The Financial Meltdown: This Time Is Different

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Whatever we know about today's financial crisis. Think we know. Eventually will know in the fullness of time. This time is really different. In 1922, Henry Ford put it this way in his book titled "My Life and Work:"

"The (economy's) primary functions are agriculture, manufacture, and transportation. Community life is impossible without them. They hold the world together....The great delusion is that one may change the foundation. The foundations of society are the men and means to grow things, to make things, and to carry things."

Real enterprise producing value. Tangible products. Not casino capitalism. Computerized gambling. The illusion of wealth. Disappearing once liquidity dries up. Or even now when it's abundant. With a keyboard click, or when investors fear an approaching economic storm.

Until recently, and even now, many observers pretend that the US and major world economies will avoid recession. Or at worst experience a mild one with healthy growth resuming in 2009. Slowly and grudgingly, opinions are changing. Output is falling. Unemployment rising. Wages stagnant. Personal consumption falling and so are equity, bond and commodity prices. At the same time, households are way over-indebted and so are businesses, states, cities and the federal government. At issue is how bad things will get. For how long, and what, if any, corrective measures at this stage can stabilize and reverse conditions.

It's effects are broad-reaching. Chicago mayor Richard Daley faces a $469 million budget gap. As a result, he'll shut down "non-safety related city services" for six days over the holidays to save millions of dollars. California "faces the potential of a perfect storm created by the financial crisis effect on liquidity, lower-than-anticipated revenues currently coming into the state, and our late budget," according to governor Schwarzenegger's communication director. Another administration official agreed and said "the (revenue) window is shut, and if it stays shut, we are in deep trouble." The state needs an emergency $7 billion loan. It wants Washington to buy that amount of state bonds that it can't sell in the marketplace due to current conditions.

Other cities like New York are also strapped. With a projected $2.3 billion revenue shortfall in 2009 and gaps of around $5.2 billion in 2010 and 2011. To combat it, Mayor Bloomberg ordered a $1.5 billion spending cut and may raise property taxes by 7%. Other measures will follow as needed.

The Center on Budget and Policy Priorities reported that 29 or more states (and the District of Columbia) face an estimated $48 billion in total budget shortfalls for FY 2009. Unlike the federal government, states and cities can't run deficits or borrow like Washington for operating expenditures. They can only use available reserves, cut spending or raise taxes. Choosing the latter two will contract their economies further and contribute to a national slowdown.

Mountains of debt and multiple imploding bubbles are the problems. The housing one especially crucial for millions and the states where they live. It hits property tax revenues. Sales taxes from furniture, appliances, construction materials and other housing related products. Incomes taxes also from employment cutbacks at the same time demand for city services is increasing. Instead they're being cut for public health, education, the indigent, the elderly and disabled, and public workforces. All of which makes a bad situation worse. And according to some astute observers, it's only the beginning. The worst is yet to come.

Are We In Recession?

On October 17, the latest housing numbers added extra confirmation. New home construction hit a 17-year low in September. Housing starts fell 6.3% to a seasonally adjusted 817,000 annual rate. The lowest figure since January 1991, and single-family starts dropped 12% to 544,000. The worst showing since February 1982 in the depths of that period's severe recession. Until today called the deepest since the 1930s.

Building permits also fell 8.3% to 786,000. A 27-year low, and for single-family homes they dropped 3.8% to 532,000. The lowest in 26 years. Along with the data, the National Association of Home Builders reported that builder sentiment hit a record low in October and shows no signs of improvement. According to the University of Michigan/Reuters index (on October 17), so did consumer sentiment. Their latest reading fell to 57.5. Its biggest every monthly drop and nearing its all-time low 51.7 figure in May 1980.

Blame it on the housing slump and assets related to it causing a severe economic contraction. According to Merrill Lynch economist David Rosenberg, it will surpass the worst of the 1973 – 1975 one. He also sees huge and growing financial damage. Credit losses already around $600 billion ballooning to two or three times that amount before things stabilize. Economist Martin Feldstein, former US National Bureau of Economic Research head, sees the deepest US recession since WW II. He told CNBC: "The fact is that lenders don't want to lend, (and) asset buyers don't want to buy assets because of this tremendous uncertainty on what mortgage-backed securities are actually worth."

