Obama's Cockeyed Optimism: "We are starting to see glimmers of hope across the economy."

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Retail sales fell in March as soaring job losses and tighter credit conditions forced consumers to cut back sharply on discretionary spending. Nearly every sector saw declines including electronics, restaurants, furniture, sporting goods and building materials. Auto sales continued their historic nosedive despite aggressive promotions on new vehicles and $13 billion of aid from the federal government. The crash in housing, which began in July 2006, accelerated on the downside in March, falling 19 percent year-over-year, signaling more pain ahead. Mortgage defaults are rising and foreclosures in 2009 are estimated to be in the 2.1 million range, an uptick of 400,000 from 2008. Consumer spending is down, housing is in a shambles, and industrial output dropped at an annual rate of 20 percent, the largest quarterly decrease since VE Day. The systemwide contraction continues unabated with with no sign of letting up.

Conditions in the broader economy are now vastly different than those on Wall Street, where the S&P 500 and the Dow Jones Industrials have rallied for 5 weeks straight regaining more than 25 percent of earlier losses. Fed chief Ben Bernanke's $13 trillion in monetary stimulus has triggered a rebound in the stock market while Main Street continues to languish on life-support waiting for Obama's $787 billion fiscal stimulus to kick in and compensate for falling demand and rising unemployment. The rally on Wall Street indicates that Bernanke's flood of liquidity is creating a bubble in stocks since present values do not reflect underlying conditions in the economy. The fundamentals haven't been this bad since the 1930s.

The financial media is abuzz with talk of a recovery as equities inch their way higher every week. CNBC's Jim Cramer, the hyperventilating ringleader of "Fast Money", announced last week, "I am pronouncing the depression is over." Cramer and his clatter of media cheerleaders ignore the fact that every sector of the financial system is now propped up with Fed loans and T-Bills without which the fictive free market would collapse in a heap. For 19 months, Bernanke has kept a steady stream of liquidity flowing from the vault at the US Treasury to the NYSE in downtown Manhattan. The Fed has recapitalized financial institutions via its low interest rates, its multi-trillion dollar lending facilities, and its direct purchase of US sovereign debt and Fannie Mae mortgage-backed securities. (Monetization) The Fed's balance sheet has become a dumping ground for all manner of toxic waste and putrid debt-instruments for which there is no active market. When foreign central banks and investors realize that US currency is backed by dodgy subprime collateral; there will be a run on the dollar followed by a stampede out of US equities. Even so, Bernanke assures his critics that "the foundations of our economy are strong".

As for the recovery, market analyst Edward Harrison sums it up like this:

“This is a fake recovery because the underlying systemic issues in the financial sector are being papered over through various mechanisms designed to surreptitiously recapitalize banks while monetary and fiscal stimulus induces a rebound before many banks’ inherent insolvency becomes a problem. This means the banking system will remain weak even after recovery takes hold. The likely result of the weak system will be a relapse into a depression-like circumstances once the temporary salve of stimulus has worn off. Note that this does not preclude stocks from large rallies or a new bull market from forming because as unsustainable as the recovery may be, it will be a recovery nonetheless.” (Edward Harrison, “The Fake Recovery”, Credit Writedowns)

The rally in the stock market will not fix the banking system, slow the crash in housing, patch-together tattered household balance sheets, repair failing industries or reverse the precipitous decline in consumer confidence. The rising stock market merely indicates that profit-driven speculators are back in business taking advantage of the Fed’s lavish capital injections which are propelling equities into the stratosphere. Meanwhile, the unemployment lines continue to swell, the food banks continue to run dry and the homeless shelters continue to burst at the seams. So far, $12 trillion has been pumped into the financial system while less than $450 billion fiscal stimulus has gone to the “real” economy where workers are struggling just to keep food on the table. The Fed’s priorities are directed at the investor class not the average working Joe. Bernanke is trying to keep Wall Street happy by goosing asset values with cheap capital, but the increases to the money supply are putting more downward pressure on the dollar. The Fed chief has also begun purchasing US Treasuries, which is the equivalent of writing a check to oneself to cover an overdraft in one’s own account. This is the kind of gibberish that passes as sound economic policy. The Fed is incapable if fixing the problem because the Fed is the problem.

