StoneX Flow Report

October 2024

Shadow Work, Shadow Lending, and Shadow Savings

1 – Real growth has remained at 3% for eight quarters, despite the Fed's hikes and this year's negative fiscal impulse
2– Self-employment tax collections suggest the gig economy is twice as large as Brazil's GDP and is growing by 10% **+**
3 – Private debt and direct lending have displaced banks: shadow lenders added another junk bond market
4 – The everything rally has increased households' wealth by the equivalent of half a century of savings since COVID

"Of truth we know nothing, for truth is in a well" — Democritus
"In the shadows, we find the truth." — The Dark Knight

Make bragging great again! I have been correct on three major out-of-consensus calls since COVID:

- Predicting the great post-COVID inflation in April 2020
- Realizing that the Fed's 2022 rate hikes would cause a bear market, but no recession
- Remaining bullish on nominal growth over the past two years and arguing that recessions have been canceled

The first call was the most obvious. I still do not understand why investors thought that choking supply chains, locking workers at home, and sending them checks would be deflationary. The second one could be derived from Keynes: deficit spending has a clear and immediate effect on growth, while monetary policy primarily impacts assets prices.

On the other hand, even a Keynesian economist would have expected a slowdown this year. Record tax collections reduced the federal deficit by $300 billion and states should cut spending by 6.2% this fiscal year. And yet, the economy is on track to post an eighth consecutive quarter of about 3% real growth.

This report looks for **the hidden causes of the US growth miracle**.

First, **the gig economy**. Self-employment tax collections should reach $1 trillion this year and are growing by nearly 10%. **A large and booming BRIC-sized economy is hiding inside the US**. Most gig economy platforms have grown by more than 20% annually since 2018, and YouTube paid creators $107 billion in the past three years.

Second, **shadow lending**. Bank have tightened lending standards, but they are no longer the marginal lender to US consumers and businesses. Private debt has tripled to $1.7 trillion since 2018. **Private lending has effectively added the equivalent of another junk bond market in six years.**

Third, the **wealth effect bonanza**: households' net worth has increased by $44 trillion since COVID. The everything bull market generated the equivalent of half a century of personal savings. The growth boom will continue while the Fed's economists keep arguing about "monetary policy's long and variable lags" and "depleted excess savings".

Truth Coming Out of Her Well, J.L. Gerome, 1896

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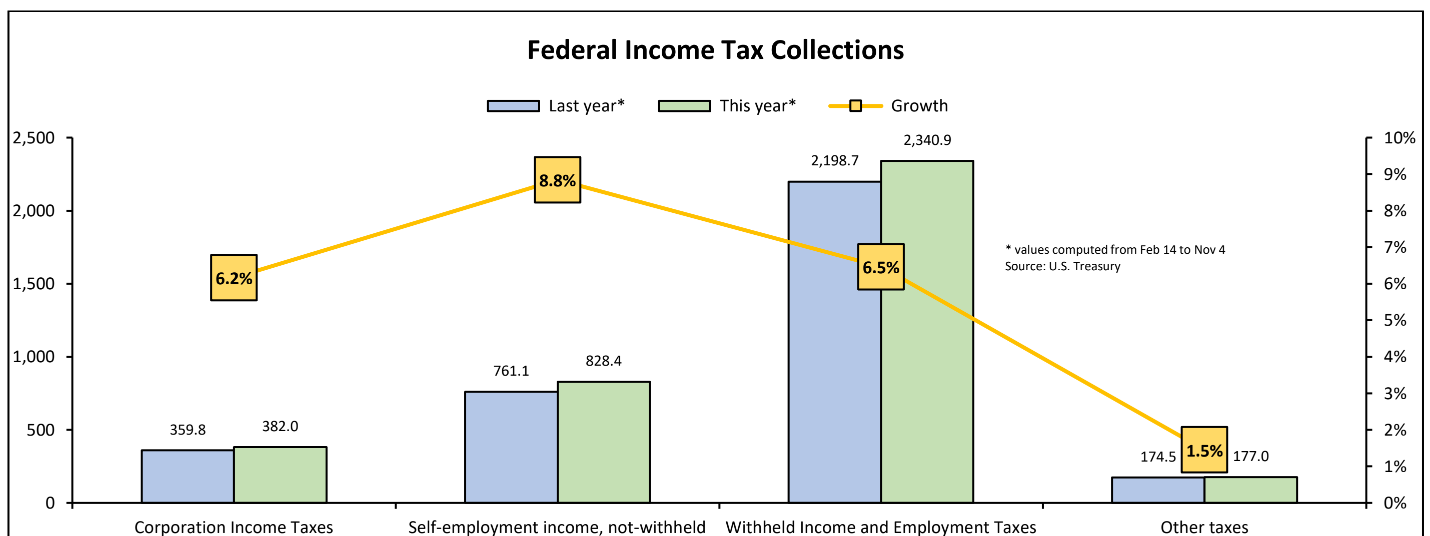
Shadow Work

