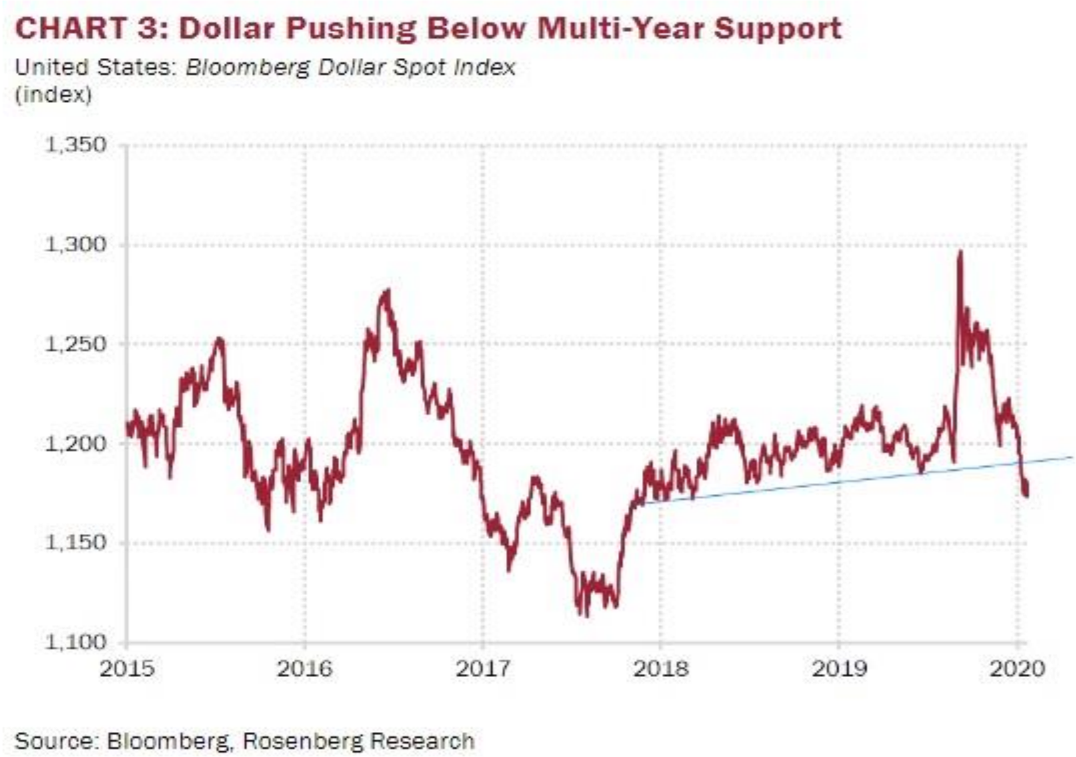
Money Explodes; Gold Glitters; The Recovery Slows

I often get asked why the price of gold is rising, and, as a follow on, will it continue. The price of gold has always had a significant correlation (80%) with the Fed's balance sheet (i.e., the "money supply"), especially during periods of significant balance sheet expansion (money printing). The table shows the Y/Y change in the money supply of the western world's major economies. The U.S., clearly the largest western economy, has increased its money supply at a much faster pace than any of the other majors. Note that the EU, the only western economy that approaches the size of the U.S., is growing its money stock at less than 40% of the pace of the U.S. Federal Reserve (Fed).

	Y/Y Chg. In Money (%)	GDP $trillions (2019)	GDP/U.S. GDP (Pct)
U.S. (M2)	22.9	$21.4	100
Canada (M2)	14.9	$1.7	8
U.K. (M2)	11.5	$2.8	13
NZ (M3)	9.4	$0.2	1
EU (M3)	8.7	$15.6	73
Australia (M2)	8.4	$1.4	7
Japan (M2)	7.2	$5.1	24

Noteworthy is the fact that the value of all of these countries' currencies have risen since the virus' outbreak as the U.S. money supply has exploded and the U.S. Congress has sent helicopter money to the U.S. populous. In fact, at the time of this writing, the U.S. Congress is in the time honored process of having the two major political parties posture on how the opposition party doesn't care about the American people etc. etc. This, of course, is a prelude to what will be another multi-trillion "stimulus" package. The CARES Act "stimulus" amounted to about $2 trillion, and it's a pretty sure bet that the upcoming one will be in the same area. That's $4 trillion total, bigger than the entire GDPs of most of the western world's economies (only Japan and the combined EU are larger). In fact, the big news out of the EU in the latter part of July was that they finally reached agreement on a "stimulus" package of their own – total was $860 billion! So, $4 trillion vs. $860 billion. Is it any wonder why the dollar's exchange rate is in free fall?