Last week, the market shot up on news that Wells Fargo’s first quarter net income rose 50 percent to $3 billion pushing the stock up 30 percent in one session. The financial media celebrated the triumph in typical manner by congratulating everyone on set and announcing that a market “bottom” had been reached . The news on Wells Fargo was repeated ad nauseam for two days even though everyone knows that the big banks are holding hundreds of billions in mortgage-backed assets which are marked way above their true value and that gigantic losses are forthcoming. Naturally, the skeptics were kept off-camera or lambasted by toothy anchors as doomsayers and Cassandras. Regretably, creative accounting and media spin can only work for so long. Eventually the banks will have to write down their losses and raise more capital. Wells Fargo slipped the noose this time, but next time might not be so lucky. Here’s how Bloomberg sums up wells situation:

“Wells Fargo & Co., the second biggest U.S. home lender, may need $50 billion to pay back the federal government and cover loan losses as the economic slump deepens, according to KBW Inc.’s Frederick Cannon.

KBW expects $120 billion of “stress” losses at Wells Fargo, assuming the recession continues through the first quarter of 2010 and unemployment reaches 12 percent, Cannon wrote today in a report. The San Francisco-based bank may need to raise $25 billion on top of the $25 billion it owes the U.S. Treasury for the industry bailout plan, he wrote.

“Details were scarce and we believe that much of the positive news in the preliminary results had to do with merger accounting, revised accounting standards and mortgage default moratoriums, rather than underlying trends,” wrote Cannon, who downgraded the shares to “underperform” from “market perform.” “We expect earnings and capital to be under pressure due to continued economic weakness.”

What happened to all those nonperforming loans and garbage MBS? Did they simply vanish into the New York ether? Could Wells sudden good fortune have something to do with the recent FASB changes to accounting guidelines on “mark to market” which allow banks greater flexibility in assigning a value to their assets? Also, Judging by the charts on the Internet, Wells appears to have the smallest “ratio of loan loss reserves” of the four biggest banks. That’s hardly reassuring.

http://www.housingwire.com/2009/04/09/credit-cost-smoke-at-mirrors-at-wells-fargo/

Paul Krugman takes an equally skeptical view of the Wells report:

“About those great numbers from Wells Fargo….remember, reported profits aren’t a hard number; they involve a lot of assumptions. And at least some analysts are saying that the Wells assumptions about loan losses look, um, odd. Maybe, maybe not; but you do have to say that it would be awfully convenient for banks to sound the all clear right now, just when the question of how tough the Obama administration will really get is hanging in the balance.”

The banks are all playing the same game of hide-n-seek, trying to hoodwink the public into thinking they are in a stronger capital position than they really are. It’s just more Wall Street chicanery papered over with vapid media propaganda. The giant brokerage houses and the financial media are two spokes on the same wheel gliding along in perfect harmony. Unfortunately, media fanfare and massaging the numbers won’t pull the economy out of its downward spiral or bring about a long-term recovery. That will take fiscal policy, jobs programs, debt relief, mortgage writedowns and a progressive plan to rebuild the nation’s economy on a solid foundation of productivity and regular wage increases. So far, the Obama administration has focused all its attention and resources on the financial system rather than working people. That won’t fix the problem.

Deflation has latched on to the economy like a pitbull on a porkchop. Food and fuel prices fell in March by 0.1 percent while unemployment continued its slide towards 10 percent. Wholesale prices fell by the most in the last 12 months since 1950. According to MarketWatch, “Industrial production is down 13.3% since the recession began in December 2007, the largest percentage decline since the end of World War II”….The capacity utilization rate for total industry fell further to 69.3 percent, a historical low for this series, which begins in 1967.” (Federal Reserve) The persistent fall in housing prices (30 percent) and losses in home equity only add to deflationary pressures. The wind is exiting the humongous credit bubble in one great gust.

Obama’s $787 billion stimulus is too small to take up the slack in a $14 trillion per year economy where manufacturing and industrial capacity have slipped to record lows and unemployment is rising at 650,000 per month. High unemployment is lethal to an economy where consumer spending is 72 percent of GDP. Without debt relief and mortgage cram-downs, consumption will sputter and corporate profits will continue to shrink. S&P 500 companies have already seen a 37 percent drop in corporate profits. Unless the underlying issues of debt relief and wages are dealt with, the present trends will persist. Growth is impossible when workers are broke and can’t afford to buy the things the make.

