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A LOOMING US RECESSION

ANALYTIC INSIGHTS - SEPTEMBER 2013

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A LOOMING US RECESSION

The European recession recently completed its 7th quarter and was longer than the 2008 recession, which was 5 quarters. Since the EU is 25% of Global GDP, as might expect the protracted recession is having a tremendous impact around the world.

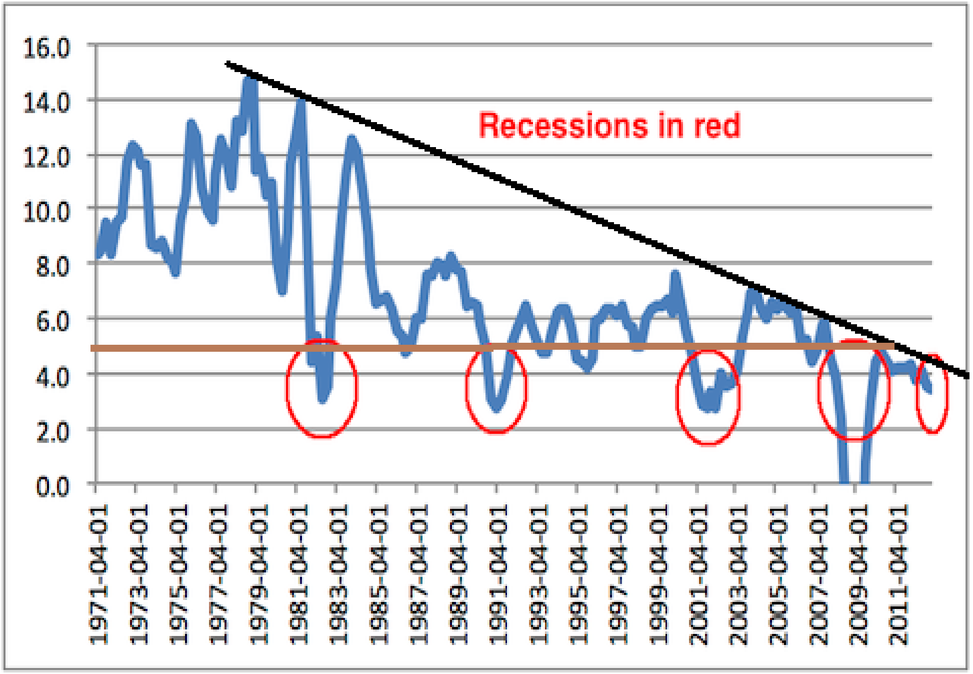
GordonTLong.com just released a Macro Analytic video entitled "China Slowdown Crippling Asia" with China expert Bert Dohmen of the China Boom-Bust Analyst. You will see in it the seriousness of the European recession waves washing ashore across Asia.

I encourage you to listen to it. It is posted on our Macro Analytics page.

Even the perennially positive Bloomberg Orange Book covering US earnings and conference calls is now sounding bearish about the US Economy.

To me the Nominal GDP (that is removing the manipulated 'Deflator') tells the real story

> *"Macro concerns emerged again toward the end of the quarter and were reflected in lower activity levels and risk appetite in certain businesses."*



The current levels NORMALLY warn of pending Recession conditions

As an aside it also suggests that the politically manipulated Deflator should presently approximate 5%. Similar in distortion to John William's ShadowStats numbers suggest the true CPI is well north of 9%.

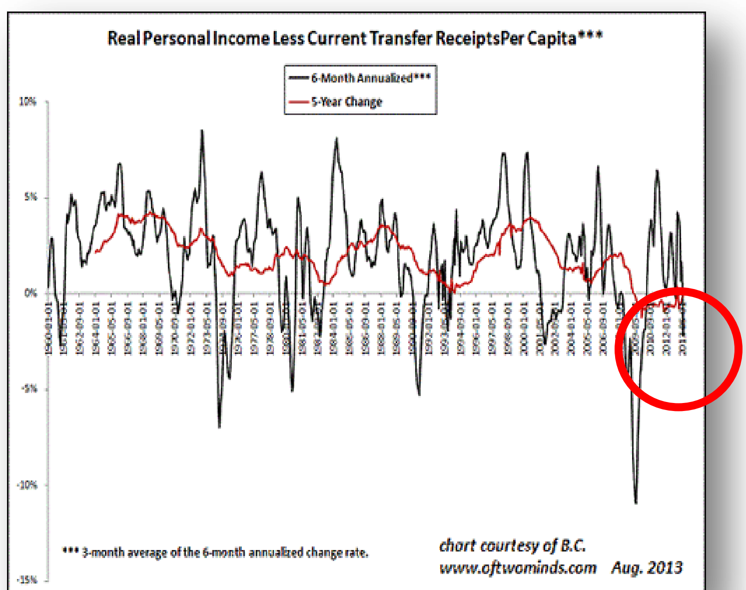
My Macro Analytic Co-Host, Charles Hugh-Smith of OfTwoMinds recently wrote that:

> *"Every time real personal income goes negative, a recession occurs. Now that personal income is falling, a recession is baked in."*

The long-term chart of real personal income he cites, highlights a strong correlation between falling real income and recession.

