

36 South Views

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Bug vs windshield

Firstly I will say that this pandemic is a tragedy of unimaginable extent to those severely afflicted and my heart goes out to those people.

The antidote is also a tragedy for a lot of otherwise healthy people.

Governments around the world are pumping frankly unbelievable amounts of freshly printed money into the system. Financial market participants, driven to more and more risky and exotic yield enhancing structures were caught in an illiquidity trap. Artificially low interest rates drove this behaviour. Central banks fearing a meltdown, rightly or wrongly have once again socialised the cost upon everyone on the understanding that the tab will be picked up by that fabulous "money tree" which exists in the back garden of every central bank. It is the 2008 playbook.

People demand it, they have been habituated upon relying on the government instead of relying on themselves. The ubiquitous lack of savings is a testament to this. The one good thing that might emerge from this, I hope, is that people will have had their behaviours surrounding "saving for a rainy day" irrevocably changed by COVID19

Governments are mostly broke, they have no money, they can only help to the extent that there is faith in their currency which in turn is primarily premised upon the ability to tax. But everyone is now not working so where is the money coming from?

Out of thin air that's where....

The central banks' credit standing is the last line of defence. It is now being sorely tested.

I suspect we will begin to see central banks begin to doubt each other's creditworthiness and demand gold as payment instead of dollars or yen or euro or any other paper currency. That will be the start of the gold bull market as gold is effectively the credit default swap of central banks.

Fiscal and monetary stimulus was inevitable but the size and scale is only important when you understand the fragility of the financial system.

Bailing out companies, states, municipalities and potentially cruise ship companies and airlines is questionable but to do it via special purpose vehicles is eerily reminiscent of Enron.

The heart of the matter is the delusion that governments are using someone else's money to help. They are not.

Governments are borrowing from us and our future.

How would you feel about the \$2.2 trillion stimulus if you were asked for \$19,000 (approximate cost per US taxpayer) in a direct levy? I bet everyone would think a bit harder about whether to bail out companies like Boeing who have spent the majority of their free cash flow buying back shares which enriched management and shareholders and now everyone must bear the cost!

There is a chart pattern called a Prussian helmet in which one observes a parabolic increase followed by a parabolic decrease. The rate of expansion of world debt is in the parabolic increase stage which is unsustainable. What follows is the parabolic decrease... either serious inflation or deflationary default.

We are all on the bus and that bus is now on the highway to stagflation hell. There are no off-ramps.

Inflation running concurrently with recession or depression.

I have seen this movie before, being an ex-Zimbabwean.

Stagflation rewards speculators, people in debt and those closest to the central banks' money spigot. It punishes pretty much everyone else... the ordinary people who make up everything good about society. That is the real tragedy.

Coronavirus was simply the catalyst that has exposed our delusions.

And the antidote i.e. more debt will just hasten the reality adjustment that one cannot bring create value by creating money.

Alexis de Tocqueville - Democracy in America:

*"The government covers the surface of society with a network of small complicated rules, minute and uniform, through which the most original minds and the most energetic characters cannot penetrate, to rise above the crowd. The will of man is not shattered, but softened, bent and guided; men are seldom forced by it to act, but they are constantly restrained from acting. Such a power does not destroy, but it prevents existence; it does not tyrannize, but it compresses, enervates, extinguishes, and stupefies a people, till each nation is reduced to nothing but a flock of timid and industrious animals, of which the government is the shepherd."*¹

US debt history²

1835 US\$ 33,700
1860 US\$ 65 million
1865 US\$ 2.7 billion (civil war)
1918 US\$ 15 billion
1945 US\$ 259 billion
1971 US\$ 398 billion
1988 US\$ 2,602 billion
2008 US\$ 10,025 billion
2020 US\$ 23,680 billion³

Disclosure

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¹ (Tocqueville, Originally published 1835 - 1840. Republished 2003.)

² <https://www.thestreet.com/politics/national-debt-year-by-year-14876008>

³ <https://www.statista.com/statistics/273294/public-debt-of-the-united-states-by-month/>