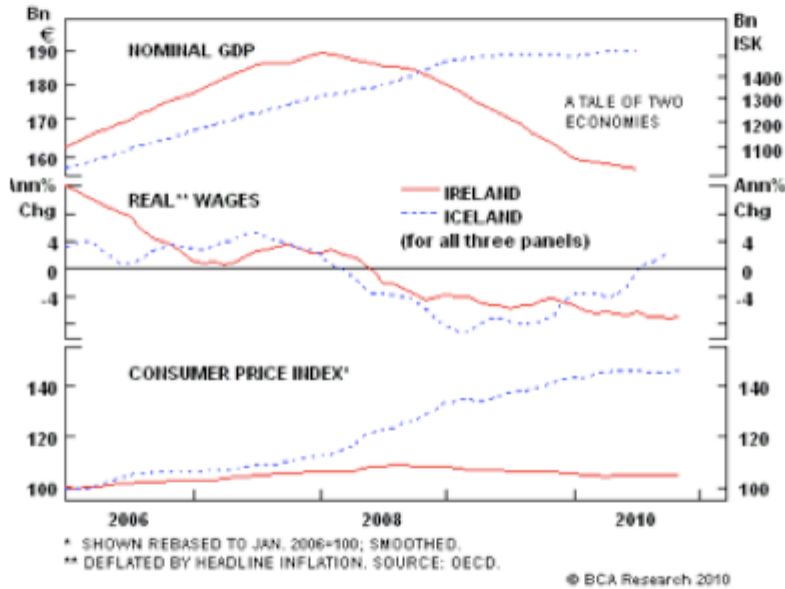
"Apart from the Armageddon of a sovereign default, two partial escapes exist. The more trivial would be a reduction in the rate of interest on Ireland's borrowing: a 1 per cent reduction in the rate of interest would save the state 0.4 per cent of GDP a year. That would be a small help, at least. A more valuable possibility would be a writedown of existing subordinated and senior bank debt, which currently amounts to €21.4bn (14 per cent of GDP).

"The ECB and the other members of the European Union have vetoed this idea, fearful of contagion. Indeed, the assistance package was partly to prevent just such an outcome. Yet the idea that taxpayers should bail out senior creditors of massively insolvent banks at such risk to the solvency of their state is both unfair and unreasonable. If the rest of the EU is determined to protect senior creditors, it should surely share in the cost of doing so. Why should the taxpayers of the borrowing country pay all? The new Irish government should make this point firmly." (http://www.ft.com/cms/s/0/436234b8-3ebb-11e0-834e-00144feabdc0.html#ixzz1F1aZpM1L)

There are a significant number of Irish voters who wonder why they should pay any of it. Not the majority (yet), but enough. This is the Maginot Line for the ECB. If they renegotiate with Ireland, then Greece will be at the door in a heartbeat. Ditto for Portugal.

As one story I read about Ireland said, "Parties we go to now are going away parties as people, especially young people, leave for other countries with better opportunities." The mood of the country will grow more dour.

Look at this chart. Notice how well Iceland did after it simply repudiated its debt. It wasn't easy, and inflation is brutal, but they are better off than if they had taken on a debt burden that would have made them indentured servants to British taxpayers for decades. The ECB, the IMF, and the rest of the EU is asking Ireland to willingly fall into a lengthy depression. Would walking away from the debt, or restructuring it, be any worse?



What if the opening negotiating line started was, "We will repay the principle, but no interest, and the timeline has to be stretched out over 25 years?" And no payments for five years. Oh, and we have about 300,000 houses you can have as our first payment.

Yes, the Irish would be frozen out of the bond market. It would result in an even more serious recession. But they could actually grow their way out of it over time. A lot faster than if they were trying to pay off the debt at 6-7% interest. And remember that Argentina, for God's sake, got money just a few years after defaulting – twice, if I remember right! If Ireland got back on a sound footing, they could once again find acceptance in the bond market.

I know, that sounds radical. But give it a few years of austerity and see what the next elections bring. Irish debt will default, not because the Irish don't have hearts of gold or don't want to not pay their debts, but because they are under such a burden they can't. And eventually enough voters will realize that. It may not be next month, or even next year, but it will come. You can only ask so much of a people. Defaulting on sovereign debt is only unthinkable in elite European Union circles. And asking German voters to pay for those defaults? Care to run on THAT platform?

This has the potential to really roil the debt markets, not to mention the interbank markets. The US is doing ok, except that job creation has been slow. A European debt crisis could throw a wrench into the world gears.

And that is the heart of the problem. The Irish really do want to do the right thing. The Greeks, not so much. Portugal? Spain?

The leadership of the EU is living in denial if they think that more debt is the answer to too much debt. It is all well and good for the Germans to tell everyone to cut back (and they should) but to do so means that the countries go into recession and have even less money to pay their debt burdens. They get into a debt spiral and the only way out is restructuring, which is default by a nice name.