Investor Warren Buffett thinks a sharp downturn is underway, but he showed up in an October 17 New York Times op-ed saying now is a good time to own stocks. So he's buying. Others disagree and say we're in much more than a cyclical slump. The result of an unsustainable house of cards. No one knowing the amount of economic damage. From rampant speculation. Mountains of debt. The housing bubble, and the entire financial unraveling affecting households, businesses, all parts of the economy, and sentiment.

Noted economist Joseph Stiglitz is grim in his outlook. He sees "the most serious problem since the Great Depression (that) in some ways (is) worse in terms of the financial institutions….The reason, in part, is that while some of the same problems that occurred (then and since), such as excessive leverage, pyramid schemes, bubbles, have happened before, the so-called innovation of Wall Street, the financial innovations, that were supposed to manage risk, created a kind of non-transparency that is now so great that no one knows exactly the magnitude of the risk they face. It is particularly bad because our financial institutions are based on trust" that you can get your money out of banks you put it into.

Because of the current unraveling, that trust is fractured. “We are in the midst of micro-economic failure on a grand scale….rather than managing risk, the financial markets created” more of it. “The failure of our financial system to do what it is supposed to do matches in destructive grandeur the macro-economic failures of the Great Depression.” The “country as a whole” lost out. What happened to “the American economy was avoidable.” Stiglitz sees a protracted downturn, L-shaped at best, and lasting up to 18 months before it ends.

The economy may or may not face another Great Depression, but for many it’ll feel like one. According to Yale economist Robert Shiller, it’s possible. He devotes an entire chapter of his new book, “EconoPower,” to it. He claims that the US economy is no longer “depression proof,” and lists three potential scenarios that could threaten the nation’s monetary system. The third is most ominous: “a series of unexpected events that could trigger a major financial accident – a run on the dollar, a real estate crisis, a major terrorist attack, or a natural disaster, that could overwhelm the monetary authorities.”

Shiller sees the current real estate crisis far from over and so severe that the Fed and Treasury will have to take emergency measures to avoid collapse. Effective tools are available. Interest rates will be cut to zero and much more. Well beyond what’s already done. Great Depression-like measures will be crucial to keep the economy afloat. In his judgment, if the right ones are adopted they’ll work, but not swiftly or easily.

Others aren’t as sure. Last year, even the central bank for central bankers, the Bank for International Settlements (BIS), was worried. It warned that loose Fed monetary policy, speculative finance, and excess household debt, among other factors, could cause another Great Depression. It passed without notice, and here we are today. Easy credit and no oversight brought us to the edge of the abyss. The possibility of a systemic meltdown and economic calamity. The consequences are unimaginable. The human wreckage incalculable. The toll already severe and increasing.

Proposed Bailout “Too Little, Too Late,” and Counterproductive

Leading financial expert and investor safety advocate Martin Weiss is very critical of the Paulson plan and gave Congress his views. He called it “too little, too late (and) too much, too soon for the US bond market.” It’s apparent in rising bond prices and 30-year mortgage rates. Around 6.50% compared to about 5.75% in mid-September.

He recommended reconsidering “a broad bailout for US debts given the wide diversity of mortgage holders” and total outstanding debt in the country. Besides mortgages, over $20 trillion in private-sector consumer and corporate debt and other $2.7 trillion in municipal securities.

Among banks and thrifts with over $5 billion in assets, he estimates 61 banks and 25 thrifts heavily exposed to non-performing mortgages. He urges a greater understanding of the derivatives build-up and the consequences if enough of them sour. He calls established safety nets inadequate. FDIC for depositors. Securities Investor Protection Corporation (SIPC) for brokerage customers, and state guarantee associations for insurance policy holders. If the entire $700 billion was used responsibly (and it won’t be), it’s “just a drop in the bucket” to address the debt crisis.

He says it’s foolhardy to expect the bond market to handle the bailout burden without upward pressure on interest rates. The opposite of what's needed. He sees skyrocketing federal deficits exacerbating things further and "aggravating the very debt crisis that the bailout plan seeks to alleviate."

Instead of protecting "imprudent institutions and speculators," he recommends strengthening "existing safety nets" for individuals and savers. Informing the public about significant systemic risks, and explaining how limited government is to contain them. He says savers and investors should avoid risk for safety.

