

## THE FED GENIE AND THE BANKERS' CAVE.

*This article looks at two current economic phenomena, how retail sales always out-perform and how investment banks in the USA always make profit come rain or shine.*

A quick re-examination of US unemployment data, which is an embarrassment. According to the Bureau of Labour Statistics, there were 151.1 million in work in February plus 1.7 million (Labour Department data) insured workers claiming continuing unemployment benefits making a total of 152.8 million workers. In June, the number in work according to the BLS was 138.5 million and the number claiming benefits according to the LD was 17.3 million making a grand total of 155.8 million. An increase of 3 million. Now either the number in work has been overstated by 3 million or the number of claimants have.

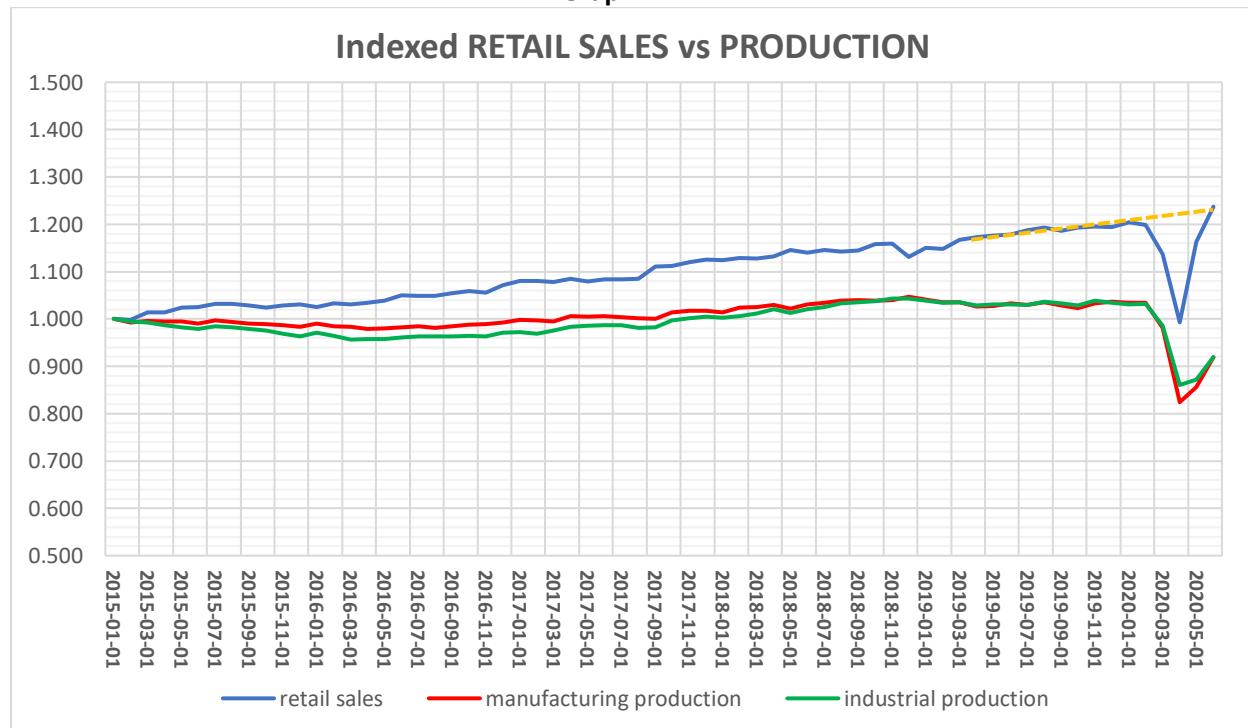
This 3 million+ difference is equal to a 2.0% rate of unemployment. If we added back this 2% then the unemployment rate has hardly fallen from April (14.7%) vs May (13.3%) and June (11.1%) or 13.1% when the 2.0% is added back. The embarrassing fact is that the number of insured benefit claimants exceeds the number of unemployed workers when measured by the unemployment rate of 11.1%. Truly a mystery worthy of the new US-China cold war, which at the moment remains a game of bluff.

