The Great Deflation

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More than $US 32 TRILLION has been erased so far from the value of global equity markets. That is twice the size of the entire annual US GDP. That is the carnage in only one area. There are two other global deflations, the one in real estate and the worldwide crash in commodity prices. Add those to stock market losses and the damage exceeds $US 50 TRILLION.

Woe to the Lenders Of The World:

The global credit money system, each nation having its own component, is taking massive losses as balance sheets are torn apart. Credit losses and bad loan write-downs are now past $US 910 Billion with much more to come, diminishing capital to a matching degree. This is for certain the worst worldwide financial crisis since the Great Depression. Desperate attempts are now being made to keep the lenders standing upright by means of shoveling taxpayers' money, borrowed by national Treasuries, into banks and other lenders as new "capital". Parallel attempts are being made by central banks to hand their banks and other lenders new "money" so that they can redistribute it as new loans in a futile attempt to reignite a credit expansion. All of these attempts are puny, minuscule - against the overpowering global fact that the global financial system has already suffered a deflation of more than $US 50 TRILLION.

The Central Global Economic Fact:

In any market system which uses money as a medium of exchange, it is not the level of money prices which matter, but whether these prices clear the market. In a deflation, money holders value their money at a higher level than prices on offer so they don't buy. All prices, then, must fall.

The Case of The Fed's "Missing" $US 2 TRILLION:

We live in astonishing financial times. In its latest reports, the US Fed has let it be known that total Fed lending has climbed above $US 2 TRILLION for the first time. That is a rise of 140 percent - or $US 1.172 TRILLION - in SEVEN WEEKS! The total includes a $US 788 Billion increase in loans to banks through the Fed and another $US 474 Billion in other lending, mostly through the central bank's purchase of Fannie and Freddie bonds. Here comes the problem. The Fed has refused to identify the recipients of almost $US 2 TRILLION of emergency loans and what the Fed has accepted as collateral!

Bloomberg has sued the Fed under the US Freedom of Information Act, trying to get this information, but the issue is stuck in Federal Court. Somebody out there got this $US 2 TRILLION from the Fed but they are not talking. The Fed, in turn, got some financial paper as collateral, but it won't say what it is.

The Global Steel Depression Indicator:

ArcelorMittal, the world's biggest steelmaker, said last week that it will reduce production by as much as 35 percent in the US and 30 percent in Europe after global steel prices tumbled. China is now expected to produce about 500 million tons of steel this year according to recent statements by the China Iron and Steel Association. Chinese hot-rolled steel coil prices are down nearly 30 percent from a month ago to around $US 595 a ton. Rio Tinto Group, the world's second largest iron ore exporter, will cut output at its mines in Western Australia by 10 percent because of reduced demand from the steelmakers in China, following the lead of bigger rival Cia Vale do Rio Doce. The Fortescue Metals Group Ltd, Australia's third largest iron ore exporter, said on November 10 that it is bringing forward a planned shutdown of its port and mine processing plant, reducing production this year by about 10 percent. Shipyards have seen their orders for new ships cut by 90 percent over the last three months and will now start to idle.

Then - And Now:

Historically, the concrete data given above is in fact worse that what happened in 1931-32 after the world was hammered into the Great Depression by nations raising their tariff barriers. Back then; ocean shipping also came to a near standstill and steel mills and shipyards stood idle. This time, it is not tariff walls which are the cause. This time the cause is the great deflation. Tariffs are political, and can be altered by making a different political decision. Deflations are both monetary and financial.

A deflation is the contraction in the total stock of money and volume of credit in circulation. It is a strictly monetary event and abides by the laws of economics, not laws passed by any legislators.

Deflations are also financial in the sense that a contracting total volume of money and credit in use leaves more and more lenders with bad loans on their books. The total debts have not declined in volume, while the means of payment with which to service these debts has in fact declined in volume. It is these bad loans on the books of the lenders which cause a deflation to move into its second stage, the stage where it is the lenders who are going broke because of accumulated losses.

As stated in our previous issue, this is where the world is - NOW! The great deflation has hit the ground economically in a real and direct way. This can be seen from the data on steel and iron ore already given. When the largest steel maker in the world announces cuts in production of 35 percent in the US and 30 percent in Europe, it does so for a reason. The reason is that it expects total output in the US and Europe to contract by 35 and 30 percent by around June-

July 2009. Any fall in total output of 30-35 percent is great DEPRESSION economic territory. What it shows is that by June-July 2009, about one third of US and European goods producing factories will be standing still.

Deficit Territory:

Governments across the world are now diving into deficit spending, chosen as a means with which to "stimulate" their national economies. The US is leading the global parade. Only two weeks ago, the deficit estimates for next year were between $US 1.5 TRILLION to an average of $US 2.1 TRILLION.

But in an interview last weekend, President-elect Obama said that the government should not worry about deficits over the next two years while spending money to jumpstart the ailing economy.

This is economic primitivism of the first order. It presupposes that the basic problem is that there is not enough money in circulation, so the government will borrow that money and spend it all into circulation. Presto, the economic problem is solved. The REAL problem is the mountain of debts piled on top of American households and businesses and the stark lack of savings. The solution is to cut taxes as well as spending but to cut spending faster than taxes to leave more real economic and financial resources in private and individual hands so that they can repair their balance sheets. On top of that, interest rates must be raised - not lowered - to reward savers for producing more than they now consume.

