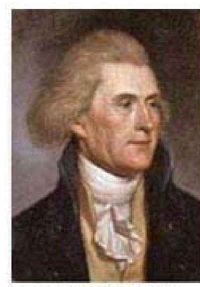
After the Bailout

…a happy landing?

Chapter 10 "Recognizing Deception"

By Dene McGriff

"*I believe that banking institutions are more dangerous to our liberties than standing armies. If the American people ever allow private banks to control the issue of their currency, first by inflation, then by deflation, the banks and corporations that will grow up around the banks will deprive the people of all property until their children wake-up homeless on the continent their fathers conquered.*"- *Thomas Jefferson 1802*



Thomas Jefferson warned us of Banking Institutions--but we didn't listen...

This is the third article on the bailout of the economy, and I am beginning it on Wednesday, October 1, 2008, knowing that it will pass Congress in the next couple of days. After the 777 point plunge in the Dow on Monday, the powers that be are scared and convinced they must act in order to avert disaster.

Anticipation of passage caused the market to recover much of its losses yesterday. Well, here we are Friday morning out in California and after a arm twisting, pork and another $150 Billion give away, the $700 Billion has been approved – with both Presidential candidates celebrating with reluctance and blaming each other for the financial fiasco; go figure! (and John McCain said the fundamentals of the economy were strong just two and a half weeks ago!)

Today's ***Daily Reckoning*** quips*:*

"And then, it was only a few months ago that they were telling us that there was nothing to worry about...the subprime problem was contained...property prices had hit bottom...everything was fine. Really… Then, two weeks ago, Ben Bernanke and Hank Paulson appeared before Congress and warned that if Congress didn't put up $700 Billion of taxpayers' money pronto, the whole world economy could meltdown. Ben Bernanke, former head of the economics department at Princeton, and now head of the world's biggest banking cartel – the Fed – told the politicians: 'If we don't do this, we may not have an economy on Monday.'"(The Daily Reckoning, October 3, 2008)

If you have watched the "***Daily Report***" with Jon Stewart or NBC Morning News, you have probably seen the clips of Paulson, Bernanke and Bush telling us just a couple of months ago that everything was great; the fundamentals of the economy are strong. Suddenly, like a thief in the night, we are facing a financial Armageddon according to them, and they never saw it coming until it got here. We are supposed to trust these men with the answers? Let's look at this carefully. What is likely to happen now that another $700+ Billion is being pumped into Wall Street?

The Fed's Personal Bailout…

Many don't realize it, but the bailout has been going on for some time. In December, 2007 the ***Federal Reserve*** began giving emergency loans to banks through the "***Term Auction Facility***" (TAF). The purpose of these loans is to take **toxic paper** (e.g., sub prime and ARM mortgages in foreclosure used as collateral). Originally, they were 28 day loans but later extended to 84 days. Some call it the ***inflation machine*** since it increases the banks liquidity (more dollars in circulation = inflation). It has been ***auctioning*** $75 Billion every other week; $150 Billion every 28 days.

It appears the Fed has run out of money and thus the need for the bailout. So if a Trillion dollars hasn't done anything to solve this credit crunch, what makes the lawmakers and experts think another $700 Billion will? The ***Fed loaned record*** amounts to financial companies over the past two weeks, averaging from $40-$45Bn a day for a total of $700 Billion. If this hasn't done any good, why would another $700 Billion help? In fact, the Fed is making ***$620 Billion*** available to central banks around the world. **Could this really be a bailout for the Federal Reserve?**

As we have discussed in previous articles all of these loans were tied to ***derivatives*** (aka, counter party agreements, default credit swaps, etc.). In the case of ***Bear Stearns***, although the bailout was only $29 Billion, the exposure in derivatives was $13.4 Trillion. Fannie Mae and Freddie Mac had a joint ***exposure*** estimated at $62 Trillion. Another form of derivative is the "credit default swap" – which is why they bailed out ***AIG*** for $85 Billion because their exposure was $70 Trillion! Not only that, the credit default swap was a type of insurance for the banks against defaults. All these previous bailouts and/or consolidations are/were mandatory to keep the ***Ponzi Scheme*** in tack. Add up all the bailouts, the money the Fed has already passed out, other budget deficits, the wars and you are at about $3 trillion!