He estimates 1479 FDIC member banks with $2.4 trillion in total assets at risk of failure. Another 158 S&Ls with $756 billion. A total of $3.2 trillion or 41 times the assets of banks on the FDIC's watch list. He notes $51 trillion in interest-bearing debts. Over $12 trillion in residential mortgages on single and multi-family homes. "Fannie, Freddie and GSAs still at risk" after being taken over. They hold $5.4 trillion in residential mortgages, but a government guarantee doesn't prevent them from deteriorating and requiring much larger funding than contemplated.

Private sectors and local governments also own residential mortgages:

— asset-backed securities issuers – $2.1 trillion;

— non-bank finance companies – $426 billion;

— credit unions – $332 billion;

— state and local governments – $159 billion'

— life insurance companies – $62 billion; and more in

— private pension funds, government retirement funds and households.

Commercial mortgages are also at issue and are souring. A total of $2.6 trillion "dispersed widely beyond the banking sector." And mortgages are less than half the problem. Add to them credit cards, auto and student loans, and various other kinds of private-sector debt. Consumer and corporate. Around $20 trillion in total plus nearly $15 trillion in residential and commercial mortgages.

State and local governments are at risk with $2.7 trillion in outstanding municipal securities and huge growing budget shortfalls given the current crisis.

The derivatives problem is especially ominous. At extreme levels and very dangerous. An estimated $180 trillion held by commercial banks alone meaning those with most of it are technically insolvent. JP Morgan Chase holds half of it. An "unprecedented concentration of risk in modern US history." The large counterparty default risk in this market isn't understood. Currently the Office of the Comptroller of the Currency (OCC) reports credit derivatives exposure (or risk of trading partner default) at $465 billion. Up 159% from 2007. Failure to address the derivatives time bomb "leaves a gaping hole through which financial panic can spread."

In addition, beyond the above lowball figure, no estimates are available of derivatives default amounts or forecasts of more likely in a continuing downturn.

In sum, a monumental problem. Too big to ignore, but precisely what Congress is doing. At enormous risk to the economy, businesses, households, the American way of life, and the nation as the world's economic superpower. Plus the effect on world economies and people everywhere.

Politics, Finance and Consumer Sentiment

With the November 4 election approaching, pocket book issues show up in consumer sentiment polls and have incumbents worried. Especially Republicans seen as mostly to blame. The October 15 Reuters/Zogby Index on the mood of the country plunged from 96.3 in September to 89.7 currently. Approaching a record low 87.7 number. The poll also gave George Bush his lowest ever job approval rating at 21%. Congress scored just above its worst reading at 10%. Zogby called the results "a double-whammy" and compared the public mood to the Great Depression's early years.

An October 6 – 8 Gallup tracking poll showed much the same results. A similarly dramatic difference from the previous month:

— in September, 38% of respondents rated current conditions poor; in October, the number jumped to 59%;

— in September, 78% expected conditions to worsen; in October, 90% were negative.

Gallup commented that the polling data trend suggests that "consumer confidence is reaching historic lows." Further, "given the current financial crisis and associated recession, it is likely to take some dramatic efforts to turn consumer confidence around." Gallup numbers vary up and down weekly. However, given the state of things and strong likelihood they'll worsen before improving, expect the trend ahead to stay decidedly negative. Meaning bad news for incumbents being blamed.

Maybe not for the most important job according to investigative journalist Greg Palast. He uncovered convincing evidence that the 2000 and 2004 presidential elections were stolen and now has a new article titled "It's Already Stolen." It follows his joint year-long investigation with Robert F. Kennedy, Jr. revealing "a systematic program of 'GOP vote tampering' on a massive scale." They cite:

— swing-state Colorado Republican Secretaries of State "have quietly purged one in six names from their voter rolls;" a shocking "ten times the average state's rate of removal;"

— among newly registered voters, "more than 2.7 million have had their registrations REJECTED under new procedures signed into law by George Bush;" individuals affected are largely blacks and Latinos; likely to vote Democrat;

— "a fired US prosecutor….accus(ed) leaders of his own party, Republicans, with criminal acts in an attempt to block legal voters…."

