Economic depression in America: Evidence of a withering economy is everywhere

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Global Research, June 02, 2008
Information Clearing House 2 June 2008

Region: USA
Theme: Global Economy

Look around. The evidence of a withering economy is everywhere. In "good times" consumers shun the canned meat aisle altogether, but no more. Today, Spam sales are soaring; grocery stores can't keep it on the shelves. Everyone is looking for cheaper ways to feed their families. The Labor Dept. assures us that core-inflation is only 4 per cent, but everybody knows it's load of malarkey. Food prices are going through the roof. White bread is up 13 percent, bacon is up 7 percent and peanut butter is up 9 percent. Inflation is rampant and there's no end in sight. The dollar is closing in on the peso and working people are struggling just to get by. The bottom line is that more and more people in "the richest country on earth" are now surviving on processed pig-meat. That says it all.

In Santa Barbara parking lots are being converted into hostels so that families that lost their homes in the subprime fiasco can sleep in their cars and not be hassled by the cops. The same is true in LA where tent cities have sprung up around the railroad yards to accommodate the growing number of people who've lost their jobs or can't afford to rent a room on service-industry wages. It's tragic. Everywhere people are feeling the pinch; that's why 9 out of 10 Americans now believe the country is now headed in the wrong direction and that's why consumer confidence is at its lowest ebb since the Great Depression. This is the great triumph of Reagan's free trade "trickle down" Voodoo economics; whole families living out of their cars waiting for the pawn shop to open.

The economy is on life-support. The rest of the world would be doing us all a favor if they decided to chuck the dollar and boycott US financial products altogether. That would put an end to Wall Street's chicanery once and for all. Foreign investors should be demanding restitution and impounding American assets to compensate for the trillions of dollars they lost in the subprime/securitization swindle. Litigate, litigate, litigate; that's the only way to make the guilty parties pay for their crimes. Either that or set up a gallows on Wall Street and get down to business.

The pundits on the business channel are telling us that the "worst is over"; that the Force 5 hurricane in the financial markets has weakened to a squall. Don't believe it. The corporate bond market is still frozen, housing is in free fall, and the banking system is buckling from the overload of bad investments. The FDIC is even trying to lure former employees out of retirement to deal with the tsunami of bank failures set to touch down later in 2008. Corporate defaults are on the rise and and commercial real estate is crashing.

"Commercial property prices in the US in February saw their sharpest decline since records began nearly 15 years ago as sources of finance for deals has dried up, according to data from Standard & Poor's out yesterday. Sales of commercial properties were down 71 per cent in the first quarter compared with a year earlier." (Financial Times) Commercial real estate is following the same downward trajectory as residential housing. They're both headed for the bottom of the fish-tank. Any slump in CRE will send unemployment skyrocketing while adding to the solvency problems facing the banks.

We're not out of the woods by a long shot, and won't be for years to come. According to Bloomberg News, soaring raw material costs have caused a sharp rise in costs to producers that they won't be able to pass on to cash-strapped consumers. That means that corporate profits will fall and stock values will plunge.

Last week, Oppenheimer analyst Meredith Whitney announced that:

"The real harrowing days of the credit crisis are still ahead of us and will prove more widespread in effect than anything yet seen. Just as strained liquidity pushed so many small and mid-sized specialty finance companies to the brink, we believe it will do the same to the US consumer. We believe losses will only accelerate further and far worse than the most draconian estimates."

Whitney has been one of the few consistently accurate analysts of the current market meltdown.

The fate of the larger investment banks is just as uncertain as the smaller "depository" banks. Carlyle Group Chairman David Rubenstein summed it up like this last week, "US and European banks and financial institutions have enormous losses from from bad loans they haven't yet recognized and may have a harder time wooing sovereign fund rescuers. Based on information I see, it will take at least a year before all losses are realized, and some financial institutions may fail. Many financial institutions aren't going to be able to survive as independent institutions."

