

Economic Crisis Moving Steadily Towards Denouement

December 09, 2009

First of all, apologies for the lack of posts recently. I have simply not had the time to post.

Are others seeing that there is a slow and steady unwinding of the economic situation? There now appear to be signs of substantial cracks in the edifice of the illusion economy. A review of the news sees several apparently unrelated stories, but nevertheless they cumulatively represent the underlying flaws in the attempts to hold back the underlying reality of the world economy.

First of all, there is the ongoing [saga of Dubai](#), the exemplar of the worst excesses of property speculation:

Fresh fears about Dubai's ability to resolve its huge debt mountain returned to global stock markets today as shares across America, London and Europe tumbled.

In America, the leading Dow Jones industrial index fell 111.63 points to 10,278.48 at 3.40pm in New York.

Earlier today, Abdulrahman al-Saleh, Dubai's finance minister, admitted that six months may not be enough to restructure Dubai World, the state-owned conglomerate which owns Nakheel, the property developer.

It later emerged that Nakheel made first half losses of \$3.65 billion, according to Bloomberg, after taking a huge writedown on the value of its land and developments. Two weeks ago, the Dubai Government asked creditors to grant Dubai World a six-month standstill on its repayments of nearly \$60 billion of debt. Dubai World then announced plans to restructure \$26 billion of its liabilities.

Likewise, there are the ongoing problems of Greece, perhaps an outlier for the larger Western economies. Greece presents [another crack](#) in the edifice of confidence in government debt:

The agency placed the country on credit watch negative, meaning it is likely to lose its A- rating within months. The country already has the lowest credit rating in the eurozone, but has come under greater scrutiny amid fears that its newly-elected government may avoid imposing significant cuts on the public finances

[and]

Following the recent crisis in Dubai, investors have become doubly sensitive to the risks of sovereign debt crises, with others warning that the UK is similarly exposed.

S&P also revised its outlook on Portugal's sovereign-credit rating to "negative" from "stable", blaming a deterioration in public finances.

As I have previously argued, if the UK falls, the US will soon follow. In the meantime, President Obama is reacting to a swathe of bad news with [yet more 'stimulus' spending](#), at a time when the creditors to the US are already very nervous:

WASHINGTON – *President Barack Obama called for a major new burst of federal spending Tuesday, aiming to jolt the wobbly economy into a stronger recovery and reduce painfully persistent double-digit unemployment.*

Despite Republican criticism concerning record federal deficits, Obama said the U.S. must continue to "spend our way out of this recession" as long as so many people are out of work. More than 7 million Americans have lost their jobs since the recession began two years ago, and the jobless rate stands at 10 percent, a statistic Obama called "staggering."

Congressional approval would be required for the new spending, the amount unspecified but sure to be at least tens of billions of dollars.

This new stimulus comes on top of the news that the fiscal situation in the US is already in an absolutely [appalling state](#):

In October and November, the government spent \$292 billion more than it took in, the nonpartisan Congressional Budget Office said.

That was even worse than the same period last year, when the government was on its way to posting a record \$1.4 trillion deficit for the fiscal year that ended Sept. 30.

The federal budget has been battered by the worst economic downturn since the Great Depression of the 1930s, as tax revenues have plunged and spending on safety-net programs like unemployment insurance have skyrocketed.

What we are seeing is the ongoing unwinding of the many bubbles, and that the forecasts and announcements of the end of the crisis are indeed premature (which has long been my argument). Even [Bernanke is admitting](#) that there are ongoing and deep problems, and the \$US continues to decline:

The dollar resumed its slide against the yen, euro and other currencies after climbing in recent days amid hopes the US might stage a quicker-than-expected rebound.

On Monday, however, Fed Chairman Ben Bernanke said the world's largest economy was facing "formidable headwinds" — including a weak job market, cautious consumers and tight credit — that would limit the pace of recovery.

Obama expressed shock at the relentless rise in unemployment, but around the world a dire situation continues to deteriorate. This is just one example from the [Times](#):

London traders were also unnerved by new data on industrial production, revealing flat output in October, signalling that Britain, which is still in recession, has made a weak start to the fourth quarter. The CBI also published its industrial trends survey, which showed factories expect output to fall in the coming months.

