Repo Revenge

09-20-2019

Borrowing at the human level is pretty straightforward. A person seeking a loan to purchase a home with an established credit worthiness obtains a mortgage at a certain rate of interest. The person gets a home, and the bank obtains an income on the loan and has the house itself as collateral. But now with our financialized economy there is a great deal of rapid transactions involving financial instruments far removed from anything that is real or concrete. Yet they still must be funded as rapidly as they are initiated, and for some that requires both cash and collateral.

The Fed lowered its Fed Funds rate for the second time since 2008 to a base of 2%. That is a target interest rate for banks with excess cash to loan to other banks at a rate near the target. The banks negotiate the actual rate, and the average of the daily negotiated rates becomes the Effective Fed Funds Rate. These loans are overnight and un-collateralized.

There is a similar short term loan that normally has a rate (Repo rate) close to Fed Funds. Hedge funds, banks, large institutional investors and the like enter the repo market for their financial investments. This is a short term loan that is collateralized with securities that will be repurchased (Repo) with interest when settled. What happened this week is that banks suddenly decided that they didn't care to participate in these loans and that caused the repo rate to rise as high as 10%.

Such an occurrence is of grave concern now that the financial sectors rule the entire economy. The Fed had to intervene four times in the week by buying $200 billions of securities and in that way adding cash liquidity to the economy. The last time the Fed had to do this was in 2008, but not to worry said the Fed and mainstream media, it's just the near end of the federal fiscal year, and corporations have to pay taxes, as if they don't have to do that every year. But the thing is that such an explanation doesn't explain the suddenness of the rate increase, or that their have been two similar repo surges in the past ten months.

John Williams, the head of the NY Fed which handles the emergency purchases, said today that they are looking into why banks suddenly shied away from loaning their excess cash. The obvious answer is that banks hesitate to loan if they sense significant weakness in the economy. And given the shabby nature of the so-called recovery a simple scratch can expose a fatal illness. Before the 2008 slump a GDP rate falling below 2% was considered the financial well-being line between just OK and time to look for burial insurance. Well our great 'robust' economy has averaged 2% for the past decade. With $3 trillion worth of daily repo transactions buttressing a flimsy economy it's likely that the Fed will create a special entity to handle repo emergencies now that the private system shows signs of opting out.

And for now on our bank overseers will be on full alert the final two weeks of a quarter. Bear Stearns failed during that period in the first quarter of 2008, and Lehman collapsed during the same stretch of the third quarter. The flow of sufficient money and credit must be maintain. Under capitalism that is the foundation of the real world.

Economics Info

– The Initial Public Offering phase of our sickly world economy may be ending if the canceling of the WeWork IPO after its initial estimated value of $40 billion declined by half as the IPO date got closer. There is also concern that two of the most promising ride-share IPO's will ever earn a profit. According to Arete Research Lyft and Uber must obtain 50 rides per year by active users to become profitable. So far they haven't managed more than 30.

– Perhaps the best method of determining the health of the real economy is a measure of the volume of commodities being transported. The Cass Freight Index fell 3% in August, the ninth consecutive month of a decline. Cass sees a risk of negative GDP by the end of the year. One economy going briefly negative does not mean a recession, but what the US is experiencing is occurring around the world.

– A relative comparison of growth. In the 39 quarters from 1991-2001 GDP growth was 43%. In the 39 quarters through April 2019 GDP growth totaled only 22%. That illustrates the recession within a 'recovery', all the negative vibes among folks who were expected to be thrilled with the system's success. It also explains the phoney low unemployment rate. There are fewer jobs to be had when an economy shrinks thus making it easier to have those available filled.

– According to the chief global strategist of Deutsche Bank one of the most accurate indicator of a coming recession is the rate of job increase. Annuals US job growth in the middle of last year was 2.5%. It was 1.3% this August, the weakest in 10 years. Every time its dropped before 1% the US has had a recession.

– The US consumer accounts for 70% of the GDP growth, and is a major source of economic growth in most of the larger industrial economies of the world. According to a consumer sentiment survey last week consumer confidence fell last month at the fastest rate since 2012.

– China industrial output growth rate fell in August to 4.4% from 4.8% in July. That's the lowest growth since 2002.

– According to the German financial services company Allianz China's net financial assets fell by 10.2% last year. That meant a gross financial asset decline of 3.4% in 2018 for Chinese households. The first decline since 2000.

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