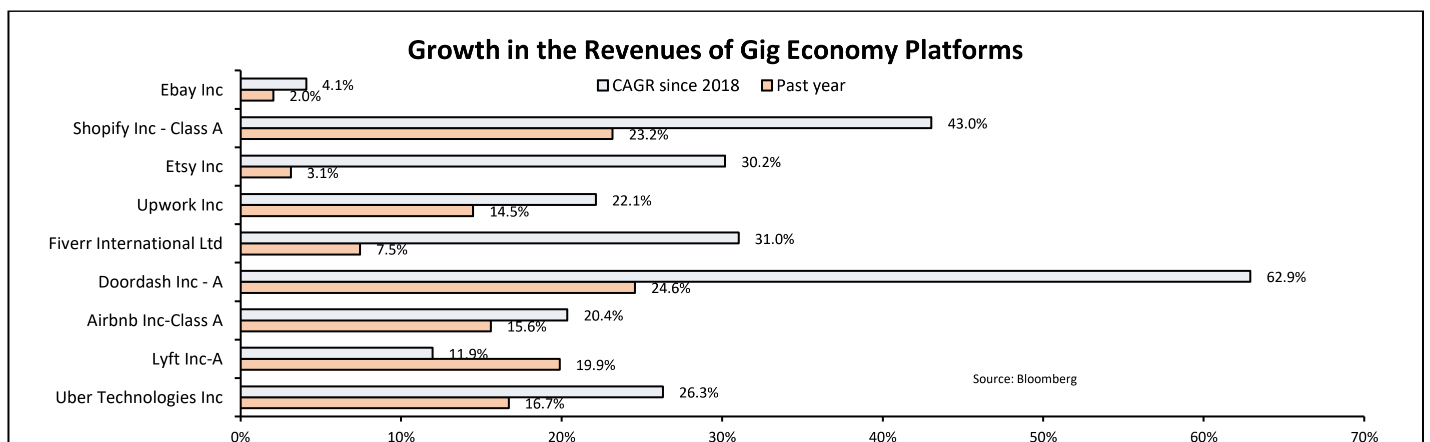
The US government collects taxes on three kinds of income: corporate income, withheld employment income, and self-employment income. All three sources have grown rapidly despite a 5.5% increase in tax brackets for income earned this year, which is more than inflation.

Self-employment income has risen the most, with $828 billion collected between February 14 and November 4[1]. Extrapolating taxes for the rest of the year and assuming a tax rate of 20% puts the size of the underlying self-employment economy at around $5 trillion. My estimate is likely too conservative because the average income tax rate is around 15% and a large share of gig income is not reported to the IRS.

Even with this conservative estimate, **the self-employment economy would be twice the size of Brazil, and it is growing by almost 10% in real terms**. A large booming BRIC-sized economy is hiding inside the US.



