A Review of Markets: What Prospects for the US Economy?

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"The trade of governing has always been monopolized by the most ignorant and the most rascally individuals of mankind." — Thomas Paine

The 10-year note auction yielded 3.73%. The bid to cover was 2.49 to 1 versus the average of the last ten auctions of 2.48 to 1. Indirect participation was 45.7% versus an average of 30%; we believe this is because foreign central banks are buying in behalf of the Fed via money they swapped with them.

As we discussed previously we expect this second half of 2009 to improve slightly. 2010 should pick up more about mid-year. We believe second quarter GDP figures were not minus 1.5%, but closer to minus 4%. We see real GDP at even by the end of the year and into the first half of the year with a plus 2% in the second half of 2010. If another stimulus package of $2 trillion is not passed and banks continue to reduce lending, the economy will begin to slide again.

Our guess is if the stimulus package is not increased the Fed will instruct the banks to increase lending, which will monetize money and start higher inflation. It is really a tragedy for the American people and particularly business interest to have to deal with bogus government figures and continued lies. If neither events occur then the economy will resume degeneration and that will force the Fed to further monetize fund injections into the economy to avoid being overwhelmed by deflation. If economic and financial stability is to be maintained over the next ten years trillions of dollars will have to be injected and monetized into the economy and no lasting growth will be achieved.

In the meantime de-leveraging will have to be dealt with, especially among the banks and Wall Street; coupled with their terrible losses on their balance sheets. This will be a mean feat. As this transpires we will experience chronically rising unemployment. No economy can intrinsically grow under such conditions and it can only end in stagflation indefinitely. As we move along over the next five years people will finally discover that free trade, globalization, offshoring and outsourcing have robbed them of their once vibrant economy. The public will finally demand tariffs on goods and services in order to save what is left of their economic structure. In time world economic weakness will be reflected in commodity prices, which will slowly retreat. All of the above will advance government intrusion into the economy via regulation, as consolidation of monopolizations takes place.

It will take three more years for residential real estate to bottom out and then we'll have seven to 20 years of bumping along the bottom. That is if the derivative market and the financial system don't implode. The fall in housing, the market and bonds will pauperize many who do not hide in gold and silver related assets. For those who survive net worth will have been decimated. As we have said previously things will be like they were in the 1950s and 60s.

All those who see recovery are the same group that saw recovery 1-1/2 years ago. It is just more propaganda and misdirection. Even if a recovery took place it would barely take growth to more than even and it would take years to recover. Writing off debt will be no easy task.

In the commercial real estate sector, the victim of over building, falling demand and unbelievable financing, which was the fault of the lenders, over the next three years sees $150 billion in properties up for refinancing. Sixty-three percent will not qualify for refinancing due to a 40% fall in value that will be followed by another 30% drop. In all about $500 billion in mortgages will have to be dealt with of which 50% won't be refinanced. That means the banks' balance sheets will be further clogged with properties with 70% losses. If you think the banks are buried now, three years from now most all of them will be insolvent. What else would be expected when they were lending 50 times their deposits when 8 to 10 times was normal? The Federal Reserve knew this was going on and they encouraged it.

At best the North American and European economies will move sideways over the next year as unemployment grows, but at a slower pace. The course from then will depend on whether there will be another stimulus package or a large increase in loans by banks. Either way there will be serious inflation and government cannot avoid engaging in monetization, because they cannot allow continual massive unemployment. Such conditions will continue to entice workers to save and reduce debt, which is not inductive to grow an economy. In order to augment employment, government, which makes up about 50% of spending and employment, will have to increase that year after year. That means more debt and higher taxes. This is not a very positive future, but that is the way it is.

The signals are being run up for the second stimulus package for this administration. The one under Bush did not work and the one started this year hasn't worked as yet either. The bulk of this stimulus package in fairness doesn't hit until next year, an election year.

The feedback we are now getting is that the Keynesian solution really hasn't been tried yet, and it is time for that $2 trillion we predicted would be demanded in January, to be passed. How else can Keynesianism survive?

As we pointed out earlier if the relief is not forthcoming then the banks will have to start lending and monetizing. We are told the true measure of the success of the stimulus is not the actual level of unemployment, but what unemployment would have been without the stimulus. Talk about double talk. These great thinkers should reflect back to the fact that they caused this monster. Here they are telling us we are lucky it is not worse, and only the same old Keynesian nostrums can save us. These are the same policies that buried us.

For political reasons 75% of the stimulus will be spent in 2010, an election year, and some in 2011. Politics screwed up the package and we will never know if it would have been successful. The one-third devoted to tax cuts has been a loser just as the checks to citizens was. Banks seeing what is going on won't lend easily in a depression. At the same time consumers are reluctant to borrow. Only business is in the mood to borrow and that is just to keep things going.

