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Economic Collapse amidst a Mini-Recovery

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If the entire financial system does not come down upon our heads and if we do not have another war, global growth is going nowhere in the year's ahead. We had a mini-recovery, but it cost $1.8 trillion. We had a second recovery and that cost $1.5 trillion. We are entering a third of what is becoming yearly recoveries that will probably cost $1.3 trillion. In other worlds without these massive injections of money and credit we would probably be in a deflationary depression.

As a result of overspending and poor financial choices state, county and local governments continue layoffs, increase taxes, cut services and attempt to pay back unemployment loans from the Federal government by creating more debt, by floating additional bond issues. The people who run these governments just do not get it. They expect the next bull market is just around the corner and it isn't. In 2014-2015 we can expect a housing inventory at banks of 9.8 million homes, all for sale. That guarantees no housing recovery for years to come.

The massive exodus of good paying jobs, one million a year, due to free trade, globalization, offshoring and outsourcing and the loss of 450,000 manufactures will soon end, as a number of countries debate trade barriers. Such protectionism will initially cut back on world demand and the expansion of world debt. Austerity is already a by ward and means restrained spending as well. Governments will become more onerous with additional regulation and taxes, because they have no intention of really cutting spending. We have been waiting for more than three years for debt reduction and saving and it has not as yet really materialized on an ongoing basis. We ask, are American consumers capable of reducing debt and savings? If they do will personal consumption of GDP fall from 70% to lower levels? The answer is of course it will.

Thus far Americans cannot or will not in any meaningful way reduce spending and we see that mode continuing with an absence of savings. In this regard the Europeans are cutting back spending. China's export growth has fallen to a 2-1/2 year low and Europe is China's largest customer.

Over and over again we see other professionals still recommending US Treasuries yielding anywhere from zero to 1.87%, while official inflation is 3.8% and real inflation is 11.6%. These buyers of Treasuries have to have some fierce pressure put on them to purchase such investments; some are predicting a 2-1/2%, 30-year bond and a 1-1/2% 10-year note. Those gains are fine, but they nowhere offset the inflationary risk. For 25 years bonds have outperformed stocks, but few money managers talk about the outsized returns in gold and silver related assets. That isn't acceptable and probably never will be. Professionals going the income route may be able to return 5% or even 7%, but that is not sufficient in having to deal with inflation and the volatility of the market. Producing gold and silver mines are selling at 15 times earnings when they could sell substantially higher based on P/E and gold and silver prices. You are looking at very easy 50% increases. Just recently we recommended Pretium (PVG) at $6.00 and it traded up over $16.00 this week.

Due to the dreadful financial situation in Europe and in the euro and its European members we will see a firm to stronger dollar most of the year. Actually Europe will be happy about that, because it makes their exports cheaper. That will hold true as well with Canada and Mexico, keeping them competitive. That will wreck havoc with the US balance of payments deficit. Dollar strength today only has a 20% connection with gold, so it will play only a small part in the ascendancy of gold and silver prices.

House prices will fall 20% over the next three years and foreclosed inventory could reach close to 10 million homes. Even though your rent is rising, stay where you are for a few more years. If that in fact is the bottom how many years will house prices bump along the bottom? Will it be 8 years or 30 years? We don't know, but a home is not a good investment at this time.

As we pointed out earlier retail consumption is going to fall. Except for the second and third world in major countries growth in GDP has only been available with massive stimulus and we see nothing to change that. Look at what the Fed and the ECB did three weeks ago; they poured $10 trillion into the European economies, if needed. That approach won't change because there is no alternative and the situation is worsening. All Western economies will be lucky to have 2% GDP growth this year in spite of stimulus.

As consumers eliminate debt and cut back on credit card usage, retail sales will fall. This tact could be a long-term phenomenon, as spenders use cash and debt cards, because they cannot control their spending otherwise. Even the lay-a-way plan is making a comeback, something we haven't seen since the 1960s.

From here on out we should see very conservative portfolios, and falling GDP gains as soon as stimulus ends. If it doesn't end then we will see lots of higher inflation. Low quality equities will be marginalized and the Dow and S&P will trade in a tight range.

Things are changing very quickly, especially in Europe as Germany's credit rating is lowered from AA to AA-, because Germany is backstopping all the losers. It wasn't but a few days ago the Finance Minister Schauble rejected the ECB as Lender of Last Resort.

We are not behind the scenes, so we do not know which way Germany will go on the euro. There is little chance of austerity working in the six problem countries. How can you grow your way out of debt when everything is being cut? How can you sell things to countries that have little money to spend? German citizens no longer want the financial burden of bailing everyone out and for doing so have their own ratings lower, which means higher interest payments for being the good guy.

Frank Schaeffer, the CDU political partner says current downgrades will force Germany to shoulder not 40% of the financial burden with Austria, but 75%. That should further alarm Germans. He says the socialization of losses via bailouts cannot continue forever.

As we have written before, lurking in the wings is the French presidential primary in April. Socialist François Hollande, is now parroting Marine Le Pen of the Front National, to dump the euro and the EU. Sarkozy is only two-points ahead of Hollande and his plan for a financial transaction tax is losing momentum. He may not even make the May final.

