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Views and Analysis on the Economy and Precious Metals

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Recession, Depression, or Systematic Breakdown

By James Quinn

As crooked politicians, Federal Reserve hacks, and cheerleading media pundits inform you the recession is over, you probably have a sneaking suspicion they are lying.

The National Bureau of Economic Research is the arbiter of business cycle recessions. They define a recession as "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production."

A depression is characterized by its length, and by abnormal increases in unemployment, a decline in the availability of credit, shrinking output and investment, numerous bankruptcies, reduced amounts of trade and commerce, as well as highly volatile relative currency value fluctuations, mostly devaluations. Price deflation, financial crisis, and bank failures are also common elements of a depression. Let's assess where the U.S. economy stands at the moment:

Economic Factor	Peak to Trough So Far
Real GDP Decrease	3.7% real decline from December 2007 until June 2009 totaling $500 billion
Personal Income	Personal income declined by $339 billion from mid-2008 to the 1st Qtr of 2009
Investment	Fixed investment has declined by $543 billion, or 24%, since December 2007
Unemployment	There are 8.1 million less people employed today than in 2007
Industrial Production	Has fallen 12% since 2007
Bankruptcies	National bankruptcies have risen from 800,000 in 2007 to 1.4 million in 2009, a 75% increase
Trade	Exports and imports declined by 22% and 31%, respectively, between July 2008 and June 2009
Currency	The USD has fallen 17% in the last year versus a basket of world currencies
Bank Failures	140 banks failed in 2009, with 700 banks in danger of failing, according to the FDIC

A few economic indicators such as GDP and Personal Income have shown minor positive blips in the most recent quarter due to the unprecedented stimulus applied by the government and Federal Reserve. These effects will be short lived as the stimulus wears off and the economy resumes its downward spiral. At this point in the crisis, real GDP has only fallen 3.7%. By contrast, between 1929 and 1930, real GDP declined by 8.6%.

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Towards a New Monetary Order

By Thorsten Polleit

Henry Ford is alleged to have said that "it is well enough that people of the nation do not understand our banking and monetary system, for if they did, I believe there would be a revolution before tomorrow morning."

The spirit of his words encourages us to put forward questions about the banking and monetary system — especially in view of the international credit-market crisis. Is it a good thing that central banks have cut interest rates essentially to zero and have increased the base-money supply dramatically to support the financial sector? Will depression be prevented if governments underwrite banks' balance sheets and run up huge deficits in an attempt to strengthen production and employment?

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Euro Crisis Totally Out Of Control? Implications?

Christopher Laird

The evolving Euro crisis is expanding and deteriorating rapidly. In only one week since the $1 trillion EU proposed bailout, the following happened:

- Merkel's party got creamed in the regional German elections last week. This is paralyzing Germany politically.
- UK's Brown resigned and Cameron took over.
- France's Sarkozy threatened to pull out of the Euro and banged his fist on the table, making Merkel blink and leading to their disastrous German elections.
- Now Germany bans short sales on Banks and CDS and sovereign bonds - revealing the panic out there in the EU.
- EU is in total chaos politically, they cannot solve this crisis with their many nations who must approve each major fiscal measure like bailouts. The ECB and EU are not capable of the quick unilateral action like the Fed is capable of - meaning they are always behind the curve on this rapidly EU escalating sovereign bond crisis, which is spreading now to EU banks and CDS, not only sovereign bonds, and spreading to the Euro.
- They say the Euro has never been tested severely like this since its inception in 1999/2000. The test is a huge FAIL. The Euro is falling in an out of control way.
- ECB's Trichet had to relent and do the nuclear option to buy bad paper

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And by the end of 1932, real GDP had collapsed by 26.7%.

