The Bitter harvest of Bush's economic 'management'

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'Ownership society' hits the canvas

[We have it on good authority that those responsible for the current economic collapse -- insider elites -- are making contingency plans to evade responsibility and future arrest. It is imperative that these corporate criminals are monitored, as they are likely to flee to nations that do not have extradition treaties with the home nation. Maintain tracking of all felons (and war criminals); the peoples' demand for justice must be satisfied! Ed]

The economy is in tatters. Consumer confidence has plummeted, food and energy prices are soaring, and the housing market is experiencing its biggest crash since the Great Depression. Manufacturing is down, unemployment is up, gasoline is topping $4 per gallon, and tent cities are sprouting up throughout the Southwest. If there's a silver lining to this mess; it's not visible from planet earth.

'Milton' Bush

The trillion dollar mortgage-backed securities (MBS) market is barely limping along. Investors are brushing off the higher yields and staying on the sidelines. How bad is it? In the first five months of the year, sales of mortgages repackaged into bonds are down a whopping 89 per cent. The wholesale market is dead. The same is true of commercial paper (CP) which has declined $452 billion in the last 44 weeks alone. There's no appetite for structured investments of any kind; it's a broken model. More worrisome, the Fed's low interest rates have failed to restart the economy or stabilize declining home prices. (Long term interest rates are actually going higher!) While oil and food continue to rise, housing prices have tumbled more than they did during the 1930s. And, even though housing inventory is bulging, it is more difficult than ever to get financing. Bigger down payments are required as well as stricter documentation of earnings. Underwriting standards have tightened overnight. The days of no down, "no doc", no collateral mortgages are over.

Last week, Fed chief Ben Bernanke made light of the nation's economic woes saying:

"Despite the unwelcome rise in the unemployment rate that was reported last week, the recent incoming data, taken as a whole, have affected the outlook for economic activity and employment only modestly. Indeed, although activity during the current quarter is likely to be weak, the risk that the economy has entered a substantial downturn appears to have diminished over the past month or so...The Federal Open Market Committee will strongly resist an erosion of longer-term inflation expectations.''

"The risks to the economy have diminished over the past month"?

Not bloody likely, Ben.

Bernanke's remarks were part of a broader public relations campaign to strengthen the dollar by "jawboning". The objective is to scare-off the speculators from the futures market and (hopefully) bring down the prices of oil and grains. His comments were followed by equally supportive "strong dollar" statements by Bush, Philadelphia Fed President Charles Plosser and Henry Paulson. Paulson went so far as to say that "intervention was still on the table".

But why would the Fed threaten to intervene and distort the currency markets rather than simply raise interest rates and send the speculators running for the exits?

Bernanke is bluffing; he has no plan to raise interest rates. It's all for show. Besides, the Fed doesn't care about the pain its policies cause to working people; Bernanke even said so in his speech. He discounted the increases in food and oil as insignificant (they are not part of the core inflation) The Fed focuses on the "wage-price spiral". In other words, the only time the Fed calculates inflation is when working people get a raise to keep up with the soaring cost of living. The consumer price index (CPI) is the most class-based of all the governments figures.

In real terms, inflation is off the charts; anyone whose been to a gas station or the grocery store lately knows that. The Fed responsible for keeping interest rates too low to try to keep the investment banks afloat and the stock market awash in cheap capital. Last week, Sun Zhenyu, China's ambassador to the World Trade Organization said what most people have already figured out for themselves: "The dollar's depreciation has further added fuel to the rapid increases of crude oil and food prices and hurt the exports of developing countries."

Dollar weakness is at the center of the economic malaise that is generating political instability around the world. Spanish truckers are blocking highways outside Madrid and other parts of the country protesting the spike in gas prices. In Malaysia, at least 2,000 protesters marched through Kuala Lumpur to protest this month’s 41% surge in fuel prices. In Haiti, food riots have broken out over rising price of rice. Countries throughout Southeast Asia have banned rice exports and have begun hoarding for anticipated future shortages. Corn, soybeans and wheat futures are at record highs while many basic crops are threatened with blight, floods and weather-related disasters. "Global inventories are at a 24 year low" according to the US Dept of Agriculture while food aid volumes sunk to their lowest levels in 50 years". (Financial Times) "The World Bank says now that grain, rice and other staples have become so expensive that 100 million people are on the verge of going hunger, joining the 850 million people who already were malnourished." (Globe and Mail)

It all started at the Federal Reserve with their whacky macroeconomic gymnastics. Now the global financial system is stuck with the task of wringing out the excess credit created by Greenspan's low interest policy.

