August 07, 2008

Fractional-Reserve Banking at its Finest

by The Mogambo Guru

"TFC is what gets created with the literal push of a button at the Fed, and then deposited into the banks (or into the Fed itself!) and then turned into actual money when someone borrows this just-created-out-of-thin-air credit..."

Bill Buckler of the-privateer.com writes that as of July 29, 2008 "Global financial stocks have led declines that have wiped about $US 11 trillion from world equity markets worldwide so far this year." Just in the USA, Andy Sutton of My2CentsOnline.com reports, "the Dow Jones Wilshire 5000, which is the broadest measure of total market capitalization here in the United States, has lost over $3 trillion in shareholder value since the highs of 9 months ago."

As an American like me, I know you are interested in the losses of the Wilshire, and regardless of whether you give a rat's patootie about the rest of the world or not, such losses are, according to Mr. Buckler, "immensely deflationary", and beyond that, "As of the end of June, those who are still holding this paper can sell it today for $US 11 trillion less than they could late last year", which is "like removing about three quarters of the entire US economy."

I was quite unprepared for that startling revelation, which was apparently evidenced when I opened Barron's to see that their table labeled "Indexes' P/Es & Yields" showed that the Dow Jones has a negative earnings! Earnings of the Dow were $827 a year ago, $132 a month or so ago, and now earnings are less-than-zero! A loss! The P/E is thus "nil"; as is "earnings yield" a big, fat "nil!"

Probably because of this, I had a feeling that something bad was going to happen since so many bad things had happened, so many other bad things were happening, and it feels like more bad things are going to be happening soon, and my brain was spinning, spinning, spinning in confusion and fear, mostly from the fear that the Mighty Mogambo Backyard Steel Reinforced Bunker (MMBSRB) might be breached by angry, desperate people rioting in the streets as they act out their quite-understandable hysteria as they watch their own economic demise descending inexorably upon them.

Sure enough, after double-checking the locks on the doors of the MMBSRB and arming myself with enough firepower to stop a tank, I noticed that I was right; Total Fed Credit went up by a whopping $9.8 billion last week! Yow! No wonder I sensed something bad was happening! This TFC is the fabled "money from thin air" that you have probably heard about, and which gets multiplied by the banks (who are the recipients of that credit), and which turns into money when the credit is borrowed, which increases the money supply, which causes inflation in consumer prices, which I am SURE you have heard about.

And apparently the banks desperately need the money, as I gather from the Reuters report that "Banks borrowed a record amount of funds from the Federal Reserve in the latest week as the year old credit crisis took a persistent toll," which is apparent when they go on to report that "Banks' primary credit borrowings averaged $17.45 billion per day in the latest week." Per day!

This has GOT to be a lot of money on an annual basis, and I wonder how much, but the thought of wrestling with a calculator only to come up with a series of wrong answers that end up making me look like an idiot gives me (as Albert Alligator in the old Pogo comic strip used to say) the cold robbies.

Fortunately, Ed Steer of GATA comes to the rescue and calculates, "At $17.45 billion/day...times about 250 work days in the year...we're talking over $4 trillion dollars/year. Pretty soon we'll be talking real money!!!"

I notice with delight that he has punctuated that last sentence with three exclamation points, normally used to indicate extreme emphasis, thus illustrating yet another useful function of punctuation; the "humor via sarcastic understatement."

Agora Financial's 5- Minute Forecast added (sans exclamation points even though it would seem to merit a few of them), "Not only did the Fed dole out record funds from the discount window this week, but Bernanke and his crew also conducted another wave of TAFs and TSLFs. Earlier this week, the Fed 'successfully' conducted its 17th TAF. Banks were able to secure another $75 billion in emergency loans. And yesterday, another TSLF came and went. In less than 30 minutes, the Fed took on another $28 billion in illiquid asset-backed securities in exchange for U.S. Treasuries."

I looked around for Mr. Steer to calculate $28 billion in 30 minutes as an annual amount, but he was nowhere to be found, probably because he knew that we would both go crazy to actually find out...and that it would be a pretty stupid statistic, too.

So I went on to read that the scorecard is, "Between the TAFs and TSLFs, the Fed has now dedicated over $1.5 trillion to keeping financials afloat." Yow! This is 11% of GDP!

Ignoring my pounding heart, I deduce that a lot, if not all, of this money must be created, and it neatly explains why Total Fed Credit went up so much, as TFC is what gets created with the literal push of a button at the Fed, and then deposited into the banks (or into the Fed itself!) and then turned into actual money when someone borrows this just-created-out-of-thin-air credit, and at some huge, huge, freaking HUGE multiple of each dollar of new credit ("fractional-reserve banking at its finest!").

This means, in case the look of stark horror on my face is not enough to alarm you, that the money supply is being inflated like there is no freaking tomorrow, which means that prices of things will be going up like there is no freaking tomorrow, which explains why desperate angry people will be banging on the massive door of the Mighty Mogambo Backyard Steel Reinforced Bunker (MMBSRB), demanding that I give them some of my gold and silver because they are the only things that are worth anything anymore as the same, sad story is re-played for the umpteenth time in human history; a government encouraged the creation of excess money and credit so that they could go on a gluttonous spending spree, and the economy had a wonderful boom, which caused a terrible bust and the people suffered mightily.

Well, to be fair, this is ordinarily true, but right now money is being lost like crazy, too, which means that parts of the money supply are falling because debts owed to the banks are not being paid back. And since money comes into existence by virtue of the banks making loans, it goes out of existence when the loans are not paid. Oops!

As if to underscore that, Doug Noland in his Credit Bubble Bulletin at PrudentBear.com reports, "Bank Credit dropped $13.8bn to $9.403 TN (week of 7/23). Bank Credit has expanded $190bn y-t-d, or only 3.6% annualized.", which is less than half the rate of consumer price inflation, which means that not only is nominal bank credit not expanding, but the inflation-adjusted money supply is actually being contracted, although Mr. Noland notes that "M2 (narrow) 'money' supply surged $48.7bn to a record $7.747 TN (week of 7/21)".

Bill Bonner here at The Daily Reckoning says that the latest figures show the economy "growing more slowly than the population - which means, the average citizen is getting poorer."

So I yell out to the wife, "See? Everybody is poorer! Not just us! So shut up about what a lazy skunk I am and always demanding that I get a real job!" I could see that she was glumly accepting the fact that people are poorer, until Mr. Bonner ruined it by saying, "the figures are not very helpful anyway. In a consumer economy, GDP growth rates tend to measure the rate at which people consume wealth rather than the rate at which they create it."

I knew that talking about reduced consumption was going to set her off again; yammer, yammer, yammer about how I spend all the money on myself and how she and the stupid kids would like to spend a little on themselves, too, and blah blah blah.

Cleverly, I left in a hurry, because I know how this always plays out; the economy will collapse from ruinous inflation in prices as a result of the ruinous inflation in the money supplies, she will not shut up, and pretty soon the kids will be home from school and they will take her side of the argument. Like I said, I cleverly left in a hurry.