Another Nail in the Coffin

By The Mogambo Guru

01/15/07 **The Daily Reckoning PRESENTS:** The Mogambo is attempting to stay calm…but when he looks at the housing market…and then back at the Fed…and then back at the housing market, not only is he getting whiplash, but some serious indigestion, too. Find out why below…

ANOTHER NAIL IN THE COFFIN

An estimated $300 billion of consumer spending has already disappeared in the United States, as that is roughly the reported drop in mortgage equity withdrawal lately. If you think that the American economy is so powerful and so dynamic that it can ignore a drop of $300 billion in final consumption, then I want to ask what kind of medicine your doctor has you on, because, brother, I need some of that kind of pharmaceutical "you'll believe any silly crap" horsepower right about now!

And apparently Stephen Church at Piscataqua of Research could use some too, as I gather from reading his report "The Consumer Crunch: December, 2006 Update." He agrees, "The slowdown in household mortgage debt flow SHOULD lead to a recession – BUT the Federal Reserve is determined to prevent one."

He goes on to say that things are worse than just a lousy $300 billion gone-missing, as "The latest economic statistics show that consumers depended on new debt for 90% of their cash flow during 2006. In 2005, 88% of new consumer cash flow came from debt."

And sure enough, I think that the preliminary effects of this reported $300 billion slowdown in mortgage equity withdrawal seems to be showing up, as he reports,"M2 mortgage-related accounts have been near 0% growth on a year-over-year basis since the end of September. M2 itself has declined to under 5% growth on a year-over-year basis."

He further says, "We are experiencing a monthly cash flow pattern that implies consumer debt service levels have become too high," which means to me that nobody has enough money to make the monthly payments on anything new, because every drop of income is being used to service the existing debt, and I am now reduced to stealing money from the employee pension fund and/or my wife's purse.

If I get caught at this blatant theft, then I hope I get the same punishment as Franklin Raines and those other guys at Fannie Mae, who are merely being asked to give back part of the bonus money they arranged to "earn" by being so corrupt that Fannie Mae's books are in such undecipherable disarray that they should, by the rules of the NYSE, be de-listed, but are allowed an exception to the rules because Fannie Mae is so freaking huge that it is, literally, "too big to fail."

Of course, I am not sure of any of these facts, and don't really care, as it is just a microcosm of the incredible corruption and gluttonous personal enrichment by the rich and powerful that is always pandemic at the end of long booms fueled by an excess of money and credit.

Mr. Church is apparently horrified at my outburst of rude, crude, scandalous, slanderous squawking about the filthy corruption everywhere around us, and offers no comment about it at all. But about the apparent lack of money in the hands of the consumer, he has plenty to say, such as "Our preferred liquidity measure includes all checkable deposits included in M1. This measure has declined to under 20 days of funds in December 2006. At the start of the last recession, we had nearly [one] week more of funds at about 26 days."

And, I will dryly note, this means that 26 day's worth of savings was not enough to prevent a recession last time, when the economy was smaller, and so it seems silly to assume that only 20 day's worth of savings will be enough this time, when the economy is bigger! Hahaha!

The guys at ContraryInvestor.com hear us in the hallway, laughing and talking about this housing thing, and they come out of their office just as I was wondering if, and how soon, mortgage equity withdrawal would start up again so that consumers could increase their spending again. While they did not actually say "In your dreams, you Stupid Mogambo Butthead (SMB)", they said the same thing by noting that using "housing starts" as a proxy for the mortgage market/real estate sector, "The average cyclical peak-to-trough decline in starts historically spanned a 46-month time frame. The shortest contraction on record over the past 45 years was twenty-eight months. Can it really be that the current down cycle is done after only eleven months? We think not."

Apparently, they thought that I was still skeptical, and so put another nail in that housing-boom coffin by saying "Moreover, the average percentage decline in starts from cycle top to bottom historically has been just shy of 62%. So far our current experience has been 30.0%."