So where does this take us? If the derivatives begin to unwind (and they do have to be settled if there is a **default**—as in financial institution default unless they merge with another financial institution), there isn't enough money in the world to cover these bank financial instruments—which are wholly unregulated. Total derivative exposure is about $800 Trillion, many times the GDP of the entire world!

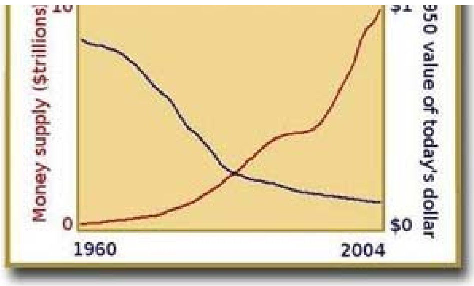
An American Family in Deep Trouble…

Let's put this in terms you and I can understand. The Smiths are a typical American family with two kids, one in college and the other one going into college next year. Both have good jobs. Five years ago, seeing their house going up in price, they took out an equity loan to build the swimming pool the kids always wanted; and, oh yes, to pay credit card debts.

The Smith's house kept soaring in value, so they took more from the house line of credit to pay cash for a new car and clear off some more credit card debt—great idea, since now they could deduct the interest on the house off their taxes, whereas before this little "tax trick" they couldn't. They had retirement savings, along with college savings for the kids, and were looking pretty good. All of the sudden, the house plummets in value; Mr. Smith loses his job; and, they eat into their savings, and the college fund. They can't pay their house payment (i.e., first and second mortgages, which have readjusted up a bit). The only money left is their retirement but there are penalties for taking money out of their retirement; so what are they going to do? It appears even their retirement funds are losing money. Even if they could borrow more money, would that make any sense? If they were the government, they would just go deeper in debt, take out more loans, print more money – but the Smiths can't do that. The Government only thinks it can get away with it.

Two Economic Schools -

Back to economic theory – but in very simple terms. There are two schools of economics: ***Keynesian Economics*** believes that through



government and central bank intervention all you need to do is control the flow of money – one person spends and another earns. Keynes solution to the Great Depression was for the government to prime the pump, create more and more money until the wheels began to turn. In a sense this works but with unintended consequences of inflating the currency until there is no value.

The ***Austrian School of Economics*** believes the government should not interfere, but let the economy achieve its own balance. Government can't resist printing money and spending more and more. As a result, since the ***Federal Reserve*** began in 1913, the dollar has lost 98 percent of its value. Another way of looking at it is the more you inflate money supply, the less the dollar is worth.

Congressman Ron Paul said this week (ending, Oct. 3)

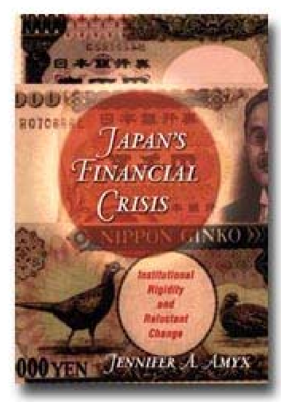
"The financial meltdown the economists of the Austrian School predicted has arrived.

"We are in this crisis because of an excess of artificially created credit at the hands of the Federal Reserve System. The solution being proposed? More artificial credit by the Federal Reserve. No liquidation of bad debt and malinvestment is to be allowed. By doing more of the same, we will only continue and intensify the distortions in our economy – all the capital misallocation, all the malinvestment – and prevent the market's attempt to re-establish rational pricing of houses and other assets."

Since the economic bailout has be passed by the US Congress and signed in lightning speed by President Bush, this will pour massive amounts of new money into the system – not counting the $150 Billion the Fed has been putting in every month, the $630 Billion they injected this week, the $29 Billion for Bear Stearns, the $83 Billion for AIG, the $200 Billion for Freddie and Fannie, the $700 Billion for the bank bailout, $100 Billion less in taxes by eliminating the Alternative Minimum Tax, increasing the FDIC limit and a few other sweeteners. The bill language doesn't say the bailout is just $700 Billion, but that is the maximum that the Secretary of Treasury and President can ask for at one time (meaning, **they will be back to the trough for another $700 Billion**).

