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Whatever it takes…

At a speech in London on July 26, 2012, Mario Draghi uttered the now immortal words…

"Within our mandate, the ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."[1]

What is this "whatever" you speak of?

It is money printing. To buy bonds and other debt instruments, keep the universal price of everything credit-related i.e. interest rates low.

Why is this so important to central banks?

Firstly: the government funds itself at this rate, and the amount it has borrowed is so ginormous that any movement up in interest rates crimps their ability to spend. In fact, governments don't have the money to pay higher rates.

Secondly: the economy is on steroids, created by low interest rates. Move them higher and the economy might crash.

Thirdly: most people's wealth is in property with huge mortgages at low rates. Increase interest rates and their net wealth diminishes quickly and they feel poor and stop spending, further cratering the economy.

Ok, low interest rates are a good thing then?

What could derail this magnificent party?

Bond vigilantes used to be the blue lighted car that pitched up at the party and shut it down. They fulfilled this important role for the longest time… until central bank party animals realised they could simply pay them off by buying them.

That has worked for a long time; the party continued and the local blue lighters were paid off.

Now, the party has got so out of hand that the military have stepped in, the incorruptible, no nonsense party destroyer.

The military is inflation.

Surely now the party is over?

Central banks will raise rates, destroy demand and inflation will settle down to that magical 2% rate?

Remember what Dragi said… "Whatever it takes"

Whatever it takes to keep the government spending, the economy going and property prices to keep rising, NOT whatever it takes to curb inflation and keep prices stable.

The central bank party continues unabated, with the music turned down a little maybe.

Inflation is an exponential function, if you don't get the hint the first time, exponentially larger inflation will ensure you do.

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[1] Bank, E., 2022. Verbatim of the remarks made by Mario Draghi. [online] European Central Bank. Available at: <https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html>

Central bank party hosts are ignoring the hint by raising rates too slowly or not at all.

Bank of Japan insists that inflation is cyclical and will return to zero in the near term so there is no need to raise rates. Their currency has depreciated 25% this year as partygoers realized the BOJ's intransigence with the military is not going to end well.

ECB ditto…

Fed? They are moving rates up mainly, I believe, because of mid-term elections and inflation is the NO 1 voter concern. Still, the rate of increases are not enough to put inflation back in the box.

The "whatever it takes" could result in inflation significantly higher than what we have already experienced.

Millions of middle class getting thrown into poverty will not change this. Demand destruction will not change this.

Inflation can coexist with recession and even depression.

Goldman Sachs predicts 20%+ inflation for next year. Liz Truss wants to cut taxes and bail out people affected by the massive energy rises. Keep the party going with whatever (freshly printed money) it takes. Others want a windfall tax on energy providers but likely that money could be better spent on infrastructure/increasing supply to avoid another crisis.

All short-term solutions lead to worse medium or long-term scenarios.

This path has basically been chosen.

"Whatever it takes" leads us to higher inflation, which invariably leads to political polarization, normally right-wing, which in turn leads to war – internal or external. Nothing is more unfair than inflation and our societies are fuelled by envy.

The only question is how long we take to get there… slowly or quickly.

Equities will surely retrace as they are essential valued at all future earnings cash flows discounted by interest rates.

Earnings will be affected by demand destruction and higher interest rates will discount the future earnings significantly. Add rising negative sentiment to that brew.

To understand the reluctance of central banks/governments to combat inflation one has to keep in mind…

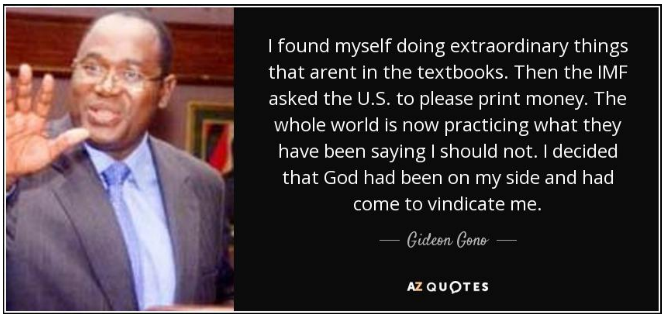
Inflation is the individual's problem but the governments solution.

Governments tax receipts rise and the debt/GDP ratio falls as prices rise nominally.

How to position a portfolio? Very difficult with an "everything bubble".

The one safe haven in my opinion is long volatility, which will inevitably rise.

Gideon Gono - Zimbabwe's ex Central Bank Chief who presided over the country's hyper-inflation.



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