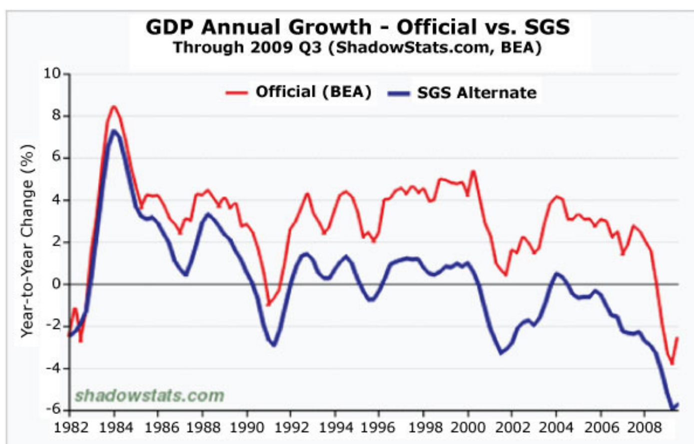
Remarkably, real GDP then surged by 43% between 1932 and 1937, to a level significantly above the 1929 level. This fact should be kept in mind as politicians crow about a 2.8% increase in GDP between 2nd and 3rd Quarter of 2009 as the end of the crisis.

To date, the Federal Reserve has printed well over a trillion dollars in an attempt to evade a deflationary collapse, including a $700 billion bank bailout and a $787 billion stimulus package. And then there was $3 billion wasted on Cash for Clunkers ($24,000 per vehicle), $28 billion squandered on the $8,500 homebuyer tax credit, and an artificial suppressing of interest rates to 0% with $300 billion of mortgage-backed securities. And all we've gotten is a 2.8% increase in GDP?

Based on government-reported figures, our GDP has not fallen anywhere near the amount it declined during the Great Depression. But if you believe government-reported figures, I have an indoor ski resort in Dubai I'd like to sell you.

The fact is the government has systematically underreported inflation since the early 1980s. By doing so, it has systematically overstated GDP. Economist John Williams presents the true GDP growth in the following chart. As you can see, the U.S. has effectively been in a recession since 2001. Using these figures, it is probable that we are in the midst of a second Great Depression.

In response, the bureaucrats and financial gurus scoff, pointing to unemployment of 25% during the Great Depression versus 10.2% today. Again, the government figures dramatically underestimate unemployment. The true, non-government-manipulated rate according to John Williams is currently 22%.



During the Great Depression, there was no FDIC. One-third of all the banks in the United States failed over a five-year period, with 8% of all U.S. banks going under in the first two years alone. In 2009 only 124 banks failed, but bank analyst Chris Whalen from *Institutional Analytics* predicts that at least 1,000 banks will follow before this crisis is over.

That would be 12% of all the banks in the U.S.

The fact is that the U.S. banking system has seized up, with many banks now deserving the label of

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To answer these questions, a diagnosis of the root cause of the debacle is indispensable, and once the root cause has been identified, a proper remedy can be formulated.

The diagnosis provided by the Austrian School of economics can be distilled into one sentence: governments have caused the monetary and economic debacle by taking control of money production.

Money and Credit

To explain this one-sentence conclusion — which may of course be surprising or even irritating to many — it must be noted that the defining characteristic of today's monetary systems is that state-controlled central banks hold the monopoly over the money supply. The US dollar, euro, Japanese yen, British pound, and the Swiss franc share the essential feature of being currencies produced by governments.

What is more, these monies are produced through circulation-credit expansion — credit that is not backed by real savings. One can even say that today's monies are produced out of thin air. These monies are often called fiat money: they are established by government decree, not legally convertible to any other thing, and created by political expediency.

Fiat money regimes create economic disequilibria, and do so inevitably. This is because the rise in circulation credit lowers market interest rates below their natural levels — that is, the levels that would have otherwise prevailed, had the credit supply not been artificially increased.

The downward-manipulated interest rate induces additional investment and, at the same time, provokes a rise in consumption out of current income, at the expense of savings. Monetary demand outstrips the economy's resource capacity. A rising money supply pushes up prices sooner or later, be it the prices for consumer goods or for assets.

What is more, the artificially suppressed interest rate shifts scarce resources increasingly into more time-consuming production processes for capital goods — at the expense of production processes for consumer goods, causing intertemporal distortions of the economy's production structure.

