The Coming Economic Collapse

Graham Summers
June 12, 2009

Today's essay details the ongoing collapse of the US economy with a focus on why this coming fall will prove the "worst is over" crowd wrong yet again. Earlier this week, I detailed three major developments. They were:

- The US's economic shift from manufacturing to services (mainly financial)
- The massive drop in US incomes
- The beginning of the debt bubble

Today, we're addressing how the debt bubble encapsulated the US government as well as why Obama's Stimulus Plan won't fix anything.

To revisit the above three points, the US began outsourcing jobs in earnest soon after we re-opened trade with China in 1971. As outsourcing spread to higher and higher skilled jobs, this meant fewer jobs in the US market. This resulted in US consumers having to use credit to maintain their standard of living. It also meant more than one parent working to make ends meet.

On a national level, the US government began living beyond its means as well. Adjusted for inflation, gross tax receipts have only risen 40% in the last 39 years. However, over the same time period, total government spending increased 2,600%!!!

To fund this insanity, the US issued debt in the form of Treasuries. Foreign governments (most notably China) which were generally getting richer selling us stuff loaded up. The whole scheme is similar to buying a toy from the store, then having the store lend you money to buy another toy ad infinitum: hardly a sensible long-term plan for financial solvency.

Now, everyone knows we run deficits. But not everyone knows that the deficits we publish are unbelievably understated. Corporations, in order to qualify for generally accepted accounting principles (GAAP) have to count their pension and healthcare expenses for retirees.

Uncle Sam doesn't.

John Williams of www.shadowstats.com notes that official US deficit statistics do NOT include net present value of unfunded social security OR Medicare expenses. A lot of folks have made a big deal about the US running a $1 trillion deficit this year. Well, if you included the net value of those unfunded Social Security and Medicare expenses we **cleared a $1 trillion deficit in 2007, a $5 TRILLION deficit in 2008 and are on course to clear a $9 TRILLION deficit this year**.

To give you an idea of how big a problem these deficits are, consider that the US government could tax its citizens **100% of their earnings and NOT have a balanced budget**.

In light of these issues, the government's $787 billion stimulus package doesn't exactly breed confidence in an economic turnaround. Incomes have lagged inflation in this country for 30+ years. Creating a bunch of temporary positions related to construction and the like is NOT going to alter this in any significant way.

Moreover, most of the job growth in the last 10 years has come from Bubbles: two out of five jobs created between 2002 and 2007 came from the housing industry. The irony here, of course, is that the Stimulus Plan is merely following this trend, creating jobs from our latest (relatively unreported) Bubble: the bubble in government spending and employment.

Bottomline: the US needs to create sustained job growth involving skilled professionals with high wage earning potential, NOT more guys laying concrete. We need fundamental structural changes to the US economy, NOT temporary positions resulting from one-time government projects.

And with a $9 trillion deficit in the works, $787 billion doesn't really mean much in terms of increased tax receipts. Also, and this is bit of a personal aside, it's hard to believe that throwing $787 billion towards creating jobs really shifts our economy away from financial services when we've thrown $2 trillion+ towards Wall Street and the banks (via direct loans and lending windows).

The US has a MAJOR debt problem. Including future social security and Medicare expenses we owe $65 TRILLION. Because we live in a world in which the words, "billion" get thrown around with too much ease, I'd like to put that number into perspective.

Let's say you have a stack of $1,000 bills. $1 million would be a stack eight inches high. $1 billion would be a stack 800 feet high (think the Washington Monument). And $1 trillion would be a stack 142 miles high. Total US debt, if laid on its side, would be a **stack of $1,000 stretching more than 1/3 of the way around the earth**.

Ok, so where is the US economy REALLY at right now?

Year over year real employment, real industrial orders, real housing starts, and real retail sales are all posting their largest drops since the production shutdown following WWII. Put another way, the last time the US economy fell this hard this fast, **we were intentionally shutting down the monster than was the US war machine in WWII**.

This is no recession. We are already on our way to a Depression (a GDP contraction of 10%) possibly even another Great Depression. One in nine Americans are currently receiving food stamps. Real unemployment (without birth/death seasonal nonsense and all the other Federal gimmicks) stands at 20%.

So I don't buy the "green shoots" theory at all. Having things get horrendous at a slightly slower rate is NOT a sign of a recovery. Green shoots can pop up anywhere including the asphalt in the parking lot outside my office. That doesn't mean the parking lot is about to become a lush meadow.

No, the US is heading for a really, really rough time. The US monetary base has doubled in the last year. We owe $65 trillion in liabilities. The US government could tax every company and every American 100% of their annual incomes AND NOT PAY THIS OFF. The Feds will have to inflate this mess away. And they've got a master money printer Ben Bernanke overseeing this situation.

Now, I cannot foretell precisely how this will all play out. Typically when a bubble bursts it takes 10+ years, possibly an entire generation, before the assets that participated in the Bubble return to new highs (sometimes they NEVER do).

Now, we just got off the biggest credit/ debt bubble in the world's history. I'm talking about 30+ years of spending money we don't have culminating in a period in which Americans were speculating in the single largest asset they ever purchase (a house) without putting a cent of their own money at risk (0% down NINA loans).

We also saw a bubble in stocks, Treasuries, and most every other asset you can invest in. So the idea that we can recover from this in a couple of years seems over enthusiastic to say the least.

Remember, Japan experienced a similar Bubble (though they had higher savings than we did) and "lost" a decade of economic growth. It's worth noting that Japan WAS NOT an Empire like the US. Japan did not have with bases in 170 countries, a world reserve currency, and a crippled job market (history rhymes, it does not repeat).

So in terms of the real US economy, I don't foresee a recovery anytime soon. The stock market may soar thanks to the Fed's money printing, but a jump in financial speculation is NOT an economic recovery. If the S&P 500 goes to 20,000, but we're drinking $1,500 beer and wiping ourselves with $100 bills, we haven't gotten richer (never mind the fact that an S&P 500 of 20,000 DOESN'T create jobs).

So how will we know when a bottom is in and the economy will recover? I've postulated a few signs (some humorous, others not so pleasant). Bear in mind, much of this in tongue in cheek. But like all sarcasm, there's a grain of truth.

We will bottom **WHEN**:

- *CNBC and Bloomberg* start firing anchors and cutting their coverage time by hours, not minutes.
- Maria Bartiromo and Jim Cramer start telling investors to short the market with all they've got.
- Questions like "*do you think we're heading for a recovery*" result in the questioner getting punched in the face or ignored like a loony tune.
- People HATE stocks and stock ownership has plummeted back to one in ten Americans (the pre-401(k) levels).
- Investing is no longer a hobby and people fight tooth and nail to retain their nest egg (honestly what the hell is "play" or "speculative" money?)
- The number of mutual funds has fallen by at least half (why are we paying fees for people who can't beat the market?).
- People no longer want to get an MBA to become a broker or a financial advisor.
- Our economy is based on "making something," not "offering advice."
- Books about Warren Buffett no longer comprise an entire publishing industry (seriously, Amazon lists 5,000+ books on him).
- The Richest 500 people in the world are no longer all billionaires (never happened before in history how's that for concentration of wealth?)
- Guys like me are no longer writing about finance or investing but instead take up a respectable profession.

Then we will have probably hit bottom. In the meantime, I've prepared a FREE Special Report detailing three investments that will soar when the Second Round of the Financial Crisis hits. I call it the *Financial Crisis Round Two Survival Kit*. Swing by www.gainspainscapital.com/roundtwo.html to pick up your free copy today.

Graham Summers