SHOW ME THE MONEY!
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"Show me the money!" shout the lead characters in the film "Jerry McGuire" (Cameron Crowe, director; 1996).

ACCOUNTS

In various forms and fashions, accounting greatly matters in cultural domains. Economic realms employ professional accountants and other measurers and judges of accuracy (and compliance, responsibility, and virtue), but money meadows are not the only field involving accountability. In financial playgrounds- as in politics, war, romance, and elsewhere- it's important to carefully evaluate the truth, quality, and implications of accounts and other storytelling.

Money, worth, value, and reputation can grow or disappear in Wall Street, often rather suddenly. Not via magic, but sometimes by something akin to it! And not only due to brilliant decisions by marketplace wizards, big errors in trading judgment, or the rare yet scandalous exploits of "worthless people of no account" such as rogue traders and con artists. In any event, there's more to the appearance and reality of making, losing, and keeping money than mere buying and selling. Suppose a financial institution changes its accounting model or its application. What if a bank finally decides to mark most or all of its badly delinquent real estate loans to market? Picture inactively traded corporate or sovereign debt that has suffered a bloody price slump. People may disagree how bad the injury has been, as well as the likelihood of recovery or default.

On September 20-21, America's Federal Reserve guardians will sit around their campfire and evaluate the economy and their monetary policy. The International Monetary Fund/World Bank luminaries powwow soon thereafter, on 9/23-25/11. As these important monetary meetings loom on the horizon, why not review a few United States marketplace snapshots of big money and its changes?

KEEPING IT REAL

"The best things in life are free
So give them to the birds and bees
I need money (that's what I want)". "Money (That's What I Want)" (Gordy and Bradford, lyrics)

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Despite the ongoing excitement of the European sovereign debt crisis, European banks are not the only ones facing significant challenges. Thus some gloomy bystanders perhaps want to avoid renewed scans of America's banks in the context of real estate and derivatives.

According to the FDIC (Quarterly Banking Profile, Table II-A; FDIC-insured institutions), bank equity capital is over $1.5 trillion (up 4.8 percent year-on-year) at the end of 2Q11. This equals 8.9pc of assets (compare 9.0pc in 2Q10). Of 2Q11's $13.6 trillion in total assets, $4.1 trillion is loans secured by real estate. If all these property loans were marked-to-market, what would happen to bank capital?

The Fed says the charge-off rates (all banks) in 2Q11 for both commercial and residential real estate was 1.7 percent, beneath the 4Q09 highs of about 2.8pc. Yet 2Q11's delinquency rates for residential were a lofty 10.5pc (compare 2Q06's mere 1.6pc), with those for commercial about

7.1pc (2Q06 only one pc). A realized loss estimate of three percent on $4.1tr arguably is fairly cautious. That equals $120bb. 120 billion bucks is not pocket change, is it? It would swallow up about eight percent of the $1.5tr in bank capital.

FDIC institutions held $251 trillion (yes) notional amount of derivatives. Does the 11.4pc year-on-year increase suggest growing risk taking (or prudent hedging) by these firms and their customers? Anyway, even if the potential loss on this huge sum is well under one percent, just what is the potential loss?

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Some sunny audiences might enjoy corporate profit counting. Look at the current scene of massive US corporate profits. The 2Q11 $1.47 trillion in after tax earnings (annualized) broke above the peaks of both calendar 2006 and 2007 (Bureau of Economic Analysis, GDP release, Table 11, 8/26/11). Looking forward, how substantial will US and global real growth be?

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Others may prefer to chat about the decline in and prospects for America's household net worth. US household net worth was $64.3 trillion at end 2006 and end 2007. Despite the economic recovery beginning around 1Q09, it still was only $58.5tr end 2Q11. (Federal Reserve, Z.1, Table B.100, 9/16/11). And these totals are nominal, not inflation-adjusted. Over the almost four year span from end 2007 to the present, a five percent subtraction from current net worth levels due to inflation seems conservative enough.

Sometimes the titanic numbers of billions and trillions mask the crucial importance of what's going on in the provinces of smaller quantities. US real median household income in 2010 was about $49,400, a 2.3pc slide from 2009. Since 2007, real income has tumbled 6.4pc. It is 7.1pc under the median household income peak in 1999, back to the 1996 level of $49.1m ("Income, Poverty, and Health Insurance Coverage in the United States: 2010", Census Bureau, p5; tables A-1 and A-2, September 2011). There are various measures of earnings. US real average hourly earnings fell 2.3pc from August 2010 to August 2011 (Bureau of Labor Statistics). This suggests (as current consumer confidence measures underline) that most Americans probably have not become more prosperous since 2010.