"Under privatized money production, the government and its central bank would be closed down and lose control over money production."

A circulation-credit-driven boom is economically unsustainable and must be followed by bust. If the injection of additional credit and money out of thin air was a one-off affair, it presumably wouldn't take long for the artificial boom to unwind. A recession would restore the economy back to equilibrium.

Unfortunately, however, the increase in credit and money out of thin air is not a one-off affair under today's monetary systems. As soon as recession approaches public opinion calls for countermeasures, and central bankers increase the credit-and-money supply even further, thereby bringing interest rates to even-lower levels. In other words, monetary policy fights the correction of the debacle by taking recourse to the very action that has caused the debacle in the first place.

Such a strategy may work occasionally. But as soon as credit expansion comes to a halt — that is, when commercial banks refrain from lending altogether — the inevitable adjustment will unfold. Borrowers will default, and firms will liquidate unsound investments and cut down jobs.

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The Promises Must Be Broken

By Steve Saville

Many governments, including those of the US, Japan, and most euro-zone countries, have made extremely costly promises to provide entitlements to their citizens and to repay their creditors. These promises must be broken, firstly because they cannot be kept and secondly because they should not be kept.

It should be blatantly obvious to anyone with a basic knowledge of finance that the promises cannot be kept. The government of Japan, for example, has amassed liabilities to bondholders amounting to two-times the country's annual gross domestic product (GDP), and on top of the debt that has already been issued there is an unknown (to us) -- but undoubtedly large -- quantity of "unfunded" (off-balance-sheet) liabilities associated with various entitlement programs such as social security.

Taking another example, within the next 12 months the liability to bondholders amassed by the US federal government will exceed one-times GDP, but when the so-called "unfunded" liabilities are added to the equation it can be seen that the total present value of all US government promises to pay is already more than 5-times GDP.

Considering other examples, the debt-related predicaments of the "PIIGS" governments are well known, but less well known is that the governments of both France and Germany have total (on- plus off-balance-sheet) liabilities exceeding 4-times GDP. So, what's the point of pretending that these liabilities will ever be covered?

There is not only no point pretending,

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The longer an artificial boom is kept going, the greater the malinvestments are that have to be corrected, and the higher will be output and employment losses.

Mises knew that pushing down interest rates to ever-lower levels would not solve the problem but would lead to an even-bigger disaster. He wrote,

There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.

Intervention and Reform
If one subscribes to the diagnosis provided by Austrian School of economics, two important observations must be made. First, more circulation credit and fiat money at lower interest rates will not, and cannot, prevent a disaster that has been caused by too much credit and money. Second — and this aspect may not attract peoples' attention right away — governments' ongoing attempts to fight the economic correction will destroy what little is left of the free market order.

In his book Interventionism, Mises explained that market interventions would not create a lasting system of economic organization. He wrote,

If governments do not give them up and return to the unhampered market economy, if they stubbornly persist in the attempt to compensate by further interventions for the shortcomings of earlier interventions, they will find

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(bonds etc) off the Greeks for starters. ECB loses huge credibility.

- Net effect of the political and financial failures is huge uncertainty for the Euro and the EU.
- This all leads to a Lehman like contagion, which is now in process. It's all out of control.
- EU and ECB are only reacting to this mess and are they not in control at all.
- Contagion is spreading to all financial markets, and appears unstoppable.
- Electronic trading and ETFs cause liquidity to dry up in minutes to zero (means crashes are not controllable whatsoever).
- EU countermeasures are too late and are panicky - (they have lost control of the Euro and debt situation). Derivatives (like ETFs) have made markets highly susceptible to huge flash crashes. Attempts to counteract this only makes things worse. Markets are now totally out of control as circuit breaker measures in one market are merely circumvented by others moving to alternative markets/exchanges where they can still trade.

This list goes on but you get the idea.

Overall, you can say that the US housing crisis spread to the US financial system first, The US blew up first, but now the others with the same problems (EU) are breaking down, and as the world tried to reflate financial markets and succeeded with public money, that is now over and the new outcome is the EU region is the next 'Lehman' style crisis, but it's a crisis of the biggest economic aggregate in the world the EU (Yes it's bigger than the US).