Platforms' rapid growth confirms that the **gig economy has grown at a double-digit annual rate since COVID**. The revenues of Doordash, Uber, and Airbnb have grown at annualized rates of 63%, 26% and 20%, respectively, in the past six years. Even niche platforms, such as Fiverr or Upwork, have 20% growth rates, and EBay's revenues are still growing, despite the fact that **Facebook Marketplace attracts 1.3 billion (!!!) users every month**.



[1] The format of the Daily Treasury Statement changed on February 14, 2023 so full-year comparisons are not available for all line items

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Because platforms do not report payments to creators and most of the gig economy happens in the shadows, we can only rely on anecdotal evidence, but these numbers are already gargantuan. For example, YouTube paid over $107 billion to creators in the last three years via the YouTube Partner Program. That is about 0.3% of US GDP.

According to tech industry-focused The Information, "Google reported that YouTube's revenue from ads and subscriptions over the past four quarters crossed $50 billion for the first time, **making YouTube bigger than Netflix by revenue.**"

Hopper HQ's Instagram Rich List estimates that sponsored posts by mega-influencers (accounts with more than one million followers) range between $5,000 to $25,000. About 0.8% of Instagram's 1.6 billion users are mega influencers, which is the size of Belgium's population.

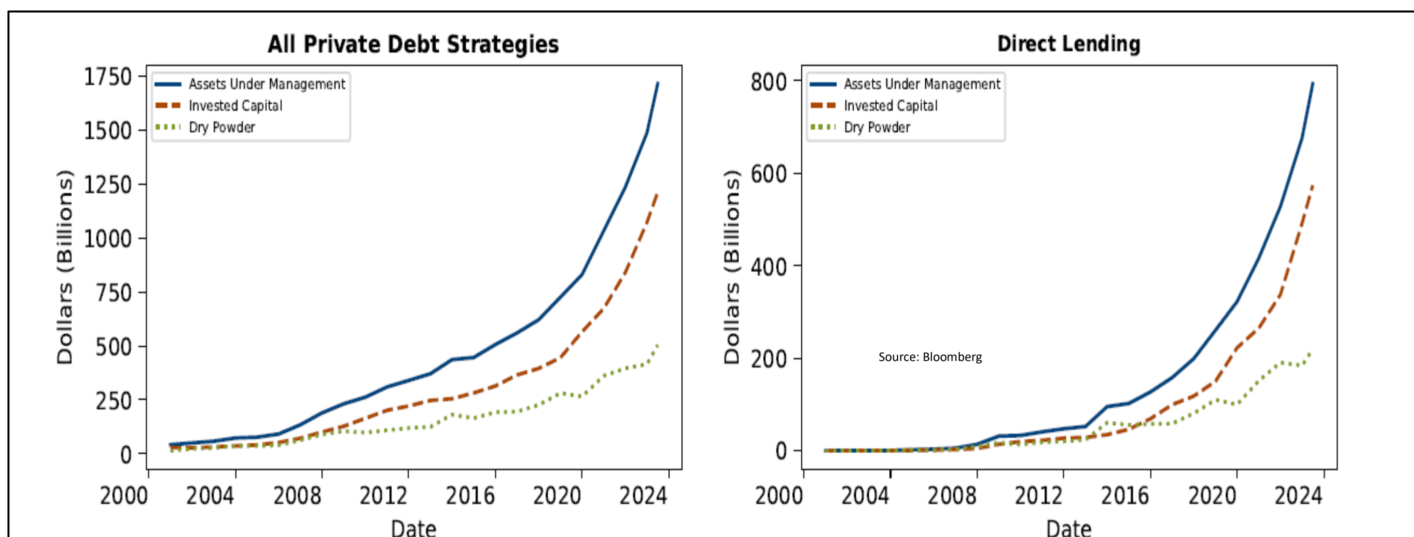
Privately held OnlyFans paid creators $6.6 billion in 2023, exceeding the combined outlay to all NBA players of $4.9 billion.

These anecdotal estimates dramatically understate creators' actual earnings because most influencers leverage platforms to sell other goods and services, such as courses, digital products, clothing, affiliate marketing, brand partnership, donations, tips, and to drive traffic towards one's brand or website.