— in 2004, a little known practice called "caging" purged 1.1 millions voters; it's used to suppress minority voters by delisting them for failing to answer "do not forward" registered mail sent to homes they're away from for various reasons; Palast predicts far greater "caging" this November; and

— post-2004, "states used dubious 'list management' rules to scrub at least 10 million voters from their roles."

Palast and Kennedy believe Republicans intend to steal the 2008 presidential election. Much like they did in 2000 and 2004. They state: "Republican operatives – the party's elite commandos of bare-knuckle politics (are) systematically disenfranchis(ing) Democrats. If Democrats are to win (in November), they must not simply beat John McCain…they must beat him by a margin that exceeds the level of GOP vote tampering."

If the latest Pew Research poll numbers are accurate and hold, Obama appears headed to do precisely that, and on November 5 headlines will read: "President-elect Obama." On October 21 (based on October 16 – 19 polling), Pew noted that "Barak Obama's lead over John McCain has steadily increased since mid-September," and he now "enjoys his widest margin yet over McCain among registered voters, at 52% to 38%" with 10% undecided or for other candidates. "When the sample of voters is narrowed to those most likely to vote, Obama leads by 53% to 39%."

Palast and Kennedy are on top of vote tampering whoever wins in November. They released a 24-page full-color comic book called "Steal Back Your Vote." It's available in print or can be downloaded on "StealBackYourVote.org."

Dirty politics and fraudulent finance are close bedfellows. Together they explain much about the current economic crisis. Its effect on ordinary people, and what might be expected ahead. Given the current climate (vote tampering notwithstanding), it should be a slam dunk election for Obama. People in distress mostly blame incumbents. It showed in 1932 when Franklin Roosevelt trounced Herbert Hoover carrying 42 of the (then) 48 states. A majority 57.4% to Hoover's 39.7% and 472 Electoral College votes to 59.

Given it was three years after Wall Street crashed. In July that year the Dow average had lost 89% of its peak valuation, and in August unemployment reached 25%. Using realistic figures, it's half that number today. But increasing to where it may reach alarmingly high levels before the current downturn bottoms.

Few today expect the 1930s to repeat, but economic conditions are worsening. Housing, consumption affecting retail sales, and production dropping 2.6% in September. The largest monthly decline since May 1980. The Philadelphia Fed said its manufacturing index plunged at the fastest pace in its 40-year history to a minus 37.5 reading. The sector overall had job cuts every month since July 2006.

It may be 2010 at the earliest before conditions stabilize. Consumer sentiment is near record lows. Millions of homeowners face foreclosure. Loss of income. Jobs and inadequate social safety net protections are in place for backup. People are worried, angry and with good reason. Yet if Palast and Kennedy are right, Republicans may retain the White House given the level of fraud they uncovered. It says much about our faux democracy and offers faint hope for better times in 2009.

Future Prospects – Bleak and Growing Bleaker

Maybe not as bad as Ambrose Evans-Pritchard saw them last month in the UK Telegraph. But who knows. He may be right. His September 22 column was headlined: "Crisis may make 1929 look (like) a walk in the park." He cites meager and fleeting effects from "buckets of liquidity" and quotes economist (92-year old) Anna Schwartz saying "Liquidity doesn't do anything in this situation. It cannot deal with the underlying fear that lots of firms are going bankrupt. The banks and the hedge funds have not fully acknowledged who is in trouble. That is the critical issue."

Schwartz also gave the Wall Street Journal an October 18 interview in which she said Treasury and Fed policies are wrong. She repeated that liquidity isn't the problem. At issue is uncertainty "that the balance sheets of financial firms are credible." As a result, credit spreads haven't budged because you don't know who's solvent and who isn't and too many are in the latter category.

Liquidity was the issue in the 1930s when the money supply contracted sharply. Not today with bank problems on the asset side of their ledgers. "All these exotic securities that the market does not know how to value. They're toxic because you cannot sell them. Your balance sheet is not credible, and the whole market freezes up. We don't know who to lend to because we don't know who is sound." Schwartz is worried that Paulson is trying to save banks, not the system. Insolvent ones and said we shouldn't "be recapitalizing firms that should be shut down." They should be allowed to fail. "Everything works much better when wrong decisions are punished and good (ones) make you rich."