Since Germany just acted unilaterally to ban short sales in the Sovereign bond market and CDS, it indicates a lack of EU financial coordination. Germany never wanted to do this bailout, and is dragging its heels, making any attempts at countermeasures too late to increase confidence. (CDS by the way have been the ONLY real market with real pricing for the last several years, and the CDS markets always led to the final deterioration and final 'verdict' before the crises of the day spiraled out of control.

CDS are bets on debt defaults, their prices reflect the reality. Hitting the CDS market takes away any remaining market transparency. Now all markets are being hidden inside huge public purses).

What This Means For The Markets

Overall, this means that the EU is in serious trouble. It means the EU has shown they cannot contain this situation. It probably means the Euro is going down to parity with the USD at least. If the situation is not brought under control, the EU itself is threatened, and imagine what would happen to the Euro if Germany or anyone bolts the EMU (Euro monetary union). The Euro would collapse.

The USD benefits, the carry trades are unwinding (USD, Yen and others). Gold benefits because it's a major haven, even with the USD rallying hard and commodities tanking. Gold can still get dragged in if there is a huge world stock sell off, so be cautioned.

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"zombie banks." Collectively, these zombie banks have hundreds of billions in toxic assets sitting on their balance sheets. Bankers know there is an avalanche of Option ARM and Alt-A loans that will reset in the next three years, setting off another bout of foreclosures. Bankers know commercial real estate is crumbling. Bankers know credit card and auto loan debt defaults are soaring. They will not lend in this unforgiving environment. The worst lies ahead for the banks.

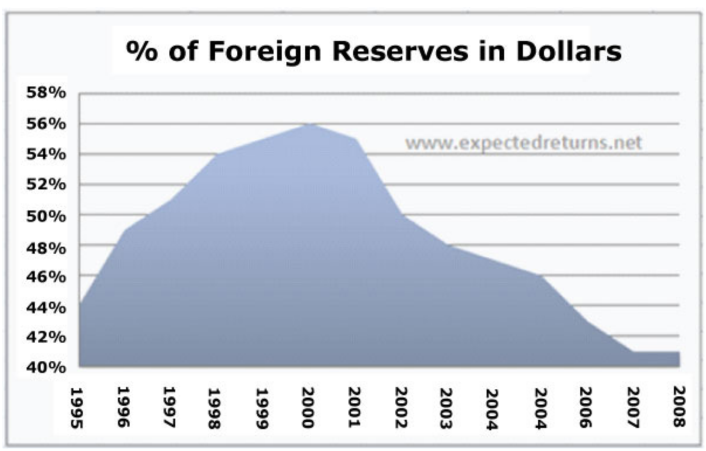
Based on truthful economic figures, the current downturn is unmistakably not a normal cyclical recession caused by an overheating economy. Based on an accurate assessment of economic statistics, it appears that we are in the early stages of a second Great Depression. And it could be much worse than the first.

The economy bottomed in 1932 and proceeded to accelerate at a tremendous rate over the next five years. There is absolutely no likelihood for a strong economic recovery today. The structural problems fashioned by ignorant politicians and the Federal Reserve over decades have gathered into a perfect storm that threatens the crumbling, fragile levees that are keeping this country from economic collapse.

The Federal Reserve policies since its inception in 1913 have resulted in a 95% decline in the purchasing power of the U.S. dollar. The last 5% will be more traumatic and violent than the first 95%. The dollar has declined by 17% versus a basket of other fiat currencies just in the last year. The Obama administration and Ben Bernanke have blessed the dollar decline. But by doing so, they are playing Russian roulette with the U.S. financial system.

The Federal Reserve has set short-term interest rates at 0%. Inflation has been running at a 4% annual rate over the last four months, so real interest rates are a negative 4%. This is certainly one major factor in the dramatic decline of the dollar. The foreign countries that hold U.S. Treasuries know they are getting screwed. On a short-term basis, they have no choice but to hold these Treasuries. But on a medium- and long-term basis, China, India, Japan, and the Middle Eastern countries are exiting their USD positions.