Another way to appreciate sizeable amounts of cash is to have a perspective on the absence of it. The US poverty rate for 2010 was 15.1 percent (over 46 million people), up from 14.3pc in 2009 and 11.3pc in 2000. Compare highs of 15.1pc in 1993 and 15.2pc in 1983. Before the recent economic crisis erupted, 2007's level was 12.5pc (Census Bureau, p14; Table 4, Table B-1).

OVERSEAS FLOWS

US Treasury debt obligations offer flight to quality enthusiasts in America and elsewhere an outlet for their nervous funds. In troubled times when some oracles question the stability of several large banks, and as deposit insurance at any given US bank has per customer dollar limits, Treasuries may appear an attractive safe haven (almost a cash-in-hand equivalent) even if yields are low. Nevertheless, US government interest rates at or near zero for much of the short end of the yield curve otherwise are unappealing. And 10 year notes with a two percent yield offer no real return relative to current inflation benchmarks.

According to the US Congressional Budget Office, the 2011 baseline budget deficit is about $1.28 trillion, with that for 2012 $973 billion ("The Budget and Economic Outlook: An Update",

Summary, Table 1). Suppose little genuine progress is achieved on slashing near and long federal budget deficits anytime soon, leaving a gaping revenue hole.

Recent overseas money flows hint that foreigners have become increasingly reluctant to finance America's fiscal spending sprees. Given their crucial recent role in this process, this is an ominous sign. Though doomsayers probably are mistaken in heralding that the economic world could reach a dangerous point of no return, little or no yield on UST debt obligations is not an alluring return. Moreover, what if the US dollar depreciates further?

According to the US Treasury's recent TIC statistics (9/16/11), major foreign holders (official and others) of Treasury securities (these include bills, notes, and bonds) held about $4.48 trillion of them in July 2011. This is down slightly from June 2011's $4.50tr and May's $4.51tr. They held $4.45tr in January 2011. In sum, they've essentially not been net buyers for several months. Even relative to July 2010, they've been mediocre net buyers. Foreigners held $4.13tr in July 2010; July 2011 thus represents a meager add-on of only about $353 billion to the year-ago month. Mainland China tossed the US only about a net $20bb for UST from January to July 2011 (and its July 2011 holdings of $1.17tr are almost exactly the same as its October 2010 total). Japan sent over $29bb during this January-July 2011 span, but only $7bb since its March 2011 earthquake.

It's wonderful that the bountiful Fed used its flood of money to buy Treasuries during these difficult times, right?

US taxpayers may hand more money for Treasury securities to the federal government to help fill any hole left by reluctant overseas players. But maybe households won't do so very readily, as they're already stretched thin. If interest rates are close to the ground, how happy are those domestic savers with spare cash about receiving almost no nominal return on their money when they lend it to Washington? The US GDP implicit price deflator for 2Q11 ascended 2.5pc versus the prior period (seasonally adjusted, annual rate; Bureau of Economic Analysis, GDP release, Table 4, 8/26/11). Though QE2 ceased at end June 2011, perhaps the helpful Fed will provide another temporary solution and deluge the world with yet more dollars (money printing, round three) in order to buy the debt (finance the deficit).

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Treasury International Capital System ("TIC") data reveal that foreign official holders of Treasuries equaled 72.3 percent of the foreign total in July 2011. This is about unchanged from the January 2011 percentage. However, although the official sector added about $100bb in Treasury notes and bonds from January to July 2011, it reduced its T-Bill hoard by around $47bb. There is no data for the overseas private sector regarding this. However, the statistics for the official group indicate that foreign hunger for short term debt at or around zero yields (especially when there is some inflation) is very low.

There's a twist suggested by the se net foreign sales of T-bills. Suppose the US government decides to issue more short term debt so that current outstanding quantities increase, perhaps electing to sell somewhat less long term debt. Who will buy that short term debt at yields close to zero?

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Treasury data summarizes overseas activity in US Treasury securities on a monthly basis in another way. Its statistics separate (as well as add up) foreign official, private sector ("other

foreigners”), and international and regional organizations regarding their net purchases (sales) of UST notes and bonds. This data does not include Treasury bill dealings.