### Retail sales.

In China, June retail sales did not sparkle, unlike in the USA. In China retail sales were still down 1.8% June on June 2019. However, in the USA retail sales were up 5% in June compared to the year before. Outstanding. This meant that total retail sales only fell 0.6% for the first 6 months of this year compared to the first six months of 2019. Outstanding<sup>squared</sup>. (<https://fred.stlouisfed.org/series/RSXFS/> & [http://www.stats.gov.cn/enGliSH/PressRelease/202007/t20200716\\_1776339.html](http://www.stats.gov.cn/enGliSH/PressRelease/202007/t20200716_1776339.html))

This falsification of retail sales and with it, GDP, began when tensions with China rose. In early 2017 the difference in growth between retail sales and production was of the order of 3%. This rose to 17% by February 2020 and now stands at 31.7% or ten times the level which occurred in 2017.

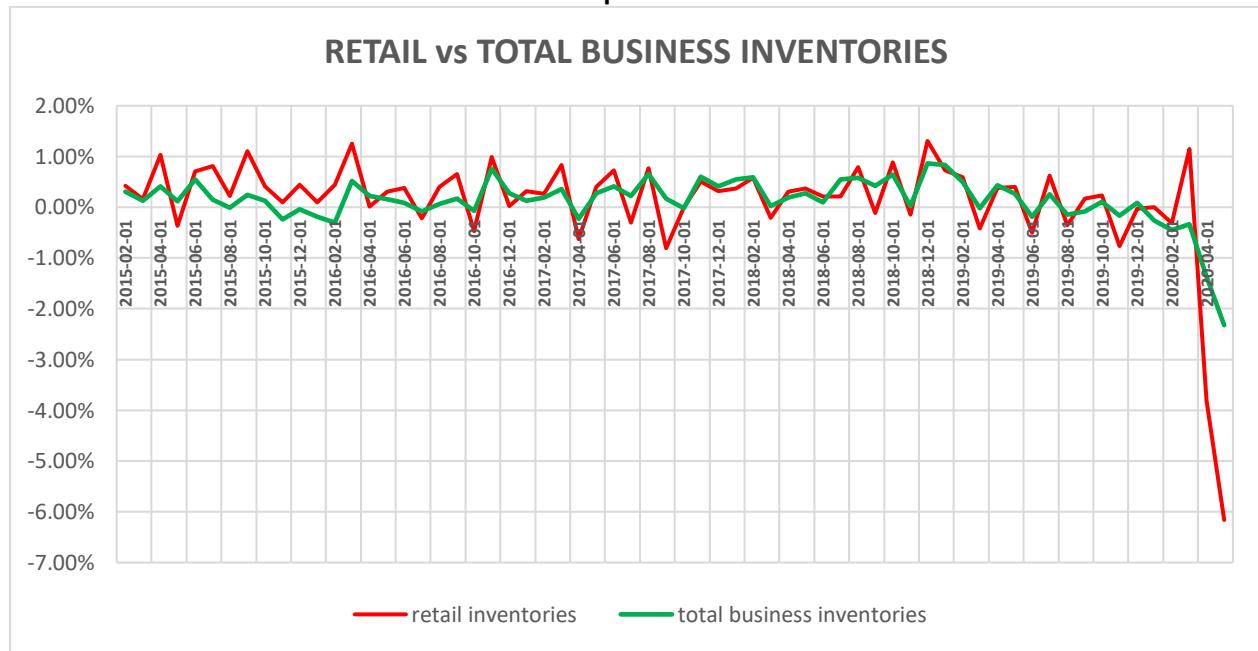
Graph 1.