As if that was not enough, "Current levels of U.S. homes for sale [are] really light years above prior historical peaks. And against this context, mainstream commentators are calling for a bottom in housing? C'mon, do you think we're complete idiots?"

As refreshing as it is to hear of someone else being thought of as a complete idiot for a change, the point is about the supply of excess housing for sale, which is the subject of "Incredulity Redux!" by Edmund M. McCarthy, of Financial Risk Management Advisors, writing at PrudentBear.com. He writes that the supply of houses for sale is actually bigger than the numbers suggest, as while "We now see cancellation volumes reaching 30%-40%", the error is made when "These cancellations are not, through a quirk, subtracted out of the 'Houses for Sale' inventory, vastly understating supply"

Even without this interesting bit of statistical news, ContraryInvestor.com says that the "simple message" is, obviously, "that unless we are about to very meaningfully depart from what has been very consistent historical experience, the housing cycle isn't even close to a bottom right here."

Now, Stephen Church at Piscataqua of Research has already opined that “The slowdown in household mortgage debt flow SHOULD lead to a recession – BUT the Federal Reserve is determined to prevent one” and here is ContraryInvestor.com saying the same thing when they write “although it’s a very simplistic comment, the Fed will not sit still and watch housing deteriorate to any meaningful degree in 2007.”

Indeed, they say that if you look at the historical record of a month’s supply of homes for sale against the historical movement of the Fed Funds rate, it is “Highly correlated directionally.” Hmmm! One goes up, the other goes up! One goes down, the other goes down! Very interesting indeed!

But noticing the dark and gloomy music in the soundtrack, you know that it can’t be as simple as that, and that something bad is getting ready to happen to that “Highly correlated directionally” thing. Thus, you are prepared when he says ominously, “what seems quite the differentiating factor in the current period is that during this cycle housing price acceleration was not choked off in large part by restrictive credit.”

He asks, rhetorically, that since interest rates have only moved about one stinking percent, “Is it really a 100 basis point increase in the cost of conventional financing that is responsible for bringing the greatest residential real estate cycle in history to its knees?”

In short, it looks like housing prices are headed down because they had gone up too high in an insane inflationary bubble, thanks to the idiotic Federal Reserve creating all the money and credit that made it possible, and now all the interest-rate grease in the world ain’t a-gonna change that woeful fact one iota.

For a summary of the jobs report, I had planned to say that it looks like the gains occurred in jobs providing services, but then I thought to myself “Why bother working? I’ll bet Peter Schiff of Euro Pacific Capital has something to say about it, and it will be even better than anything you could come up with, you moron!”

And then I thought to myself “Why are you talking to yourself in the second person? Are you crazy or something?” and I reply, “Yes, I am! And I’m very sensitive about it, too, you rude bastard!”

In an angry huff at the rude exchange, I stomp off to go to Mr. Schiff’s site, and sure enough, I find that he writes, “The bloated service sector added 178,000 jobs, while manufacturing shed another 12,000 jobs. What this means is that 178,000 more workers will be consuming goods while 12,000 fewer will be making them.” Hahaha! And perfectly phrased, as I was easily able to read sneering, sarcastic contempt into it!

The clever wags at the View From Silicon Valley newsletter put it in an acronym, and say, “we invented a new statistic ‘CHARGE’ (Construction, Healthcare/ Hospitality And Retail, Government, Education) jobs. A distressingly large portion of what jobs there are show up in this category.”

One of the basic tenets of Dow Theory is that if consumption is up, then production must be up (to supply that consumption), and transportation must be up because the goods have to be shipped. It's not a good sign when one, or some, or all three of these three are not up.

Until next week,

The Mogambo Guru
for The Daily Reckoning
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**** Mogambo sez: It's a very good time to really load up on gold, silver, and other commodities like, especially, uranium and oil, as these prices are unrealistically low. My teeth actually ache from the bargains being too sweet!