The weak data was released ahead of the Pre-Budget Report tomorrow when the Chancellor is widely expected to reduce his forecast for Britain's economic growth this year from a decline of 3.5 per cent to 4.75 per cent.

Meanwhile, European markets were unsettled by Fitch's decision to cut Greece's sovereign debt rating to BBB+ from A- with a negative outlook - the first time in 10 years a major ratings agency has put Greece, the eurozone's weakest economy, below an A grade. Fitch cited fiscal deterioration as the reason.

Also weighing on European stock markets was worse-than-expected German industrial production data. German industrial output fell 1.8 per cent in October, largely as a result of weaker production of machinery and cars, against expectations of 1.1 per cent growth.

As ever, the nervousness about the situation continues to be seen in the [price of gold](#):

***G**OLD soared through US\$1,200 (S\$1,657) as investors and speculators feared renewed US dollar weakness following President Barack Obama's decision to substantially boost the war effort in Afghanistan.*

Other factors that have boosted the demand are worries about quantitative easing, that is, money printing in the US and UK, punitively low interest rates for savers seeking a home, fears of renewed inflation and persistent turmoil in the Middle East.

Uncertainty in Dubai with expectations of bailouts and a general rise in oil and other commodity prices are other reasons.

There are some curiosities in the news, such as the ongoing rise in house prices in the UK. One just has to ask why house prices might be rising in a sinking economy to know that this is yet another illusion. After all, with [unemployment rising](#), where is the money coming from? One [article](#) suggests that it is a lack of supply of houses for sale as the driver, but it is certain that the rise in prices does not reflect the real economy.

Essentially, any review of the news shows that the attempts to reflate economies with printed money and massive government borrowing are simply not working. The cash for clunkers, the massive spending on 'make work' projects are a dead end. Printing money with no economic foundation will simply not work.

The one thing that might work, the reforming of the economic structure of the troubled economies, is the one thing that is never considered. In the early days of my blog, I wrote some examples of how the UK economy might be reformed. I am not sure that the UK will be able to even afford to support the reformed economy that I proposed. It is too late. Instead of using credit to manage the transition to a more lean and competitive economy, credit has been used to try to hide the reality of the economic situation. The same might be said of other economies, such as the US.

I keep on asking how long can this continue? How long before the illusions shatter? I am amazed that it has lasted this long.

Note 1:

In an early post during the bailouts, I mentioned that all of the money given to support the UK banks was not to protect little old ladies' savings, but to support overseas creditors. This is what I had to say in a post titled '[The UK and the Silent Bank Run](#)' (written March 2009, but I think I argued this point at the outset of the bailouts, but cannot find the article):

If we think of the numbers that we are looking at, it becomes self-evident why the endless bailouts by the government are falling into a black hole. The government is having to bail out the banks to repay these overseas investors such that, as fast as the money is pumped in, it is pumped straight back out to meet the demands of overseas depositors. With the banks sitting on mountains of toxic debt, with no market left for the sales of these toxic assets, there is nowhere to turn except to the government.

It is as I have long suspected. I have always been of the view that this is not really just about bailing out little old ladies with their savings held by [RBS](#), but also about bailing out all of the overseas investors who stand to lose so much money.

This is an [article](#) in the Telegraph:

***B**ritish taxpayers stand behind more than £167 bn of toxic assets in the US, Ireland, the Middle East and beyond, it has emerged as the Treasury disclosed details of what Royal Bank of Scotland has dumped in the state insurance scheme for bad debts.*

Most of the £281.9bn of assets RBS has placed under taxpayer protection are based outside the UK, with loans secured against everything from negative equity properties in Dublin to hedge fund assets in Caribbean tax havens and container ships docked in ports around the world.

I suspect that this is just the tip of a very large iceberg, and the same will be found for the US. What we have witnessed is the salvation of the banks to protect overseas creditors. These were the same creditors who flooded the economies of countries like the UK and US with money, which in turn created the asset price bubbles and credit bubbles. In the case of the banking industry, it is heads I win, tails I win. It was never about protecting the small domestic depositors, but bailing out overseas investors.

Note 2:

A slightly rushed article as I am still pressed for time. However, I hope it provides some evidence that we are a long way from any real or sustainable recovery.

<http://seekingalpha.com/article/177230-economic-crisis-moving-steadily-towards-denouement>