The percentage of foreign reserves held in dollars has declined from 56% in 2000 to 41% today. China is using its dollars to buy natural resources across the globe. India used its dollars to buy $200 billion of gold from the IMF two weeks ago. The implications of our foreign creditors not trusting our fiscal policies will have dire consequences.



Peter Bernholz, professor of economics at the University of Basel, Switzerland, in his most recent book, *Monetary Regimes and Inflation: History, Economic and Political Relationships*, analyzes the 12 largest episodes of hyperinflations – all of which were caused by financing huge public budget deficits through money creation.

His conclusion is that the tipping point for hyperinflation occurs when the government's deficits exceed 40% of its expenditures. The deficits being run by the Keynesians in Washington are now at that level, well beyond anything ever attempted in U.S. history. Our leaders have chosen to allow insolvent banks to keep toxic assets on their books at inflated prices, propped up bankrupt union-controlled automakers, instructed Fannie Mae, Freddie Mac, and GMAC to make loans that will never be repaid, and squandered $787 billion on payoffs to congressmen through pork projects that have stimulated nothing.

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US markets benefit as money flees into the US, but still US markets are continuing to drop - this is hugely bearish.

Three weeks ago, we told subscribers that the Dow peaked at 11,000. The Dow peaked at about 11200. It looks like that call is going to hold up.

With Asian and EU markets down, commodities tanking due to expected economic slowing, and US markets down and looking to continue falling, and China already in the early stages of popping their construction bubble (60% of China GDP is construction related) there are no bright spots out there. The US recovery will stall and is stalling now.

None of the above trends are a surprise because the world tried to remove public stimulus and QE (where the public treasuries buy all falling assets) at end of March 2010. We predicted back then that taking out QE would crash markets in two months well, here we are. Going back to QE with the ECB now is not working either. QE may be a dead resource at this stage. (IE we are not going to see another big world stock rebound with new QE).

The only remaining question here is when will markets really start a long grinding decline, with the EU and Euro right in the middle of the storm. This has probably already started.

Article by:
Christopher Laird
May 19, 2010
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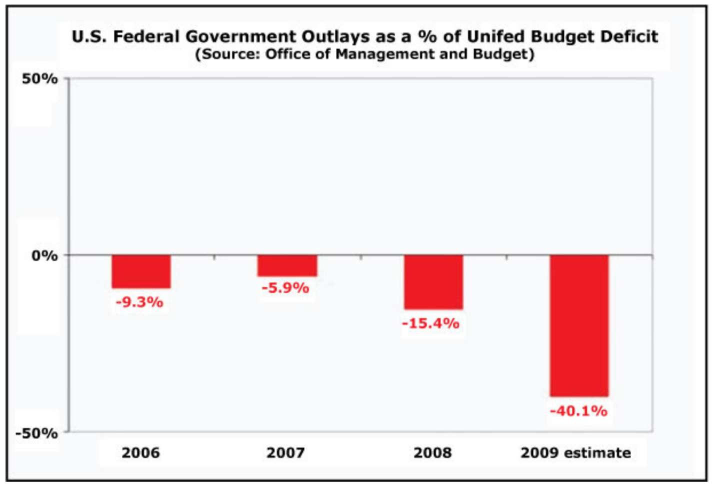
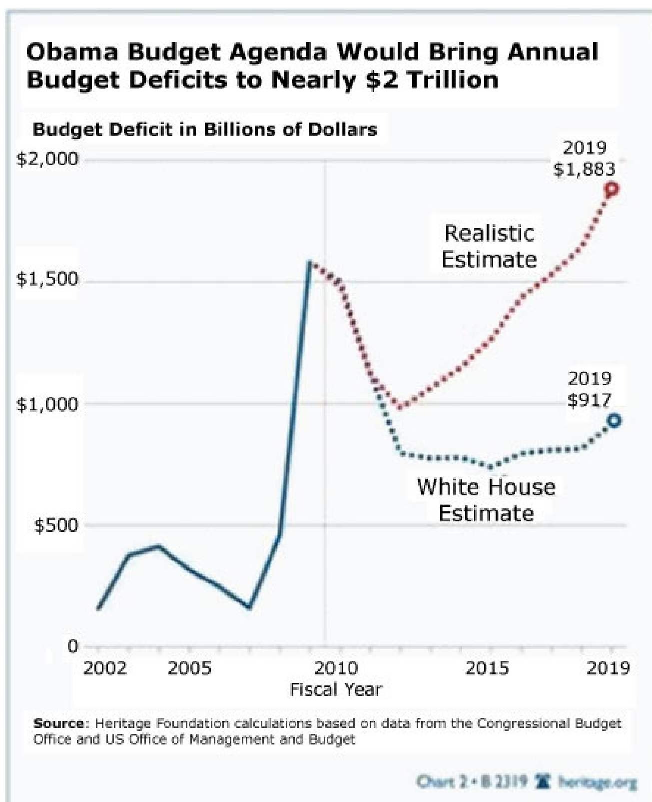