Shadow Lending

According to the FEDS Note, private credit or private debt investments are debt-like, non-publicly traded instruments provided by non-bank entities, such as private credit funds or business development companies, to fund private businesses. Private credit is typically extended to middle-market firms with annual revenues between $10 million and $1 billion but has grown rapidly in recent years to fund larger companies that were traditionally funded by leveraged loans.

Total private credit has grown exponentially in recent years, reaching nearly $1.7 trillion, comparable to those of leveraged loans (roughly $1.4 trillion) and high-yield bond markets (about $1.3 trillion). Direct lending soared to $800 billion, or about one half of the total. There is also a growing amount of committed but uninvested in the industry, suggesting that the supply of private credit funding is outstripping demand.



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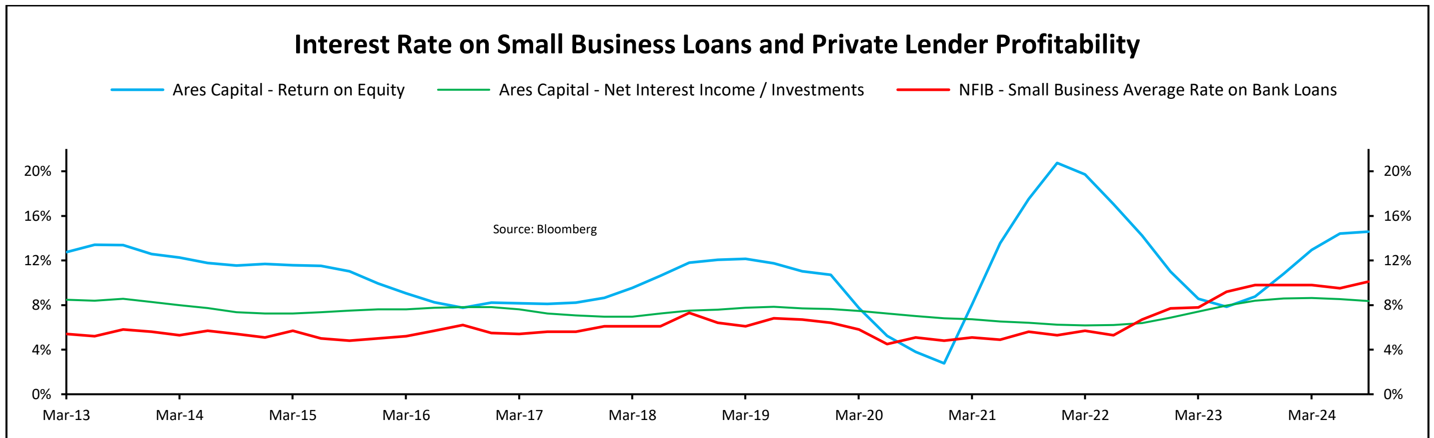
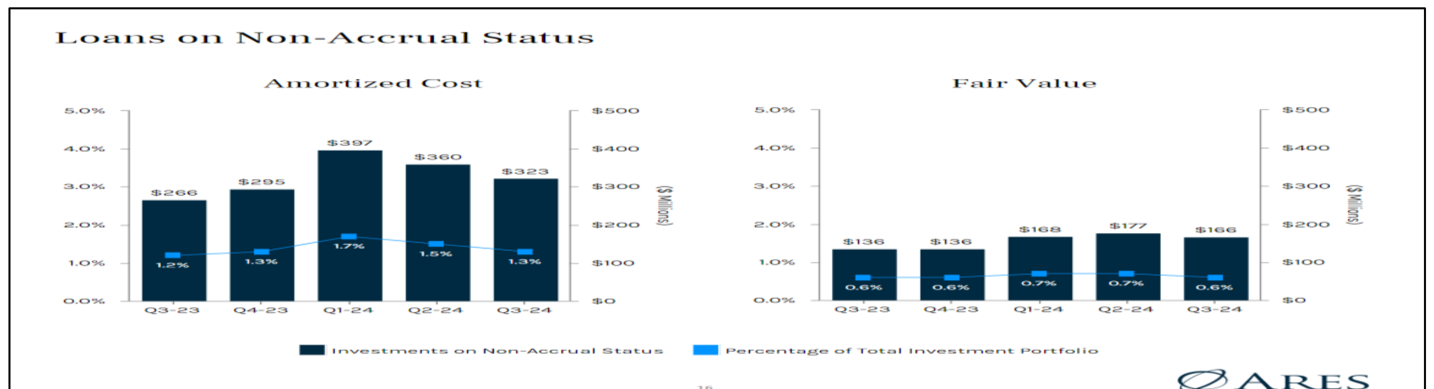
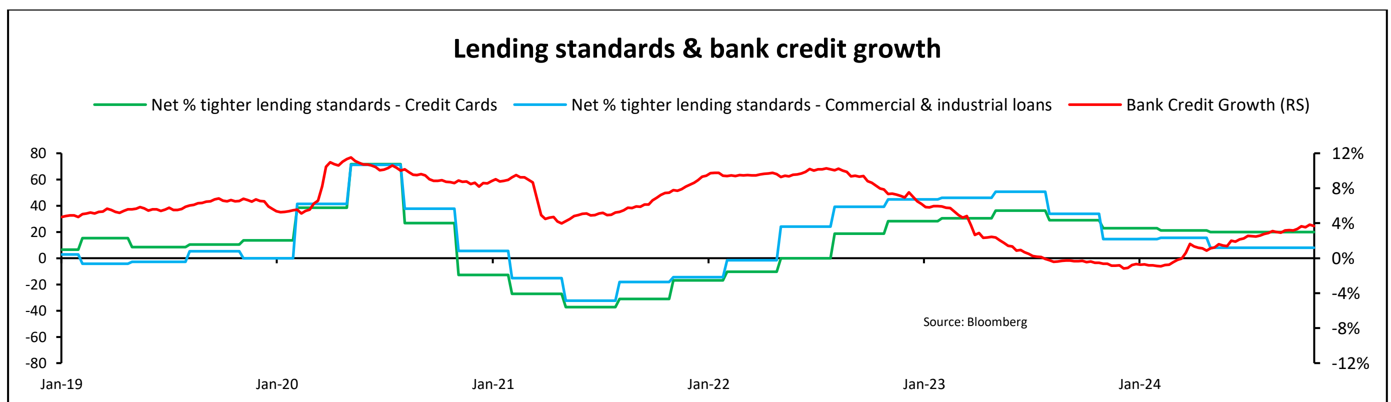
The popularity of these strategies can be explained by the **10% rate charged by banks on small business loans**, which translates into a 15% return on equity for the largest private lenders. By contrast, the Bloomberg US Corporate High Yield Index pays 7.2% for a duration of 3.1 years. Most private loans are issued at a variable rate or reset rapidly, protecting investors from rising rates.



