Cumberland Advisors
2 N. Tamiami Trail, Suite 303, Sarasota, FL 34236
614 Landis Avenue, Vineland, NJ 08360-8007
1-800-257-7013 http://www.cumber.com

Treasury Dept. and Small Business by Bill Dunkelberg

October 14, 2011

Dr. William Dunkelberg is the Chief Economist of the National Federation of Independent Business.

The Treasury Department has just announced a new program to encourage lending to small businesses, the State Small Business Credit Initiative. Selected states can access the $1.5 billion fund if they can demonstrate that each dollar provided by the Treasury will generate $10 in loans to small businesses. Exactly what factual information led the Treasury to conclude that this program was needed was not made clear. More likely it is a result of the incessant drumbeat in Washington blaming the slow recovery on the reluctance of small banks to lend money to "creditworthy" (by Congressional and Treasury standards) firms. If they can't blame it on the banks then the impotence of the policy makers would be exposed.

This $10 to $1 multiple requirement is based on the textbook model of banking. If $100 is deposited in a bank and reserve requirements are 10%, then the bank has $90 it can lend out. The borrower of that money writes a check to someone who deposits it in another bank which is obliged to keep $9 as required reserves and can lend out $81 which will be spent. This check is deposited in another bank which must keep $8.10 in reserves and can lend out $72.90. Carried to its limit, loans will rise by 10 times the initial amount of excess reserves, 10 x $90 = $900 in loans. Notice of course that this is identical to the increase in checking accounts along the way which make up the bulk of the M1 measure of the money supply (which is the basis for concerns among those who see an inflation threat from Quantitative Easing).

The important thing to note is that for this to happen, someone must **borrow and spend** all of the excess reserves. If no one shows up to borrow the initial $90 in excess reserves, none of this happens and the $90 is just added to excess reserves held at the Federal Reserve.

This is the current state of affairs. The percent of small business owners who report not even being interested in a loan is at a record high 53%. Housing starts (and related loans) are a million short of "normal", removing immense amounts of credit demand from the system. Capital spending by small firms is at a 35 year low. Consumers are reducing their debt. Banks have over a trillion dollars in excess reserves now held at the Fed earning 0.25% interest. Applying the money multiplier to that would produce

$10 trillion in new loans (and money supply growth!) – if there were agents willing to borrow the money and spend it. But obviously no one is because if there were credit-worthy borrowers (by Main Street criteria, not those of Washington critics who have never made a loan or worked at a real bank), any bank would be happy to make a 6% loan instead of earning 0.25% on the savers money they are holding.

One possible conclusion seems to be that the Treasury Department doesn't understand this (or they have data confirming their view that credit availability to credit-worthy borrowers is actually slowing growth, yet to be revealed to us). If it did understand, such a program would not be launched (especially since the Congress just authorized another special $30 billion of funds to be made available to banks who promise to increase their lending to small businesses). If the "problem" is not understood, bad policy is a result. If this is just "PR", it's an expensive program indeed.

We thank Bill Dunkelberg for this guest commentary.

David R. Kotok, Chairman and Chief Investment Officer

Resources:

To sign-up for **Market Commentaries** from Cumberland Advisors: http://www.cumber.com/signup.aspx
For **Cumberland Advisors Investment Portfolio Styles**: http://www.cumber.com/styles.aspx?file=styles_index.asp
For personal correspondence: david.kotok@cumber.com

****

Copyright 2010, Cumberland Advisors. All rights reserved.

The preceding was provided by Cumberland Advisors, **Home Office**: One Sarasota Tower, 2 N. Tamiami Trail, Suite 303, Sarasota, FL 34236; **New Jersey Office:** 614 Landis Ave, Vineland, NJ 08360. 1-800-257-7013. This report has been derived from information considered reliable, but it cannot be guaranteed as to accuracy or completeness.

For a list of all equity sales/purchases for the past year, please contact Therese Pantalione at 1-800-257-7013, ext. 315. This report is currently about 600 pages in length. It is not our intention to state or imply in any manner that past results and profitability are an indication of future performance. This does not constitute an offer to sell or the solicitation or recommendation of an offer to buy or sell any securities directly or indirectly herein.

Cumberland Advisors supervises about $1.5 billion in separate account assets for individuals, institutions, retirement plans, government entities, and cash-management portfolios. Cumberland manages portfolios for clients in 47 states, the District of Columbia and in countries outside the U.S. Cumberland Advisors is an SEC registered investment adviser. For further information about Cumberland Advisors, please visit our website at www.cumber.com.

Please feel free to forward this Commentary (with proper attribution) to others who may be interested.

Archived Commentaries: http://www.cumber.com/comments/archiveindex.htm

To discontinue receiving Cumberland Commentaries, please go to http://www.cumber.com/listserv/remove.asp