In this unsettling atmosphere the US is now running the show, but no one in Europe will admit that. The Fed has lent the ECB, illegally, $1 trillion in what they call a swap, which is simply phony. Using fractional banking prudently we see ultimately $10 trillion being available to function with. Whether fractionalization will be use remains to be seen. As you can see, $1 trillion alone can keep the euro floating for a year, whether one or three countries drop out.

The situation in France is desperate. Hollande is polling 27%, Sarkozy 23.5% and Le Pen 21.5%. It is very possible Marine Le Pen could knock Sarkozy out of the race. If that happens it will cause a great turmoil and one of the US's powerful allies will be gone. We will approach the consequences of the primary after it is completed.

The downgrading of the EFSF rating is going to make raising funds more difficult and more expensive to bail out the six problem countries. The new ESM, which strips nations of their sovereignty, should be ready by July. This plan simply enhances the EU's ability to control every member state to take them eventually into world government.

Factories in the U.S. churned out more computers, cars and construction material in December as manufacturing remained at the center of the expansion.

Output climbed 0.9 percent last month, the biggest gain since December 2010, according to Federal Reserve data issued today in Washington. Other reports showed homebuilder confidence jumped and wholesale prices unexpectedly dropped.

Gains in consumer and business spending, combined with lean inventories, may prompt factories to continue to boost payrolls and hours, bolstering economic growth. Additionally, more demand from emerging markets may help shield American industry from a slowdown in exports to Europe as the region's financial crisis and a weaker euro threaten to restrain sales.

Confidence among U.S. homebuilders rose in January to the highest level in more than four years as sales and buyer traffic improved.

The National Association of Home Builders/Wells Fargo sentiment gauge increased to 25 this month, exceeding the median forecast of economists surveyed by Bloomberg News and reaching the highest level since June 2007, the Washington-based group said today. Readings lower than 50 mean more respondents still said conditions were poor.

Record-low borrowing costs, a growing population and reduced prices may drive demand for homes this year even as another round of foreclosures threatens to weigh on the market. The confidence measure, which increased for a fourth straight month, improved in all four regions of the U.S.

Builders began work on fewer houses than forecast in December, capping the worst year on record for single-family home construction and signaling recovery in the industry will take time.

Housing starts dropped 4.1 percent to a 657,000 annual rate last month, reflecting a slump in multifamily dwellings, Commerce Department figures showed today in Washington. Building permits, a proxy for future construction, were little changed.

Four years after housing helped spark the last recession, falling home prices and ongoing foreclosures are hampering an industry-wide recovery. For all of 2011, work was started on 428,600 single-family homes as construction competed with the surfeit of previously owned dwellings.

Applications for home mortgages surged more than 20 percent last week, fueled by a wave of refinancing demand as interest rates dropped, an industry group said on Wednesday.

The Mortgage Bankers Association said its seasonally adjusted index of mortgage application activity, which includes both refinancing and home purchase demand, jumped 23.1 percent in the week ended January 13.

The MBA's seasonally adjusted index of refinancing applications climbed 26.4 percent, while the gauge of loan requests for home purchases rose 10.3 percent.

"With mortgage rates reaching new lows, refinance volume jumped," Michael Fratantoni, MBA's vice president of research and economics, said in a statement. "Purchase activity also increased as buyers returned to the market after the holiday season."

The refinance share of total mortgage activity rose to 82.2 percent of applications from 80.8 percent the previous week, making it the highest refinance share since October 2010.

Fixed 30-year mortgage rates averaged 4.06 percent, down 5 basis points from 4.11 percent.

The survey covers over 75 percent of U.S. retail residential mortgage applications, according to MBA.

Wholesale prices in the U.S. unexpectedly dropped in December, consistent with the Federal Reserve's assessment that inflation remains tame.

The producer price index fell 0.1 percent, the second decrease in the past three months, Labor Department figures showed today in Washington. Economists projected a 0.1 percent gain, according to the median estimate in a Bloomberg News survey. The core measure excluding volatile food and energy rose 0.3 percent as the cost of light trucks climbed.

Manufacturing in the Philadelphia region expanded at faster pace in January as employment picked up and factories grew more optimistic about business in the

next six months.

The Federal Reserve Bank of Philadelphia's general economic index increased to a three-month high of 7.3 from 6.8 in December, according to a report released today. Economists surveyed by Bloomberg News forecast the gauge would rise to 10.3. Readings greater than zero indicate expansion in the area covering eastern Pennsylvania, southern New Jersey and Delaware.

Fewer Americans than forecast filed first-time applications for unemployment benefits last week, easing concern that post-holiday firings were on the rise.

Claims plunged by 50,000 to 352,000 in the week ended Jan. 14, the lowest level since April 2008, Labor Department figures showed today in Washington. The median forecast of 41 economists in a Bloomberg News survey projected 384,000. A Labor Department spokesman said the decrease reflected volatility seen during this time of year. The four-week average, which smoothes out fluctuations, decreased to 379,000 last week from 382,500.

The cost of living in the U.S. was little changed in December for a second month as stores cut prices to boost holiday sales and fuel expenses fell, reinforcing the Federal Reserve's view that inflation will remain in check.

The unchanged reading in the consumer-price index reported by the Labor Department today in Washington compared with a median forecast of a 0.1 percent gain, according to a Bloomberg News survey of 78 economists. Excluding volatile food and fuel costs, the so-called core rose 0.1 percent as projected.

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