Of course, it is entirely possible, and even likely, that private credit is experiencing a bubble, but recent trends in delinquencies as well as the vast amount of dry powder suggest that **the bubble is still in its ascendancy phase**. Ares Capital non-accrual rate, i.e., loans which do not pay, is still small and has declined recently.



The rise of shadow banking is a major reason for the ineffectiveness "long and variable lags" of monetary policy. The Fed's economists look at charts like the one below, which shows that rate hikes curbed bank credit and led to tightening lending standards. And yet, financial conditions remained loose, and real growth stayed a 3% plateau for eight consecutive quarters.



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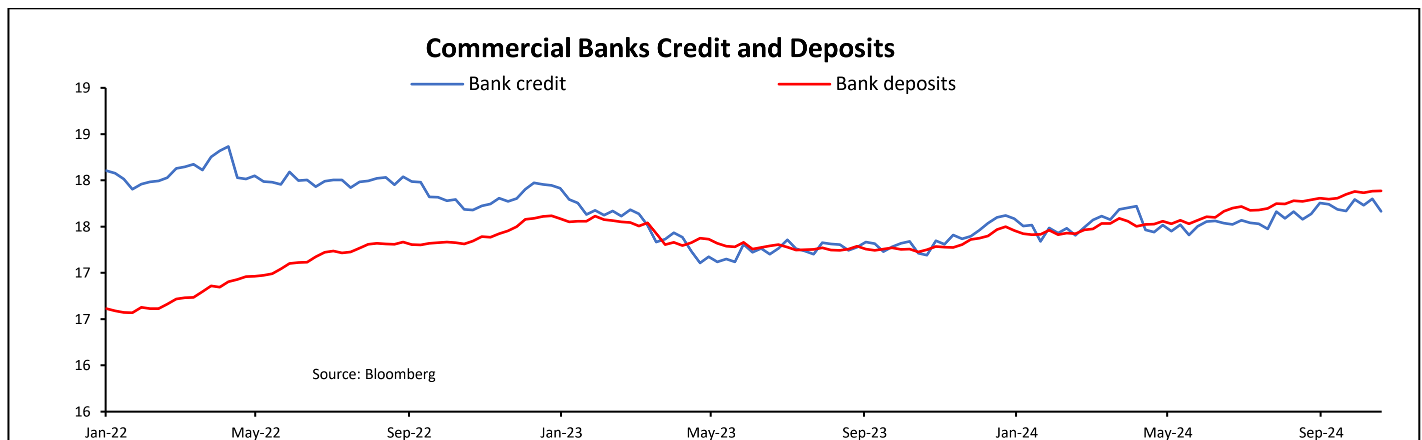
Lending is increasingly taking place outside of the banking sector and growth in bank credit does not capture the boom in private lending. It is true that many private lenders borrow from banks, but lenders decide on credit standard and leverage. **This intermediation allows banks to keep reporting strict lending standards, while ultimately financing increasingly risky and leveraged loans.** Dodd-Frank and higher capital ratio requirements effectively moved credit risk management from banks' balance sheets to bank-financed private lenders.

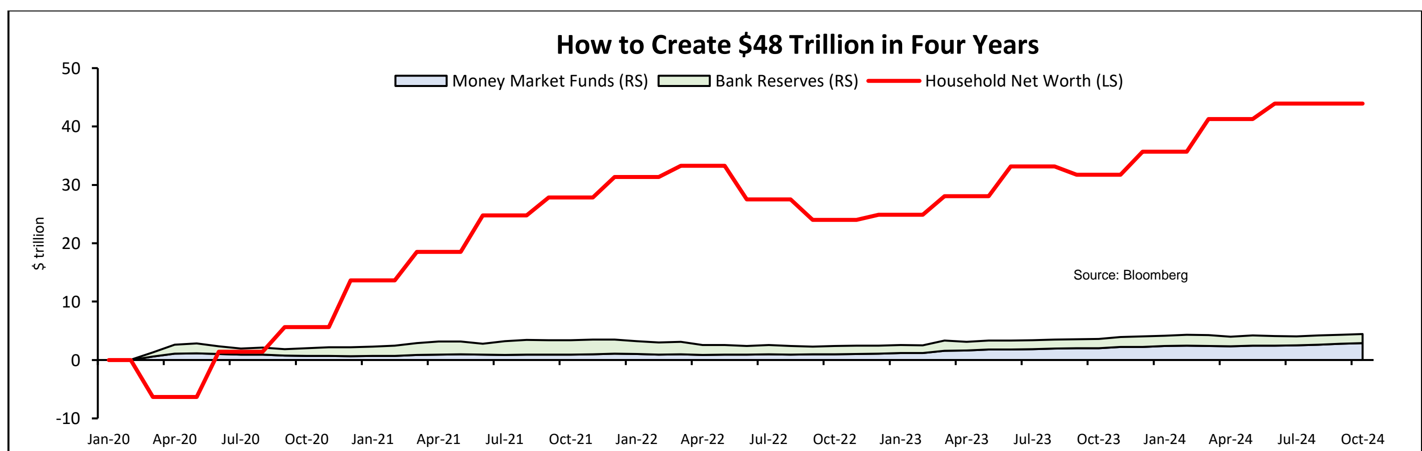
The rise of the gig economy and shadow banking could explain the recent divergence between bank credit and deposits. US commercial banks' deposits exceed credit by $222 billion, while bank credit exceeded deposits by $1.5 trillion in early 2022. **About $1.7 trillion of bank deposits has magically appeared in the past two years**, without a corresponding increase in bank credit.