A.K. Gupta explains the erratic behavior of the commodities in his article in Z magazine "Market

Madness: How Speculators are Manipulating and Profiting from the Global food crisis":

"One striking aspect of the rising commodity prices is that when charted, they look similar to the Internet stock mania a decade ago or the charts of soaring (and plunging) home prices of late. This is no mere coincidence. One of the main factors in accelerating commodity and food costs is financial speculation. The same Wall Street banks and hedge funds that gave us the stock bubble and the housing bubble are reportedly throwing billions of dollars at the commodity markets, betting they can make a fast buck. One analyst interviewed by the Wall Street Journal estimates that "investors have poured roughly $175 billion to $200 billion into commodity-linked index funds since 2001." The Journal explained, "As with energy markets a few years ago, pension funds and hedge funds have flocked to grain investments as the supply of farm acreage and crop output shrinks relative to the growing global population and new demands for crops for biofuels and food. Many such investors make predominantly bullish bets," that is, expecting the price to rise.

The daily fluctuations on commodity exchanges are at times greater than used to occur in an entire year. On February 25 alone, at the Minneapolis Grain Exchange, one type of wheat jumped 29 percent. On a single day in March, "the price of cotton jumped 15 percent despite reports showing cotton supplies were at near record highs," according to the Toronto Globe and Mail. During the CFTC hearings, commodity producers laid the blame for soaring prices at the speculators' door. A representative of the National Grain and Feed Association testified, "Sixty percent of the current [wheat] market is owned by an index fund. Clearly that's having an impact on the market," while a cotton producer stated, "The market is broken, it's out of whack." (A.K. Gupta "Market Madness: How Speculators are Manipulating and Profiting from the Global food crisis", Z Magazine)

Oil and commodities prices won't normalize until the Fed stops flushing cheap money into the financial system. As long as Bernanke fixes interest rates below the rate of inflation, investors will continue to trade their paper assets (US dollars) for raw materials that promise to maintain their value. Its as simple as that. Bernanke has fooled the bond market into believing that he will raise rates at the Fed's August meeting, but others are not so easily convinced.

Tom Petruno of the LA Times believes that Bernanke is just "saber-rattling" and that surging unemployment (5.5%) and a crashing real estate market will keep the Fed from following up its threats of credit tightening. Petruno is right; Bernanke is just blowing smoke. There's no chance of a rate hike unless the world's central banks decide they've had enough of the Fed's misguided approach to monetary policy and trigger a global run on the dollar. But we're not quite there yet. So the dollar is likely to strengthen temporarily from the Fed's "tough talk" until investors realize that its all hot air. The Fed has no intention of raising rates and driving a stake through the heart of the banking system. That will NOT happen.

The Fed is currently in panic-mode because it doesn't have the tools or resources to fix the problems its facing. Its already eaten through more than half of its $900 billion balance sheet and has traded away hundreds of billions in US Treasuries for worthless MBS and collateralized debt obligations (CDOs) which are steadily losing value every month. The Fed is trying to revive the moribund banking system which has lost its main sources of revenue (structured financial investments) and is teetering on the brink of insolvency from its steadily wilting assets, a collapse in commercial and residential real estate, and a rise in corporate defaults. Bernanke has the banks on life support by stealthily providing liquidity via rotating loans (repos), but the banks have been forced to sluice the money into other "less conventional" areas of investment in search of revenue. According to Bloomberg News: “Trading in derivatives, led by short-term interest-rate futures, climbed 30% to a record $692 trillion in the first quarter... the Bank for International Settlements said. The value of short-term interest-rate futures traded on exchanges rose to $548 trillion…” The larger question is whether the investment banks---faced with a frozen bond market and ravaged balance sheets---are diverting the money they're getting from the Fed into commodities (via the hedge funds) driving the prices upward and triggering political turmoil around the world?

The Fed knows, but they're not saying.