That means there will be greater consolidation and more formidable banking monopolies, all of which is bad for the consumer.

The banks and financial institutions have never been in worse shape. They've already written down $344 billion since the credit crisis began last August and they'll write down another $200 billion next year. By the time the crisis is over, they will have racked up an estimated $1 trillion in losses. That represents a $3 trillion contraction in loans to consumers and businesses. Also, these estimates don't take into account the losses of revenue from the slowdown in consumer spending, shrinking GDP, and massive business failures; all of which will wreak further havoc on the financial sector.

The amount of stress on the banking system is unprecedented. The Fed is loaning out money hand-over-fist just to keep the scaffolding in place. Take a look at what is going on at the Fed's so-called "auction facilities" where the Fed is providing loans and US Treasuries for "unsellable" mortgage-backed junk and other toxic bonds. The numbers are staggering.

According to the Seattle Times:

"The Federal Reserve's emergency loans to banks climbed to the highest level on record even as Wall Street investment companies scaled back their borrowing....Banks stepped up their borrowing, according to the Fed report. They averaged $15.95 billion in daily borrowing for the week ending May 28, compared with $13.5 billion for the previous week, and the total was a record. The previous high of $14.4 billion came in the week ending May 14…In the broadest use of the central bank's lending power since the 1930s, the Fed in March scrambled to avert a market meltdown by giving investment houses a place to go for emergency overnight loans.…The Fed also announced Thursday it will make a fresh batch of short-term cash loans available to banks as part of an effort to ease stressed credit markets…The Fed said it will conduct three auctions in June; each will offer $75 billion in short-term cash loans. It would mark the latest round in a program that the Fed launched in December to help banks overcome credit problems so they will keep lending to customers." ("Banks step up Fed loans, investment firms scale back", Seattle Times)

Another $225 billion?!?

The Fed is trashing its balance sheet–to the tune of $225 billion–when the money could be used to provide free college tuition and universal health care. What a waste. Instead, the money is being used to throw a lifeline to dodgy speculators would were trying to snooker foreign investors with garbage securities. At the same time, the Fed's emergency facilities have done nothing to restore trust between the individual banks who are more reluctant to lend to each other than ever. The ongoing scandal surrounding Libor (the interest rate that banks charge each other and which determines the rates on $3 trillion of financial products including mortgages) strongly suggests that the banks are lying about the true rate they are paying so the public doesn't find out how battered they really are.

Bloomberg News: "Banks routinely misstated borrowing costs to the British Bankers' Association to avoid the perception they faced difficulty raising funds as credit markets seized up."

Consumer spending is sluggish too, since lending standards have tightened and home equity continues to vanish. Subprime problems have migrated from Wall Street to Main Street as credit trends appear to be getting worse. Consumers are maxed-out on their credit cards, student loans, mortgages and car loans. The lack of personal savings is not the result of a profligate lifestyle (as the right wing media likes to opine) but 30 years of stagnant wages and class warfare waged via big business and the federal tax code. None of the baby boomers are counting on Social Security to pay the bills when they retire but, still, that doesn't justify the money being ripped-off from their paychecks every week and slipped into the general fund where it is used to pave roads and purchase cluster-bombs. Social security is nothing but a flat tax for paupers. (The rich get a free-ride after the first $87,000 income) These are some of the factors that are bearing down on an American economy like a Daisy Cutter. 2009 is looking is looking more and more like a chapter out of Revelation.

An article is this week's The Economist summarizes the malaise in housing in particularly apocalyptic terms:

"America's house prices are falling even faster than during the Great Depression. As house prices in America continue their rapid descent, market-watchers are having to cast back ever further for gloomy comparisons. The latest S&P/Case-Shiller national house-price index, published this week, showed a slump of 14.1% in the year to the first quarter, the worst since the index began 20 years ago. Now Robert Shiller, an economist at Yale University and co-inventor of the index, has compiled a version that stretches back over a century. This shows that the latest fall in nominal prices is already much bigger than the 10.5% drop in

1932, the worst point of the Depression. And things are even worse than they look. In the deflationary 1930s house prices declined less in real terms. Today inflation is running at a brisk pace, so property prices have fallen by a staggering 18% in real terms over the past year." ("The Economist")

The country is undergoing a collapsing real estate market that surpasses the Great Depression and former Fed-chief Alan Greenspan's book is still on the New York Times Best Seller list. How's that for irony?

