"There is always a bull market raging somewhere on this planet" - *Byron King*

The Credit Cycle Peaks.

By Joe Average,
November 2007.
www.lifetoday.com.au

"I don't think the worst is over. We are coming off the greatest lending bubble .... not housing bubble! ... in U.S. history. We will feel its impact for a very long time."

Robert Arnott, CEO Research Affiliates.

To get some idea of the extent of the "lending bubble" that has developed over recent decades let's compare it to two previous notable credit expansions. In the 1890's the ratio of credit growth to Gross Domestic Product jumped from 25% to almost 75% of GDP. While in the Roaring Twenties the best the credit cycle could manage was to approach 50% of GDP.

These figures are totally overshadowed by **the present credit expansion** which has occurred in the world's leading fifteen industrialized countries. Credit has leapt from 25% of GDP in the mid-1960's, to around 60% of GDP in the mid-1970's, to **a staggering 135% of GDP in 2007 (Australia has the dubious distinction of being top of the group at more than 150% of GDP).**

A credit expansion of this length and magnitude is unprecedented. Moreover, of greater concern this time around is the disturbing fact that unlike in the past (where business borrowing accounted for the lion's share of the credit growth), **85% of the rise in credit ratio to GDP over the past fifteen years has been in household credit accounts.**

What is different this time is that the financial deregulation which began in the 1980's has increased the ability to borrow and coaxed households away from a situation of being very lowly geared and owning much of their assets outright, to the current situation where many are cash poor and reliant on inflated property and equity prices and low interest rates to carry the extra debt. Such a household balance sheet is a gamble and a disaster waiting to happen should the world economy suddenly turn down into recession and financial shocks cause asset prices to fall or interest rates to rise.

And we all know that the two previous credit expansions ended very badly indeed. They ended in the devastating global depressions of the 1890s and 1930s that saw property and equity prices decimated and unemployment soar to thirty per cent in some regions.

The view of economic heavy weight Stephen Roach (Chairman Morgan Stanley Asia) is that **"After nearly five fat years, the global economy is headed for trouble….The subprime fiasco is the tip of a much larger iceberg … an asset-dependent American consumer who has gone on the biggest spending binge in the modern history of the global economy….post-bubble adjustments seem likely to hit US consumption, which at 72% of GDP, is more than five times the share the capital spending sector was seven years ago. …A capitulation of the American consumer spells considerable difficulty for the global economy…In an increasingly globalized world…Asia will be hit hard… As always, the cycle of risk and greed went to excess."**

www.johnmauldin@investorsinsight.com

Bushfires and Mild Sneezes.

Stephen Roach doesn't buy the "global decoupling theory" (Ii.e. that the world economy is no longer as reliant on the U.S. economy as it once was and won't be dragged down this time if America slides into

recession), but is adamant that **“in an increasingly globalized world, cross border linkages have become even more important”.**

On the other hand Simon Johnson, head researcher at the International Monetary Fund, has spent the past months trying to settle nervous world markets. In April this year he told reporters **“You might ask, ‘If the U.S. sneezes won’t the rest of the world catch cold?’…Our bottom line view is that while the U.S. may indeed have sneezed, it appears to be a mild sneeze thus far, and not likely to spread.”** Now that the sub-prime fiasco has exploded onto the scene a not so confident Johnson is sounding more like a fire-fighter. **“Like a forest that has not seen a fire in many years, a benign financial environment…has built up a sizeable underbrush of risky loans, relaxed lending standards, and high leverage in certain areas. When problems ignited in the U.S. sub-prime mortgage market, the fire jumped in somewhat surprising ways to other areas…the brush-fire jumped at least three important firebreaks** (asset-backed commercial paper, banks exposed to risky sub-prime mortgages, and “less risky” jumbo credit markets)**…the smoke has not cleared yet.” (***Tony Walker, Australian Financial Review, 19 October 2007).*

In spite of Johnson’s reassurances I suspect the rest of the world is still looking on nervously and worrying about spreading sneezes and firebreak-jumping bushfires.

What Mid-life Crisis?

Ceri Shepherd recently wrote an article in Jim Puplava’s Financial Sense University entitled “FOR EVERY $100,000 YOUR HOUSE HAS APPRECIATED YOUR SON OR DAUGHTER IS NOW ANOTHER $100,000 IN DEBT.” http://www.financialsense.com/fsu/editorials/shepherd/2007/1016.html

A recent study (for Saga Health Insurance) out of Britain now tells us that the Quarter Life Crisis is perhaps an even greater problem than the Mid-life Crisis ever was. When a section of Brits aged over 50 was surveyed they revealed that only one-in-five felt they were under any financial pressure, while half had no financial worries at all.

