GordonTLong.com

WORRIED BANKERS – *They Are Seeing Things We Only Presently Suspect*

MACRO INSIGHTS

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WORRIED BANKERS

A 70% CONSUMPTION ECONOMY

Besides the central economic problem of consuming more than it produces and operating an unsound money system, the US has the additional problem of being a 70% consumption economy.

The 71% shown here (below) in 2009 is a staggering level compared to a mid 50% level for other indebted developed economies and only 35% for China.

For decades economist pondered just when the US consumer would be tapped out? It was a futile game as the US consumer couldn't be stopped. Absolutely nothing seemed to slow US consumption for decades. It powered global supply expansion to meet this insatiable demand. China was the most obvious over the last 15 years.

United States & China
GDP Breakdown 2009

	United States	China
Personal Consumption Expenditure	71%	35%
Gross Fixed Capital Formation	16%	45%
Net Exports	-3%	4%
Government Spending	Now 20-24% 17%	13%

Maintaining Consumption is Causing Strain

But maintaining GDP growth with a 70% consumption rate has put great strain on investment capital because of a lack of savings, trade and current account balances. As you can see here the current 68.4% is down from the 2009 graph above.

Government spending has had to increase to compensate and keep the economy barely growing with a current 2015 Q1 GDP marginally above zero.

GDP = private consumption + gross private investment + government spending + (exports - imports)

or, as it is commonly expressed in algebraic shorthand :

GDP = C + I + G + (X-M)

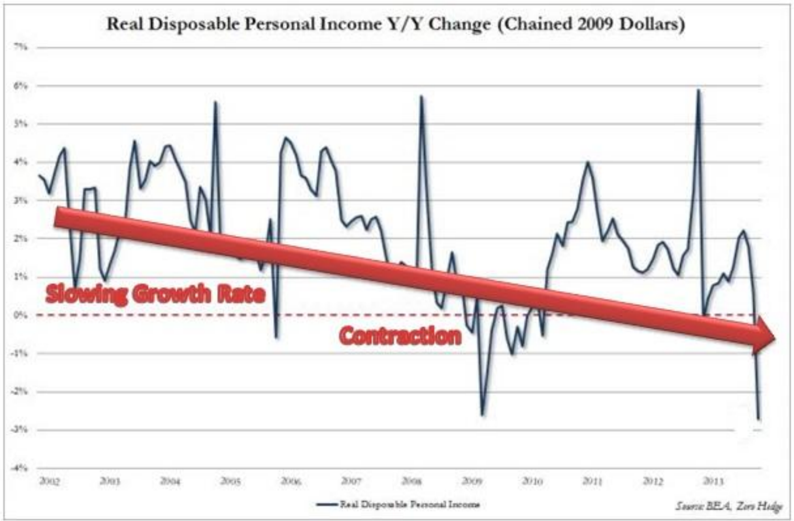
In the new report the values for that equation (total dollars, percentage of the total GDP, and contribution to the final percentage growth number) are as follows :

GDP Components Table

	Total GDP	=	C	+	I	+	G	+	(X-M)
Annual $ (trillions)	$17.7	=	$12.1	+	$3.0	+	$3.2	+	$-0.6
% of GDP	100.0%	=	68.4%	+	16.7%	+	18.0%	+	-3.1%
Contribution to GDP Growth %	2.18%	=	2.83%	+	0.83%	+	-0.32%	+	-1.16%

A Secular Trend in Real Disposable Income

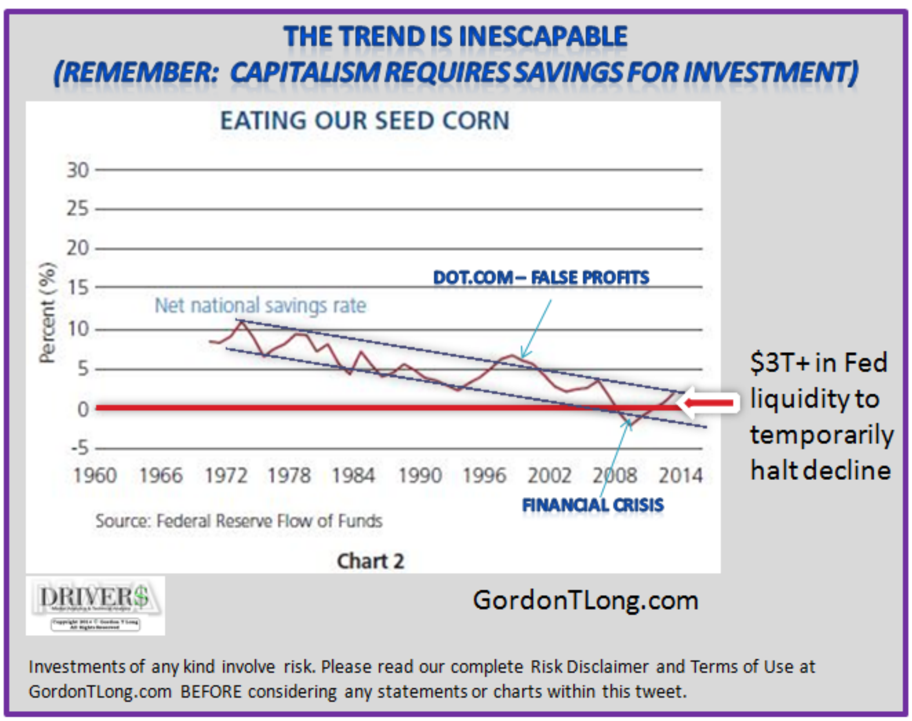
70% consumption is especially difficult to maintain when we have secular trends like a collapsing middle class, well paying jobs disappearing and shrinking real disposable income. This is a long term secular trend which appears to be accelerating.



A Secular Trend in Savings - No Savings is Impairing Consumption

Another long term secular trend is a falling national savings rate which borders on going negative again.

Savings are the life blood of capitalism is savings which is required for investment into productive assets. Credit can only go so far since it comes with debt service payments and collateral requirements.



Additionally, we have 75M Baby Boomers retiring on a population of approximately 320M, who will spend less in their retirement years and begin drawing down their savings.