If you step back and look at what the Fed and government has done you will see they have spent trillions bailing out Wall Street, banking and insurance, as well as the auto sector. This is called corporate welfare. The recipients contend if they go down the system goes down and they are right. We believe they should have been allowed to fail. They were the ones lending 50 times assets while playing in a grand casino. Taxpayers will never get that money back and they will be forced to pay that principal and interest to foreign lenders over many years. You might also notice that only a few crumbs were thrown to the public.

Even if there is a second stimulus plan it won't work. All it will do is buy more time, just as increased bank lending will. The victim is the dollar. It simply has to fall and as it does real interest rates will rise and the market will fall. Monetization will create more inflation and lending by foreigners will dry up forcing further monetization. A vicious circle that will end in hyperinflation. No one is willing to bite the bullet and that is what it takes to solve this problem. Even Joe Stiglitz wants the Keynesian solution, which will be much worse than it has to be.

As the financial "experts" continue to attempt to spend us out of depression the US financial authorities want foreign banks to do what the Fed has done, that is stuff banks with money, there is a virtual bank war going on. The Europeans are saying no and that is an impasse that will be the hot topic of discussion at the up and coming G-20 meeting in London. The ECB has already moved into a more conservative position by cutting back on the issuance of money and credit to 4.7% and by not lowering interest rates to 1%. Moving in the opposite direction are the British banks, such as HSBC, which in behalf of the black nobility is dictating what JP Morgan Chase and BoA should be doing. They have just created new market bubbles on the FTSE and the NYSE and when they break the fall will be resounding.

Market Trends

The median price for a used home rose mildly in the second quarter from the first quarter, a favorable sign for the housing market.
The national median existing single-family price was $174,100, the National Association of Realtors said Wednesday.
While 15.6% below the second quarter of 2008, the price was higher the first quarter's $169,300. The price data aren't seasonally adjusted.
Falling prices help make homes more affordable, which is good in a day when the jobless rate in the U.S. is at 9.4%. But steady decline in price has negatives. For one thing, it decreases the net worth of households. And it tends to hinder home sales, as would-be buyers put off a purchase in hopes for a better deal.
The NAR report said 129 of 155 metropolitan areas reported lower median existing single-family home prices compared with the second quarter of 2008. Twenty-six had price gains.

Total existing-home sales, including single-family and condos, rose 3.8% to a seasonally adjusted annual rate of 4.76 million in the second quarter from 4.58 million units in the first quarter. The sales level was 2.9% below the 4.90 million-unit pace in the second quarter of 2008.
Trade deficit widened in June, as a higher bill for oil imports offset gains in exports of industrial supplies and capital goods.
The U.S. deficit in international trade of goods and services increased 4% to $27.01 billion from a slightly revised $25.97 billion in May, the Commerce Department said Wednesday. The May trade gap was originally reported as $25.96 billion.
The June deficit was smaller than Wall Street expectations. Economists surveyed by Dow

Jones Newswires had estimated a $28.7 billion shortfall.

While the ongoing recession had sapped demand and started to make a dent in the yawning trade gap earlier in the year, the recent rebound in oil prices has pushed the deficit back up.

Still, trade has been one of the few bright spots on the economic front, estimated to have contributed 1.39 percentage points to second-quarter gross domestic product. Overall GDP contracted 1% last quarter, according to the advance report, though the decline was less than expected. Updated figures will be released later this month.

The real, or inflation-adjusted trade deficit actually narrowed to its lowest level since the end of 1999 in June. The real deficit, which economists use to measure the impact on the overall economy, fell to $35.95 billion from $36.27 billion in May, Commerce said Wednesday.
U.S. exports registered their biggest gain in a year in June, rising 2% to $125.78 billion from $123.36 billion. Imports increased by even more, however, up 2.3% to $152.79 billion from $149.32 billion.

The U.S. bill for crude oil imports in June jumped to $16.59 billion from $13.41 billion the month before as oil prices surged. The average price per barrel climbed $7.96 to $59.17. Crude import volumes rose to 280.42 million barrels from 261.89 million.
The U.S. paid $22.42 billion for all types of energy-related imports, up from $17.70 billion in May.
Imports of industrial supplies increased $3.88 billion in June, largely on the back of crude oil purchases. Auto and related parts imports increased $858 million, while food and feed imports rose $79 million.

Imports of foreign-made consumer goods like toys and televisions fell $1.69 billion. June purchases of foreign-made capital goods, such as drilling and telecom equipment, fell $74 million.