The Fed, of course, has been on a mission of its own to protect asset values and has expanded its balance sheet by over $3 trillion since February. And when the Congress appropriates free money, the federal government must issue new debt. Normally, when a huge amount of new debt supply comes to market, the laws of supply and demand would require that the price (i.e, the rate of interest) would have to rise to clear the market. However, the Fed has pledged that interest rates won't rise for several more years (i.e., until inflation rises to their targeted 2% level, which won't happen until the economy is much further along in the recovery process). To keep interest rates at current levels means that the Fed must buy the new debt, in effect, monetizing the federal government's "stimulus." That means that the U.S. money supply will continue its rapid escalation, and the value of the dollar will continue to fall vis a vis other currencies. The chart shows a 5 year history of an index of the dollar's value. Note the fall in value since the pandemic.



The Price of Gold

What does all of this have to do with gold's price? Gold is priced in dollars, and the dollar is the world's reserve currency. As the dollar falls in value vis a vis other currencies, the price of gold in terms of dollars is going to rise.

Gold is the ultimate currency, i.e., it can't be manipulated by any government. Its supply is limited, growing at a rate of about 2% per year (new mining). Historically, gold has been a hedge against inflation. But it is also a safe haven, i.e., a hedge against uncertainty (like a pandemic). So, it would be natural for its price to rise in the current worldwide pandemic, even without money supply growth. While the U.S. is clearly the money supply glutton, it isn't as if the money supply of other countries isn't growing at a faster pace than their economies (i.e., they are also creating excess money, just not as fast as the U.S.). Together, uncertainty and money creation are pushing gold's price up. Will it continue? You already know the answer.

There is a danger, however, to the policies being pursued by the Administration, Congress and the Fed. The danger is that if the U.S.'s money creation continues at a much faster pace than that of the rest of the western countries, there is a good chance that the dollar loses its status as the world's reserve currency. What would take its place? Probably no singe country's currency (like China). More likely, a basket of currencies, like an index. This would be a big blow to the U.S economy. As the reserve currency, almost all international transactions are done in dollars, creating a demand for the currency and providing cheap financing for U.S entities. All this would disappear if the dollar loses its reserve currency status.

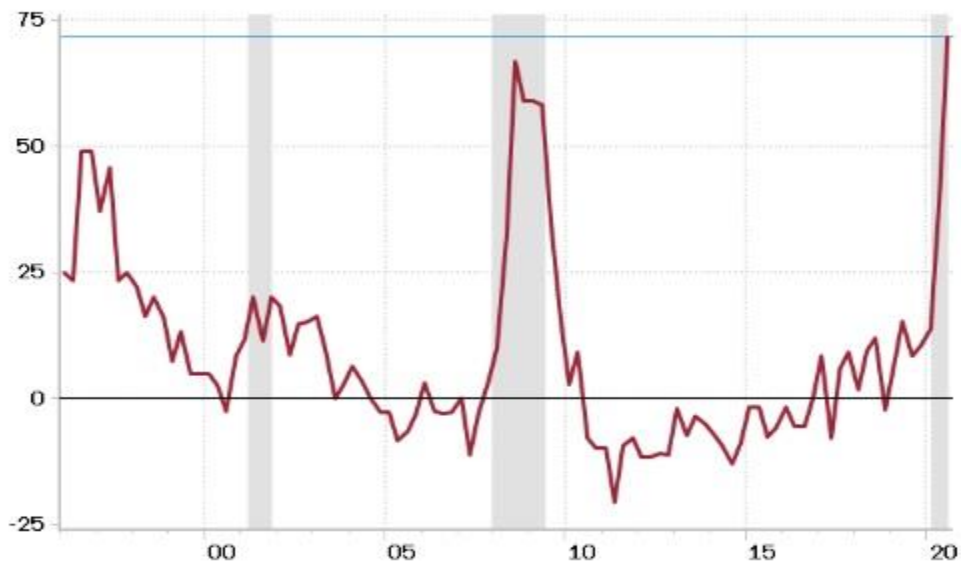
<u>What's Trending</u>

Here's what's trending in the U.S. economy:

- Bank Lending: According to the Fed's latest Senior Officer Loan Survey, nearly 75% of banks have tightened credit standards of Commercial and Industrial loans, for Commercial RE loans, and for Credit Cards (see chart). For auto loans, the survey said nearly 60% have tightened. This can't be a surprise. Banks always tighten credit during recessionary periods (when lending is most needed!). That makes the recovery much more difficult to sustain.