KEEP IT GOING AS LONG AS POSSIBLE

Consumer Confidence & the Nightly DOW Sound Byte

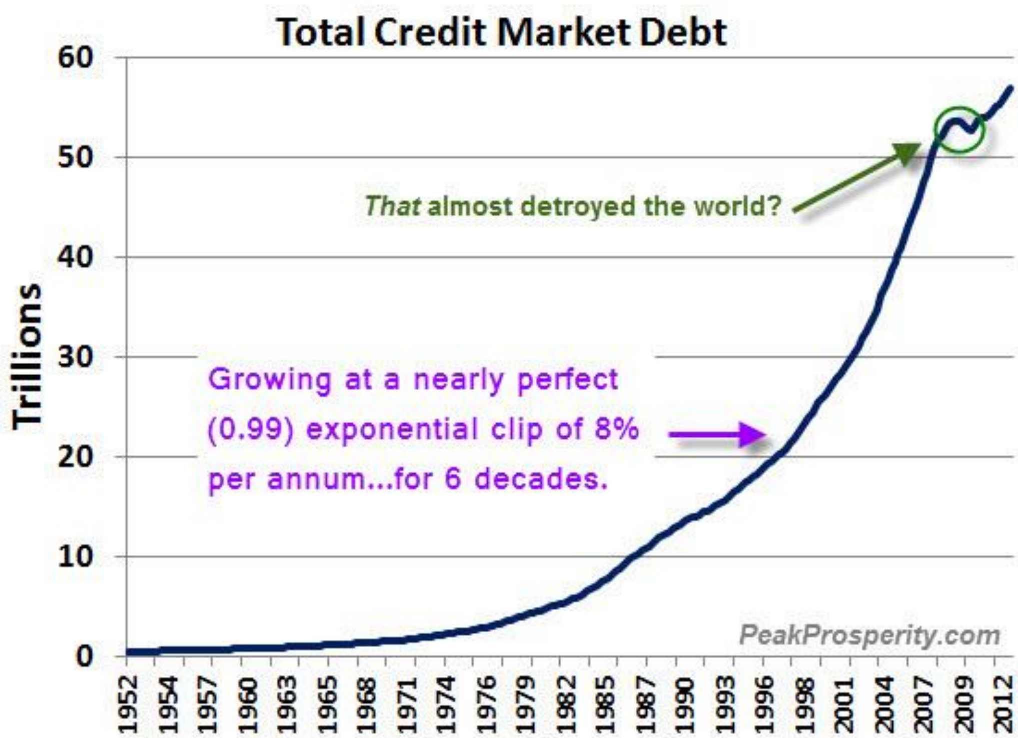
No matter what you may conclude it is imperative that the US consumer not lose confidence and start to worry, thereby possibly reducing consumption and increasing savings.

As a consequence the government and its paid statisticians are incented to do everything in their power to make an ailing economy look healthy. We discussed some of those means last month.

Almost Stalled but Slower Rate after $$$Trillions

Increased credit is no longer increasing demand at a sufficient rate to stop producers from cutting production and new orders for raw materials. How much credit can be created before all that new credit simply becomes ineffective?

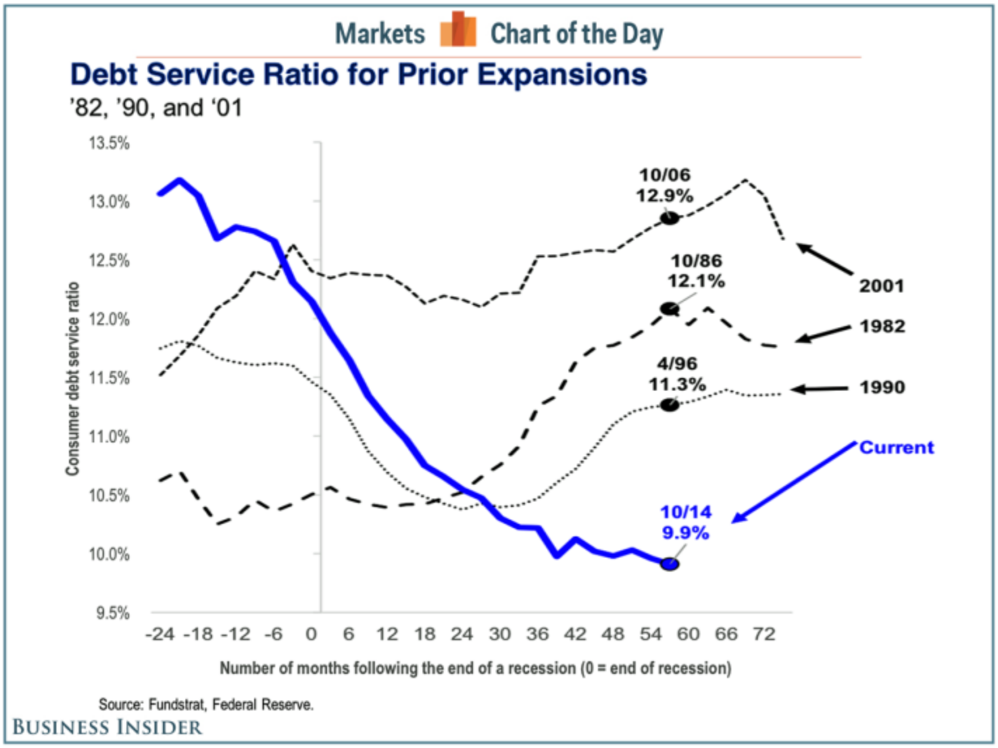
The exponential credit growth curve shown below has a limit or we begin to mutate into something other than capitalism as we know it!



Had to Keep Rate Lower for Longer But Still Not Working

I find the chart below very telling because it shows that interest rates have had to be kept low to sustain even the deteriorating consumption rates we are currently experiencing.

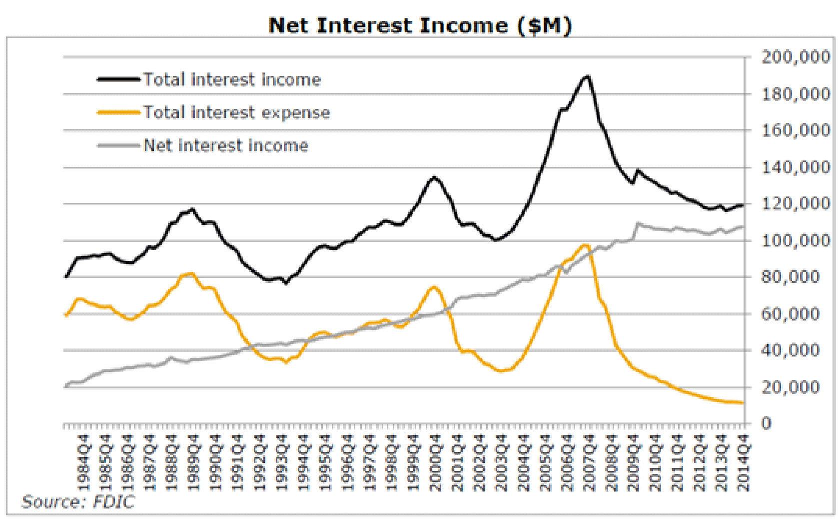
If rates were even closer to previous recoveries do you think car sales would be anywhere near the level they are today?



Central Bankers and the Money Center Banks know they have no choice but to sustain low rates to both keep consumption alive and make the debt serviceable. Lower consumption also means lower sales taxes and lower corporate profits.

It would appear almost everything in America revolves around consumer consumption.

With over 50,000 manufacturing enterprises having left America since the dotcom bubble burst we need to appreciate that corporate consumption of all those materials to run those factories has also fallen.