Shadow Savings

Last summer, Fed economists claimed that "the US excess savings stock is currently completely depleted, which contrasts with other advanced economies where households still hold a buffer of excess savings of about 3 to 5 % of GDP" . I immediately rebutted that claim in "Excess savings Have Not Just Disappeared" and the Bureau of economic Analysis eventually settled the debate, but most major banks had already spread the news that COVID savings were depleted.

A year later, bank reserves have still not normalized from their post-COVID increase and money market funds assets have grown by another trillion to a record $6.6 trillion. However, **these amounts are dwarfed by the $44 trillion spike in household net worth**. If gig work and platforms stealthily added at the equivalent large BRIC economy to US GDP, the **post-COVID wealth shock handed households 50 years of personal savings**!



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The wealth effect may be even more stimulative than usual for two reasons. First, stock-based compensation at Nasdaq 100 firms has been multiplied by seven in the past decade. **Nasdaq 100 firm paid out $163 billion in stock-options this past year,** or about 1% of personal disposable income.

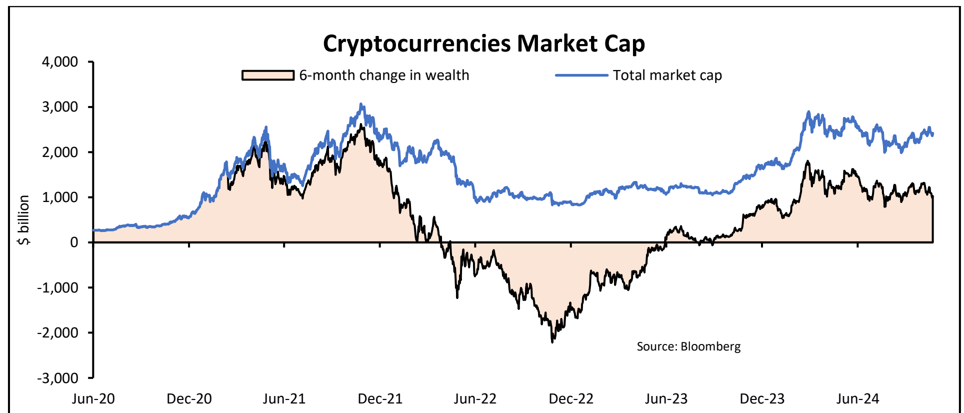
Second, the bull market in cryptocurrencies created gains of about $1.1 trillion in the past six months. [NBER economists]() found that the marginal propensity to spend capital gains on cryptocurrency was much higher than on traditional assets. Based on their estimates, the unfolding crypto bull market should boost consumption by close to $100 billion.

Table 6

Propensity to Consume out of Crypto Wealth

This table shows the marginal propensity to consume (MPC) out of crypto wealth for various spending categories. *Avg. Quarterly Crypto Gains* is the average quarterly change in crypto wealth over the prior year defined in Equation 2. All regressions include a control for the household's income from the previous quarter, as well as household and state-by-quarter fixed effects. The regressions are estimated using two-stage least squares (2SLS) where passive crypto gains, defined in Equation 4, are used as an instrument for crypto gains. Passive gains are calculated as what the household would have received if their portfolio had been fixed 12 months prior and had experienced the value-weighted returns of Bitcoin and Ethereum. *t*-statistics in parentheses are heteroskedasticity-robust and clustered at the household level. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively.

