The Economy of Gentlemen

By The Mogambo Guru

06/26/06 **The Daily Reckoning PRESENTS:** It's a rather gray, overcast Monday here in Baltimore, which compliments the undertone of today's issue of the Mogambo Guru. But in true Mogambo fashion, he sets out to make us laugh about that for which we should cry. Read on…

The Economy of Gentlemen

I don't know if I am just confused as usual, but I am unsure whether last week's $4.6 billion drop in Total Fed Credit is cause for celebration (that the Fed has stopped acting like profligate monetary morons) or panic (that the economy is now totally dependent on the Fed acting like profligate monetary morons).

New Fed-created bank credit is supposed to mean new debt and new money, but where is it? As a result, the M2 measure of the money supply is just languishing all of a sudden. It is not a good sign, and toting an Uzi with me everywhere I go is not a good sign either, but they are both connected. Why? My finger suddenly spasms, and a bullet unexpectedly gets fired into the wall. My wife screams, "What in the world was that all about?"

I fix her with a glare, instead of explaining that it might have something do with Ty Andros, of TraderView.com, writing, "The fiat currencies and debt creation model the industrialized world has implemented will collapse unless money and credit is continuously being expanded. It is basically a type of Ponzi finance scheme where new buyers must take out existing holders of assets at always-higher prices."

This is oddly in keeping with Puru Saxena, of the Money Matters newsletter, who writes, "In 1971, the non-gold reserves of all countries were worth US$100 billion and today these have grown to roughly $4.3 trillion – an alarming 43-fold increase in 35 years! Rampant monetary inflation fuelled by the growth of credit turned the capital markets into one giant casino as punters worldwide (often loaded with credit) searched for the next opportunity to make a fortune."

And I notice with a Grim Mogambo Frown (GMF) on my stupid face that required reserves in the banks actually went down to the bottom of its range for the last zillion years or so. Shoot, picking a date in random, say, in May 1995, which was eleven long years ago, total deposits in the banks ("savings") were only around $110 billion, and total loans and leases on the books of the banks logged in at only $204 billion. And against that, the banks were saddled with $57 billion in required reserves.

Now, I notice how my blood has run chilly, and how everything is dark and gloomy. Gaunt buzzards have gathered in the trees to sit and lick their chops as they glare into the deep, dark, dangerous depths of my soul. I realize, in a sudden cold sweat, that the dollar and the banks (as we Professional Mogambo Economists (PME) say) "are doomed!"

The scene is now perfectly set to reveal the ugly fact that total deposits at the banks are up to $5.2 trillion, which is 47 times bigger than it was in 1995. That's a growth rate of 42% a year, compounded! And the total loans and leases is now $5.7 trillion, which is 27 times bigger than in 1995, which works out to an annual growth rate of 35% a year! Big, Big increases!

Yet against that monstrous, cancerous rise in both assets and liabilities, the required reserves went down from $57 billion in 1995 to only $42 billion today in 2006! Hahahaha! Surprise! Down! Required reserves went down! Hahahaha! To keep the same 0.518 ratio of required reserves against total deposits in the banking system in 1995, the banks would need to have, right now in required reserves, $2.693 trillion! Instead, they have only $42 billion, 1.6% as much! Hahahaha!

In short, more than all of the money and credit created in the banking system since 1995 has been literally created without any underlying cash deposits of any kind! None! Zero money! This is an infinite multiplication of deposits! Fractional-reserve banking at its insane, suicidal extreme!

But the latest stupid shenanigans of us Americans and our precious little Federal Reserve are getting to be almost insignificant. Bloomberg.com reports that China's Shanghai Securities News revealed that, for May, "the Chinese M2 money supply growth rose 19.5% higher than the level last year."

Anyway, foreign holdings in custody of the Fed went up by a hefty $6.8 billion last week, which is, I guess, how foreigners are trying to help us "manage" the planned decline in the dollar.

And you wonder why it is that I am always screaming that you buy gold and silver? Hahaha! Wonder no more!

The latest "official" annual rate of inflation is 4.2%…4.2%! Even after all the rubbing, scrubbing, and statistically falsifying of the raw price inflation numbers and "adjusting" the contents of the market basket they are measuring, this is the best lie they can come up with? Hahaha! I laugh in contempt until little specks of spittle start flying off my rubbery lips, as disgusting and obviously revolting as it is to the other people around me in the restaurant, huddled together in their stupid booths, eating their stupid hamburgers while plotting against me and saying terrible things about me behind my back.

