Hard Times

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Hard and troubled. Racked by fear and uncertainty. For many trauma. Experts predict, speculate and conjecture, but no one knows for sure what's ahead. Key questions are whether we're in a protracted and severe recession. Or at the onset of another Great Depression. So much is unresolved. The problems have built for years and are immense. Maybe nothing at this stage will work and the best hope is for light at the end of a very long, dark tunnel.

Again no one knows. The worst may or may not be too late to avoid. At best, stabilization and recovery will take time. Likely years. The degree of pain along the way will depend on future policy responses. Ones so far taken aren't encouraging. Their details aren't entirely clear. They're slowly emerging and from what's known since the original EESA/TARP announcement, the Treasury:

— will invest $125 billion to recapitalize nine major banks, including Goldman Sachs, JP Morgan Chase, Citigroup, Bank of America, Wells Fargo, Morgan Stanley, Bank of New York Mellon, Merrill Lynch and State Street; another $125 billion will go to smaller banks and thrifts;

— according to Bloomberg.com, amounts range from $25 billion to JP Morgan Chase and Citigroup; another $25 billion to be divided between Bank of America and Merrill Lynch; $20 billion to Wells Fargo; $10 billion each to Goldman Sachs and Morgan Stanley; and $3 billion each to Bank of New York Mellon and State Street; the winners in the "bailout" sweepstakes;

— investments will be in specially issued preferred (non-voting) shares; they'll pay 5% interest to be increased to 9% after five years;

— the government will receive warrants worth 15% of the preferred shares' value;

— FDIC insurance will cover all small business deposits so they won't be shifted from weak to more stable banks;

— the government will guarantee banks' newly issued unsecured debt for three years to make refinancing liabilities easier; retail deposits up to $250,000 also guaranteed as previously announced;

— toxic assets will be bought to restore liquidity in mortgage-backed securities market; also previously announced; banks' "toxicity" is in the multi-trillions of dollars; no amount of government largesse can change that;

— all available tools will be used to avoid a systemic meltdown; the IMF and other international lending agencies will also be involved;

— the Federal Reserve will serve as buyer of last resort for commercial paper; and

— measures are intended to be temporary, but no time horizon was indicated.

Will these and other planned measures work? On October 14, Bloomberg interviewed numerous analysts. Some were reassuring. Others weren't. They noted heroic measures to unfreeze money markets and interbank lending. Suggested any improvement helps but expected too little, too late, to matter. They also cited little easing in stress measures in stark contrast to soaring world equity valuations. Early on, then plunging. Continuing the same volatile pattern indicating fear and uncertainty. Plus lots of manipulation so speculators can profit hugely on ups and downs.

Steps so far taken do nothing for distressed households. They're an aggressive attempt to save major banks that are effectively insolvent. Stabilize world economies if it works. Yet huge problems remain at the "end of an era as credit bubble bursts," according to Lloyds TSB economist Trevor Williams on October 13:

"Too much debt led to bubbles….no one really knows when or how this crisis is going to end….this is the latest of many bubbles to have plagued the world economy in the last 10 – 15 years….(it didn't) develop overnight and will therefore take time to resolve….one year (after it was clear that) asset markets, especially housing and credit, were grossly overvalued and so (were) the value of the securities written on them (on which so many financial firms borrowed heavily), the crisis is intensifying rather than abating…."

For Williams and others, the challenges are formidable. "Hence, this is a long-term problem that will not result in business as usual anytime soon as the changes required are far reaching and complex. The adjustment of the balance sheets of firms in developed economies caught up in this crisis will take many years….cutting interest rates alone will not work….it may be like pushing on a piece of string (because) developed country households are already hugely in debt." Low interest rates "reduces their income (further eroding) spending and weakening growth….Tax cuts and public spending increases would help….but with public finances strained by the bank rescue, this is unlikely." How long recovery "will take is anybody's guess."