> *This makes sense. If real (that is, adjusted for loss of purchasing power a.k.a. inflation) income is declining, households have less income to spend and less income to leverage more debt.*

> *Note that real personal income is per capita (per person) and that government transfer payments (checks from social programs such as welfare, Social Security, etc.) are excluded.*



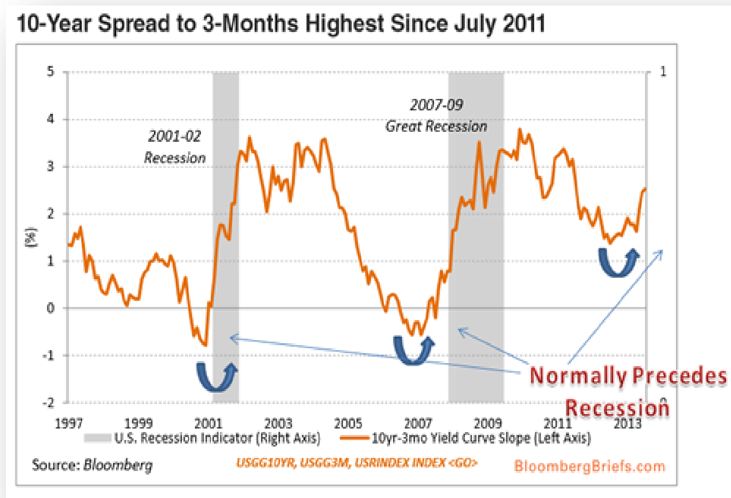
Charles also highlights that there are two noteworthy points in this chart.

> *One is that real personal income has been negative for the past five years, with one tax-related spike in late 2012 as those who could do so reported income in 2012 rather than 2013 to take advantage of the lower tax rates that expired in 2012.*
>
> *The second point is that every time the black line (the 6-month annualized rate of change) of real personal income fell below 0% (that is, went negative), a recession occurred.*

An important caveat is that the weak 6-month annualized comparison is against the spike in income at the end of '12. Still, the year-over-year and smoothed 6-month annualized rates were already falling below the historical recession threshold in late summer '12 and again in winter-spring this year.

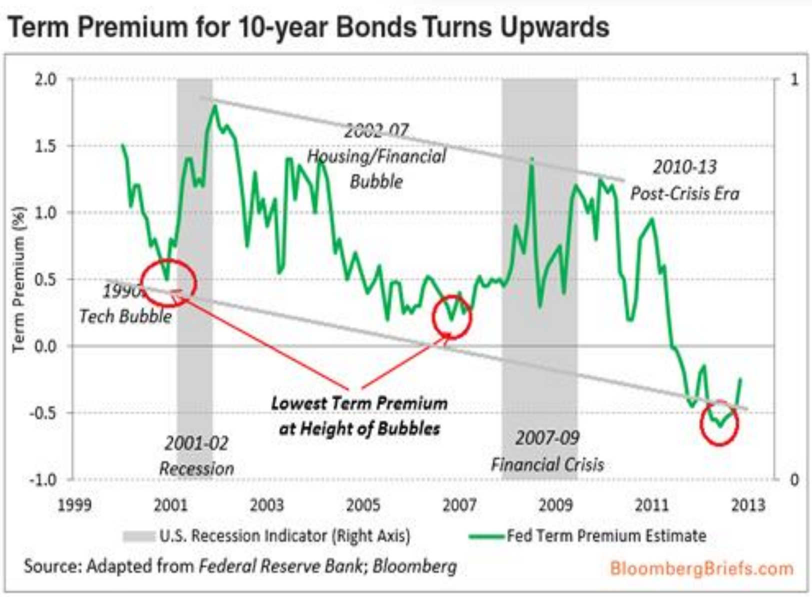
A similar pattern and trajectory occurred after [recessions had begun]() (as per the National Bureau of Economic Research NBER):

Aug.-Sept. '08
June-July '01
Oct.-Nov. '90
Feb.-Mar. '82, Apr.-May '80, and
Sept.-Oct. '79
Mar.-Apr. '74
Nov.-Dec. '70
Nov.-Dec. '60



CREDIT & TERM STRUCTURES

In the most current Trigger$ webzine, I talked about watching Term Structures for clear Recession signs.



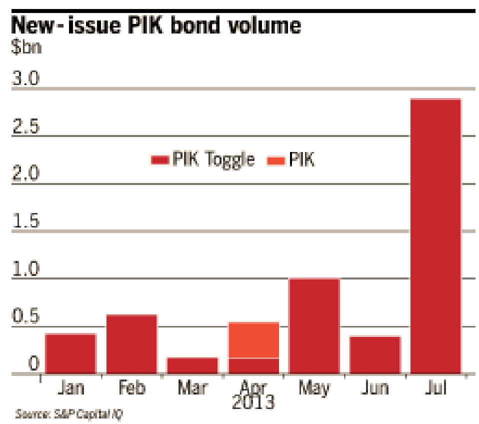
Credit always warns of pending crisis long before multiple Hindenburg Warnings (which by the way we now have multiple recordings of).