Flatten But Don't Lose!

Don't for a moment feel sorry for the banks that must manage on smaller interest charges. They have carefully "managed" Washington and the Federal Reserve with their army of lobbyists.

The chart to the right shows that despite falling rates the bank's net Interest Income has steadily risen and with ZIRP has been flat to marginally higher.

The banks are not feeling the pain that pensioners and savers are feeling, who are being decimated as they try and live on minimal income from their life-time of savings.

There really is no excuse for public policy like this and it tells us Washington sold out to the banks as they threw the "great generation" and baby boomers "under-the-bus" to save bank profits.

I encourage you to really think about these last two charts.

Too Much Going to Pay Debt and Insufficient into "Real" Investment

We now live in an economy of financial engineering. Wall Street is disconnected from Main Street.

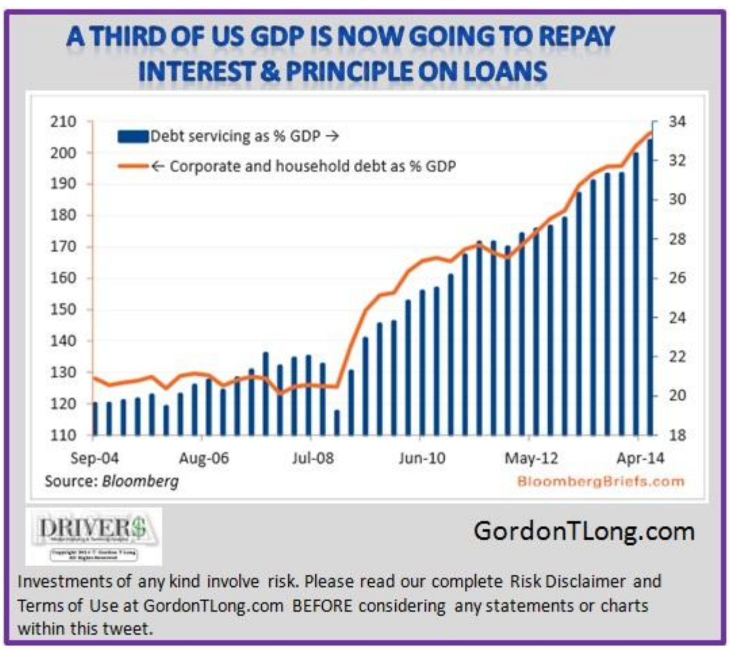
Remember:

Financial Engineering fixes the Bottom Line, often at the expense of the top line!

We are presently experiencing shrinking top line sales growth in the S&P 500 with 90% of last quarter's profits being used for Buybacks and Dividends. Minimal profits wre actually used for reinvestment.

This is the equivalent of a farmer eating his seed corn!

We now continuously deplete excessive amounts of the nations precious capital on existing interest and principle on loans.



Richard Duncan's Debt Liquidation

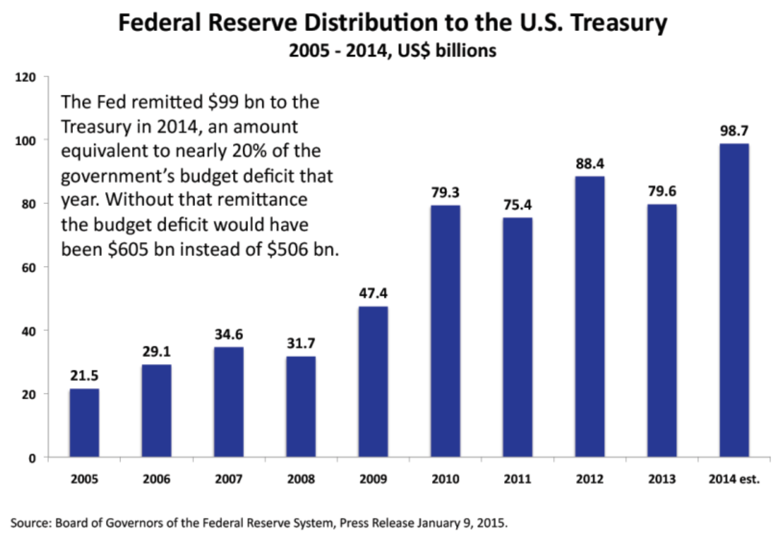
My colleague Richard Duncan writes:

> *What is going on here is the government and banks are trying to buy time until a miracle happens or the current elected officials are no longer in power and can claim it "didn't happen on their watch"!*

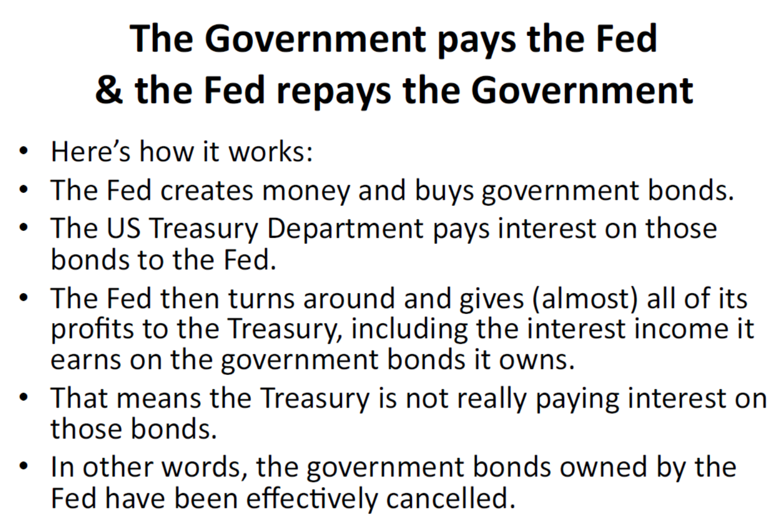
There is actually a lot more going on than just that as I have laid out in the Financial Repression series where indebted countries as a Macro Prudential Policy are debasing the store of value of their currency in circulation and thereby reducing over time the effective size of the government indebtedness.

There may also be another game going on that my associate Richard Duncan at Macro Watch has carefully laid out.

When the Fed makes a profit it gives it to the government. The Fed has given the US Government $500 Billion since 2008.