As for exports, U.S. sales abroad of industrial supplies, such as fuel oil and chemicals, increased $1.16 billion. Sales of capital goods, including semiconductors, increased $441 million during June. Exports of food, feed, and beverages went up by $252 million, while auto exports increased $70 million.
Meanwhile, consumer goods exports, such as artwork, fell by $26 million.
Regionally, the U.S. trade deficit with China widened to its highest level since January, to $18.43 billion from $17.48 billion the month before. Exports to China rose by $301 million.

Trade deficits with other major trading partners also grew in June, with the deficit with Japan rising to $3.70 billion from $1.91 billion. The trade gap with the euro area increased to $4.07 billion from $2.1 billion, while the deficit with Canada rose to $1.6 billion from $540 million.
The U.S. gap with Mexico narrowed to $3.43 billion from $3.94 billion, however.

The Mortgage Bankers Association said its seasonally adjusted index of mortgage applications, which includes both purchase and refinance loans, for the week ended August 7 decreased 3.5 percent to 499.0.

Borrowing costs on 30-year fixed-rate mortgages, excluding fees, averaged 5.38 percent, up 0.21 percentage point from the previous week. It was the highest rate since the week ended June 19 and significantly above the all-time low of 4.61 percent set in the week ended March

27. The survey has been conducted weekly since 1990.

Interest rates a year ago were at 6.57 percent.

Mortgage rates were above 5 percent for an 11th straight week. Some experts say rates at 5 percent and below are needed to make a significant impact on home loan demand.

The MBA's seasonally adjusted purchase index rose 1.1 percent to 267.2, the third, albeit small, gain in the last four weeks.
The four-week moving average of mortgage applications, which smooths the volatile weekly figures, was down 0.7 percent.
Moody's Economy.com is expecting 3.85 million defaults this year compared to 2.7 million last year, she said. First mortgage defaults are the first step in the foreclosure process; not all defaults turn into foreclosures.

The Mortgage Bankers seasonally adjusted index of refinancing applications decreased 7.2 percent to 1,853.8, following an increase of the same amount the previous week.

The refinance share of applications decreased to 52.3 percent from 54.2 percent the previous week, significantly lower than the peak of 85.3 percent in the week ended January 9. The adjustable-rate mortgage share of activity increased to 5.8 percent in the latest week, up from 5.4 percent the previous week.
Fixed 15-year mortgage rates averaged 4.71 percent, up from 4.60 percent the previous week. Rates on one-year adjustable-rate mortgages increased to 6.71 percent from 6.67 percent.

The Federal Reserve said it will slow the pace of its $300 billion program to buy U.S. Treasuries as the recession eases and anticipates that the full amount will be purchased by the end of October.

"To promote a smooth transition in markets as these purchases of Treasury securities are completed, the committee has decided to gradually slow the pace of these transactions and anticipates that the full amount will be purchased by the end of October," the Federal Open Market Committee said in a statement after a two-day meeting in Washington. The buying was previously scheduled to end in September.
Officials left the benchmark interest rate between zero and 0.25 percent, and said economic conditions mean the rate will stay "exceptionally low" for an "extended period." The decision was unanimous.

Chairman Ben S. Bernanke's $1 trillion expansion of the Fed's balance sheet, providing emergency funding for banks and markets from commercial paper to asset-backed securities, is helping spark a recovery from the worst recession since the 1930s. Employers cut fewer jobs last month, and the unemployment rate dropped, encouraging analysts to project an annual growth rate of at least 2 percent in the second half of 2009.

"Information received since the Federal Open Market Committee met in June suggests that economic activity is leveling out," the Fed said in today's statement. The central bank added that "household spending has continued to show signs of stabilizing, but remains constrained by ongoing job losses, sluggish income growth, lower housing wealth and tight credit."

The U.S. budget deficit reached a record for the first 10 months of the fiscal year and broke a monthly high for July as the recession curbed revenue and the government ramped up spending to rejuvenate the economy.

The shortfall so far for the fiscal year that ends Sept. 30 totaled $1.27 trillion compared with a $389 billion year-to- date gap in 2008, the Treasury said today in Washington. The excess of spending over revenue for July climbed to $180.7 billion compared with a $102.8 billion gap in July 2008 as the government spent more than in any month in U.S. history.

Tax receipts are sliding and spending is surging even as some economists say the recession may have ended. The government is trying to spark business and consumer spending through a $787 billion stimulus plan spanning tax cuts, infrastructure projects and a goal to create or save 3.5 million jobs. President Barack Obama also is pushing a health- care overhaul that may cost $1 trillion over a decade.

"Spending is bound to increase as the year goes along" and money from the stimulus package is distributed, said Stan Collender, managing director of Qorvis Communications in Washington and a former U.S. House and Senate Budget Committee analyst. "That's good news given the state of the economy. You want to do that, to get the recovery going."