Economist Nouriel Roubini approves of bank recapitalizations but cites "significant downside risks" in the coming weeks:

— Treasury plans aren't entirely clear;

— they're woefully inadequate;

— world economies are weakening; fiscal stimulus is lacking, so "macro news will surprise on the downside;"

— so will quarterly earnings;

— confidence has been severely damaged;

— "deleveraging of the shadow financial system" will continue;

— major stresses remain, possibly including a credit default swap (CDS) market blowout; hundreds of hedge funds collapsing; noted money manager Jeremy Grantham believes 5000 ultimately will disappear; asset liquidations will follow pressuring market valuations lower;

— insurance companies' troubles are increasing; more rescue packages needed for "other systemically important financial institutions;" crises emerging in developing and advanced countries; deleveraging causing a continued asset price deflation, margin calls, still lower asset prices and creating "further downside risks to housing and home prices."

In addition, G-7 and EU plans include no fiscal stimulus to boost aggregate demand. Personal income is falling. In a state of collapse are: personal consumption, residential and non-residential investment, and capital expenditures. Unless government fills the breach massively (at least $300 billion for starters), "an unavoidable two-year recession (may) become a decade long stagnation." Roubini cites the usual type stimuli:

— for instructures;

— green technologies;

— increased unemployment benefits;

— targeted tax rebates for lower income households;

— aiding distressed homeowners to "avoid a tsunami of foreclosures;" potentially 10 million or more; rising rapidly to greater numbers in 2009; measures should include a plan to reduce mortgage face values; also let troubled homeowners retain their property and pay affordable rent;

— further steps to relieve over-indebted households; the result of home equity loans, credit cards, auto and student loans; failure to reduce these stresses assures a more protracted and deeper economic crisis; how can banks lend to unwilling borrowers;

— federal block grants to states and local governments among other measures.

Crucial for many experts is that without rapid implementation of these type measures, financial institution rescue plans will be undermined. Aggregate demand will decline further and prolong an already severe recession. "If Main Street goes bust in the next six months, (Wall Street will again) as the real economy implodes further."

In an October 14 Bloomberg Interview, Roubini predicted the worst US recession in 40 years. "We're going to be surprised by the severity of the recession and (resulting) financial losses." It will last 18 to 24 months. Push unemployment to 9% from its reported 6.1% level, and drive home prices down another 15%. He upped his bad mortgage credit loss estimate to $3 trillion from his previous $1 – 2 trillion amount. He also believes that $250 billion in bank recapitalizations is just the beginning. At least double that amount is needed to save banks from bankruptcy. Even that total may be too little, too late. And the soaring national debt presents its own unwelcome problems.

Another issue involves the source of bailout funding. It either has to be borrowed or created. Printing dilutes the currency. A prescription for future higher inflation although today's problem is deflation. Borrowing won't be simple either. EU and other foreign central banks have their own problems to resolve. China, Japan and wealthy petrodollar states will have to partner with the Treasury and Fed as lenders/bankers of last resort. In greater amounts than they may be willing to assume.

Other Problems – Too Great to Solve and/or Ignore

Earlier by others and on October 12, the London Independent cited the resident elephant few in the major media acknowledge. Especially in America. A "$516 trillion derivatives 'time-bomb,' " according to writers Margareta Pagano and Simon Evans. Roughly equal 10 times world output and "not for nothing (that) Warren Buffett call(s) them (financial) 'weapons of mass destruction.' "

These are financial instruments that derive their value from an underlying asset, reference rate or index. In exchange-traded and privately negotiated forms, all sorts of them exist – swaps, forwards, futures, puts, calls, swaptions, caps, floors, collars, captions. Combined they represent (by far) the world's largest financial market. They're complex, opaque and called "the world's biggest black hole because they" comprise the shadow financial system. Unregulated and allowed to explode to unmanageable size. Creating potentially overwhelming risks. If enough of them sour, world economies may crash in a cascading domino effect.

Long-time financial observer and analyst Bob Chapman is dire in his assessment. Using Bank for International Settlements (BIS) figures, he cites a "quadrillion dollar (1000 trillion) powder keg waiting to blow' and places this problem (led by credit default swaps – CDSs) at the heart of the financial crisis." He thinks "catastrophic losses are inevitable."