Here's what may be going on:



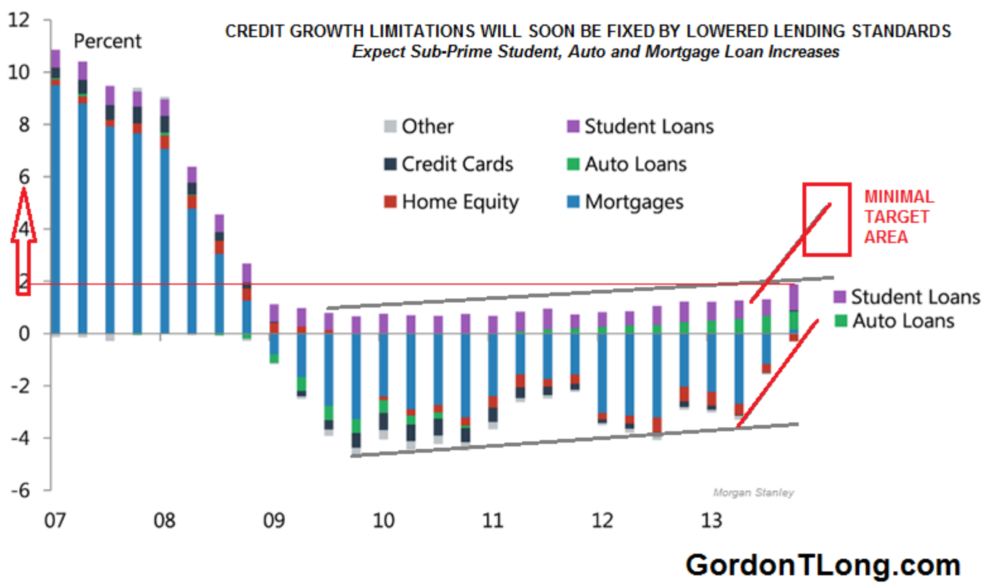
Has long as the bonds stay on the Fed's books this shell game of accounting could go on indefinitely effectively creating debt liquidation. It comes with some major downsides which I won't get into here but suffice it to say the government wins if it can buy more time and keep things relatively stable in the interim.

A GAME OF STUDENT LOANS AND CAR LOANS

The Only Choices Available

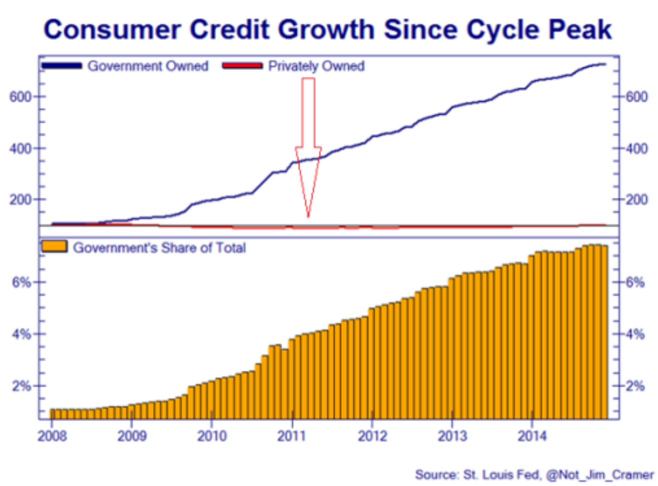
To keep the 'gig' going since the 2008 crisis the bankers have had to come up with new sources of credit creation due to the implosion of securitization of MBS' and ABS'. Don't get me wrong, they are both still alive but nowhere near where they were prior to 2008.

I drew this diagram in 2013 based on how I expected credit growth would be created by the government going forward. We are now more or less in the red box (below) with growth coming from Car and Student loans. Exactly as expected.



Private Credit not playing along

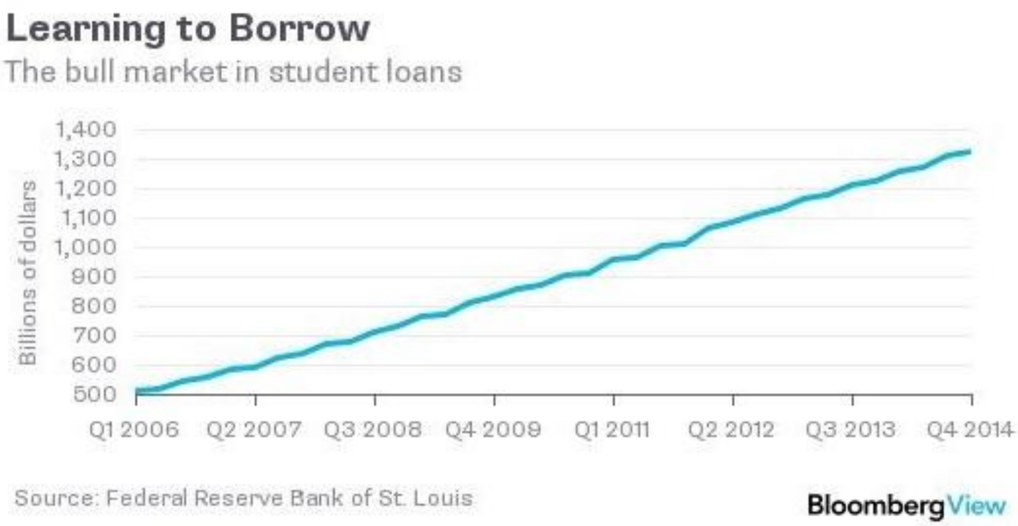
What is very telling is the vast majority of all that growth was backstopped by the government through Sallie Mae or Government Motors (the former GMAC taken over by the government and until December still a major shareholder).

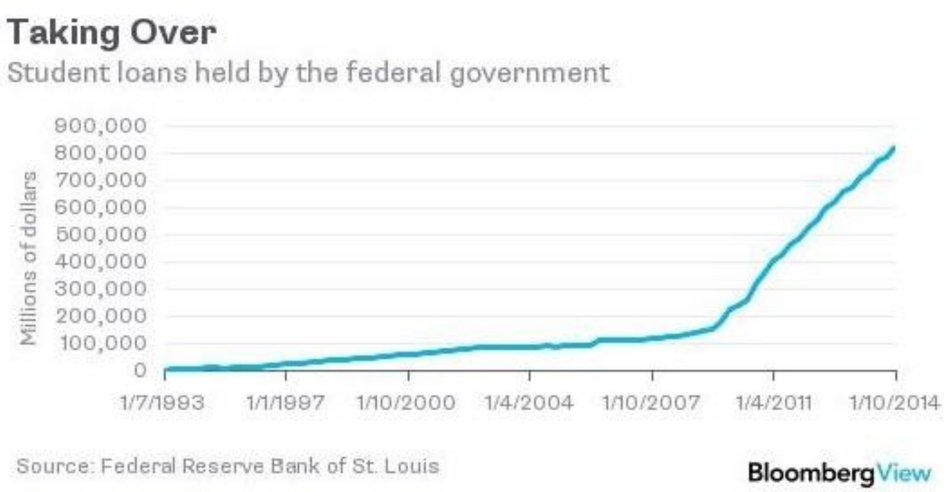


Pumping As Hard as They Can

We are all well aware of the dramatic increase in student loans, but we somehow separate it from the 2008 crisis.