With unemployment of 10.2% and headed higher, the Federal Reserve has absolutely no intention of raising interest rates. President Obama and Timothy Geithner can do a hundred interviews declaring that reducing deficits is a huge priority, but their actions speak louder than their lying words. The national debt increased by $1.8 trillion in 2009, to $11.9 trillion. The OMB projects the 2010 deficit to reach $1.5 trillion. Even without a new colossal $2 trillion healthcare bureaucracy, deficits were expected to stay in the $1-trillion-per-year range for the next decade. The truth is that deficits will exceed $1 trillion annually and approach $2 trillion by 2019. The national debt would reach $25 trillion by 2019.



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it is dangerous to pretend. It is dangerous because attempting to keep alive the illusion of solvency necessitates theft on an increasing scale, either directly via more taxation or indirectly via more inflation. A case in point is the plan put together by Europe's political leadership with the aim of preventing the Greek government from immediately defaulting on its debt.

This plan involves higher taxes in Greece, the transferring of Greek government obligations from private bondholders to other governments, and debt monetisation (inflation) by the ECB, but leaves the overall debt burden the same. It therefore wastes resources, confiscates savings and reduces economic growth for the sole purpose of delaying the 'day of reckoning'.

Another case in point is the claim made by a famous economist (Joseph Stiglitz) to the effect that the large and rapidly-growing debt burden of the US federal government won't lead to a default thanks to the government's ability to print whatever amount of money it needs. It is true that the US government could turn to the printing press (with the help of the Fed), but it is vital to understand that an attempt by the US government to use monetary inflation to cover the bulk of its liabilities would, in effect, be an attempt to surreptitiously transfer tens of trillions of dollars of wealth from the most productive parts of the economy to bondholders and the recipients of entitlements. This type and scale of wealth transfer would destroy the dollar and devastate the economy, all for the sake of maintaining an illusion.

It is argued that the direct default by a government would eliminate that government's future access to the debt market, which is true. But that would be a huge positive rather than a negative. The world would be a better place if governments were not able to access the debt market. For one, there would be much less chance of war.

It is also argued that government promises must somehow be 'made good' because many people have come to depend on these promises. In particular, many people have paid taxes and social security contributions throughout their working lives on the understanding that the government would provide them with certain payments and other benefits after they retired. The problem with this argument is twofold.

- First and as explained above, it is not possible to make good on the promises. The promises will eventually have to be broken, the only question relates to how much more damage will be done in the period between now and when default is confirmed.
- Second, a wrong cannot be made right by committing another wrong. To be more specific, while it is certainly wrong that promises were made that could never be kept, this wrong cannot be corrected by stealing more money from savers and current taxpayers.

Some governments now appear to be coming around to the realization that their debt situations are untenable, and are introducing "austerity measures" in response. However, while such measures could prevent the debt problem from worsening in the short-term they don't address the main issue, which is that current debt levels are already so high that default or major restructuring is both essential and inevitable.