Put it another way, since the nadir in April, retail sales have rebounded by 24% while industrial production has grown by only half that, or 12%. How do we account for the difference? Clearly the first option is to examine inventories. The data for May is now in. Retail inventories did see a big draw as opposed to the modelling in New York and Philadelphia cited in a previous article. The draw down in inventories in April and May amounted to \$65.1 billion or over 9% of total inventories. This draw down can be seen in Graph 2 below.

More importantly compared to retail sales for April and May of \$680 billion, this draw down amounted to 7.8% of the combined sales over the two months. This is only half of the 17% enlarged gap between the production and sales series over the same time. There is a further consideration. Retail inventories fell two and a half times more than Total Business Inventories (TBI) as the graph below also shows. TBI is the sum of manufacturing, wholesale and retail inventories. They collectively comprise about 85% of total economy wide inventories. Much of the inventories found in manufacturing and wholesale (which includes imports) serves retail. Unless the supply chain was constipated with unfinished inventory due to disruptions caused by Covid, it is difficult to see why the gap in inventories should have widened to the degree it did, especially when just in time techniques are in place. Once again there is cause for concern over the validity of retail inventory.

**Graph 2.**



(Sources: FRED Table RSXFS for retail, Table INDPRO for industrial production and IPMAN for manufacturing.)

If we address the issue of retail sales from the opposite end, further concerns are raised. If we look at the advanced retail sales release for June, the value of motor vehicles sold amounted to \$566.8 billion over the six months ended June 2020. This amounted to a fall of 6.4% compared to the first half of 2019. But when we examine the quarterly data for actual sales by the major car companies a larger fall should have occurred. These are physical sales data released by each company for Q2 2020.

G.M.	FORD	CHRYSLER	TOYOTA	NISSAN	VOLKSWAGEN
-34%	33.3%	-38.6%	-34.6%	-49.5%	-20%

Therefore, unless sales soared during the first quarter, which they did not do, and provided dashboards were not inlaid with mother of pearl, nor tyre rims gold plated in order to boost Q2 list prices, the fall of only 6.4% cannot be substantiated.

Nor do consumer surveys point to robust spending. Here is a Bloomberg report based on a survey of 2,200 respondents between 26<sup>th</sup> and 28<sup>th</sup> June. *“Some of the hesitation is economic. Americans became more frugal during the pandemic, the survey shows. Over the past three months, 23% of respondents purchased more generic items, 28% increased bulk purchases and 41% chose to save money more often by forgoing a purchase. People also increased price comparing, while putting luxury and expensive purchases on hold at a higher rate.*

*This thriftiness could be here to stay, permanently shifting the makeup of the average American consumer—not unlike the Great Depression’s impact on spending habits 90 years ago. More than three-quarters of consumers say they expect to increase their savings rate and financial conservatism after economies fully reopen.”*

