

Learn to Love the Depression



08/19/09 Ouzilly, France

A V-shaped recovery?

A W-shaped recovery?

Forget it...**there ain't no letter in the alphabet that describes a "recovery" we're likely to have.**

We say that in the spirit of mischief as well as elucidation. Of course, the world won't stay in a depression forever. And even depression ain't so bad, once you get used to it. The world economy will probably drag around a bit on the bottom...with low, or negative, growth rates in most places...until it finds a new model. The old model is dead. The authorities can put on as much rouge and powder as they want. They could even give the corpse jolts of electricity to make it sit up. But they can't revive it. It's finished. Over. Kaput.

The old model involved lots of players playing lots of different roles. But the main protagonists were the USA. and China. Not to put too fine a point on it, but China was the maker; the United States was the taker. It was a relationship that seemed to serve both parties well...but one that actually enabled foolish and, ultimately, destructive behavior – especially on the part of the United States.

When we were growing up, China was a 'Red Menace.' It was full of mad people doing mad things. They humiliated people by making them wear dunce hats and march through town. The Chinese made steel in backyard barbecues. They built hidden palaces for Mao (the Great Helmsman)...wore odd outfits...and threw female babies onto trash piles. (We're not making any of this up!)

But then came a period of sanity. Deng Xiaoping decided to turn the whole country in the direction of capitalism. At first, this was thought to be a great boon to the West. We had won! And suddenly, there were a billion more consumers in the world economy. Company executives went to sleep with sweet dreams: 'If we can sell one refrigerator to just one out of every 1,000 Chinese...'

The dreams became nightmares. Instead of selling American-made refrigerators to the Chinese, the Chinese sold Chinese-made refrigerators...and toaster ovens...and tables...and every gadget, gizmo and whatchamacallit known to man...to Americans. **Instead of being a consumer...China became a manufacturer** – taking the 'export route' to prosperity, pioneered by Japan in the '60s and '70s...and perfected later by Korea and Taiwan. Instead of adding to the world's demand for products made by the developed countries, China became the biggest supplier of stuff on the planet.

China made...China sold...China took its money, bought US Treasury paper, thereby helping to keep lending rates low in the United States, and made some more. It worked beautifully as long as Americans were willing and able to continue spending. But no camel's back is infinitely strong. The final straw came in 2007 – with total debt equal to 370% of GDP.

And now the jig is up. **The old formula won't work – neither for Americans nor for the Chinese.** Despite the urging of their government, Americans cannot be expected to take on more debt in order to continue consuming more stuff from China. Nor can the Chinese reasonably expect to work themselves out of an overcapacity problem by creating more of it.

But the officials in both countries seem equally benighted. They don't seem to think very deeply, no matter what language they think in. On one side of the Pacific, the Americans think they can bring a recovery by encouraging consumers to borrow and consume more stuff. On the other, officials offer credit to entrepreneurs and industrialists – encouraging them to build more factories and add more capacity so they can make more stuff. Neither seems to realize that the real problem is **THAT THE WORLD HAS TOO MUCH STUFF ALREADY.**

In the United States, the private sector drags its feet; it's had enough of debt. But along come the feds like Fred Astaire or Arthur Murray...ready to borrow and spend until the champagne runs out. When it comes to self-destruction, the feds are no slouches.

They're borrowing and spending trillions – **\$8 trillion is to be added to US debt over the next 8 years.** So far, this money has done nothing to relieve the underlying problem: the consumer has too much debt and too little income. The government can give him a tax rebate...or give him a check for a clunker. These giveaways will produce a temporary boost. But when the giveaways give way there is nothing left. Does the guy who bought a car with government cash in 2009 buy another one in 2010? Does the fellow who brought his mortgage up-to-date with a tax rebate in 2008 go out and buy a new house in 2009?

The problems are real...at the heart of the real economy. They are not problems that can be solved by monkeying with the money supply, interest rates, or even fiscal policy. They are problems that need to be solved by the real economy...in the real economy...by consumers, who need to pay off their debts, and by businessmen, who need to adjust to the realities of the real world – adapting their capacity so as to produce things for people who can actually afford to buy them. **It's a long process...with many bankruptcies and disappointments along the**

way...

That process has only just begun. It will deepen and get worse, as both consumers and businessmen realize that there will be no quick recovery...and no return to the old model – ever. Look for more layoffs...more foreclosures...more cutbacks and workouts...

Look for more depression, dear reader...

And learn to like it; it will be with us for a long time.

<http://dailyreckoning.com/learn-to-love-the-depression/>