Ponzi Economy

By The Mogambo Guru

07/10/06 Money is disappearing, and that's not good for stock prices, home prices – or what's left of the Mogambo's sanity.

My hands were shaking as I looked for the latest report of Federal Reserve data, especially Total Fed Credit. This is always an awkward moment for me, as I know that I am going to hate the news, no matter what it is. And my family hates it, too. That is why they lock themselves in the bathroom in anxious anticipation of this very moment.

If Total Fed Credit is up, then I am angry that the Fed is creating more inflationary credit in the banks. If Total Fed Credit is down, on the other hand, I am not happy either, since this means that credit is not being created, which means more money won't be created, which is (as we professional economists refer to it in our scholarly research papers), The Big Freaking Bloodthirsty Horseman Of The Economic Apocalypse (TBFBHOTEA) when you are operating (as we do) a Ponzi economy (financed by inflation in money, prices and debt) and a Ponzi system of governments (financed by increasing debt, size, taxes and spending), based on a derivative currency (electronic digits) that is, in itself, based on a mere fiat/paper currency, with a banking system that allows itself an infinitely low reserve ratio (zero retained cash on hand as reserves against additional deposits or loans).

This brings up the embarrassing fact that in last week's exciting issue of the Mogambo Guru, I made a Big Mogambo Mistake (BMM) as was tactfully pointed out by several readers, which was (as embarrassing as it was), actually a delightful change of pace from the usual e-mails from readers (e.g. "You're stupid! I hate you!").

Well, what was this big mistake? I inadvertently used figures for loans and deposits of New York banks, and not the total for U.S. banks. The real figures, in December 1996, are bank credit was $2,769 billion, and savings was $2,214 billion. Now, in the here-and-now, July 2006, loans and leases are $5,738 billion and savings is $5,457 billion.

The interesting thing, which was (and is) the whole point, is that also in December 1996, required reserves were $48,935 million. Today, 10nyears later, and with twice as many loans and twice as many deposits in the banks, required reserves are only $44,139 million, down about five billion bucks!

This means that every dime of debt and money created by the banks for the last 10 years was literally created out of thin air, as there is no fractional-reserve backing (in cash) as a rainy-day fund for one thin dime's worth of the doubling of loans created, or the liability created by doubling of deposits! Zero reserves! In fact, reserves are about 10% less than they were 10 years ago!

But this is not about how I make mistakes due to chronic laziness, inattention to details, or slovenly work habits, but about Total Fed Credit and how it creates the credit, which creates the debt, which creates the money that creates the bubbles. And not only do they create bubbles, but actual spending cash, as we learn from Stephen Church, of Piscatasquaresearch.com, in his essay at PrudentBear.com entitled: "Consumer Crunch Update." He writes, "The latest 2005 economic statistics show that consumers depended on new debt for more than 90% of their cash flow during 2005. Most new consumer cash flow now comes from new debt."

Intrigued, I urge him to go on. He does so by saying, "Consumer liquidity has resumed its downward trend. Liquidity has fallen to 3 weeks of funds on our preferred measure. Consumer money supply now flows backward."

I'm thinking to myself, "Hmmm! I wonder what this 'money supply now flows backward' thing means? And, more importantly, will I have to do actual work to find out?" Luckily, Church immediately went on to explain: "Historically, household incomes were sufficient to generate a cash surplus after consumption and debt service. Now, households have a large cash deficit."

But I have stalled looking at Total Fed Credit long enough that out of the corner of my eye I can see that my wife and family are timidly peeking around the bathroom door, wondering if it is safe to come out. With a chuckle I fire off a couple of quick shots from my .45 ACP out through the window. They immediately duck back inside, slamming and locking the door. I can hear them praying to Jesus to protect them. That ought to hold them for another 20 minutes or so.

So, imagine my conflicting emotions upon seeing that Total Fed Credit was actually down by $1.1 billion last week. I look at the chart. I note that in 2000, Total Fed Credit, astonishingly, also stopping growing, admittedly for a little longer time than this. But it caused the stock market to crash, and the S&P500 lost about half its value over the next couple of years. There have been a couple of other short times since 2000 when Total Fed Credit stopped growing, and the stock market was not pleased, but it did not actually crash. Mostly because, I assume, all the other central banks and "investors" were taking up the slack

But things are a lot different now. There is a growing consensus that global liquidity may be drying up, just like it seems to be doing in our own Federal Reserve.

So, if you have forgotten The Infallible Mogambo Market Indicator (TIMMI), it is that if Total Fed Credit is going up and keeps going up, then stocks and the economy will go up. If Total Fed Credit is not going up and keeps not going up, then stocks will not go up. They will, instead, go down, just like everything else when money is withdrawn from any overheated, highly inflated, grossly overvalued, monstrously over-indebted market.

Now, combine that Classic Mogambo Sign (CMS) with the dismal fact that the Fed only bought up a miniscule $52 million in government debt last week. And then, combine that with the ugly fact that foreign central banks only put a stinking, piddly $830 million into buying more U.S. government and agency debt.

Money is suddenly disappearing, and this is not good for stock prices, housing prices, or my wife's natural homicidal belligerence toward me when she realizes that some of her money has, likewise, disappeared from her purse because she stupidly left it unguarded on the hall table. I mean, I was just standing there. I see the purse. I see she is nowhere around. I notice that neither she nor my tattletale daughter can see me. I have no impulse control. So, who is the real victim here?

But this is not about what my wife believes versus what she can prove, but about how the lack of new money means that the Ponzi-stock market, the Ponzi-bond market, the Ponzi-real estate market, and the Ponzi government program market are going to be too, too, too starved for funds to continue rising in price.

Except gold, which will soar when people (by which I mean those whose retirement funds were stupidly entrusted to these markets) will be panicky and desperate to make up for their losses as they realize that all their other stupidly inflated stock assets, and stupidly inflated bond assets, and stupidly inflated real estate assets are almost all destined to fall mightily in price from their current hugely inflated prices.

Everyone will look around for someplace safe to put their money, and they will eventually look at gold and silver. They will discover, just as all other people have discovered through time and space, that there is no other asset that has ever performed like previous metals. Nothing has even come close.

Soon, gold and silver will be rising, rising, rising, because all the rich and smart people will cash out of stocks, bonds and real estate to buy gold and silver, making the price rise and rise, month after month, year after year.

And as we slower, intellectually impaired, low-level, gutter Mogambo-type trash (if you know even who The Mogambo is, that is you) will also look around for someplace, anywhere, anything, to make a lot of money fast, because nobody will be hiring. In agony, we real morons out here accidentally get sober enough to realize that we have watched other people constantly making big profits in gold and silver, and now we want in, too. The rush will become a stampede, as the stories of the fortunes made in gold and silver will fill the newspapers, airwaves, newsletters and popular magazines.

And that, my Adorable Mogambo Darling (AMD), is how gold and silver will have a spectacular bull run. That's why you should buy gold and silver now.

Until next we meet…

The Mogambo Guru
for The Daily Reckoning

Mogambo sez: The way that the gold lease rates have just collapsed tells me that the gold market manipulators are going to try to manufacture a sell-off in gold. Get ready to do some bargain buying! Whoopee!