THE FED IS IN A BOX

1. The US Economy is hinging on a Recession (GordonTLong.com videos: LONGWave on a US Recession, Is the US in a Recession, Dohmen - China Slowdown Crippling Asia) so it needs to be adding stimulus (according to Keynesian Economic Theory).
2. The Improving US Trade deficit is squeezing Global Liquidity via the Triffin Paradox at exactly the wrong time after a 7 quarter EU Recession.
3. Additionally, several recent regulatory proposals will increase the pressure on banks to reduce assets that carry low risk weights. Repurchase agreements are a large source of banks' low-risk assets, and it is expected that banks will reduce their matched book operations in response to these proposals. We are already seeing Treasury fails. HOWEVER:

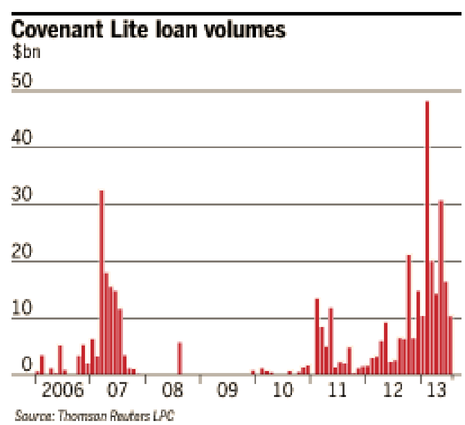
There are serious credit issues that are forcing the Fed to "TAPER"

1. Excess Speculation as witnessed by:
    a. PAYMENT IN KIND (PIK) NOTES
    b. COVENANT-LITE LOANS
    c. DIVI RECAPS
    d. LBO LEVERAGE
2. Fracturing occurring in US Term Structures
3. Shortage of High Value Collateral due to the Fed almost completely dominating the risk free US Treasury Market. This is causing serious credit problems in the Collateral Transformation trade and a reduction in Repo balances.



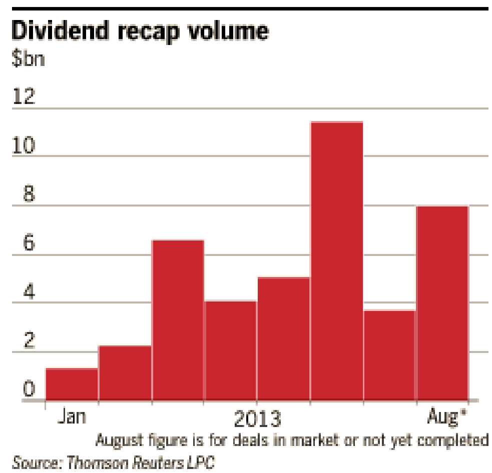
PAYMENT IN KIND (PIK) NOTES

This year's issuance of payment-in-kind notes, which allow borrowers to put off cash interest payments, is close to passing the total for the whole of 2012, having had the biggest month this year in July.



COVENANT-LITE LOANS

Issuance of covenant-lite loans hit an all-time record in February but even through recent turbulence it has remained elevated at monthly levels that were typical in the first half of 2007.

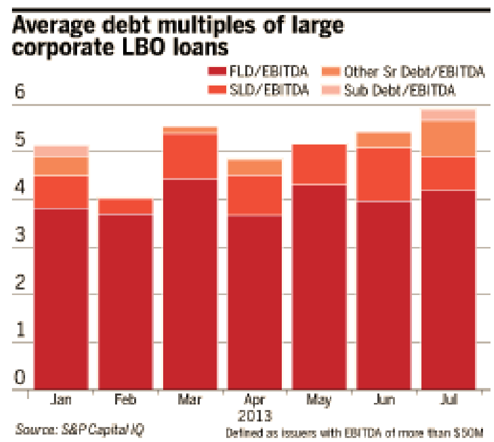


DIVI RECAPS

The use of borrowing simply to pay private equity shareholder dividends – "divi recaps" – doubled in the second quarter from the first. July was slow, but there are $8bn of deals slated for August, which will be at least the second-highest month this year.

LBO LEVERAGE

And finally, the leverage in large buyout deals in July was 5.9 times, the highest since 2007. There is still a wall of money chasing the higher yields from junk bonds and leveraged loans. Leveraged loan funds just recorded their 59th successive week of inflows.



THE REQUIRED 'COVER' OR NO CHOICE?

The Fed may be forced to let the US enter a recession hoping it will give it the cover to insert massive more liquidity into the system which is needed as deleveraging from NPL continues unabated globally.

KEY WORDS IN THE COMING CRISIS

2002 Enron:

1.	SPV, SPC	Off Balance Sheet
2.	Securitization	Debt to Asset Mechanism

2008 Financial Crisis:

1.	SIV, CDO, CDS	Credit Vehicles
2.	Shadow Banking	Credit to Collateral Transmission

TODAY:

1.	Risk Free	Sovereign Debt & Solvency
2.	Collateral Transformation	Warehousing Risk
3.	Rehypothecation	Pyramiding & Counter-Party Risk
4.	Repo	Third Party Repurchase Agreement
5.	Shadow Banking	Credit versus Money

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