America's Economy in Crisis: First Quarter Growth Goes Negative while Bond Yields Plunge

Back in the Red

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"I liken the economy to a car on a flat road that has no momentum. When you take your foot off the gas, the car just stops moving." — Stephanie Pomboy, Interview Barron's

If you follow the stock market, you probably think the economy is sizzling. But if bonds are your thing, then you probably think we're still in recession.

So which is the better gauge of what's going on in the real economy; stocks or bonds?

The bond market is more accurate. And recently, long-term yields have been dropping like a stone which is not a good sign for the economy. Investors seem to think that slow growth and low inflation are here to stay, and they could be right. According to Bloomberg, "Falling yields on longer-term Treasuries historically reflect periods of lackluster growth. Since 1960, they have predicted seven of the last eight recessions when 10-year yields fell below 3-month bill rates." As of today, the benchmark 10-year UST is a dismal 2.44 percent.

The reason investors have been piling back into Treasuries is because is the labor market is weak and there's no sign of inflation anywhere. When wages stagnate and incomes drop–as they have since the slump ended– then there's no upward pressure on prices because everyone is making less dough, so there's less demand, less growth and, hence, less inflation. Of course, Obama could have fixed the situation by holding off on slashing the deficits or by increasing the amount of stimulus in his fiscal package. That would have circulated more money into the economy boosting employment and revving up growth. But that would have put the economy back on its feet again which was not what he wanted. What he wanted was to grind working people into the ground by keeping the economy on life-support while his chiseling Wall Street buddies made out like bandits on the latest stock market bubble. The Wall Street Journal explains what's going on:

> "Bond yields are – once again – plunging worldwide. The reason for this revived buying among fixed-income investors is that central banks are – once again – signaling their intent to ease monetary conditions in yet another bid to kick-start sluggish economies and forestall a downward spiral in prices, or deflation. The prospect that central banks will continue to inject money into the world's bond markets…has acted as a green light for the world's bond buyers."

So investors think the Fed will have to taper the "Taper" and start buying more government paper. But why?

Because they have no choice. Many of the usual buyers of US Treasuries have cut back on their monthly purchases or stopped buying altogether. That means that rates will have to rise to attract more buyers unless the Fed makes up the difference. Check out this blurb from Barron's interview with Stephanie Pomboy:

> "Foreigners are buying about $10 billion a month of Treasuries. This compares with deficit financing needs for the U.S. government of roughly $40 billion a month, based on this year's deficit. So the Fed needs to pick up roughly $30 billion a month in slack. When the Fed slashed its buying to $25 billion, effective this month, it for the first time opened up a demand deficit for Treasuries. If they continue to taper, that gap will expand, and things could get bumpy in the Treasury market. Rates won't go up five basis points before the Fed would start talking about more QE." (Barrons Interview Posits Weak US Economy, Barron's)

It'll get bumpy alright, real bumpy. Higher rates will send housing and stocks into freefall. The Fed will have no choice but to step in to stop the bleeding.

The economy is already suffering from chronic lack of demand. Add higher rates to the mix, and cost-conscious consumers are going to cut back on everything from auto loans to nights-on-the-town. Yellen's not going to let that happen. She's going to come up with some cockamamie excuse for buying more USTs and hope-like-hell that wages and incomes rebound so she can start tapering again.

This illustrates the conceptual flaw in Central Bank policy. QE and zero rates are supposed to reduce the price of money, thereby enticing consumers to take out loans and spend like crazy. That, in turn, is supposed to generate more activity and stronger growth. But there's a slight glitch to this theory, that is, consumers aren't the brain-dead lab rats the Fed thinks they are. Most people don't base their spending decisions on price alone. Sometimes, for example, it doesn't make sense to borrow money no matter how cheap it is. The average working stiff doesn't give a rip if he can get a loan at 3.5 percent when his credit card is already maxed out and the only job he can find is working graveyard at Jack in the Box. That guy doesn't need more debt, he needs a decent paying job. Here's how the managing partner of MBMG Group, Paul Gambles explained the phenom in an interview on CNBC:

> "People and businesses are not inclined to borrow money during a downturn purely because it is made cheaper to do so. Consumers also need a feeling of job security and confidence in the economy before taking on additional borrowing commitments." (Washington's blog via Zero Hedge)

Bingo. Of course, the members of the Fed know that this whole "cheap money" thing is bogus, but they keep reiterating the same blather so they can keep the wampum flowing to their crooked friends on Wall Street. It's worth noting that: since the end of the recession, "one-third of all income increases in this country went to just 16,000 households, 95 percent of it went to the top 1 percent, and the bottom 90 percent's incomes fell, and they fell by 15 percent."

