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Liquidity Shortage Intensifies!

In our July 26 issue, we released an editorial entitled "The Greatest Shortage – Liquidity." We explained that loan defaults and bankruptcies were developing at such a fast pace the Fed could no longer print enough money to guarantee economic expansion. We concluded "the greatest shortage of all could prove to be liquidity rather than copper, energy or food."

Since that time, the liquidity shortage has intensified, spreading throughout the world...

- This week, Reuters reported the People's Bank of China held capital of about $3.2 billion. Their capital is insufficient to cover the nearly $1 trillion in treasury debt and mortgage-backed bonds it had purchased in recent years. They are now appealing to the finance ministry for a bailout.

- The Federal Deposit Insurance Corporation (FDIC) that guarantees bank deposits indicated they would need more capital in months ahead. Experts now expect at least 100 banks to fail by next summer. Financial analysts believe the Treasury will need to inject billions into the FDIC in months ahead to prevent bank runs as people may fear FDIC insurance will not be enough to protect their savings.

- *Barron's* recently interviewed Nouriel Roubini, economics professor at New York University. He correctly warned of the housing bubble two years ago and cautioned it would lead to a collapse in home prices and a credit crunch. He told *Barron's*: "The taxpayer's bill is going to be huge. The International Monetary Fund estimated the bill at $945 billion, Goldman Sachs at $1.1 trillion, and last month Bridgewater Associates came up with an estimate of $1.6 trillion. At this point, *$1 trillion isn't a ceiling, it's a floor*. Banks have written down only about $300 billion of sub-prime debt so far."

- Chris Whalen, managing director of Institutional Risk Analytics, recently said: "We have seen some $505 billion in bank write-offs so far in this credit crisis. It is serious naiveté to assume that this will be the extent of it. Most of the write-offs have been mortgage related. We have not yet seen the write-offs that will come as consumers start defaulting on credit cards, auto loans, and other con- sumer debt. Neither have we seen the losses that will come from commercial real estate or corporate loans as the recession progresses."

- My friend Richard Russell recently published the following in his newsletter: "Finance has always meant providing money for non-financial agents. For the past ten years, the financial sector itself has become the largest consumer of finance in the system. If leverage characterized the path of growth in financial sector debt on the way up, de-leveraging characterizes what must happen before the world can come to rights and start once again in an upward direction."

The forgoing sample of quotes by financial experts indicates the liquidity shortage is intensifying. If the credit crunch continues in months ahead, commodity markets will continue to sink. . *Not from more supply – But from less demand.*

Bill Gary