She commented also on what caused the current crisis. Like in the 1920s, it started with a "mania." In every case, it was expansive monetary policy generating an asset boom. She's very critical of Alan Greenspan dropping interest rates to 1%. Seeing the negative effect and doing nothing about it. She's no gentler with Ben Bernanke and accused him of fighting the last war. The result so far is failure. "So my verdict on this present Fed leadership is that they have not really done their job."

As a result, lenders are hoarding cash and economist Peter Spencer said that global authorities have just weeks to make things right. Instead they're making them worse. Unless changed, things may start to implode.

Economists like Nouriel Roubini aren't as dire but nonetheless see grim times ahead. His October 17 commentary echoed them:

— continued negative economic surprises;

— "a major surge in corporate default rates;"

— a weak recovery "as the recession becomes severe" and credit spreads widen;

— "the risk of a CDS (credit default swap) market blowout as corporate defaults" spike;

— hundreds of hedge funds collapsing; liquidation of their assets and the toll on financial markets as a result;

— major insurance companies in trouble;

— "a slow motion refinancing and insolvency crisis for many toxic LBOs;"

— "the risk that other systemically important financial institutions are insolvent" and need expensive rescue packages;

— the continuing vicious circle of falling asset prices; the result of ongoing deleveraging into illiquid financial markets;

— growing numbers of margin calls as asset prices fall; cascading them lower as a result;

— the continuing housing slide "pushing over 20 million households into negative equity by 2009;" and

— the risk of an emerging or developed country experiencing a severe financial crisis; much like Iceland in recent days.

Roubini calls the last factor "crucially important" and cites about 12 or more emerging economies "in serious financial trouble." Especially in Eastern Europe, including Turkey, but also Korea, Indonesia and Pakistan. The risk of contagion is worrisome as even tiny Iceland (population 300,000) sent tremors globally.

Overall, risks and vulnerabilities remain. They're growing, not receding. Not a hint of resolution is in sight and observers expressing near-term optimism need a reality check. The best to hope for is a severe, protracted recession. Most likely globally. Further, inadequate measures are in place, and more corrective ones are needed to avoid an economic meltdown. The longer they're delayed, the worse conditions will get.

Globally we have a severe recession combined with a financial and banking crisis. The result of the largest ever leveraged asset and credit bubbles. Multiple ones in housing, mortgages, credit, equities, bonds, commodities, private equities and hedge funds all simultaneously imploding. There's no simple or easy way out of this and overwhelming risks of something much more serious loom. Unmentioned in daily business news reporting that instead touts a market bottom and a great time to buy stocks. Leaving unexplained the risk of doing it in a very hazardous climate.

People today should be cautious and demand far more from elected officials than they're getting. Critical times like these require radical measures. So far only handouts to Wall Street. To fraudsters through what economist Michael Hudson calls a "con game (and an) unprecedented giveaway of financial wealth." What financial affairs author Ellen Brown brilliantly explains this way:

We seeing "the collapse of a 300 year Ponzi scheme. All the king's men cannot put the private banking system together again, for the simple reason that (it's) reached its mathematical limits." It needs new borrowers but doesn't have them. This racket has gone on for 300 years "ever since the founding of the Bank of England in 1694." The whole world now is "mired in debt to the bankers' private money monopoly." The dirty game has reached its finite limits. "The parasite has finally run out of its food source."

World governments are scrambling frenetically as a result. Supplying mountains of credit (liquidity) to support troubled and over-indebted banks. Leaving distressed households high and dry and sticking them with the bill.

Eventually the game will end badly. In this case, a lengthy asset and debt deflation. Long after bankers took the money and ran. Wrecking economies and throwing ordinary people to the wolves. Michael Hudson puts it this way:

"Neither the Treasury nor Congress is helping to resolve this problem." Newly issued debt won't re-inflate markets or stabilize the economy. Just the opposite. "As debt deflation eats into the domestic market for goods and services, corporate sales and earnings will shrink," and so will market valuations. The end result will be "the very bankruptcy that the bailout was supposed to prevent."

That prospect is nightmarish so here we are. America's economy is eroding. Government and Wall Street are orchestrating it. Maybe even willfully, and here's the legacy they're leaving. The nation "passing from democracy to oligarchy (and steering it is) a bipartisan financial kleptocracy" chuckling all the way to their offshore tax havens.

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