CHART 17: Banks Tightening Standards for Consumer Credit Cards

United States: *Fed Senior Loan Officer Survey*
(percent balance; >0 denotes tightening)

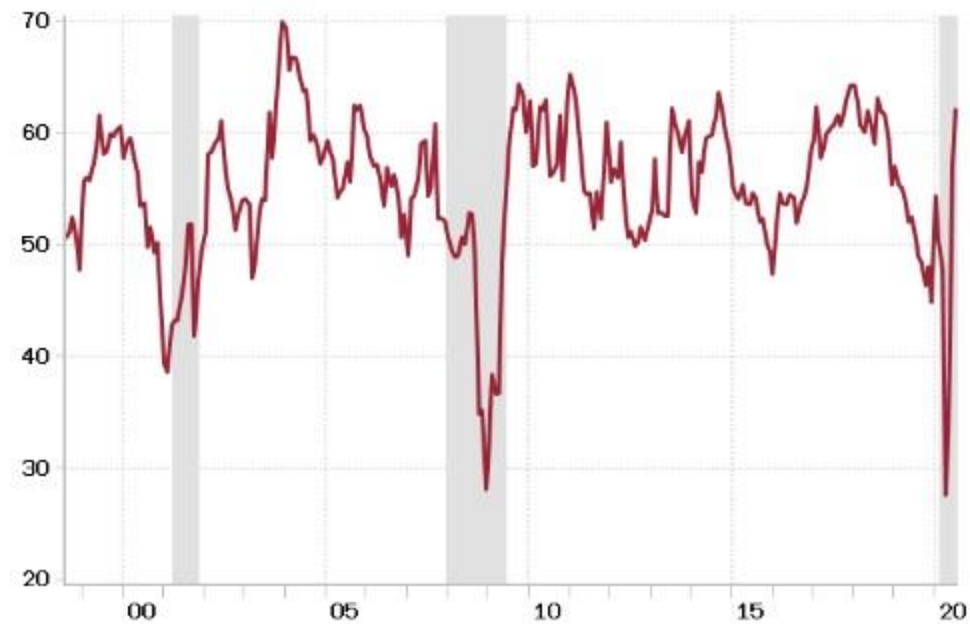


Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Rosenberg Research

- In the latest high frequency data releases, the Johnson Redbook same store sales survey for the week ending July 25 showed a -8.7% Y/Y result, a fall from the -5.7% of the June 27 week.
- The NY Fed's weekly economic activity index was -7.0% Y/Y in its August 1 reading.
- Q2 S&P 500 earnings, through August 1 (63% reporting) are off -36% Y/Y with revenues down -9.6%. (Hard to believe that the index is a hair's breadth from a new all-time high – could it be that all that money printing is having an impact?)
- TSA checkpoint data for August 6: 743,599. That's down -72.5% from the 2,707,986 travelers on that same date a year earlier. However, it is an improvement from mid-June (about 500,000 per day) or mid-May (250,000).

- PMI's (Purchasing Manager Index): In the U.S., the ISM Manufacturing PMI was 54.2 in July (52.6 in June). (see chart) The ISM Nonmanufacturing PMI was a hefty 58.1 in July (57.1 in June). Let's be careful in interpreting these numbers. The PMIs only measure expansion/contraction from the prior month. They do not measure or imply levels of activity. Let's assume that in the prior month business for a reporting company was cut in half. That company was reported as negative to ISM which gathers up all the positives and reports them as a percentage (i.e. 54.2 means 54.2 percent of the reporting businesses were expanding in the month). If, in the next month, that company's sales were 5% higher than in the prior disaster month, that company is reported as a positive for the month. So, the PMIs say nothing about levels, only the percentage of companies whose sales grew in the past month from the prior one.