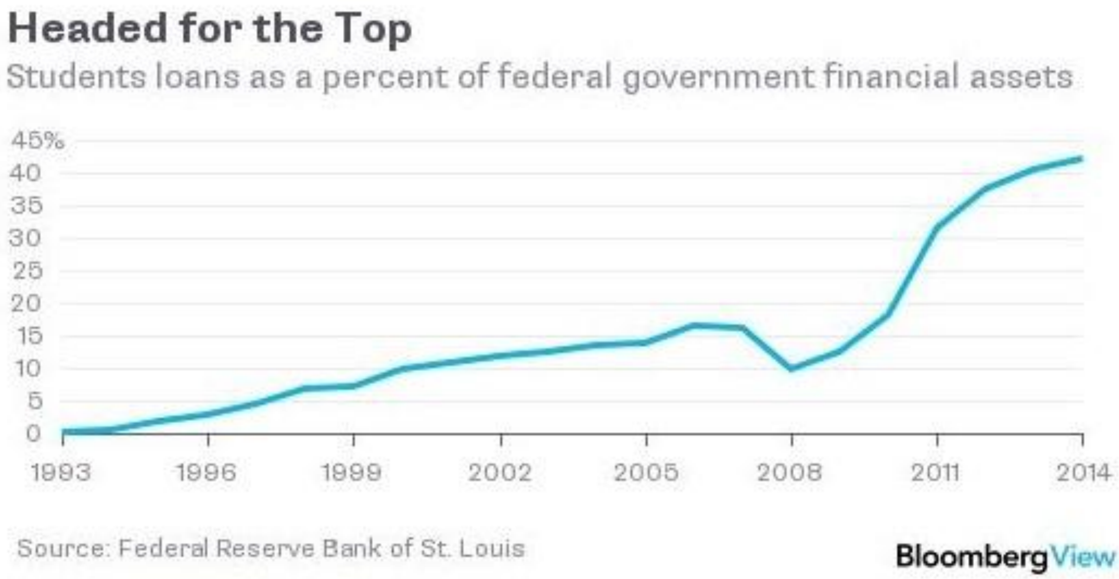
Look at the following chart to see when the government starting backstopping these loans and not the private sector. Like mortgages they have been "passed off" to the government to "hold the bag".





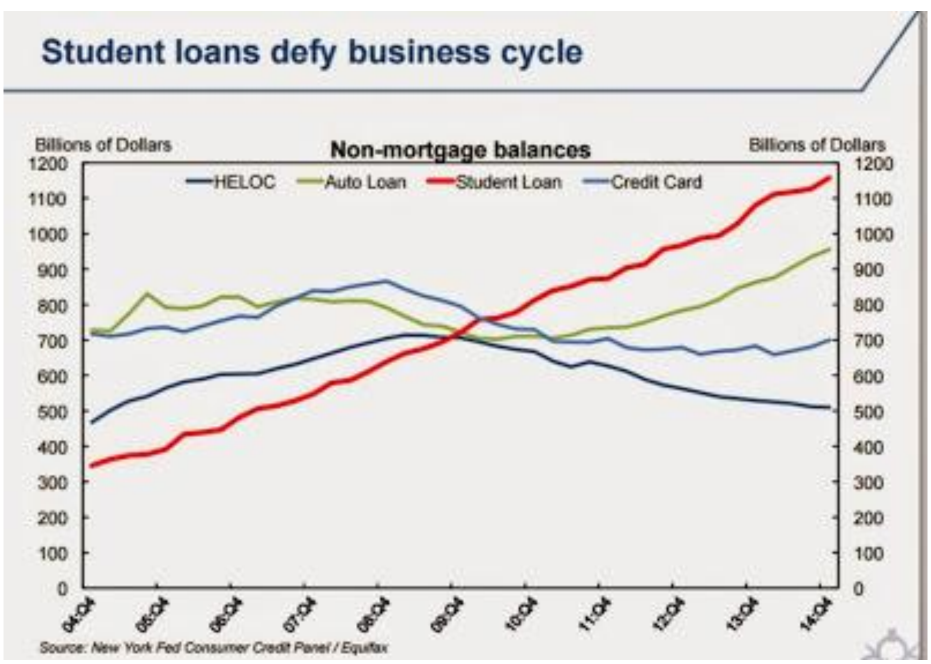
There are already cracks appearing in student loan delinquencies despite about $500B of the $1.3 Trillion now being reclassified as in "deferment or forbearance." versus delinquent or in default.

These are just more accounting games to avoid the reality that a significant proportion of these loans are never going to be repaid.



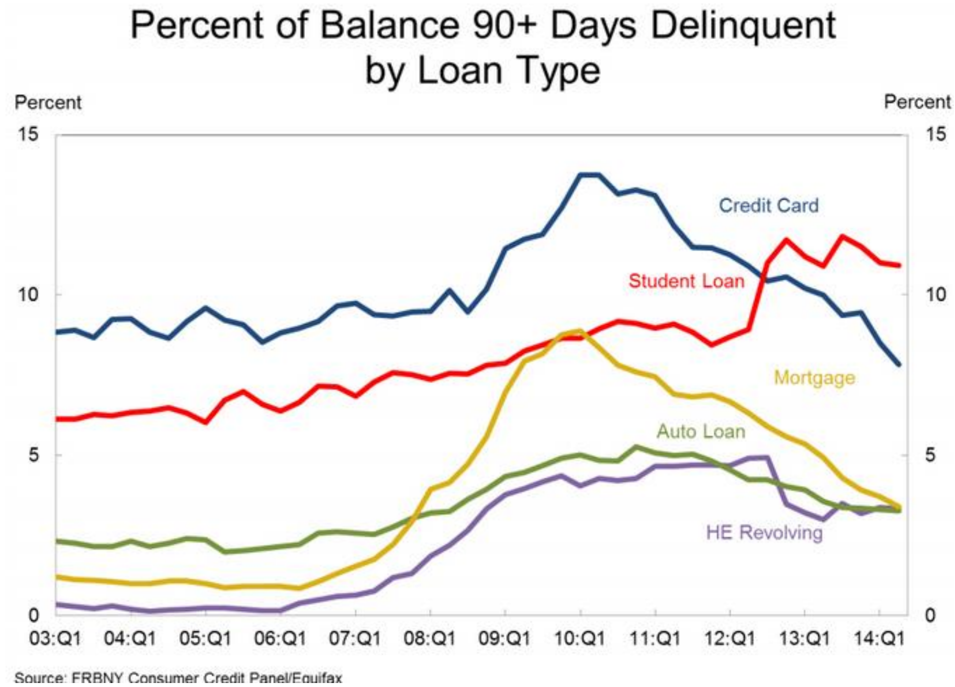
Student Loans Defy Business Cycle

In my opinion the business cycle has topped and has began to turn. It is only a matter of time before both car loans and student loans will hit a wall, because like mortgages in 2008, non-performing loans will accelerate.