Subprime and mortgage debacles are a "side show" at around a few trillion in losses. Their real estate derivatives problems are another matter. He believes that the Treasury, Fed, and other smart Wall Street types know it. They're terrified about potential losses that "may (way) exceed the entire world's GDP (and) thus obliterat(e) the balance sheets of every major commercial bank and the Fed." Take down the entire world financial system and cause an unstoppable "juggernaut of loss, insolvency, failure and bankruptcy." Resulting in world governments having to nationalize their financial systems and become bankers of last resort.

Chapman thinks the train left the station, and nothing can stop it. Current policies can only delay the inevitable through a Ponzi scheme "final orgy of fraud and profligacy." The idea is to "take total control, make markets do whatever pleases them (and) thus create their own reality."

If this happens, nations will be bankrupt. So will people. Their savings erased. Their situation unpalatable. Intolerable. A "New World Disorder." Police state tactics will be needed to contain it. But there's more to this story as some observers recognize. Today's crisis was manufactured but not as it's turning out. Far worse than planned so the best laid schemes "are unraveling," according to Chapman. Too many trillions in losses to handle may result, and at this stage, who can say what's ahead. Not what the masters of the universe had in mind except to take the money and run.

Other Assessments of Conditions

Take your choice. Opinions are everywhere. Some credible. Many not. But one thing about most is consistent. These are perilous times. The most challenging in decades. Maybe ever. Prudence and caution are essential. Enormous unpredictable risks threaten. Massive economic damage has been done, and certain hard times are ahead across the board. For businesses and households. Many in both sectors won't make it. A dark prospect to consider. Unimaginable for most.

Financial expert Martin Weiss has been a leading investor safety advocate for decades. On October 14, he issued "an urgent update on these wild, wild markets" and explained what most observers ignored. As world markets soared on October 13, "bond markets suffer(ed) a dramatic decline." He concluded: "if you think (October 13's) euphoria means the government's newer and bigger bailout plan is going to be a success, think again."

Equities aren't at the epicenter of the crisis. Bonds and credit markets are:

— "subprime mortgages first collapsed;"

— mortgage-backed bonds imploded;

— commercial paper also;

— interbank lending froze; and

— "the entire global financial system (approached) a systemic meltdown."

A future day of reckoning is ahead in global bond and credit markets. Washington's "master plan" may "temporarily stimulate" Wall Street rallies. Possibly "ease some panic in some debt sectors." That's worlds from ending a crisis of this magnitude, and Weiss' advice is to "move decisively from risk to safety." For protection and to profit from "the next phase of the crash."

Since summer 2007, all central bank plans "backfired," and the new US and EU ones "are no different." While authorities liquified markets, fires raged inside them. Instead of solving problems, they created greater ones. Instability, not calm. The "very panic they sought to avoid. The same thing is going to happen this time....The bigger it is, the more desperation it denotes." And more of it means it's likelier their plans will fail. Recovery will come eventually. First, however, "the economy will suffer a great fall," and America's contagion will spread everywhere.

Ismael Hossein-sadeh cites University of Maryland economist Herman Daly in his October 14 article titled: "Why the Bailout Scam Is More Likely to Fail than to Succeed." He lists five reasons:

— a lack of "faith and trust," not liquidity; the world is awash in the latter and more is coming;

— too little good money to redeem the bad kind; mountains of it in the multi-trillions, and no one knows how much;

— no help provided for distressed homeowners; a key source of the crisis; preventing mortgage defaults is crucial; if they're serviced, mortgage-backed securities can be restored along with the solvency of their holders; absent that, greater insolvency;

— no economic stimulus is included to inject purchasing power into the economy; it's vital to revive production, create jobs and reverse the economic slide; and

— a "socially-responsible fiscal policy" is needed; mirror opposite the current one; anchored by ruinous military Keynsianism; wealth transfers to the rich; ending responsible social policies; and creating mountains of unrepayable debt.

Add to these a regulatory-free environment. Speculative finance crowding out productive investments. Massive fraud allowed to persist unchecked, and excesses creating even greater ones. Overall a broken, pernicious, unsustainable model corroding from within and taking America and world economies down with it. Remedies being implemented assure greater problems. At best only short-term relief, and in the end economic ruin. In all likelihood the republic with it.