The bottom line is that the promises made by governments will have to be broken and should be broken, the sooner the better.

Article by:
Steve Saville
June 15, 2010
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2010 Bank Failure List

The list of Bank Failures in Brief is updated through June 25, 2010. Please address questions on this subject to the Customer Service Hotline (Telephone: 1-888-206-4662).

June

High Desert State Bank, Albuquerque, NM with approximately $80.3 million in assets and approximately $81.0 million in deposits was closed. First American Bank, Artesia, NM, GA has agreed to assume all deposits

First National Bank, Savannah, GA with approximately $252.5 million in assets and approximately $231.9 million in deposits was closed. The Savannah Bank, National Association, Savannah, GA has agreed to assume all deposits, excluding certain brokered deposits

Peninsula Bank, Englewood, FL with approximately $644.3 million in assets and approximately $580.1 million in deposits was closed. Premier American Bank, Miami, FL has agreed to assume all deposits excluding certain brokered deposits.

Nevada Security Bank, Reno, Nevada (also known as Silverado Bank, Roseville, CA), with approximately $480.3 million in assets and approximately $479.8 million in deposits was closed. Umpqua Bank, Roseburg, OR has agreed to assume all deposits, excluding certain brokered deposits.

Washington First International Bank, Seattle, WA with approximately $520.9 million in assets and approximately $441.4 million in deposits was closed. East West Bank, Pasadena, CA has agreed to assume all deposits.

Please visit the following website for complete 2010 list.

http://www.fdic.gov/bank/historical/bank/index.html

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An unsustainable trend will not be sustained. The national debt will not reach $25 trillion in 2019. Unless the current policies of the Federal Reserve and Obama administration are reversed, the U.S. economic system will collapse well before that.

In a recent report, Société Générale, one of France's biggest banks, noted the possibility for collapse:

"As yet, nobody can say with any certainty whether we have in fact escaped the prospect of a global economic collapse. The underlying debt burden is greater than it was after the Second World War, when nominal levels looked similar. Aging populations will make it harder to erode debt through growth. High public debt looks entirely unsustainable in the long run. We have almost reached a point of no return for government debt. "

Article by:
James Quinn
March 4, 2010
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The Outstanding Public Debt

National Debt:
13,049,800,081,787.13
The estimated population of the United States is **308,638,474**
US citizen's share of this debt is
$42,281.83
The National Debt has continued to increase an average of
$4.03 billion per day
Business, Government and Financial Debt exceeds
$45 Trillion

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eventually that they have adopted socialism.

Interventionism in the field of monetary affairs — most notably by governments controlling money production — has caused damage on the grandest scale.

There are a number of economists who have identified the serious economic and ethical problems caused by fiat money. Among them are, most notably, Ludwig von Mises, F.A. Hayek, and Murray Rothbard. They basically recommend privatizing money production, which would pave the way to sound money — money that is compatible with the principles of a free-market society, money that does not cause boom-and-bust cycles.

Under privatized money production, people would freely decide on the kind of money they wanted to use. Such a money would presumably be anchored by gold, but it could possibly be anchored by other media (for example, silver or platinum). The government and its central bank would be closed down and lose control over money production. From then on, the interest rate would be determined by free-market forces rather than government action.

Conclusion
The global monetary fiasco is a reminder that it is high time to seek monetary reform along the lines of that which is recommended by the Austrian School of economics. It is the only way to protect and maintain peoples' freedom and economic well-being.

Murray Rothbard wrote that "Mises, almost single-handedly, has offered us the correct paradigm for economic theory, for social science, and for the economy itself, and it is high time that this paradigm be embraced, in all of its parts." This holds true especially for Mises's monetary theory.

So if one wishes to hold a positive view on the progress of civilization, it necessarily implies that the future monetary system will be a free-market-money system, as envisioned by the Austrian School of economics — and that the era of fiat money must come to an end.

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Article by:
Thorsten Polleit
June 25, 2010
http://mises.org/articles.aspx?AuthorId=793