Troubles Mounting In Paradise

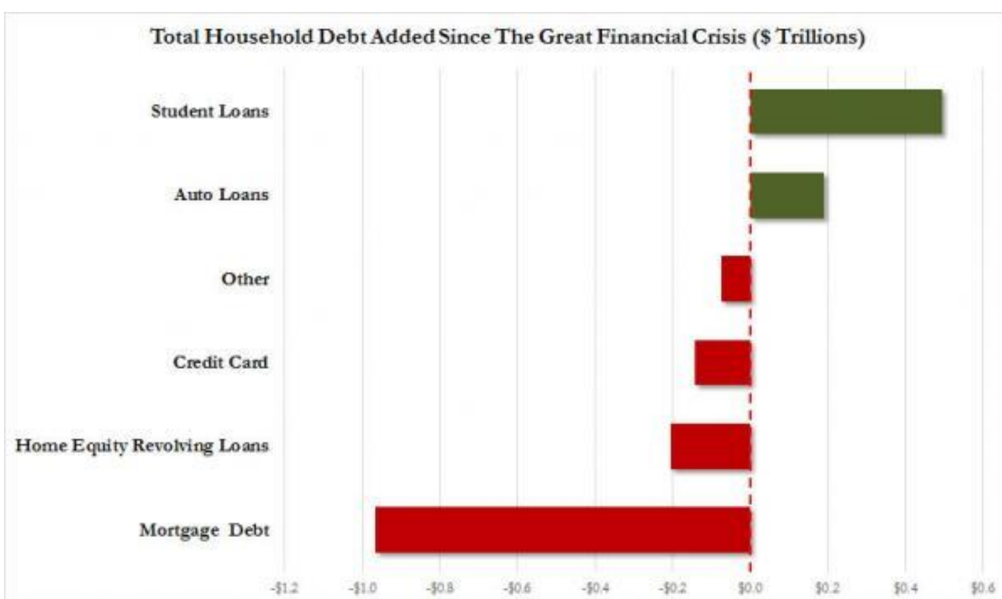
This may already be underway and **the banks would be well aware and worried**!



But Something Isn’t Working?

Everything other than student loans and car loans is already in contraction or has simply never recovered.

Thank god for tax payers once again accepting the liabilities.



Former UK PM Margaret Thatcher was famously quoted as saying "Socialism is about spending other people's money until they go broke". In many ways democracy is similar in that we feel that taxpayer indebtedness is not going to be our problem.

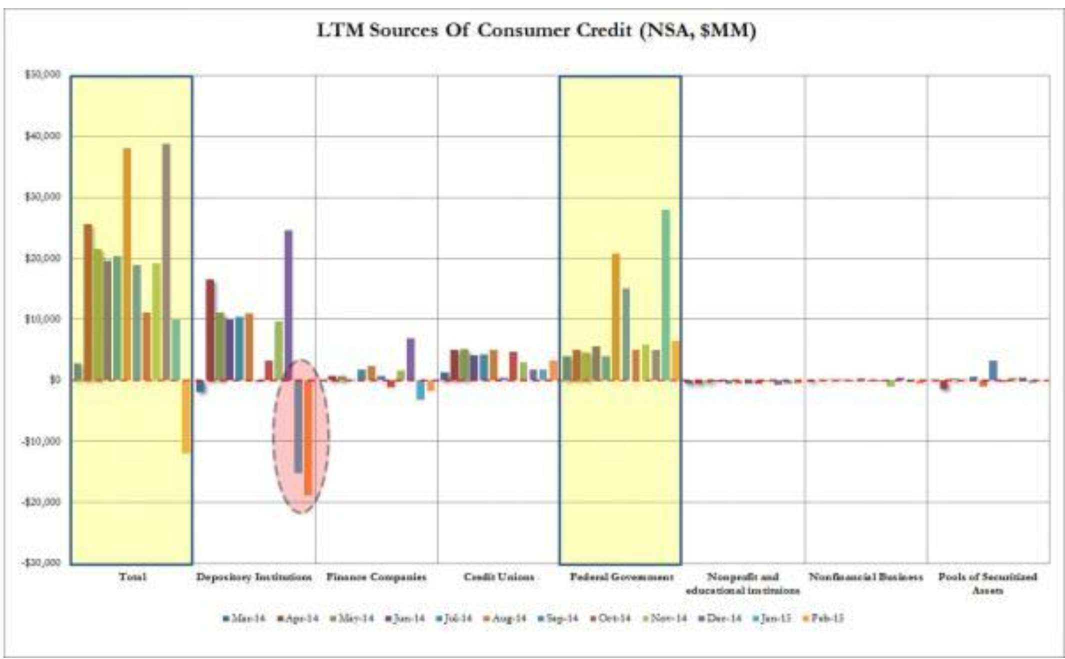
I was interviewing Mish Shedlock recently and he was ranting about a 600K house in Illinois coming with a 14-15K annual tax bill. A listener wrote in disbelief because they claimed in New Jersey it was twice that.

Property Taxes are climbing and soon your house may possibly be a major tax liability for you (as just one example of the realities of the debt).

Are banks shutting Down Lending?

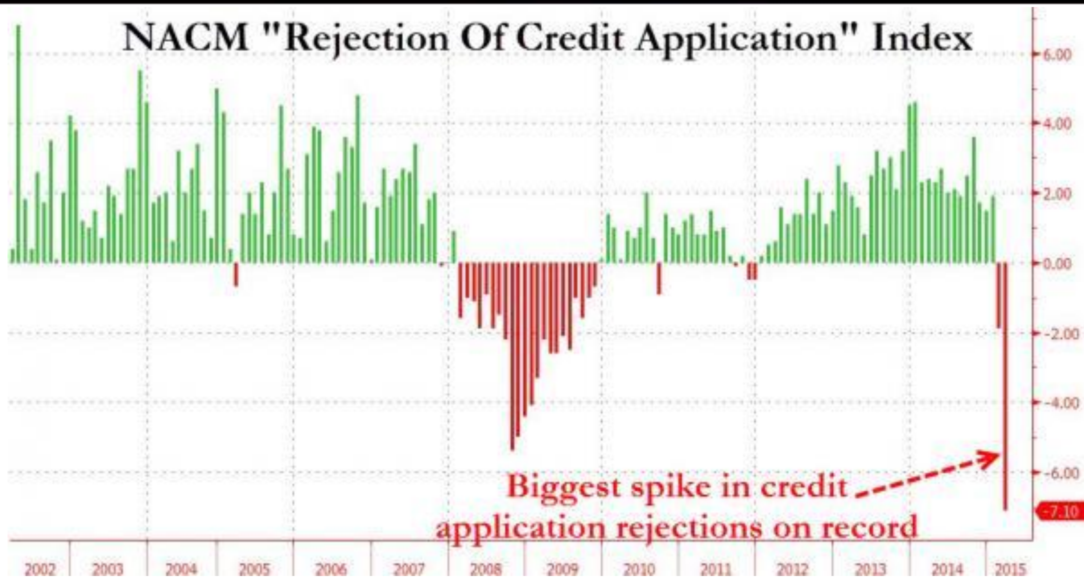
I mentioned above that I believe the banks already see this and if this was the case would be forced to begin to take some action. Below is a chart that graphically shows exactly this fact.