Regrettably, there's no sign of a bottom yet in housing. Some markets have already dropped by 30% costing the states (like California and Florida) billions in tax revenue and triggering a steep increase in foreclosures. In California, sales are not only down by roughly 50 per cent, but 40 per cent of new sales are sales of foreclosed homes. The pool of potential buyers has dried up. Now the vultures are circling and picking up homes for $.50 on the dollar. The losses are enormous. If the downward trend continues, (as many now expect) and housing prices drop 30 per cent nationwide; the market will shed $6.5 trillion in aggregate value and lower household spending by $300 billion. That means GDP will shrink at least another full percentage point.

The crisis in the financial markets won't be resolved until housing prices stabilize, that's why the Fed and Congress are scrambling to put together a plan (Hope Now) that will slow the rate of foreclosures. Trillions of dollars in complex bonds and mortgage-backed securities will continue to be downgraded until investors see that it is safe to "dip their toes in the water" again and reinvest in a (currently) moribund market. So far, Congress has made little headway in keeping homeowners from defaulting on their mortgages. Credit Suisse predicts that foreclosures will be somewhere north of 6.5 million homeowners over the next few years. It is the equivalent of Hurricane Katrina sweeping from one side of the country to the other.

The next administration—whether it's McCain or Obama—will be forced to restore the Resolution Trust Corp., which was created in 1989 to dispose of assets of insolvent savings and loan banks. The RTC would create a government-owned management company that would buy distressed MBS from banks and liquidate them via auction. The state would pay less than full-value for the bonds (The Fed currently pays 85 per cent face-value on MBS) and then take a loss on their liquidation. "According to Joseph Stiglitz in his book, Towards a New Paradigm in Monetary Economics, the real reason behind the need of this company was to allow the US government to subsidize the banking sector in a way that wasn't very transparent and therefore avoid the possible resistance."

There it is; a taxpayer-funded bailout of Biblical proportions looming on the horizon, possibly as soon as 2009. Ultimately, it is the only sure-fire way to stabilize the crumbling banking system and put a floor under housing prices. The effects on the dollar, however, will be catastrophic. Don't expect the greenback to survive as the world's "reserve currency". Those days are about over.

The troubles in the financial markets will be with us for some time. The massive expansion of credit has created numerous equity bubbles that are unwinding at an unpredictable pace. Author James Howard Kunstler calls the present process "the remorseless algebra of a deflationary death spiral". That's about as close to a perfect description as imaginable. There's bound to be considerable disagreement about the origins of the bubble and who is to blame. Was it the Fed's "low interest " policy following the dot.com bust in 2000, or the lack of government regulation in the securitzation process, or was it just the natural corollary of a political system which invariably bows and scrapes to Wall Street?

The real origin of the problem is ideological. It's rooted in the prevailing "trickle down" orthodoxy which opposes any increases in wages or benefits for working people. Henry Ford realized what today's captains of industry and finance refuse to accept; that if workers aren't adequately paid for their labor—and wages do not keep pace with production—then the economy cannot grow because consumers do not have the money to buy the things they make. It's just that simple. Greenspan and his ilk believed that they could prosecute the class war and make up the difference by relaxing lending standards, changing bankruptcy laws, and by creating a nearly endless array of exotic financial products that expanded credit. But shifting wealth from one class to another has its costs. By crushing the worker the Friedmanites have killed the golden goose. The world's most prosperous consumer society is in terminal distress and no amount of "free market" gibberish will keep it from crashing.

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