Over the weekend, the G-8 ministers called on national authorities to examine the commodity futures markets and take “appropriate measures as needed."...There are serious concerns among some G-8 members such as France, Germany and Italy that speculators have been a key driving force behind recent record-high oil prices of nearly $140 a barrel on the futures market." According to Bloomberg News:

"Goldman [Sachs] and Morgan Stanley are expected by analysts to report the best second-quarter earnings of the world's biggest securities firms this week, having limited their losses from the collapsing credit market....They also lead Wall Street in commodities trading, where crude oil futures doubled in the past year and the price of products from gold to corn soared to record highs."

Ah ha! So the investment giants ARE playing the commodities market. Could we be in the early phase of another Dot.com bubble?

In one year, oil has jumped from $65 per barrel to $135 per barrel at Friday's close. At the same time mortgage equity withdrawals (MEW) have declined from their peak of $576 billion in the second quarter of 2006 to $114 billion in the first quarter of 2008. That is $462 billion less that will be spent at the malls and home improvement stores; another blow to the flagging consumer-driven economy. (Keep in mind that the loss in MEWs far exceeds Bush's "stimulus package" by a margin of 3 to 1) As consumers continue to wither from the loss of home equity, stagnant wages and unsustainable credit card debt; the economy is bound to contract dramatically leaving Bernanke with no other option than to lower rates to 1 per cent or less.

That's right; interest rates are going down not up. Goldman Sachs has arrived at the same conclusion saying in a recent statement:

"We still believe that tightening is both inappropriate and unlikely anytime soon. It is inappropriate because: (1) the economy is fundamentally weak, with tax rebates driving the surge in retail sales; (2) financial markets remain fragile; and (3) worries about inflation are overdone ... " (Calculated Risk)

So, in the short-term, Bernanke is hoping he can rattle the commodities speculators and bring down oil prices by jawboning. But what he is really focussed on is the deflationary hurricane that is about to touch down and ravage the economy. Good luck.

Economist, Nouriel Roubini, also believes that the Fed will keep rates at 2 per cent adding:

"More persistent factors will bear negatively on consumption over the summer and especially the fall: the fall in home prices and the collapse of home equity withdrawal (with their wealth effect on spending); the stressed balance sheets and high debt ratios of the household sector (such debt is up to almost 140% of disposable income); the credit crunch in mortgage markets that is now spreading to unsecured consumer credit (credit cards, student loans, auto loans); the rise in debt servicing ratios (following the reset of mortgage rates, and higher interest rates on mortgages and consumer credit); the sharp rise in gasoline and energy prices that is a serious shock to real incomes; the further erosion of real wages through the rise in the inflation rate; the sharp fall in consumer confidence; the drop in employment (now five months in a row) and thus in income generation; the negative wealth effect of the correction in equity markets and the fall in the net worth of the household sector. All these factors will have – over time – a much more significant negative effect on consumption than the temporary boost given by the tax rebates."

As housing continues to search for a bottom and foreclosures rise, the corporate bond market will struggle and corporate defaults will increase. This will send shockwaves through the bond market and put the derivatives dominoes in motion. New York Fed chief timothy Geithner huddled with industry leaders last week to make contingency plans for an expected breakdown in the $62 trillion credit default swaps(CDS). The meeting called together 17 senior executives and dealers "to discuss ways to quickly address weaknesses in the infrastructure of the derivatives market" and (hopefully) avoid an system-wide meltdown in over the counter swaps. There is growing probability of major crisis emerging from the "unregulated" shadow banking system, where over $500 trillion of counterparty contracts are traded beyond any government supervision. As business defaults increase and derivatives bets unwind, a doomsday scenario affecting the global economy becomes more and more likely.

The present storm in the financial markets is the result of loose monetary policies which increased the amount of credit in the system. For a while, the explosion in credit was mistaken for genuine wealth creation in the form of higher home prices and the high-flying stock market. In fact, rising real estate prices were just confirmation of "uneven" asset inflation. Now that the bubble has burst, trillions of dollars are sloshing about the system looking for a new home and driving up commodities in the process. The Fed's job is to mop up the excess credit so the markets can rebalance and start anew. Everything Bernanke is doing is designed to inflate another speculative equity bubble. Its a good example of how the Fed works at cross-purposes with the people it is supposed to serve.