The stimulus must be increased to a size where it can do boost economic activity and create enough jobs to get over the hump. Yale economics professor Robert Schiller makes the case for more stimulus in his Bloomberg commentary on Tuesday:

"In the Great Depression ... the U.S. government had a great deal of trouble maintaining its commitment to economic stimulus. 'Pump- priming' was talked about and tried, but not consistently. The Depression could have been mostly prevented, but wasn't.... In the face of a similar Depression-era psychology today, we are in need of massive pump-priming again.

It would be a shame if we are so overwhelmed by anger at the unfairness of it all that we do not take the positive measures needed to restore us to full employment. That would not just be unfair to the U.S. taxpayer. That would be unfair to those who are living in Hoovervilles...; it would be unfair to those who are being evicted from their homes, and can't find new ones because they can't find jobs. That would be unfair to those who have to drop out of school because they, or their parents, can't find jobs.

It is time to face up to what needs to be done. The sticker shock involved will be large, but the costs in terms of lost output of not meeting either the credit target or the aggregate demand target will be yet larger." (Robert Schiller, Depression Lurks unless there's more Stimulus, Bloomberg)

Even though industrial production, manufacturing, retail and housing are in freefall, the talk on Wall Street still focuses on the elusive recovery. The S&P 500 touched bottom at 666 on March 6 and has since retraced its steps to 852. Clearly, Bernanke's market-distorting capital injections have played a major role in the turnabout. Former Secretary of Labor under Bill Clinton and economics professor at University of Cal. Berekley, Robert Reich, explains it like this on his blog-site:

"All of these pieces of upbeat news are connected by one fact: the flood of money the Fed has been releasing into the economy. ... So much money is sloshing around the economy that its price is bound to drop. And cheap money is bound to induce some borrowing. The real question is whether this means an economic turnaround. The answer is it doesn't.

Cheap money, you may remember, got us into this mess. Six years ago, the Fed (Alan Greenspan et al) lowered interest rates to 1 percent.... The large lenders did exactly what they could be expected to do with free money — get as much of it as possible and then lent it out to anyone who could stand up straight (and many who couldn't). With no regulators looking over their shoulders, they got away with the financial equivalent of murder.

The only economic fundamental that's changed since then is that so many people got so badly burned that the trust necessary for consumers, investors, and businesses to repeat what they did then has vanished.... yes, some consumers will refinance and use the extra money they extract from their homes to spend again. But most will use the extra money to pay off debt and start saving again, as they did years ago....

I admire cockeyed optimism, and I understand why Wall Street and its spokespeople want to see a return of the bull market. Hell, everyone with a stock portfolio wants to see it grow again. But wishing for something is different from getting it. And cockeyed optimism can wreak enormous damage on an economy. Haven't we already learned this? (Robert Reich's Blog, "Why We're Not at the Beginning of the End, and Probably Not Even At the End of the Beginning")

If the purpose of Bernanke's grand economics experiment was to create uneven inflation in the equities markets and, thus, widen the chasm between the financials and the real economy; he seems to have succeeded. But for how long? How long will it be before foreign banks and investors realize that the Fed's innocuous-sounding "lending facilities" have released a wave of low interest speculative liquidity into the capital markets? How else does one explain soaring stocks when industrial capacity, manufacturing, exports, corporate profits, retail and every other sector have been pounded into rubble? Liquidity is never inert. It navigates the financial system like mercury in water darting elusively to the area which offers the greatest opportunity for profit. That's why the surge popped up first in the stock market. (so far) When it spills into commodities–and oil and food prices rise–Bernanke will realize his plan has backfired..

Bernanke's financial rescue plan is a disaster. He should have spent a little less time with Milton Friedman and a little more with Karl Marx. It was Marx who uncovered the root of all financial crises. He summed it up like this:

"The ultimate reason for all real crises always remains the poverty and restricted consumption of the masses as opposed to the drive of capitalist production to develop the productive forces as though only the absolute consuming power of society constituted their limit." (Karl Marx, Capital, vol. 3, New York International publishers, 1967; Thanks to Monthly Review, John Bellamy Foster)

Bingo. Message to Bernanke: Workers need debt-relief and a raise in pay not bigger bailouts for chiseling fatcat banksters.

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