Prepare Yourself for a Shock

6-27-14

The second reading of the 1st quarter GDP had been revised down to -1% from -0.1%. The consensus for the third and final revision ranged from -0.5% to -2.4%. The final reading: -2.9%. The largest downward revision since this procedure was instituted in 1976. The most negative GDP quarter except for those immediately before and during officially determined recessions since they began in 1947.

Did the markets give back some of its asset bubble loot it pocketed during this historic decline of the real economy? Not at all -- it actually had a nice positive close because, you see, it was all due to bad weather, and Markit is already seeing a possible 6% growth for the second quarter. Investors know that if they obediently chase the carrot on the stick it will eventually lead them to the whole farm.

That -2.9% negative growth rate was based on an extremely low 1.27% inflation rate for the 1st quarter. Had they used a more accurate figure in the vicinity of 2% the reading would have been -3 to -5%. Or the 3.912% of the Billion Prices Project which presents a reading of -5.62. Even as it stands, 3% growth the remainder of the year will yield annual growth of 1.5%.

The following day brought a report that consumer spending adjusted for inflation fell 0.2 in May after falling 0.1 in April. The lower than expected growth in consumer spending along with a decline in inventory buildup because of the excessive buildup the previous two quarters in the 1st quarter is said to be responsible for much of the adjusted decline. Everyone is familiar with the oft-repeated statement that consumer spending constitutes 70% of the GDP, but there is the tendency to think of that as retail sales. Much of it is in fact those basic expenditures like health costs, housing, fuel and utilities -- expenditures that must precede discretionary purchases. Those costs are so high that retail sales have come in below expectations. This report did cause a number of financial institutions to lower expectations for the second quarter.

The excess capital accumulation crisis continues to be on track for an explosive downturn. In earlier times economic crises were allowed to give the system the equivalent of an enema by destroying vast amounts of impacted capital (paper wealth invested for the purpose of creating more paper wealth). Then "super smart" economists decided they could fix things. They created new uses for capital expenditure by having it finance things like infrastructure improvements. But building real stuff takes time and has its own limitations. The solution? The manufacture of multi-level piles of financial instruments secured by the ninth cousin of something real. But even the highest beanstalk must be secured by earth that holds its roots in place. Have the "experts" prepared another act to follow the close of this one, or will the last scene instead be a denoument?

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