Commodities prices (including oil) are particularly hard to control because Congress abandoned its responsibility to regulate the futures markets during the Clinton Administration. Congress passed what is known as the Enron Loophole which allows speculators to game the market beyond the reach of the Commodities Future Trading Commission (CFTC) Futures trading is now the purview of high-stakes gamblers who are now sending prices into the stratosphere. As William Engdahl notes in his article "The Real Reason behind High oil Prices" (Global Research):

"A conservative calculation is that at least 60% of today’s $128 per barrel price of crude oil comes from unregulated futures speculation by hedge funds, banks and financial groups using the London ICE Futures and New York NYMEX futures exchanges and uncontrolled inter-bank or Over-The-Counter trading to avoid scrutiny. US margin rules of the government’s Commodity Futures Trading Commission allow speculators to buy a crude oil futures contract on the Nymex, by having to pay only 6% of the value of the contract. At today's price of $128 per barrel, that means a futures trader only has to put up about $8 for every barrel. He borrows the other $120. This extreme “leverage” of 16 to 1 helps drive prices to wildly unrealistic levels and offset bank losses in sub-prime and other disasters at the expense of the overall population."

Supply and demand don't explain the sudden doubling and sometimes tripling of grain and oil prices on the futures market. The flagging dollar and lack of oversight have unleashed speculative forces which are out of control leading to food riots, massive protests and starvation. The market cannot self-correct as long as interest rates on the world's reserve currency are kept artificially low. The global financial crisis radiates from Washington, which is where the solution lies.

But the real problem goes beyond Wall Street's exotic debt-instruments or the Federal Reserves low interest funny-money. Overcapacity is the result of slacking demand which naturally arises when workers wages stagnate as they have for the last 30 years. When that happens, the only way the economy can grow is by easing lending standards and expanding credit. That's why Greenspan and his fellows were so enthusiastic about all the complex derivatives and shaky subprime mortgages; it all fit with their class-based view that wages must remain low (to fight inflation) while debt is expanded ad infinitum. This is the blueprint for the New Economy that Maestro touted. While banks were keeping less than $1 dollar in capital for every $10 they lent to mortgage applicants; the investment banks and hedge funds were amplifying that debt many times over by taking those dodgy mortgages and borrowing 20 to 30 times the value of the underlying asset to maximize their profits. Then trillions of dollars in credit default swaps were used as a way to hedge against possible default on the over-inflated bonds. Voila; the biggest equity bubble in history created by some of the smartest guys on Wall Street.

Now the underlying collateral (housing) is quickly deteriorating causing a system-wide deleveraging and a flight to safety (US Treasuries, foreign bonds). The dollar is in free fall, credit is tightening, and the banks are only able to stay open due to the generosity of the Federal Reserve.

According to economist and author Henry Liu, the same thing happened just prior to the Great Depression:

"The problem in 1929 was, as it is in 2008, that asset prices buoyant by speculation had outstripped the purchasing power of stagnant income of consumers. Assets and commodities in the economy were valued at price levels that aggregate wage income could not sustain. The solution was not to inject more useless liquidity to sustain inoperative price levels, which will only make the problem worse, but to INTRODUCE DEMAND MANAGEMENT THROUGH FULL EMPLOYMENT AND LET WAGES QUICKLY RISE BACK UP TO THE LEVEL OF WAGE-PRICE EQUILIBRIUM. This was the policy objective of Roosevelt's New Deal Program, an objective not yet recognized by policymakers in 2008 even amid a revival of populist rhetoric.

Are you listening, Barak Obama?!?

There is no way to escape the day of reckoning now facing the financial system; the hundreds of bank failures, the corporate defaults, the meltdown in real estate, the massive loss of jobs, the dreary contraction of credit, the tumbling stock market, and the blow to our national confidence. But there is a way to rebuild, to reassert control over our own currency; to "even the playing field" and recommit to a strong middle class; to smash the system that diverts the greatest portion of the nation's wealth to a handful of unelected oligarchs whose main objectives are to expand their own personal power and subvert the democratic process. The existing system cannot meet the challenges of the new century. It's gotta go.

PBS journalist Bill Moyers summed it up like this at a recent Media conference in Chicago:

"Capitalism breeds great inequality that is destructive, unless tempered by an intuition for equality, which is the heart of democracy. When the state becomes the guardian of power and privilege to the neglect of justice for the people who have neither power nor privilege, you can no longer claim to have a representative government."

You tell 'em, Bill.

http://www.informationclearinghouse.info/article20116.htm

Cleaves Alternative News. http://cleaves.lingama.net/news/story-1119.html