All Into the Pool

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In 1911 J. P. Morgan personally intervened to prevent a financial catastrophe by forming a pool of bankers to inject enough liquidity into the economy until it was able to catch its second breath. That event led to the formation of the Federal Reserve banking system. Now it was no longer necessary to depend on the top investment banker to step forward in a crisis.

Beginning in March of 1929 the financial markets began to experience mini collapses and revivals. By Labor Day the Dow hit a new peak. Following the holiday it began a steady slide. The Fed did not think there was a problem worthy of its intervention. But the investment bank J. P. Morgan was very concerned and repeated the pool remedy its founder performed in 1911. It failed and on October 29 began the famous collapse. This time It took a decade of state intervention and finally a world war to mend the world economy.

When the current crisis began in 2007-8 it didn't take very long for the Fed to begin its interventions. In this country, following a dab of convention stimulation (much to slow acting in a financial collapse), the solution was almost totally an increase in liquidity. Elsewhere there has been a certain amount of state infrastructure spending, but gradually the world is depending on fast-acting liquidity to revive the economy. As earlier rounds of money printing and interest cuts failed both efforts were increased until rates were near zero and trillions of financial paper distributed. Smaller countries required loans from the IMF to handle their debt burden. After almost running out of funds, the IMF called for an increase in contributions from the major economies in order to replenish and enlarge its standing pool.

What has become increasing clear over the 6 years of recovery efforts is that the only 'success' has been to produce a financial bubble. The real economy (the only part of the economy where life exists) has been stumbling along near the bottom. The dynamics of capitalism are such that it absorbs (exploits) every source of profit and then needs more in order to survive. That's why the world economy appears to be entering a stage in which present efforts will no longer be effective, and what is worse -- the liquidity dump has done so much structural damage that it will be very difficult to find a fresh remedy should there be another economic collapse.

By way of analogy, what has occurred is something like an athlete using Human Growth Hormone to build his muscle mass. Problem is that HGH increases other tissues besides muscles, and the quality is not very good unless a person is actually deficient in the needed hormone. As this relates to the economy, the massive injection of liquidity has produced and increased the amount and size of financial institutions that are at best extraneous, and at worst damaging, to the economy as a whole. Perhaps a better medical analogy is the recent report that those who eat a healthy diet do themselves more harm than good if they also take a multi-vitamin. They think they are covering all bases, making up for a shortage

of a particular vitamin from time to time. What they are actually doing is training their digestive system to absorb the inferior, but more easily digested, synthetic vitamins and dump the good stuff in real food. The economy functions something like the human evolutionary process. In evolution what functions most efficiently makes the evolutionary cut. Thus the digestive system easily handles the synthetics and gradually loses its ability to absorb nutrients from real food. It's somewhat like getting hooked on a drug. The gut needs to be retrained in order to function well with real food. Well, the sugar-water of liquidity has done much damage to the real economy's ability to do real work and produce real stuff. More later on the remedy.

The most significant economic news of the week was the extremely low market volumes. Housing produced two major reports that once again was converted by the popular media from what is essentially negative into positive sound bites. New home sales for April increased to 433,000 annual rate from 407,000 in March. That's a 6.4% increase. But March was a 6.9% decline from Feb. Furthermore, year to year, April sales were 4.2% less than April 2013. The three month moving average for Jan-March is 433,000. Thus, the average for our terrible winter is exactly the same as our springtime April. And when you factor in the government permitting an easing of lending requirements, this is wholly a negative report. Same with existing home sales. Rose 1.3% in April. First increase of the year but the number of homes sold were 7.3% below the same month in 2013. House prices increases slowed and actually dropped 1.3% for new home sales. The strength of the economy relies so much on increased home equity because earned income is stagnant. Then we have retail sales. In January experts predicted 13% growth in the first quarter. With about 70% of earning reports in it seems it will be a 4.1% drop instead. Just a slight miss.

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