

Bond Yields Plunge, Confidence Wanes, and the Financial Crisis Continues

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Theme: [Global Economy](#)

Global Research, July 30, 2010

30 July 2010

On Tuesday, the 30-year fixed-rate for mortgages plunged to an all-time low of 4.56%. Rates are falling because investors are moving into risk-free liquid assets, like Treasuries. That's pushing down the yield on the 10-year note which is linked to mortgage rates. It's a sign of panic, which is the result of the Fed's failure to restore investor confidence. The flight-to-safety continues a full two years after Lehman Bros blew up.

Housing demand has fallen off a cliff in spite of the historic low rates. Purchases of new and existing homes are roughly 25% of what they were at their peak in 2006. It's a catastrophe. Case/Schiller reported on Monday that June new homes sales were the "worst on record", but the media twisted the story to create the impression that sales were booming. Here are a few of Monday's headlines:

"New Home Sales Bounce Back in June"-Los Angeles Times. "Builders Lifted by June New-home Sales", Marketwatch. "New Home Sales Rebound 24%", CNN. "June Sales of New Homes Climb more than Forecast", Bloomberg.

It's all spin. The media's cheerleading is only adding to the sense of uncertainty. When uncertainty grows, long-term expectations change and investment slows. Lying has an adverse effect on consumer confidence and, thus, on demand. This is from Bloomberg:

The Conference Board's confidence index dropped to a 5-month low of 50.4 from 54.3 in June. According to Bloomberg News:

"Sentiment may be slow to improve until companies start adding to payrolls at a faster rate, and the Federal Reserve projects unemployment will take time to decline. Today's figures showed income expectations at their lowest point in more than a year, posing a risk for consumer spending that accounts for 70 percent of the economy.

"Consumers' faith in the economic recovery is failing," said guy LeBas, chief fixed-income strategist at Janney Montgomery Scott LLC in Philadelphia, whose forecast of 50.3 was the closest among economists surveyed by Bloomberg. "The job market is slow and volatile, and it'll be 2013 before we see any semblance of normality in the labor market." (Bloomberg)

Confidence is falling because unemployment is soaring. The media's spin just make a bad situation worse. Notice that Bloomberg does not mention consumer worries over "curbing the deficits". In truth, the public has only a passing interest in the deficits. It's a fictitious problem invented by think-tank toadies who want to apply austerity measures so they can divert more public money to financial institutions and corporations. In the real world, consumer confidence depends on one thing alone-jobs. And when the jobs market stinks,

confidence plummets. It's as simple as that. This is from another article by Bloomberg:

"Consumer borrowing in the U.S. dropped in May more than forecast, a sign Americans are less willing to take on debt without an improvement in the labor market.

The \$9.1 billion decrease followed a revised \$14.9 billion slump in April that was initially estimated as a \$1 billion increase, the Federal Reserve reported today in Washington. Economists projected a \$2.3 billion drop in the May measure of credit card debt and non-revolving loans, according to a Bloomberg News survey of 34 economists.

Borrowing that's increased twice since the end of 2008 shows consumer spending, which accounts for about 70 percent of the economy, will be restrained as Americans pay down debt. Banks also continue to restrict lending following the collapse of the housing market, Fed officials said after their policy meeting last month" (Bloomberg)

Consumer confidence is falling, consumer credit is shrinking, and consumer spending is dwindling. Jobs, jobs, jobs—it's all about jobs. Budget deficits are irrelevant to the man who thinks he might lose his livelihood. All he cares about is keeping the wolves away from the door. Here's a quote from Yale professor Robert Schiller who was one of the first to predict the dot.com and the housing bubble:

"For me a double-dip is another recession before we've healed from this recession ... The probability of that kind of double-dip is more than 50 percent. I actually expect it."

The odds of a double dip are gradually increasing. But there's no need for the economy to head back into recession. Fed chairman Ben Bernanke knows what needs to be done; he knows how to counter deflationary pressures via bond purchasing programs etc. He even wrote a book about it. But Bernanke has chosen to do nothing. His intransigence is a political decision. By the November midterms, the economy will be contracting again, unemployment will be edging higher, and the slowdown will be visible everywhere in terms of excess capacity. The Obama economic plan will be repudiated as a flop and the Dems will be swept from office. Meanwhile, the slump will progressively deepen.