The Housing Bubble – The Core Economic Problem

Many analysts cite the imploding housing bubble as the core US economic problem. The large and growing volume of bad mortgage loans. Heading up to 20 million under water in 2009. The implications of millions of foreclosures and their negative effect on the economy. Until home valuations stabilize, no recovery is possible. But according to experts like economist Robert Shiller, it's likely months off before it happens.

In the Great Depression, home prices plunged 30%. Today they're down around 20%, and Shiller believes they may match or exceed that era's levels. Even worse, when valuations stabilize in nominal terms, most homeowners will keep losing money. A very disquieting prospect to consider. It may force many households to walk away from their properties because retaining them is too costly.

Not helping are plunging housing data and the October National Association of Home Builders (NAHB) Housing Market Index (HMI) hitting a record low. According to NAHB's chief economist David Seiders, it's "clear evidence than an additional economic stimulus package is needed." Enough to spur home buying. All three HMI components fell. Current sales conditions and expectations hit record lows, and buyer traffic matched its July low. It affected all regions, and Seiders said builder sentiment was the worst he can remember.

Before his death in summer 2007 (at age 88), Kurt Richebacher was a well-respected economist and financial analyst. Also a fierce critic of speculative finance, particularly on Wall Street. In 2004, he reflected on the housing bubble (before most others) in a commentary titled "Property Bubbles: Beware of Property Bubbles."

He cited critical US "economic and financial imbalances." The nation's growth "depend(ent) entirely on the continuation of the frenetic housing bubble." The certainty that "all bubbles end painfully, housing (ones) in particular. They're an especially dangerous (type) asset bubble because of their extraordinary debt intensity." By extracting wealth (through refinancing) from rising valuations and by "heavily entangl(ing) banks and the whole financial system as lenders." Thus, property bubbles have historically been the main cause of major financial crises.

Japan in the late 1980s for example. Its stock and property bubbles burst, but the former got most of the attention. The "property deflation continued for 13 years" through the timeframe of his article. With "calamitous effects on the banking system through a horrendous legacy of bad loans." Japan's "building sector" also suffered and "never recovered from the depression following its (late 1980s) excesses."

Richebacher wondered if America's fate may be similar and asked "Is the US economy in better or worse shape today (in 2004) than in 2000 (as it faced recession)? Is it in a self-sustaining recovery?" Absolutely not...."it is in dramatically worse shape." The result of binge borrowing. Financing "leveraged asset purchases and soaring imports. The former involve no income creation; the latter involve income destruction. By implication, this borrowing represents entirely unproductive, or dead-weight, debt, yielding to debtors no future flow of income from which to pay their debt service." A bad ending is assured. In summer 2007 it arrived. Its effects are painful and worsening. No sign of a quick or easy resolution is evident nor will Wall Street's bailout produce one. According to University of Chicago economics professor Casey Mulligan, it represents a minute fraction of the problem. It may only buy a couple of months relief. Nothing more.

An "Oasis of Calm"

Along with Fidel Castro, Washington's favorite Latin American target is Hugo Chavez. The Wall Street Journal's Mary O'Grady attacks him relentlessly in her Americas column, and on October 6 (and earlier) said Venezuela's economy is deteriorating. In a shambles. At a time it's, in fact, experiencing robust growth.

Impressively with one of the highest world rates. It also tops most nations and the entire Hemisphere (including the US) with the largest international reserves per capita ($1300). Credit Bolivarianism. Abandoning neoliberalism. Maintaining sovereign independence. Raising taxes and royalties on foreign investors to make them pay their fair share. Imposing currency exchange controls to prevent capital flight. High oil prices. Keeping a majority of the profits at home. Using them to develop Venezuela's social state among other factors.

Amidst a world financial crisis. America, Europe and Asia on the ropes. Groping desperately for solutions. The Financial Times (on October 14) wrote: "While stock markets all over the world were ravaged in recent weeks, there was one oasis of calm: Venezuela's tiny exchange, cosseted by capital controls, actually rose slightly on days where historic losses were being reported elsewhere." Even though a "handful of local banks and brokers" face serious losses. The Wall Street Journal failed to notice.