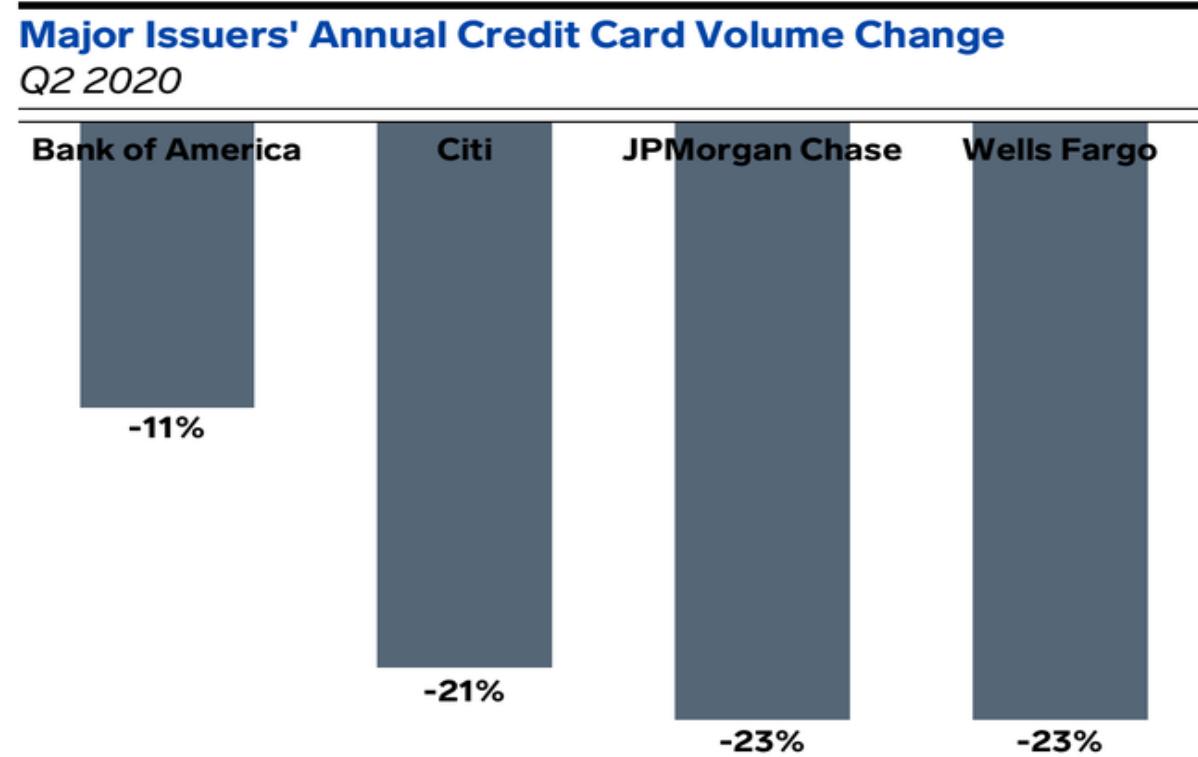
Nor does the financial data relating to consumer borrowings.

(\$ billions)	April	May	June	TOTAL
Consumer loans	-39.1	-23.6	-5.1	-67.8
Credit cards o/s	-72.3	-43.9	-13.7	-129.9 = \$197.7

In the mean-time total deposits rose by \$120 billion. Together this adds up to over half of the \$600 billion relief given by the government to furloughed workers.

<https://www.federalreserve.gov/releases/h8/current/>

Nor is spending supported by credit card usage. **Graph 3.**



*Source: Bank of America; Citi; JPMorgan Chase; Wells Fargo, July 2020  
Methodology: This data was reported in banks' quarterly earnings reports.*

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Nor is the spending bounce in June supported by foot fall which reversed towards the end of June when the virus rebounded in a number of key economic states such as Florida, Texas and California. Nor was this offset by e-commerce sales which actually fell in June, month on month, by 2.4%. It seems that cold war adjustments have once again trumped seasonal adjustments resulting in retail sales falling by only 9.4% during Q2. Clearly this will have a profound effect on GDP limiting its fall in the quarter to under 20%. The New York FED (Nowcast) puts Q2 contraction at only 14.31%. <https://www.newyorkfed.org/research/policy/nowcast>

Perhaps the US statisticians should take a sabbatical in China to acquire greater statistical rigour.

### Hail the Investment Banks.

It's true. The investment banks have conquered economic gravity. Thus, while the economy spiralled down into recession, unemployment soared and production seized up, these banks made startling profits. I will let CNBC do the talking. Below are the talking points around the release of results by JP Morgan, Goldman Sachs and Morgan Stanley (the biggest dealer in shares).

But before that, to provide context, here is the graph of the S&P 500 this year. We note all losses this year have been recovered despite the fact that the US is currently experiencing its largest daily outbreaks of COVID infections to date. This rebound has added \$8 trillion to the market cap.

Graph 4.