On Tuesday, a \$38 billion Treasury auction drove 2-years bond-yields down to record lows. (0.665%) Investors are willing to take less than 1% on their money just for a government guarantee that they'll get the principal back. They'd be better served sticking their money in a mattress. Bond yields are a referendum on Bernanke's policies; a straightforward indictment of the Fed's strategy. 3 years into the crisis and investors are more anxious than ever. The flight to Treasuries is an indication that the retail investor has fled the market for good. It is a red flag signaling that the public's distrust has reached its zenith.

British economist John Maynard Keynes showed that the business cycle can be eased by government intervention; that the state can generate demand when consumers are forced to cut back on their spending. Presently, big business is awash in savings (\$1.8 trillion) because consumers are on the ropes and demand is weak. The government's task is simple; make up for worker retrenchment by providing more fiscal and monetary stimulus. If private and public sector spending shrink at the same time, recession will become unavoidable. So, Go Big; create government work programs, help the states, rebuild infrastructure and support green technologies. The economy is not a sentient being; it makes no distinction between "productive" labor and "unproductive" labor. Spending is what counts, that's what keeps the apparatus operating as close to capacity as possible, that's what lowers

unemployment and puts the country back to work. The time to worry about deficits is when the recovery is self sustaining and recession is in the rearview mirror. Not now.

Increasing the money supply does nothing when interest rates are at zero and consumers are already cutting back. Bernanke has added over \$1.25 trillion to bank reserves but consumer borrowing, spending and confidence are still in the doldrums. The problem is demand, not the volume of money. And demand won't increase without rebalancing the economy, creating more jobs, and reducing inequality. This is from Calculated Risk:

"This report from the National League of Cities (NLC), National Association of Counties (NACo), and the U.S. Conference of Mayors (USCM) reveals that local government job losses in the current and next fiscal years will approach 500,000, with public safety, public works, public health, social services and parks and recreation hardest hit by the cutbacks.

The surveyed local governments report cutting 8.6 percent of total full-time equivalent (FTE) positions over the previous fiscal year to the next fiscal year (roughly 2009-2011). If applied to total local government employment nationwide, an 8.6 percent cut in the workforce would mean that 481,000 local government workers were, or will be, laid off over the two-year period."

The cutbacks will ravage local governments, state revenues and public services. Emergency facilities by the Fed provided \$11.4 trillion for underwater banks and non banks, but nothing for the states. The GOP is helping the Fed strangle the states by opposing additional aid for Medicare payments and unemployment benefits. Many cities and counties will be forced into bankruptcy while Wall Street speculators rake in record profits on liquidity provided by American taxpayers.

On Wednesday, Moody's chief economist, Mark Zandi and former Fed vice chairman, Alan Binder released the first in-depth analysis of the government's emergency response to the financial crisis. The paper evaluates the effects of the TARP, Obama's \$787 billion fiscal stimulus, and the Fed's liquidity facilities. Here's an excerpt from the New York Times:

"We find that the effects on real GDP, jobs, and inflation are huge, probably averting what would have been called Great Depression 2.0. For example, we estimate that, without the policy responses, GDP in 2010 would be about 6½% lower, payroll employment would be about 8½ million jobs lower, and the nation would now be experiencing deflation.

When we divide these effects into two components, one attributable to the various rounds of fiscal stimulus and the other attributable to the panoply of financial-market policies (including the TARP, the bank stress tests, and the Fed's quantitative easing), we estimate that the latter are substantially more powerful than the former. Nonetheless, our estimated effects of the fiscal stimulus policies alone are very substantial: In 2010, real GDP that is about 2% higher, an unemployment rate that is about 1½ points lower, and almost 2.7 million more jobs.... ("In Study, 2 Economists Say Intervention Helped Avert a 2nd Depression", Sewell Chan, New York Times)

The bottom line? When Wall Street is hurting, money's never a problem. But when the states are on the brink of default and 14 million workers are scrimping to feed their families, there's not a dime to be found.

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