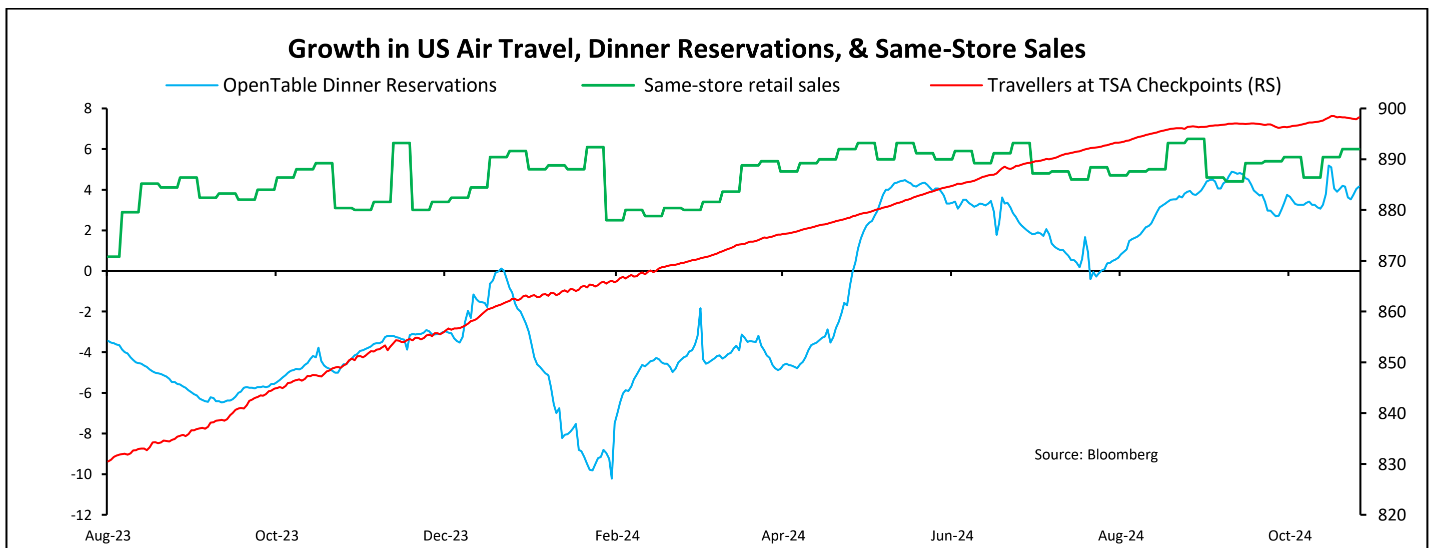
	Quarterly Spending				
	Total Spending	Auto	Cable/Telecom	Cash/Check	Charity
	2SLS	2SLS	2SLS	2SLS	2SLS
	(1)	(2)	(3)	(4)	(5)
Avg. Quarterly Crypto Gains	0.0786***	0.00354	0.000131	0.0622***	0.000614
	(3.59)	(1.57)	(0.16)	(3.57)	(0.47)



Investors can see the effect of the wealth miracle, the private lending boom, and the soaring gig economy on anecdotal indicators such as cruise line bookings, dinner reservations, same-store retail sales, and travellers crossing at TSA checkpoints.

The consumption boom will likely accelerate after the red sweep at the election, which further increased asset prices, will likely remove regulatory hurdle on bank lending and deal-making, and caused a confidence shock among Republican voters.

Stay long US nominal growth and buckle up for a second wave inflation !



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The Nasdaq 100 Index is a stock market index composed of the 100 largest non-financial companies listed on the Nasdaq Stock Market, primarily representing the technology industry. It is a popular benchmark for investors seeking exposure to growth-oriented companies.

The Bloomberg US Corporate High Yield Index measures the performance of US dollar-denominated, non-investment grade, fixed-rate corporate bonds, offering exposure to riskier corporate debt with potentially higher yields.

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