### Stock market's wild 2020 ride



### JP Morgan.

- *JPMorgan posted a record \$33.8 billion in second-quarter revenue because of shrewd moves made under CEO Jamie Dimon to build up its investment bank in the years after the financial crisis.*
- *Surging volatility and unprecedented steps taken by the Federal Reserve to support credit markets have created the best environment for trading and advising on debt and equity issuance in years.*

- *JPMorgan's corporate and investment bank posted a record \$5.5 billion profit for the second quarter, which is more money than most entire banks typically generated before the coronavirus pandemic.*
- *The bank's Wall Street division helped offset losses in two of JPMorgan's four main businesses, its consumer and commercial bank, as the firm set aside \$8.9 billion for expected loan defaults across its operations.* <https://www.cnbc.com/2020/07/14/despite-recession-jpmorgan-chase-just-posted-record-revenue-heres-how-they-did-it.html>

### **Morgan Stanley**

- *The bank generated profit of \$3.2 billion, or \$1.96 a share, exceeding the \$1.12 a share estimate of analysts surveyed by Refinitiv.*
- *Revenue climbed roughly 30% to a record \$13.4 billion, a surprise increase that exceeded expectations by a full \$3 billion.*
- *Fixed income traders had a blowout quarter, posting a nearly 170% revenue increase* to \$3.03 billion. *Equities traders generated a more modest 23% increase in revenue to \$2.62 billion. Combined, the trading division gained \$1.4 billion more revenue than analysts had expected.* <https://www.cnbc.com/2020/07/16/morgan-stanley-ms-earnings-q2-2020.html>

### **Goldman Sachs.**

- *Goldman said it generated \$2.42 billion in profit, or \$6.26 a share, crushing the \$3.78 a share estimate of analysts surveyed by Refinitiv.*
- *It was the New York-based bank's biggest earnings outperformance in nearly a decade.*
- *Revenue of \$13.3 billion was more than \$3.5 billion higher than the estimate, fuelled by strong results in its trading and investment banking divisions.*
- *Bond trading revenue surged almost 150% to \$4.24 billion, and equities trading revenue rose 46% to \$2.94 billion. Together, the trading division produced roughly \$2.5 billion more than expected.* <https://www.cnbc.com/2020/07/15/goldman-sachs-gs-earnings-q2-2020.html>

Why let a pandemic get in the way of profit making, especially when all the profits are fictitious based on bond and share trading, and arbitrage. And who is this Genie who converted bank vaults into Aladdin's caves? Why it is no other than the Federal Reserve. As Michael Roberts in his latest posting reveals, much of the financing found on Wall Street today is financial engineering. <https://wordpress.com/read/feeds/313842/posts/2815724717>

It is clear that the palliative care carried out by the FED has worked for the time being. It has extended the life of a chronically ill market with weakening life signs. But for how much longer? Talk of a V shaped recovery has given way to a W shaped recovery as Covid roars back. At least W is closer in the alphabet to Z. In turn Z stands for zero. There is a zero possibility that the global markets can avoid a

fundamental crash that will rock them to their foundations. All the FED is doing is buying time, time that will have to be repaid with compound interest.

Currently only 9% of S&P corporations have reported their earnings. FactSet's latest blended estimate for the fall in profit remains at 40%. *"Looking ahead, analysts predict a (year-over-year) decline in earnings in the third quarter (-24.4%) and the fourth quarter (-12.4%) of 2020".* [https://insight.factset.com/sp-500-earnings-season-update-july-17-2020?\\_hsmi](https://insight.factset.com/sp-500-earnings-season-update-july-17-2020?_hsmi) Should these estimates be born out, then a 25% fall in the mass of profits this year should drive the actual corporate pre-tax rate of profit close to 3% for the year, even with a significant destruction of capital. This would mark the lowest point in the rate of profit since the War. The next two weeks are going to be interesting as the reporting season hots up or should we say cools down.

Here is the reason capitalism remains on palliative care, ventilated with cheap money. And as the adage goes, 30% of a patient's lifetime's cheap money is spent on the last year of life. What an economic pantomime!

Brian Green, 19<sup>th</sup> July 2020.