In weird contrast, the official "Gross Domestic Product Deflator" went down from 3.5% to 3.3%. Hahaha! In case you have forgotten, the "Gross Domestic Product Deflator" is the rate of inflation that they use to statistically adjust nominal GDP (which is essentially the prices of all the things that were bought in a year, times the number of units bought). This wrings out the effect of inflation to arrive at real, honest, inflation-adjusted growth, and reported as "real" changes to the gross domestic product, which ain't a-going nowhere, even with all of this statistical hocus-pocus.

Perhaps this has something to do with total nominal retail sales being up a scanty 0.1% in May. And remember that these are "nominal" sales, meaning the only thing actually being reported is total money spent. When you adjust for inflation in prices, you derive the increase/decrease in the standard of living.

Failing that, you can more accurately derive the famous Mogambo Standard Of Living Index (MSOLI) as part of your professional duties (and therefore tax-deductible!) by repeatedly going to local "gentleman's" clubs and keeping careful records of how many dollar bills given away per unit of time, cross-referenced by beauty of the girl.

The dollar, as reflected in the dollar index, is still in a dead-cat bounce; it is still slightly rising when it should be crashing. I bring this up because the standard of living is connected with the value of the dollar. If the dollar buys a lot of stuff, you feel good. It's sort of like when I came home from my strenuous research at the Club Wanda Wanda Wanda, situated, as it is, way out on the dusty outskirts of town, where regulations are few, where police are scarce, where they have no cover charge, and where they serve hard liquor really, really, really cheap.

This means you get can drunker for the same amount of money, which is the same as having a strengthening currency. This, in turn, means you don't care or even notice that the girls are older and less attractive, which means, again in turn, that you can tip them less, and they are still grateful! I keep telling my wife, "Going to Club Wanda Wanda Wanda is a rise in the standard of living!" But not being a trained economist, she obviously just does not understand the whole concept.

The U.S. Labor Department said that prices paid by Americans rose 0.4% in May, which is plenty bad enough, but marginally better than in April, which showed a 0.6% increase. MarketWatch.com figures, "In the past year, the CPI has risen 4.2% – and at a 5.2% annual rate so far in 2005."

The CPI-U, a subset of the Consumer Price Index (CPI) figures, on the other hand, increased 0.5 percent in May, which is 25% higher than the headline CPI of 0.4%. Annualizing and compounding 0.5% inflation results in an annual inflation rate of 6.2%! Yow!

And none of this wholly, or sometimes even partially, reflects the big rise in energy prices, which are rising at the annual rate of 31%!

And the measure that the government uses to estimate the cost of home ownership as part of the CPI, owner's equivalent rent, jumped 0.6 percent last month, which was "the biggest increase in 16 years." The blame for this is that rents for housing are increasing, reflecting higher demand for rental housing, reflecting increasing property tax bites, reflecting higher property values (thanks to Greenspan's monstrous Federal Reserve, which spawned the housing bubble) and reflecting higher insurance costs, thanks to the Federal Reserve keeping yields so low to make up for its own mistakes that the insurance companies can't make any money from investing your premiums in bonds.

Naturally, Treasuries fell, pushing yields on two-year notes to more than five-year highs, which not only means that the yield curve is inverted, but it also means that bond prices are lower than five years ago. And they are probably going to get worse after the big increase in May consumer prices "cemented expectations the Federal Reserve will boost interest rates again this month."

And all of this nervousness is not just over-reacting as usual, accidentally pulling the trigger at every bit of bad news. Others beyond my wife, kids, and obnoxious neighbors are starting to get real nervous, too, as evidenced by the VIX, an index at the Chicago Board Options Exchange that measures stock market volatility. The index has risen to levels higher than at any time in the last three years.

And if you think that gingerly raising interest rates will stop a rising inflation, you are wrong, wrong, wrong. Until the rates get so high that they cripple the economy, higher interest rates only produce higher prices, which is de facto inflation: As the producer of goods and services borrows money to finance the on-going business, the higher costs of that borrowing have to be figured into the higher prices of the final output of goods and services so that the business can make a profit. So, in the short run, higher interest rates actually cause higher prices. And that's another compelling reason, as if you needed any more reasons, not to let inflation in prices get started by letting inflation in the money supply get started.

The only thing that will stop inflation is the inability or unwillingness (or both) of consumers to consume goods and services at those higher prices. This will cause economic contraction in our grossly distorted, mal-invested, twisted economy. And when those mal-investments fail, it is going to take everything else down with them.

The Mogambo Guru
The Daily Reckoning,
June 26, 2006

Mogambo sez: My advice on gold and silver? Instead of me droning on, hour after hour, listen to the succinct Mike Hoy, who says the same things I would in few words. Writing an editorial on Gold-Eagle.com, he says, "I believe the reasons for owning the precious metals have only intensified and become more obvious as each day passes."