Skip the Happy Talk, This Depression is Just Starting

By Mike Whitney

Too bad Pulitzers aren't handed out for blog-entries. This year's award would go to Zero Hedge for its "The 'Money on the Sidelines' Fallacy" post. This short entry shows why the economy will continue its downward slide and why the US consumer will not get off the mat and resume spending as he has in the past. The fact is the Net Wealth of US Households has "declined from a peak of $22 trillion to just under $12 trillion in early March."

Ouch!

The problem is compounded by the fact that Total US Household debt, as of first quarter 2009, amounts to roughly $13 trillion, and has stayed within that range for the last 3 and a half years.

Zero Hedge:

"From the end of 2007 through Q1 of 2009, household equity has declined by 94%. Is it surprising that today's GDP number would have been a complete debacle if the consumer had been left alone to prop the U.S. economy, on whom 70% of the economy is reliant? Obama pulled a Hail Mary with the stimulus: without it there would be no debate America is in a depression right now." Source

What does all this mean?

It means the consumer is down-for-the-count. His credit lines have been cut, his home equity eviscerated, and his checking account swimming in red ink. That spells trouble for an economy that's 70% dependent on consumer spending for growth....which brings us to another interesting point. The uptick in GDP last quarter was almost entirely the result of the surge in government spending; ie "fiscal and monetary stimulus". How long can that go on? How long will China keep slurping up US Treasuries rather than let their currency rise? Here's a clip from the Wall Street Journal on Friday:

"Shaky auctions of Treasury notes this week reignited concerns about whether the government can attract buyers from China and elsewhere to soak up trillions in new debt.

A fuse was lit this week when traders noted China's apparent absence from direct participation in two Treasury bond auctions. While China may have bought Treasurys just before the auctions, market participants read the country's actions as a worrying sign that China and other foreign investors may be ratcheting back purchases at a time when the U.S. is seeking to fund a $1.8 trillion budget deficit.

This week alone, the U.S. deluged the bond market with more than $200 billion in record-size sales. The U.S. has had little trouble finding buyers in recent months. But that demand is fading, and the Treasury market has become volatile."

Uncle Sam is goosing the bond market just like he is the stock market. (more on that later) Take a look at Treasury's latest bit of chicanery which appeared in the back pages of the Wall Street Journal in June:

"The sudden increase in demand by foreign buyers for Treasurys, hailed as proof that the world's central banks are still willing to help absorb the avalanche of supply, mightn't be all that it seems.

When the government sells bonds, traders typically look at a group of buyers called indirect bidders, which includes foreign central banks, to divine overseas demand for U.S. debt. That demand has been rising recently, giving comfort to investors that foreign buyers will continue to finance the U.S.'s budget deficit.

But in a little-noticed switch on June 1, the Treasury changed the way it accounts for indirect bids, putting more buyers under that umbrella and boosting the portion of recent Treasury sales that the market perceived were being bought by foreigners." ("Is foreign Demand as solid as it looks, Min zeng)

Hmmmm.

So, someone doesn't want you and me to know that foreign demand has gone to the dogs. That's not encouraging. So, they move the shells around the table and "Presto"---central banks and foreign investors can't get enough of those fetid T-Bills. What a racket.

This is what happens when monetary policy is handed over to bank-vermin and Ponzi-scam artists. Anything goes!

The Zero Hedge article shows that homeowners used the equity in their homes to fuel the soaring stock market.

Zero Hedge: "Most interesting is the correlation between Money Market totals and the listed stock value since the March lows: a $2.7 trillion move in equities was accompanied by a less than $400 billion reduction in Money Market accounts!

Where, may we ask, did the balance of $2.3 trillion in purchasing power come from? Why the Federal Reserve of course, which directly and indirectly subsidized U.S. banks (and foreign ones through liquidity swaps) for roughly that amount. Apparently these banks promptly went on a buying spree to raise the all important equity market, so that the U.S. consumer who net equity was almost negative on March 31, could have some semblance of confidence back and would go ahead and max out his credit card. Alas, as one can see in the money multiplier and velocity of money metrics, U.S. consumers couldn't care less about leveraging themselves any more."