In other words, the Fed knows exactly how QE works, (and who benefits) and it has nothing to do with extending credit to working people. That's malarkey. It's all about providing limitless liquidity for financial speculators so they can send stocks into the stratosphere and rake in record profits. Here's a blurb from a piece by Zero Hedge that helps to illustrate what's going on:

> "According to the most recent CapitalIQ data, the single biggest buyer of stocks in the first quarter were none other than the companies of the S&P500 itself, which cumulatively repurchased a whopping $160 billion of their own stock in the first quarter!
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> Should the Q1 pace of buybacks persist into Q2 which has just one month left before it too enters the history books, the LTM period as of June 30, 2014 will be the greatest annual buyback tally in market history." (Here Is The Mystery, And Completely Indiscriminate, Buyer Of Stocks In The First Quarter, Zero Hedge)

Why are companies buying shares of their own stock, you ask, when buybacks add no productive value to a company at all?

It's because it gooses stock prices which makes shareholders happy. It's a complete scam. And it's a huge scam, too. Currently, total stock buybacks represent a whopping $4 trillion or 20 percent of the total stock market value. Just think of the walloping prices are going to take when these same shareholders decide it's time to bail out? Look out below!

Now get a load of this clip from Action Forex:

> "Disappointment over the pace of economic growth explains at least some of the downturn in yields. The U.S. economy very likely contracted in the first quarter of the year, perhaps by as much as 1.0% annualized … Even with a strong bounce back in the second quarter … – the average pace of growth in the first half of the year will be a tepid 2.0%, about the pace it's been since the end of the recession…
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> The retrenchment in yields also reflects events abroad … However, there is perhaps another reason for the decline in yields that is more pernicious. There is the realization that even after the recovery has run its course, economic growth is likely to be slower than it has been in the past. Slower growth means that as the fed funds rate eventually moves off the floor, it will not go back to the 5.25% it was prior to the Great Recession or even the 4.0% it averaged over the quarter of a decade prior. Expectations of "lower forever"…increasingly appear to be built into longer-term interest rates." (A year in the bond market, Action Forex)

Did you catch that part about "lower forever"?

What the author means is that the economy has reset at a lower level of activity and will not return to normal. This is an admission that the managers of the system have no intention of fixing what's wrong; cleaning up the banks, writing down the debts, regulating the system, increasing workers buying power (boosting demand) or providing sustained fiscal stimulus until unemployment and growth are back where they should be. Instead, basic macro has been replaced with public relations, that is, a swindle that's spearheaded by faux-liberal icons Krugman and Summers who are pushing the "secular stagnation" folderol which is just a lame excuse for maintaining the status quo plus a few anemic add-ons, like infrastructure projects. Big whoop. It's all a fig leaf for maintaining the same wealth shifting monetary policies that are in place today.

So this is it? Are we really doomed to a future of high unemployment and slow growth?

The IMF seems to think so. Here's an excerpt from an article by Nick Beams which gives a rundown on a recent IMF report that was ignored by the media. The article is titled "No end to economic breakdown":

> "Almost six years after the eruption of the global financial crisis, the International Monetary Fund has effectively ruled out any return to the economic growth rates that preceded September 2008.
>
> Two major chapters of the IMF's World Economic Outlook … provide a gloomy assessment of the state of the world economy. In the advanced economies, investment is falling as a proportion of gross domestic product (GDP), while in the "emerging markets," there is no prospect for growth rates to return to pre-2007 levels.
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> The IMF notes that real interest rates have been declining since the 1980s and are "now in slightly negative territory." But this has failed to boost productive investment. On the contrary, what it calls "scars" from the global financial crisis "have resulted in a sharp and persistent decline in investment in advanced economies." Between 2008 and 2013, there was a two-and-a-half percentage point decline in the investment to GDP ratio in these countries. The report adds that ratios "in many advanced economies are unlikely to recover to pre-crisis levels in the next five years."
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> This conclusion is of immense significance given the critical role of investment in the functioning of the capitalist economy … Investment…is the key driving force of capitalist economic growth … But if investment stagnates or declines, the circle turns vicious. This is what is now taking place." IMF report: No end to economic breakdown (april), wsws

So no return to normal, after all. The American people are now facing a long period of high unemployment and slow growth that will shrink the middle class and change the country in ways we can hardly imagine. It's unavoidable. It's the policy.

NOTE: *As this piece was going to press, the Wall Street Journal announced that "revised" First Quarter GDP contracted at a 0.6% annual rate. So while stocks have been setting records almost daily due to the massive injections of money from the Fed, the economy is steadily sliding towards recession.*

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