CHART 8: ISM Manufacturing PMI Index: Production
United States
(index; >50 denotes expansion)



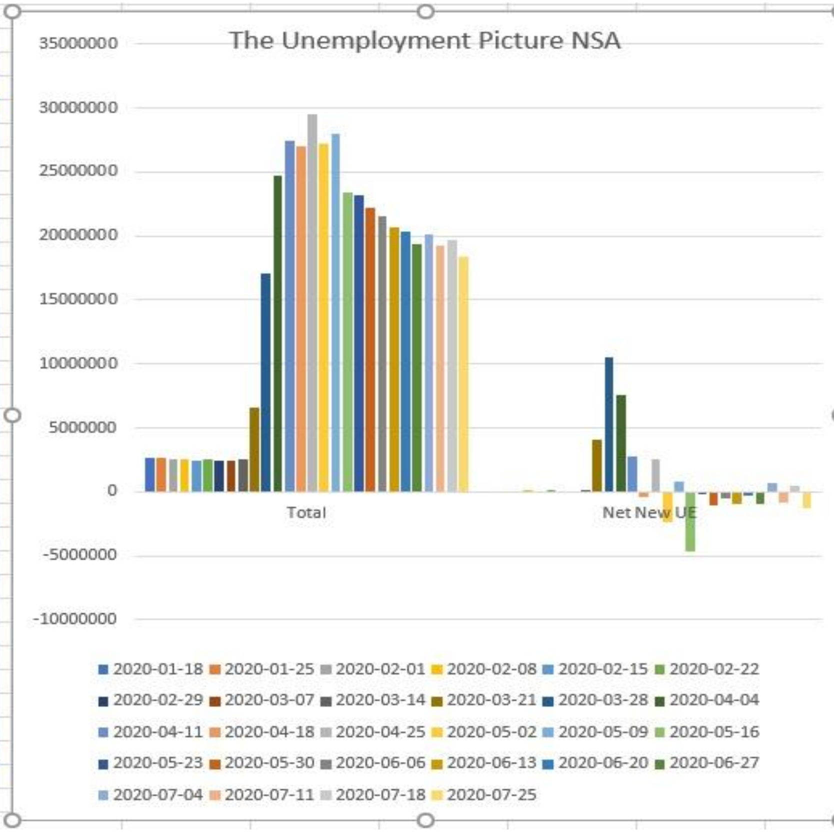
Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Rosenberg Research

- A better indicator for today's world is the University of Michigan and the Conference Board's measure of consumer confidence. Both measures remain near their April bottoms.

Employment

The big news of the week was the better than expected payroll numbers for July. The headline number for net new job creation was 1.763 million, much better than the 1.4-1.5 million expectation. Once again, the headline number was the seasonally adjusted (SA) one, and it is very misleading. Given government ever-changing edicts on business closures, re-openings, capacity constraints, masks, etc. etc., and the monumental changes in consumer behavior and attitudes toward shopping, entertainment, leisure, travel… since February, the use of seasonal factors makes no sense at all and only distorts the data. The non-seasonally adjusted (NSA) number was a much lower 591k, still positive, but only about 1/3rd of the headline.

	Total	Net New UE
2020-01-11	2815617	
2020-01-18	2699688	-115929
2020-01-25	2663823	-35865
2020-02-01	2541191	-122632
2020-02-08	2543338	2147
2020-02-15	2490606	-52732
2020-02-22	2514071	23465
2020-02-29	2473540	-40531
2020-03-07	2394636	-78904
2020-03-14	2526580	131944
2020-03-21	6588223	4061643
2020-03-28	17104358	10516135
2020-04-04	24688885	7584527
2020-04-11	27453774	2764889
2020-04-18	27041659	-412115
2020-04-25	29569682	2528023
2020-05-02	27250704	-2318978
2020-05-09	28006332	755628
2020-05-16	23399694	-4606638
2020-05-23	23195402	-204292
2020-05-30	22163312	-1032090
2020-06-06	21603986	-559326
2020-06-13	20679080	-924906
2020-06-20	20351359	-327721
2020-06-27	19403543	-947816
2020-07-04	20143462	739919
2020-07-11	19252736	-890726
2020-07-18	19704940	452204
2020-07-25	18433457	-1271483



On the state reporting level, we see the same issues. On August 6, markets were happy when the Initial Claims data (IC) from state reporting agencies showed 1.186 million new claimants (week ended August 1), much better that the 1.4 million expectation. Continuing Claims (CC) showed up at 16.107 for the July 25 week (CC lags IC by a week). The NSA data are actually much more encouraging. For IC, the August 1 week was 984k, the first time new claims have been less than one million since early March. NSA CC were also lower (15.849 million). The table shows the SA and NSA net new payroll data since February. Note that the differences weren't significant until the latest (July) count.