The Deflation Bites Harder in the US:

The second stage deflation is now showing up in prices. US producer prices fell by a record 2.8 percent in October. Note that is the price fall for that single month! It is a truism that in any credit money system which slides into a deflation as earlier loans are paid off or defaulted upon, the total amount of credit money in circulation also contracts in quantity. As a consequence, many prices hang above their market clearing levels for a while and then they break downwards, seeking the prices which will allow the goods to move. Prices for intermediate goods fell 3.9 percent in October. Prices for crude goods sank 18.6 percent. Crude food prices dropped by 11.1 percent. These lower prices in the production chain have now reached the final consumer. On November 19, the US CPI was released. It was DOWN by 1.0 percent, its biggest monthly fall in 61 years! The "core inflation" measure had its first fall for 25 years.

This is inherent in credit money deflations as consumers dedicate a larger part of their earnings to pay down debts, in the process causing the credit money system to deflate. Obviously, the sums used to pay off loans cannot be used to make purchases. After having fallen for the fourth straight month, the Commerce Department reported on November 15 that retail sales plunged by a record 2.8 percent in October as sales of autos and even gasoline plummeted. Total US consumer spending in the third quarter plunged by 3.1 percent, the biggest decline in 28 years. This is also typical deflation territory.

Pushing the Other Way:

This comes courtesy of a CNN report which informed Americans about what the sum of all the numerous US bailout packages amounted to so far. The sum so far, according to CNN, is $US 4.28 TRILLION. That is more than what was spent on WW II when adjusted for past price inflation.

Any Wage or Salary is Simply Another Price:

Back in the 1930s, one of the things which did most to prolong the devastatingly high unemployment of the time were the persistent political and union attempts to keep wages high. Economically, this is the same as holding wages above their market clearing levels, in the process forcing millions of people onto the breadlines and into the soup kitchens. This is now happening again across the US. Companies have slashed 1.4 million jobs in the last six months, the biggest cuts since 1975. Earlier this year, job losses were concentrated on the goods producing side of the economy. The latest data shows the pain spreading into the services sector. Services cut 108,000 jobs last month on top of the 201,000 lost in September.

The situation for US job seekers is even worse when discouraged workers (not counted in the statistics) are factored in. That takes REAL unemployment to 11.8 percent, up from 11 percent in September.

US manufacturing lost 90,000 jobs in October. The sector has lost 180,000 jobs over the last three months and 490,000 jobs over the last year. This shows the tragic state of what was once the world's greatest industrial machine park. The US has been de-industrializing itself for several decades and one of the larger things contributing to this has been that industrial wages have been kept too high for too long. The result has been a drastic shrinking in investment in new capital plant, leaving current plant and equipment dated and obsolete. First Europe and then Japan, rebuilt their capital plant. More recently, China joined the global parade with modern equipment and up to date factories.

Scaling To True GLOBAL Economic Size:

According to IMF figures, the EU has overtaken the US globally and leads economically with a 2007 GDP of $US 16.8 TRILLION vs. $US 13.8 TRILLION for the US. Add in Japan, China. and India and it is clear that the US is merely one large economy amongst several others. The US global trade deficit in goods remained at a staggering $US 71 Billion for September. A good case can be made that the rest of the world is holding the US economy up with an inflow of goods of close to $US 850 Billion a year while at the same time funding the US current account deficit which also comes close to $US 850 Billion a year.

The Steepening Descent In US Industry:

Manufacturing in the US contracted in October at the fastest pace in 26 years as shown by the Institute for Supply Management's factory index which fell to 38.9 from 43.5 in September. Any reading below the 50 line shows a contraction. The US purchasing managers' measure of new orders for factories decreased to 32.2 - the lowest level since 1980(!) from 38.8 the prior month. The production measure fell to 34.1 from 40.8 in September. This data shows US industry in fast contraction. Plant shutdowns loom ahead.

The States of the Union:

Thirty US states were mired in recession in September. Nineteen others are at risk of falling into recession in coming months, a survey by ratings agency Moody's said on Tuesday, November 4.

Led by California with a $US 28 Billion hole in its budget, 41 states are in financial trouble. Many of their leaders are looking to Congress to bail them out. But Congress too is broke, borrowing to stay alive.

Washington DC:

The US federal government began fiscal 2009 with a record deficit of $US 237.2 Billion in October, the US Treasury Department said on Thursday, November 13. The deficit for the first month in the new budget year was the highest monthly imbalance on record. The $US 237.2 Billion budget deficit for October included total government spending of $US 402 Billion, a record in terms of outlays. US government receipts in October totaled $US 164.8 Billion, down 7.5 percent from October 2007, a consequence of the fall on revenues from the slumping economy. Spending outlays of $US 402 Billion with tax and other revenue of $US 164.8 Billion gives a deficit $US 237.2 Billion! In October, the US government spent 144 percent more than its total tax intake!

As profits and incomes shrink and as unemployment rises, this imbalance is going to get even worse.

The Spectre of US Debt Default:

Any way one looks at it, the fiscal situation of the US federal government is absurd. Nonetheless, this is the REAL situation they face. In fact, it is now so real that there is a climbing danger to the international credit standing of the US. The spectre of US debt default raises its scaly head here. Based upon historic instances when the governments of other nations got themselves into a similar situation, the US Treasury should already have defaulted upon its present debts. That has not happened - yet - but from now on, it must be seen as a clear and present danger. The one thing that can be counted on is that when the US Treasury defaults on its debts, it will surprise everybody.

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