Also, don't forget the just passed $25 Billion loan guarantees for U.S. automakers, another half a Trillion or so for the wars and another half a Trillion for the Federal Deficit. Where is this money coming from? What effect will it have on the economy? Oh, one more thing. The Federal Reserve is talking seriously about lower the prime rate? What got us into this mess to begin with? Low interest rates! Don't they ever learn?

In the history of the world, the size of the problem is unprecedented but as the good Book says, "there is nothing new under the sun." The closest thing we have to compare to what is happening in America is the 18 year slump of the world's second largest economy, ***Japan***, where they tried all these things, including 0% interest rates and bank bailouts (which America opposed at the time). The slow recovery (and it still is very slow) began once the Japanese finally allowed their banks to fail. ALL BUBBLES BURST!

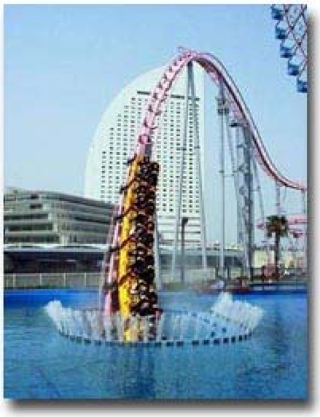


"At the beginning of the 1990s, a massive speculative asset bubble burst in Japan, leaving the nation's banks with an enormous burden of nonperforming loans. Banking crises have become increasingly common across the globe, but what was distinctive about the Japanese case was the unusually long delay before the government intervened to aggressively address the bad debt problem. The postponed response by Japanese authorities to the nation's banking crisis has had enormous political and economic consequences for Japan as well as for the rest of the world. This book helps us understand the nature of the Japanese government's response while also providing important insights into why Japan seems unable to get its financial system back on track 13 years later".

After the Bailout and Beyond

What is the government's solution to fixing the liquidity problem (lack of credit)? Throw more money at it. The problem we have today is caused by liquidity (printing more dollars) – way too much money being pumped into the economy. The Fed has been creating money at twice the rate of inflation for the past ten years. This brought us the first dot.com bubble but the Fed kept it to a "mini-recession".

Instead of letting it run its course, the Fed lowered interest rates and pumped more money into the system which led to the housing bubble and bust, which led to the commodity bubble (oil, minerals and crops); and now they want to pump in more money! This is truly like pouring gasoline on a fire to put it out. It will not only make matters worse, it will make it much worse, with the final adjustment more severe. As they say at the ***Daily Reckoning***, "**a correction is equal and opposite to the deception that preceded it.**" Thus, the blatant deception is so horrific – imagine what the correction is going to look like!



The effect of this massive infusion of capital and lowering interest rates will be to greatly increase money supply and continue to spur inflation in commodities, fuel and food (oh, I forgot they don't count fuel or food in CPI numbers—how disingenuous of them; then again, let's leave out these dirty little figures which inflate our lives and allow the myth that somehow we don't eat, nor travel much these days), and deflation in assets – languishing business, home and commercial real estate. We will have the worst kind of inflation and deflation at the same time—the 'ole roller coaster effect; imagine, going up and down simultaneously?

At first glance, anyone who understands economics can see that there is something wrong with this picture. The taxes that will need to be levied to finance this package may keep some firms alive, but they will siphon off capital, and kill jobs and make businesses less productive elsewhere. Increasing the money supply devalues the dollar and leads to inflation. It is an invisible tax that redistributes resources to debtors and those who made unwise investments, while lowering the standard of living for millions.

The ***Financial Post*** has this to say about the bailout:

[W]hat should be done when that pyramidal scheme starts crashing to the floor, because of a series of cascading failures or concern from the central bank that inflation is getting out of control? It's obvious that credit will shrink, because everyone will want to get out of risky businesses, to call back loans and to put their money in safe places. Malinvestments have to be liquidated; prices have to come down to realistic levels; and resources stuck in unproductive uses have to be freed and moved to sectors that have real demand. Only then will capital again become available for productive investments.

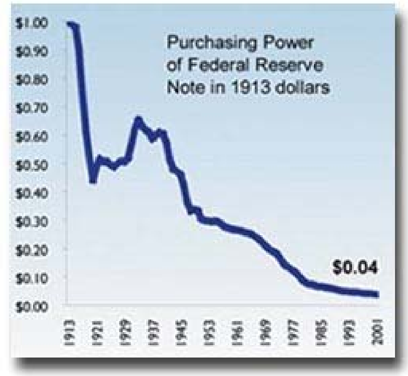
...