In 2010, the average net foreign buying (official and private groups combined) per month of these UST notes and bonds was about $58.64 billion. This equals almost $704 billion for the calendar year. The first seven months of calendar 2011 average about $24.94bb per month. Moreover, there were net sales of about $4.6bb in June 2011 (officials were net buyers, with other foreigners net sellers) with only $16.2bb in net purchases in July 2011. In any event, the $24.94 billion monthly average comes up to only $299 billion per year. Compare the size of recent CBO fiscal budget deficits numbers (2010’s $1.29 trillion; 2011 at $1.24tr, 2012 at $973 billion). And keep in mind that though these figures do not include T-bills, with other TIC stats showing that at least the foreign official buyers recently have been on balance net sellers.

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Finally, the Treasury breaks down monthly net foreign buying (selling) of US stocks (it does this for US agency and corporate bonds, too). Over the long run, foreigners have tended to be net buyers of American equities. One must be cautious about interpreting whether this Treasury data indicates future or confirms current trends in benchmark stock indices such as the S+P 500. However, in July 2011, they indicated net sales of US equities of $980 million. Yes, under a billion dollar is a rather small total- but see the downward equity move in July. May 2010 saw net foreign selling of only four million dollars, but June 2010’s net selling reached $4.3 billion. In this context, recall the S+P 500 top at 1220 on 4/26/10.

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Foreign direct investment levels in the United States (Bureau of Economic Analysis) warn that the US is appearing less attractive to many overseas players. These numbers are especially relevant when viewed alongside the flat trend of foreign ownership of US Treasuries over the past several months. First half 2011 net direct investment was about $76.2bb, generating an annualized total of $152.4bb. This is far down from 2010’s full year $236.2bb, and even below 2009’s $158.6bb. Compare 2008’s $310.1bb and 2007’s $221.2bb. In 2000 it was $321.3bb.

MONEY, SUPPLIED

Some may remember Duke Ellington’s lovely composition from over 50 years ago, “Just Scratchin’ the Surface”.

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The Fed keeps the Federal Funds rate near the floor. These navigators declare they intend to keep that rate very low into 2013. Yet the Fed also remains determined to create what it views as sufficient inflation- about two percent or so.

The Federal Reserve captains assure us that inflationary expectations are well-anchored. They emphasize their vigilance on that front. Rather high commodity prices (gasoline and food in particular) seem not to worry the Fed overly much, do they?

Greater amounts of money around (or potentially around) by one or more monetary measures do not mandate that other inflation indicators (such as benchmark consumer and producer price indices, wage levels, and so forth) will climb higher. But they should make one wonder if they will, especially if that money boost is huge and sustained for an extended period. And focus

nowadays not only still rather high commodity prices, but also statistics such as the 2Q11 GDP implicit price deflator rate of 2.5pc.

Of course the US is not the only performer on the world stage. But let's spend some words and dig a little bit into Federal Reserve money statistics. Though money supply data are only one variable relevant to inflation, they have started to hint that the future inflationary picture will be less pretty than ardent Fed professors proclaim. Even in a sluggish or recessionary economy, and even if some deflationary forces at home or overseas are strong, that does not prove that inflation will not increase. And inflation perhaps will float considerably higher than many predict.

Start with monetary base data (Fed H.3). The Fed money printing maestros have jazzed things up. For the two weeks ending 9/7/11, the monetary base is up about thirty-five percent to $2.65 trillion (at end June 2011, the end of QE2, the base also was about $2.65tr) relative to November 2010's QE2 launching level of roughly $1.97tr. In addition, the $2.65 trillion towers 3.1 times over the August 2008's $844 billion level. This gigantic swelling since August 2008 does not automatically translate into eventual money supply increases and higher inflation. However, it probably increases the odds for their appearance.

Now stare at money supply data (H.6) in the key M2 category (M2 does not include large-denomination time deposits over $100m). Look at the recent substantial jumps (seasonally adjusted annual rate). For the three months from May 2011 to August 2011, M2 grew 23.3pc. For the six months to August 2011, it increased 14.5pc, with the 12 months to August 2011 up 10.3pc. A narrow measure of money, currency in circulation, sure hints there's more and more money floating around (H.4.1). For the week ending 9/14/11, currency in circulation is up 9.2 percent year-on-year. More money supply does not automatically translate into increased inflation or higher interest rates. Yet observers should take sustained substantial money supply spikes into account as a factor that may help to produce them.