Net New Payrolls

2020	SA (millions)	NSA (millions)
July	1.763	.591
June	4.791	5.077
May	2.725	3.115
April	-20.787	-19.756
March	-1.373	-1.003
February	.251	.923

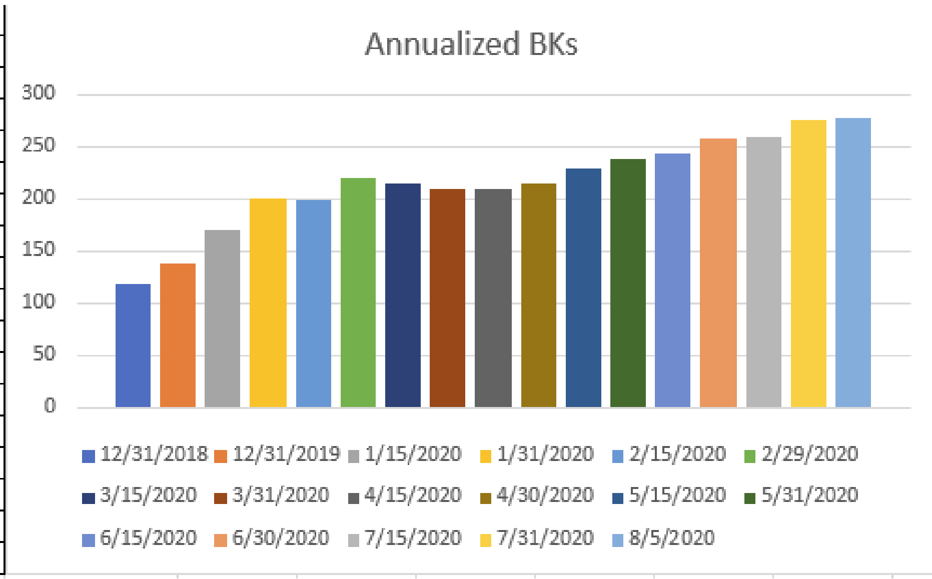
Still a steep hole to climb out of, but more encouraging than the headline SA numbers. As can be seen from the chart, the much-needed downtrend in the unemployment data may have resumed. However, let's not be too hasty. This is only one data point.

In addition, that payroll survey was taken the week ending July 17, just when the re-closings had commenced. Since then, large layoffs have been announced by companies that have given up on the concept of a "V"-shaped recovery. The August payroll survey, taken this week (week of August 10-14) will provide us a better view of the impact that the upward spiral of cases and the reaction of various state and local governments have had on the employment situation. Unfortunately, that data release is still nearly a month away.

Bankruptcies (BKs)

As discussed weekly in this blog, publicly traded company bankruptcies continue their uptrend unabated. We are now trending for 277 for the year almost double that of 2019 (139).

	Annualized BK
12/31/2018	118
12/31/2019	139
1/15/2020	171
1/31/2020	201
2/15/2020	199
2/29/2020	220
3/15/2020	215
3/31/2020	209
4/15/2020	211
4/30/2020	215
5/15/2020	229
5/31/2020	238
6/15/2020	243
6/30/2020	257
7/15/2020	260
7/31/2020	275
8/5/2020	277



Of note also is the action in the trading pits around speculative issues. We have seen what these new traders can do when they get momentum – I call it the "Hertz phenomenon" – a bankrupt company whose worthless stock is bid up by day/momentum traders (sports bettors?), and then eventually crashes. And, now, the same has occurred in the stock of Kodak. Kodak is not currently BK, but it was. It was one of the original camera companies last viable in the pre-cell phone era (some older folks may remember "Kodak Moments?"). The company isn't in the camera business anymore. In mid-July, its market cap was somewhere in the $100 million range. Then it magically procured a $765 million loan from the U.S. government to produce ingredients to make generic drugs. The loan is the first of its kind under the Defense Production Act, and it has come under scrutiny for the company's lack of a track record in pharmaceutical production and for the stock option grants given just prior to the announcement of the loan. The stock's roller coaster ride took it from $2.62 on July 28th to $29.83 two days later. It closed at $14.88 on Friday, August 7.

Conclusions

- The price of gold has risen because of the rapid rise in the money stock, because of all of the uncertainty, and because there is likely to be a continuation of that same atmosphere of helicopter money and giant deficits for the next few quarters.
- High frequency data show that there has been some recovery, but it has slowed recently.
- After slowing in June, the unemployment data trends in mid and late July improved. The August data will likely show more stagnation as the political forces reversed or paused the business re-openings beginning in July.
- Bankruptcies of publicly traded companies continue their uptrend, now showing a pace double that of 2019. The banks have tightened credit in preparation for what appears to be the coming onslaught of debt defaults.

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