" As Friedrich Hayek wrote in 1932, 'Instead of furthering the inevitable liquidation of the maladjustments brought about by the boom during the last three years, all conceivable means have been used to prevent that readjustment from taking place; and one of these means, which has been repeatedly tried though without success, from the earliest to the most recent stages of depression, has been this deliberate policy of credit expansion. ... To combat the depression by a forced credit expansion is to attempt to cure the evil by the very means which brought it about ...'"

The Piper Must be Paid!

The time to have dealt with the crisis was to reign in Fannie and Freddie years ago; to not have the easy monetary policy that led to the bubbles in the first place. Not only do we have bubbles and inflation created by central banks all around the world, we have the "shadow banking" system of derivatives created by the financial gurus who needed even more currency to spend. Oh, the price of leveraging our meager and decrepit mortgages! They should have controlled the growth of derivatives. They should have done many things but pouring more money on the problem is not the answer.

We don't seem to understand that recessions and cycles are normal, especially when economies get way out of balance (e.g. in terms of debt, an imbalance of payments between nations, etc.). Does America really think it could go Trillions of dollars into debt with other nations and never have to pay them – plus interest? Does America think that it can import $65 Billion more than it exports month after month? Does America think that the nations of the world will continue to loan us money so we can buy their products? Do we think other nations are just plain stupid and will allow us to pay them back with inflated, worthless currency? Do we think other countries will keep shoring up the dollar and our economy indefinitely? These my friends are not sustainable trends.



Our brilliant financial gurus believe they can postpone the inevitable adjustment by doing more of the same, by borrowing and more borrowing, by printing and printing even more – driving the dollar lower and lower. The incredible thing is, they actually have the gall to believe their own deceit! They believe the rest of the world will play this little game with us forever. They actually think they can get away with it (at least in their lifetime – to hell with the next generation). The piper must be paid! There is no free lunch. Statistical extremes always fall back to the mean. Any more platitudes you can suggest? You have the idea.

It's Time for Another War!

But for those who write off America as a "has been" of history, I would caution you. America discovered the secret to ending a Depression – WAR! A cornered, wounded beast is the most dangerous of all. America has a sense of calling, destiny and mission seldom found in history. America's ability to vilify enemies and make war a "just cause" knows no bounds. Her amazing ability to project her self righteous power around the world to set things right is all the more dangerous while the beast crouches in the corner licking her wounds. There is a prophetic apostate Christian ***nation***, a vast consuming empire, a military power and friend of Israel that lies in wait to unleash the final Antichrist's unholy power on the world.

"You will hear of wars and rumors of wars, but see to it that you are not alarmed. Such things must happen, but the end is still to come. Nation will rise against nation, and kingdom against kingdom. There will be famines and earthquakes in various places. All these are the beginning of birth pains." (Matthew 24:6-8)

Because of the signs he was given power to do on behalf of the first beast, he deceived the inhabitants of the earth. He ordered them to set up an image in honor of the beast who was wounded by the sword and yet lived. He was given power to give breath to the image of the first beast, so that it could speak and cause all who refused to worship the image to be killed. He also forced everyone, small and great, rich and poor, free and slave, to receive a mark on his right hand or on his forehead, so that no one could buy or sell unless he had the mark, which is the name of the beast or the number of his name. (Revelation 13:13-17)

By the abundance of your trading

You became filled with violence within

And you sinned;

Therefore I cast you as a profane thing

Out of the mountain of God;

And I destroyed you, O covering cherub,

From the midst of the fiery stones.

Ezekiel 28:16

Yes, what's needed today is a Messianic Figure – someone to take charge – someone to rescue us, deliver us from our own despair and devices! “He deceived the inhabitants of the earth” – when one speaks of such vast deception, one simply needs to see that a ***three-page document*** initially proffered by the likes of Bernanke and Paulson, simply was not enough—the final subterfuge was INFLATED (that’s more like it) to some ***451 pages*** when it came out of the Senate (and counting). The final deception: ***263 Yea to 171 Nay*** – the YEAS have it and so have we!

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