Ideas from the October 8 – 11 Caracas International Conference of Political Economy

Attended by 40 world specialists from 20 countries to propose South-based solutions to the financial crisis. They fear Western plans will worsen poverty, unemployment, and exploit workers worldwide. They reject a massive public debt increase. The greater concentration of capital, and a perverse restructuring to suck wealth to the privileged.

They fear an authoritarian capitalism. Class warfare and increased racism. Enormous productive and social costs plus weakened environmental sustainability. They call for economic and financial architecture reconstructing. An alternative post-capitalist model. What Venezuela calls Socialism of the Twenty-First Century.

They want more social spending and natural resources protections prioritized. Urgent financial regulations to protect savings, stimulate production, control currency movements, and prevent capital flight. They think it's crucial to develop regional complementation. Balanced commercial integration. Industrial agricultural, energy and infrastructure improvement. Initiatives like cooperative trade and the Bank of the South.

Globally they want international monetary system reform. To defend savings and channel investments toward prioritized people needs. To curb speculation and lessen economic disparities. Overall they want new economic institutions in place of failed ones and said the crisis awakened the common interests of people everywhere. They made specific recommendations in areas of banking, finance, and the current social emergency.

They noted the complicity of the IMF, World Bank, Inter-American Development Bank, and transnational bankers in causing the current collapse and its consequences. They call them discredited and want a new financial architecture. They announced a second political economy conference for the first quarter of 2009 in Caracas.

The Crisis of World Capitalism – A Broken, Unworkable Economic Model

Over time, "free market" capitalism has grown larger, more powerful, more complex, more exploitive, and more crisis-prone. Currently notable because of massive Wall Street fraud. Financialization. Speculative finance. Computerized gambling instead of productive investment. Largely with no regulatory oversight.

When crises erupt like today's, fire-fighting is employed to contain them. Moral hazard bailouts for investors taking imprudent risks. Insurance called the "Greenspan put" during his tenure. Currently, the Bernanke/Paulson one. So far, it worked. Eventually it won't. Eventually may be now.

If so or later, the proof is in the pudding. Each crisis begets greater ones. Sooner or later, one too big to contain. It reveals the inherent flaw of an unworkable model. Broken and in disrepair. With even Washington Post writer Anthony Faiola wondering if it's "The End of American Capitalism?" Too far gone to fix, but it likely will be. Patched up and reinvented one more time.

It was wobbly during the 1970s. At the depths of the 1974 recession and again in 1979 heading into the 1980 – 1982 one, Newsweek magazine and later Business Week ran the same headline on their covers: "The Death of Equities." One day perhaps, but they were early.

On October 10, Faiola wrote: "The worst financial crisis since the Great Depression is claiming another casualty: American-style capitalism." He means the "hands-off" kind. Not the free-market model as such. And one with more government intervention at times like these. At least "temporarily for a more restrained model, particularly in financial markets." In other words, a strategic retreat. Not a fundamental overhaul or admission that something this broken can't be fixed. Just patched, but eventually it's own internal contradictions will destroy it.

Meanwhile, prepare for what economist Michael Hudson calls "the age of oligarchy." With the "wealthiest 1 per cent of the population com(ing) into possession of even more returns to wealth than the 57 per cent" they now get. "Robin Hood in Reverse." From the public to the rich. Hollowing out America. Making it look like Mexico. Locking in "our age of deception…even more tightly." It's a "self-defeating free-market strategy. Short-termism" that will prove to be the financial sector's undoing. Perhaps industrial capitalism and the republic with it. If not soon, eventually.

Replaced by what is most worrisome. Egalitarian reforms come rarely but are possible. Past protest movements achieved them. Ones based on what Frances Fox Piven calls a "distinctive kind of power. Disruptive power." Past conditions were right and it happened. Piven wonders if another "popular upheaval" is possible. It's "the big question of our time" and even bigger with reckless militarism. A permanent war economy. The erosion of democratic freedoms, and potentially the nation's worst ever financial crisis. Nothing is certain or easy, but historically "hardship propels people to collective defiance," especially at times of extreme inequalities of wealth. Given the current state, what more urgent time than now.

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