Somewhere, sometime, this is all going to end in tears. The EU will be better off restructuring the debt, letting insolvent banks go the way of all flesh, or financing them and letting the euro drop like a stone, which will only make their exporting companies more competitive (not good for the US and China, but we don't get to vote in the EU). Or they can break up. I think the former is better than the latter, but that's just me.

The world went crazy with debt. The US, Japan (where I fly to in less than 12 hours), much of Europe, and Great Britain. And now we have to deal with it. Acting like adults would be best, and recognizing that some countries just can't assume their banking debts is just being realistic. A lot of people made bad choices and now those choices are coming home.

It is all so very sad. People are hurting. I read the blogs in Ireland and it brings tears to me Irish eyes (or the large part of me that is of Irish heritage).

There are no easy answers. No easy button. The only button we have is the reset button, for the Blue Screen of Death. That means pulling the plug and starting over. This time with realistic debt levels and bond markets.

Some Thoughts on the Middle East

Let me offer a different, and perhaps cynical, view of what's happening in the Middle East. First, the army was in control in Tunisia and Egypt, and still is. Some things will change, and hopefully the false, crony capitalism will be one of the things to go; but I don't think we will see sweeping changes for some time. Libya is 2% of the world's oil supply. Other than that, they are like Greece. They are not that big a player. Gaddafi is on his way out. His bank accounts are being frozen. He will end up in Venezuela or some equally wonderful place. Couldn't happen to a nicer bad guy. The new leadership will most likely be the army, and it will get the oil turned back on as soon as possible. (See the trend here?)

By the way, the idea that Saudi Arabia can make up for Libyan oil is a little fanciful. Libyan oil is light sweet crude, and it takes three barrels of Saudi oil to make as much diesel as Libyan oil. Oil could get very volatile and move up strongly if Gaddafi hangs on too long. $4 gas is not out of the question here in the US if he doesn't leave soon; but at the end of the day, not too much will change in Libya.

The key place to watch is Bahrain. Now THAT is an issue. It is a strategic country with the US 5th fleet based there, and it has a large Shiite population that could ally with Iran. There is no real way of knowing what will happen there, and that is something I have my Google notes set to watch, along with talking from time to time with George Friedman of Stratfor. Nice to have friends with inside information. But even he is not sure tonight.

Saudi Arabia? Pay attention, but so far it looks like the changes are still in the future. One day it will change, but it doesn't appear imminent (although anything can happen).

The one thing that I hope changes? Maybe the Iran street will force some change. I am on record saying that one day Iran will be our new best friend. The population is young and getting younger. They're on the Internet. They see what the world is like and they want it. Maybe not this year or next, but it will happen.

(Quick sidebar: My friend Barry Habib pointed out an interesting trend: the first day of the month has been a big up day for the markets. And I think we could have a solid job number on Friday.)

Tokyo, London, Oregon, and Dallas

It is time to hit the send button, as I have to get up in a few hours to catch an early flight to Tokyo, where I will only be for 48 hours. It will be interesting to see how my body does with the jet lag, so soon after Bangkok. I am just now back to normal.

I return on Tuesday and have to be ready to speak on Thursday. Reservations are now open for the second "America: Boom or Bankruptcy?" event, on March 3rd at the Dallas Lincoln Centre Hotel, from 10:30 am to 2:00 pm. It is called "Fed Friday." I spoke last year, and it was lots of fun. The 2010 event sold out. David Walker will be on the program with me. You can register at www.fedfriday.com

I will also be providing the keynote address for the West Coast-based investment advisory firm of Arnerich Massena at their 2011 Investment Symposium, on April 11-12, in Newberg, OR. Contact Bonnie Chirrick at 503-239-0475.

My friends from Copenhagen JGAM are coming to Dallas for a 2-day event April 14-15. My partners at Altegris and CMG and I will speak Thursday and Friday. JGAM has also invited Martin Barnes of BCA and Charles Rheinhard of Morgan Stanley to give presentations about the economy. Seats are limited, because attendees are invited to my house that night for a Texas BBQ dinner. If interested please contact Thomas Fischer at info@jgam.com for availability, by Friday, March 11th.

Never have I been so busy. I am actually looking forward to getting on a long plane flight and catching up on my reading. And getting to have dinner with Chris Wood of *Greed & Fear* fame is something I have always wanted to do. I told Chris I wanted bodyguards there after my speech. Telling the Japanese that they are a bug in search of a windshield might not be popular. And by the way, if some writer uses that line (and you know who you are), at least have the courtesy to quote me by name. I don't come up with that many good lines.

I see a three-week working vacation in Tuscany this June, a few days in Kiev with friends, and then Geneva in late June. I can't wait. I will be working on my next book. Life is fun. And let me say what a pleasure it is to be able to let Tiffani do the really hard work while Dad just goofs off reading and writing, with a little travel thrown in. Big things are happening. And if you haven't visited the new website, please do so. www.johnmauldin.com – and give me some feedback. I do read it!

Have a good week! Sayonara for now!

Your trying to figure out how to stay on US time analyst,

John Mauldin