

FANYA – Good Girl Gone Bad

☒ As we have written in the past the Chinese are not as infallible as they would like everyone to believe. Economic booms of the intensity of that which the Chinese have experienced over the last 15 years can bring the tendency to become self-declared Masters of the Universe. Look at the Japanese in the late 1980s, where pride definitely came before a fall and a long and depressing two lost decades for the Japanese economy. One could also say that the Vietnam War was the Waterloo of the US dominance after twenty years of post-War economic mastery over the global economy. That war saw the baton of net savings/wealth pass to the oil states of the Middle East and to the Japanese.

One of the attributes of these periods of fleeting dominance is an attitude *internally* of superiority over other economic systems (particularly over that of the displaced power). Then the attitude is manifested *externally* with criticisms about how other economies, have become fat or lazy or decadent.

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The establishment of the FANYA Exchange with its focus on specialty metals would seem a logical and inevitable evolution of the Chinese dominance of the production of (many) specialty metals and the substantial position it also held as a processor and end-user. Alas though there is an innate tendency for institutions in the capitalist side of the Chinese economy to deteriorate into illegality and irregularity with remarkable speed. In this aspect the Chinese system appears most akin to the rip-roaring US markets of the late 19th century when Robber Barons ruled the roost on Wall Street via massive cartels/trusts and rampant stock market manipulation schemes.

FANYA initially started out with specialty metals and then

diversified into fixed income products. The problems in the Bismuth, Indium and Antimony trading by the exchange's investor base are well documented now. In mid-July Metal Bulletin reported that the Fanya Metal Exchange had suspended accepting applications from companies to sell Indium, Germanium and Bismuth on the exchange between June 23 and August 31. An official from FANYA, who refused to be named, cited "Liquidity-related problems" were the major reason for the decision. That there should be "liquidity problems" in trading what were regarded as notoriously illiquid metals in the pre-FANYA era, comes as no surprise to participants in the global market for specialty metals.

Once again we have seen the Chinese "issue" with deceptive practices on bonded warehouses and the collateralization and double-counting of fictitious or "massaged" inventories. It is very easy to create theoretical liquidity by miscounting (read exaggerating) warehouse numbers then creating paper instruments based on the bogus holdings, trade them fast and furiously and, voila, liquidity. The whole scheme (never let the word "Ponzi" cross our lips) comes apart at the seams when someone wants physical delivery and then the game is over. In China of course the small and medium sized investor can be stalled for a while, while the big fish exit their positions and when the curtain is eventually pulled back to reveal that the "cupboard is bare" then the recriminations start flying. A few random death sentences may be meted out (involuntary organ donations, anyone?) and the matter is regarded as swept under the rug until the next time.

Not just Metals

Like any good scheme, over-reaching (mission-creep?) sets in. While FANYA has been most famous its metals trading, it has also had a fixed-income element, which not unsurprisingly has reputedly also gone bad. The Financial Times reported this week that earlier this week "hundreds of well-heeled urban professionals who had purchased high-interest rate products

from the Fanya Metal Exchange united with distribution agents who sold them in an unusual protest...in the financial heart of Beijing”.



The FT captured the moment at which the head of FANYA, Shan Juiliang was manhandled by a crowd in Shanghai. They dragged him off to the police to have him arrested. Whether his potential fate at the hands of the crowd or in the Chinese legal system will be a better one will remain to be seen.

Conclusion

The collateral damage to the metals markets has been brutal but hopefully short-lived. Antimony and Bismuth have seen large amounts of product tipped out into markets that are illiquid at the best of times with particularly damaging effects for Antimony that has gone from \$9,000 per tonne down to \$6,000 in a the space of a few months.

While the FANYA bust-up looks like a Chinese Madoff-like moment that will pass quickly, we doubt it. China was well positioned five years ago to have the Shanghai Metals Exchange become the leading global market for metals. Repeated scandals (most notably the copper inventory scam that caught Standard Chartered and Citibank amongst others) mean that the SME's warehouses have zero credibility. The LME has shown through its long existence that credibility is everything and the SME had a chance to grab some of that credibility for itself. It should take at least ten years to rebuild that trust, but maybe the moment has been lost.

As for FANYA, there is no chance of redemption. China's own position as the dominant force in the specialty metals world is slipping away due to over-exploitation and erratic export/import duties and other examples of unreliability. FANYA's arrival meant there was a chance to create a legacy overlordship by creating a financial dominance, even as a role

as a leading producer leaked away (much as Britain did with the LME). Instead the sleazy operators at the FANYA put on their suicide vest and blew up any chance of China controlling the "trade" in specialty metals. In a world of increasing "discovery" in both price and volumes in so many products, the Chinese authorities let some cowboys essentially create a noxious fog of misinformation which has choked a large group of investors and justified Western observers' growing belief that there are "lies, damned lies and Chinese inventory statistics".