Conversely, in the 18 to 25 age group 92% admitted to struggling under either emotional or financial stress. Many felt peeved that baby boomers had enjoyed the fruits of the property boom with 60% stating that their main concern was ever being able to get onto the home-ownership ladder. Combined with rising education costs, these modern day pressures are impacting the younger generation so that 70% feel under enormous pressure to attain high-paid careers to allow them to get ahead.

The research also revealed that many Baby Boomers were sympathetic to the fix today’s younger generation found themselves in and felt sorry for their children and grandchildren. Some richer Boomers can obviously now offer to give their children a hoist up onto the property ladder, but the point is it’s a shame and morally wrong that the younger generation has been forced into this predicament.

The Committee to Save the World Revisited.

Gerard Baker (The Times) reminds us how nine years ago the cover of Time magazine featured “The Committee to Save the World” riding to the rescue at the height of the last great global financial panic. This committee comprised US Treasury’s Robert Rubin and Larry Summers, and Fed Chairman Alan Greenspan.

Baker now thinks US **“Treasury Secretary Henry Paulson seems to be on his own mission to save the planet.”** Paulson has been feverishly scrambling to minimize further collateral damage from the sub-prime crisis by rounding up his old buddies and colleagues in Wall Street. **“Of course, in the case of Paulson, one of the original big movers on Wall Street, the committee consists of only one member – Hank himself, the former Goldman Sachs chief and Master of the Universe.”**

Paulson has corralled together some of the financial industry’s largest players to form a rescue fund, the Master Liquidity Enhancement Conduit, consisting mainly of Citigroup (the most exposed to toxic Structured Investment Vehicles), JPMorgan and Bank of America…**”to establish a $100 billion fund to provide liquidity to those of their brethren caught off-guard by the market’s reluctance to trade in certain types of asset-backed securities.”**

Seems the idea is to buy up and quarantine all the toxic-debt SIVs, ABCP, CDOs, etc that no one wants and hide them away in the hope that they can be off-loaded quietly later on. The banks want to avoid at all cost

having to try to liquidate these "assets" in today's tough environment as this would further crunch prices down and force institutions to mark down their value on balance sheets.

Baker sums up thus; "**Paulson's great strength, when he came to Washington a year and a half ago, was that, unlike his predecessors in the Bush administration, he had experience on Wall Street…It will do the world – and its financial markets – no good in the long term if the Bush administration's financial policy-making apparatus becomes The Committee to Save Wall Street."**

All the best, Joe.

www.lifetoday.com.au

Disclaimer: *This newsletter is written for educational purposes only. It should not be construed as advice to buy, hold or sell any financial instrument whatsoever. The author is merely expressing his own personal opinion and will not assume any responsibility whatsoever for the actions of the reader. Always consult a licensed investment professional before making any investment decision.*

Favourite Links:

www.financialsense.com
www.gold-eagle.com
www.freebuck.com
www.fiendbear.com
www.elliottwave.com
www.technicalindicatorindex.com
www.dailyreckoning.com
www.prudentbear.com

Archives:

October 2007 **Collateral Damage.**
September 2007 **Gonna Buy a Hat… a Big One.**
August 2007 **Holding the (Toxic Debt) Bag.**
July 2007 **Lonely in the Bear Camp.**
June 2007 **The China Syndrome.**
May 2007 **Welcome to Ponzi World.**
April 2007 **Itchy Trigger Fingers.**
March 2007 **Beware the Ides of March.**
February 2007 **Party on…but near an exit.**
January 2007 **Low-Doc Lenders Beware!**
December 2006. **New Masters of the Universe?**
November 2006 **Chasing Cash-Poor Consumers.**
October 2006 **America…Please Keep Spending.**
September 2006 **New Blue-Collar Rich. (Cashed –Up Bogans).**
August 2006 **The Devil's Advocate.**
July 2006 **Living on the Edge.**
June 2006 **Did They Really Say That?**
May 2006 **A Pact with the Devil.**
April 2006 **Cassandra's Curse.**
March 2006 **Avoiding a Bubble Bath.**
February 2006 **HIGH NOON High-Stakes Showdown, Part 2.**
January 2006 **HIGH NOON High-Stakes Showdown, Part 1.**

December 2005 **A “Cauldron of Anxiety”.**
November 2005 **The Six Horsemen of the Apocalypse.**
October 2005 **Back to The Future?**
July 2005 **Washing Each Other’s Underwear, Paper Shuffling, & McMansions.**
June 2005 **The Biggest Global Real Estate Boom of All Time…Thanks Al!**