You read that right! Only $400 billion of that fantastic 6 month "green shoots" stock market rally came from money market accounts. The rest ($2.3 trillion) was laundered through the banks and other financial institutions to create the appearance of recovery and to raise equity for underwater banks rather than forcing them into receivership (which is where they belong) Bernanke probably knew that congress wouldn't approve another TARP-type bailout for dodgy mortgage-backed assets, so he settled on this shifty plan instead. The only problem is, the banks are still broke, business investment is at historic lows, consumers are on the ropes, the unemployment lines are swelling, the homeless shelters are bulging, the pawn shops are bustling, tent cities are sprouting up everywhere, and according to MarketWatch, Corporate insiders have recently been selling their companies' shares at a greater pace than at any time since the top of the bull market in the fall of 2007."

Face it; the economy is in the crapper and Bernanke's trickery hasn't done a lick of good.

It's been two years since the crisis began and nothing... NOTHING has been done to fix the banking system or force the banks to write-down their shi**y assets to market. But the losses are real and no amount of Congressionally approved accounting hanky-panky (like suspending mark-to-market) will change a bloody thing.

So, how bad will it get?

Well, it depends on whether the FDIC decides to continue to allow financial institutions like Corus and Guaranty Banks to operate with "negative Tier 1 ratio" hoping that all the green shoots happy talk can turn insolvent institutions into thriving mega-banks. "Abrakadabra".

Karl Denninger explains this latest hoax in a recent entry on his site Market Ticker:

"So what's going on here?

Simple: An enormous number of banks are holding loans at or close to "par" that really aren't. They're holding mortgages at massively-inflated values, even on defaulted properties, and this is why you are not seeing more foreclosure sales - that is, why inventory is being held back. If they sell it the accountants will force recognition of the loss, which will render them instantly insolvent, but so long as they "extend and pretend" they are marking these loans way, way above recovery value. The upshot of this is that these firms' balance sheet claims on asset values are massively inflated, regulators know it, and they're intentionally ignoring it."

Bingo! It's all 100% fakery conducted right under the nose of the Fed, the Treasury and the FDIC.

How many hundreds of banks are being kept on life-support because the FDIC is down to its last few farthings and doesn't want to ignite a panic?

Stay tuned.

The banking system is insolvent and the fact that the politically-connected big banks talked their their friends at the Fed into pumping liquidity into equities so they could access the capital markets, doesn't change matters for the hundreds of local and regional banks that will be caught in next year's downdraft. Prepare for massive consolidation with G-Sax and JPM left to pick up former competitors for pennies on the dollar.

FIRING UP THE PRINTING PRESS

Keep in mind that Wall Street veterans knew from the very beginning that Bernanke's quantitative easing (QE) was a load of malarkey intended to justify keeping toxic asset prices artificially high while pumping trillions into the stock market. Here's former hedge fund manager Andy Kessler's analysis way back in May:

"On March 18, the Federal Reserve announced it would purchase up to $300 billion of long-term bonds as well as $750 billion of mortgage-backed securities. Of all the Fed's moves, this "quantitative easing" gets money into the economy the fastest -- basically by cranking the handle of the printing press and flooding the market with dollars (in reality, with additional bank credit). Since these dollars are not going into home building, coal-fired electric plants or auto factories, they end up in the stock market.

A rising market means that banks are able to raise much-needed equity from private money funds instead of from the feds. .....It's almost as if someone engineered a stock-market rally to entice private investors to fund the banks rather than taxpayers." (Andy Kessler "Was it a Sucker's Rally" Wall Street Journal)

What a swindle.

Bernanke's had a good go-of-it, juicing the market through the backdoor and concealing--as much as possible--who is still buying US Treasuries. (who knows; maybe it's the Fed buying its own paper offshore?!?) But what good will it do? The US consumer is broke; the tank is on empty. Household equity has declined by 94%, jobs are scarce, personal savings are rising, and families are cutting back and hunkering down. It will take a decade or more before household debt is whittled-away to a point where people can consume at pre-crisis levels. Another stock market bubble won't change a damn thing. This Depression is just beginning.

http://www.lifeaftertheoilcrash.net/Archives2009/WhitneyHappyTalk.html