Banks have stopped credit while government backed credit continues to flow.



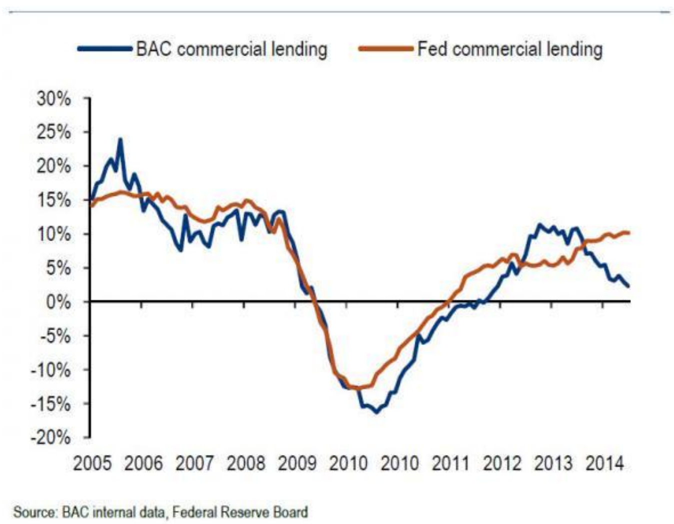
Rejected Credit Applications

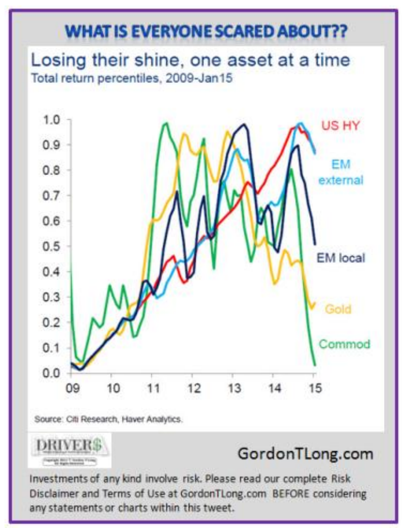
I though this NACM (National Association of Credit Managers) report spelled out clearly what I suspected was occurring.



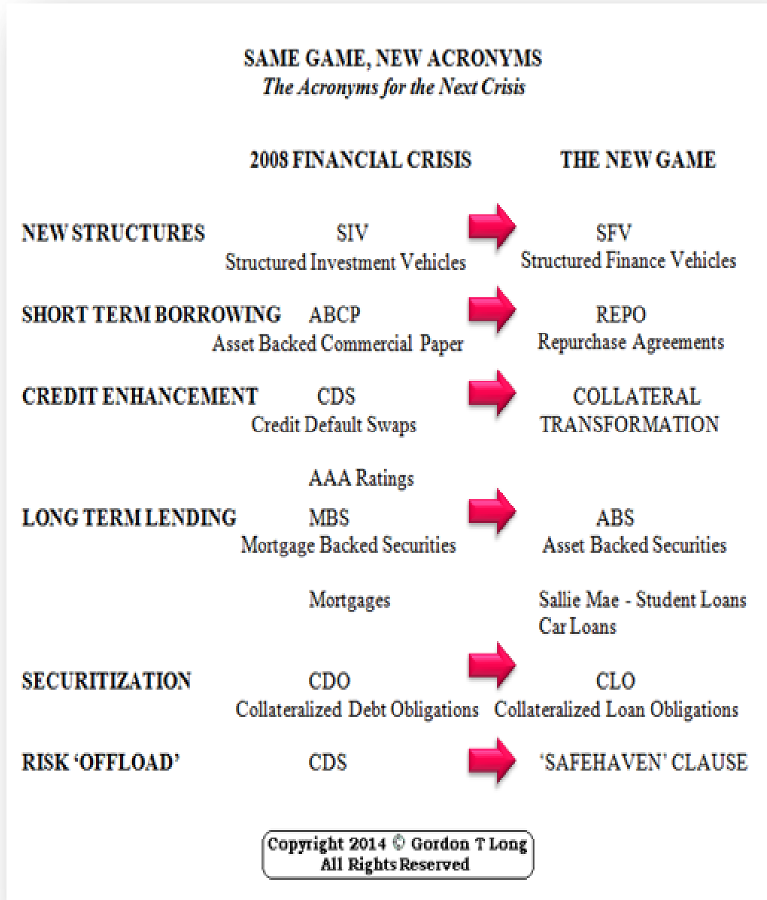
It Broad Based

The overall slowdown in credit and heightened credit concerns has been with us for awhile which and I have discussed it previously.





PROTECT YOUR ASS..ETS!



Precarious Collateral Values & Debt Payment Obligations

The banks are aggressively battening down the hatches. I talked last month about liquidity problems and high quality collateral shortages. This is a REAL problem!

Remember, in 2008 it was about the Shadow Banking System and a sudden short term liquidity problem.

The $72T global Shadow Banking system is fundamentally about borrowing short and lending long, on the expectations that short term lending is readily available.

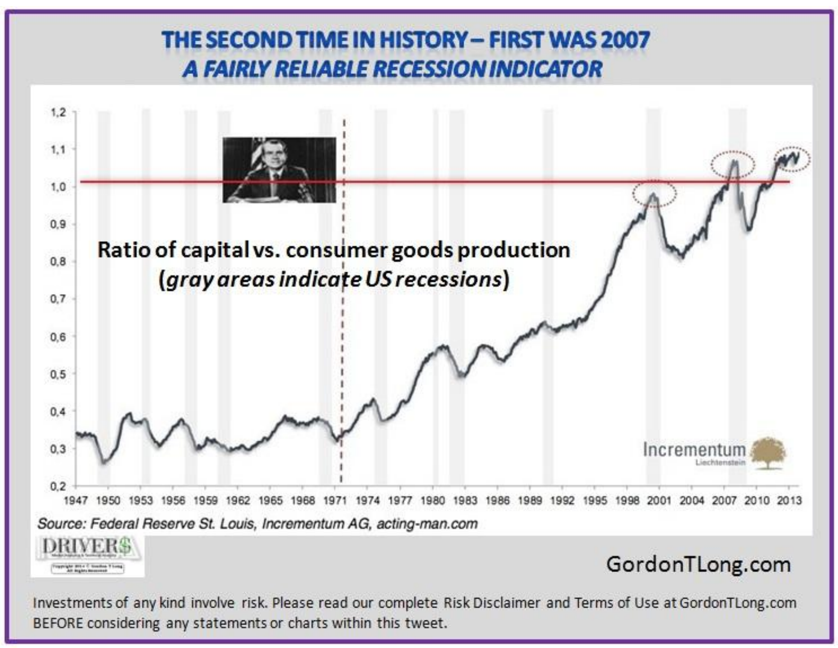
In 2008 it was a collapse in the ABCP market, when Money Markets "broke the buck", which brought liquidity to a halt.

