Squeezing the Bubble

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The first beat after a heart stoppage is a good sign but does not signify a recovery let alone the best health ever. Not according to Nasdaq which is at record high despite the worst slump since the Great Depression. The Dow and S&P 500 are in close pursuit. What is the source of all this optimism? Nothing. Not unless one should rejoice that capitalism didn't actually die because of the Covid pandemic and anti police state protests.

The financial press has regularly issued warnings to no avail that this irrational exuberance is moving into insane territory. It seems that the Fed this week took actions to squeeze some air out of this hyper inflated bubble. The final straw was likely the markets ignoring data proving that the two keys points for their optimism -- that the economy was really recovering rather than merely showing signs of life, and that the worst of the pandemic was over -- were chimeras. The former is already fizzling out while the latter is worse than ever with today registering the highest new infections since it began.

The norm for the Fed until 2008 was to make loans to banks during troubled times to be lent out to businesses and people for the purpose of reviving the real economy. But that economy which is the place where real life happens was like a seized engine; in need of replacement rather than repair. That left only the financial sector to provide a semblance of recovery. Nothing real or productive need be done, just lend the investor class easy money and they will gamble the economy into a fictitious recovery.

Speculators make their purchases on margin; that means they are backed by collateral which is financed by repo (repurchase) loans. Banks departed from this line of business after the experiences of the 2008 crisis. Since then the Fed has designated 24 primary dealers to provide fuel for the market rise. Last year they began running short of funds for repos. The level of repo fails increased to the extent that the Fed had to make an extraordinary effort to fund primary dealers. It seems that banks no longer care to make repo loans, they also shy away from lending to specialized firms that do. As of this March the Fed total expenditure on repo loans was $9 trillion. When the brief bear market occurred in March the Fed provided $442 billion in repo loans in a single week. But the Fed can also be frightened by too much of a good thing. This past week they contributed not a single dollar to repo loans. They also diminished their $7.2 trillion balance sheet by $248 billion this past month. Will this lead to a more real and grounded basis for market investing? Today Nasdaq hit a new high; in lock step with a different type of high -- more than 63,000 American contracting Covid in a single day.

China Bank Lending

China's combined relationship between private and state capitalism, or a free market economy with the characteristics of Stalinist infused state capitalism, provides a more effective basis for lending in times of financial stress. Besides a commercial banking system there are also banks among the state owned enterprises. They are gradually being reorganized to minimize losses and will inevitably become sources of profit before long. Currently there is no urgent need because the state also controls foreign exchange reserves (both gold and currency, primarily dollars). But that sum has been shrinking – from about $4 trillion in 2014 to $3 trillion today. Thus Beijing has instructed commercial banks to use 75% of 2019 profits ($212 billion) as an economic stimulus in the form of lower lending rates and service fees. The state will also lower reserve requirements. It's not military concerns that should be troubling the American ruling class, it's the inability of sectors of their class to rank preserving the strength of that class as a whole over their individual private self-serving interests.

Japan's Economy in Recession

The pandemic has been useful to world capitalism in that it can be made into the source of a world recession that in fact arrived late last year. Household spending declined 16.2% in May from the previous year; the largest decline in almost 20 years. Real wages fell at the fastest pace in 5 years. Expectations are that the country will experience the worst economic downturn since the end of WW 2. The economy fell into recession last year with a 7.2% decline in the 4th quarter. Economists are predicting a 20% for this year,

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