Today it is about repos, collateral transformations and rehypothecation.

WHAT TO EXPECT

A Fairly Reliable Recession Indicator

I have shown charts in previous reports which indicate a US recession later in 2015 is a real possibility. Below are a couple of charts I may not have shown.

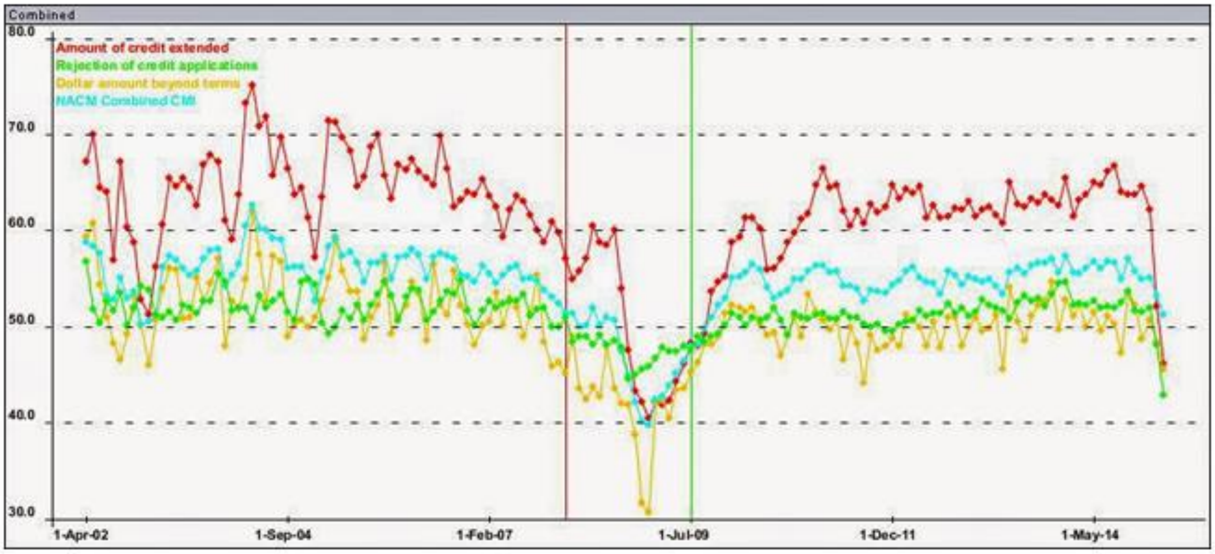


This first chart is from our associate Ronnie Stoeferle at Incrementum Li showing the ratio of capital versus consumer goods production overlaid over prior recessions.

Cyclical Recession Signals

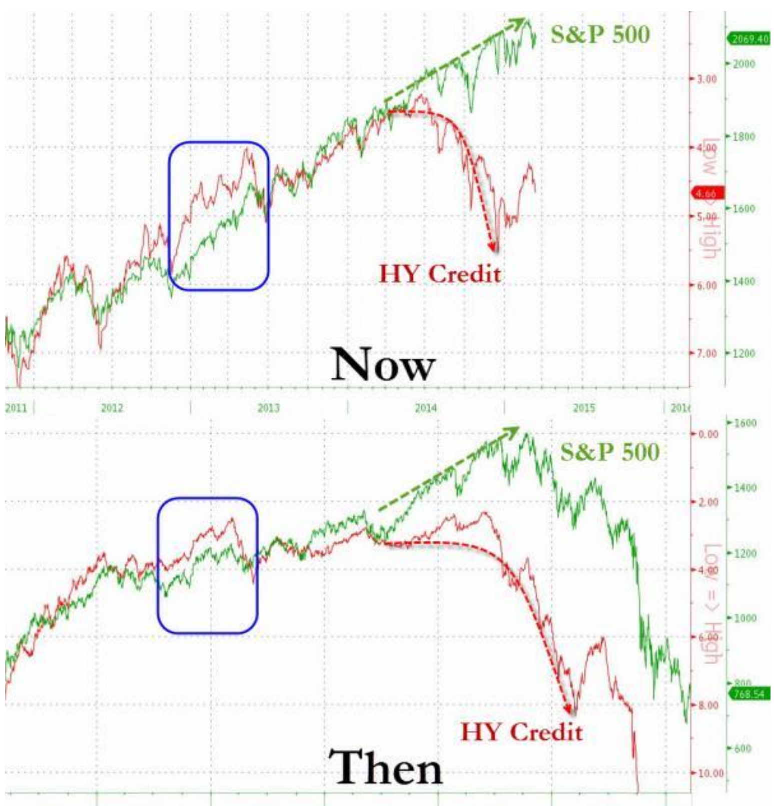
This next credit summary chart is also very telling. I have found over the years that credit markets normally warn of market dangers first. I believe this is the data that the bankers are looking at and **are increasingly worried about.**

THIS IS WHAT THE BANKS SEE



HY Credit Markets Warn First

The divergences are more than a little dramatic!



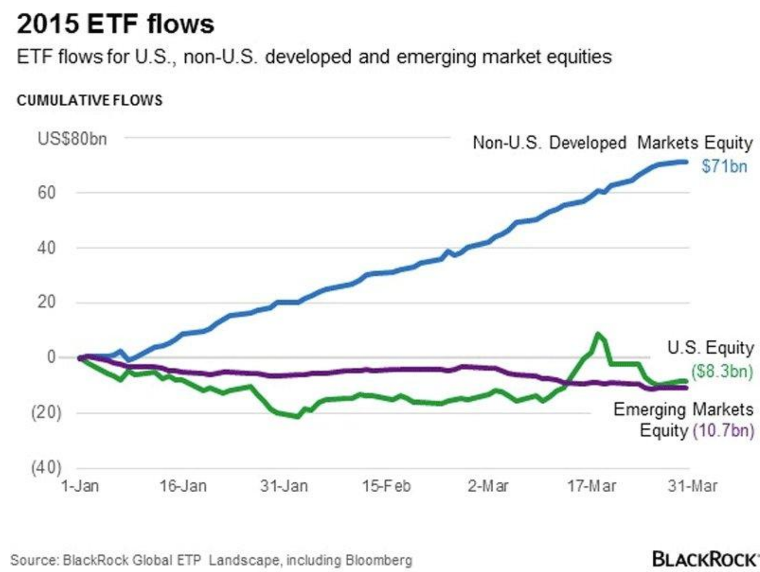
A World of Fast Money & Currency Debasement

A believe another thing **the bankers are worried about** is the growth in exchange traded ETFs that are based on foreign holdings.

Increasing geo-political tensions could trigger rapid selling shifts in these products which may not be liquid or have poor custodial procedures in place.

ETF Traders

Additionally, we have an exploding new world of non professionals and inexperienced and untested younger professional fund managers now using these tools.



Maybe not only the Bankers should be Worried?

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