Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
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Dennis Tubbergen:

Welcome back to RLA Radio. I'm your host, Dennis. Tubbergen. Joining me again on today's program is returning and popular guest, Mr. Karl Denninger. Karl is a prolific commentator on healthcare, economics, and other things as well. You can read his blog at market-ticker.org. I would encourage you to check that out. Karl, welcome back to the program.

Karl Denninger:

Thank you very much for having me.

Dennis Tubbergen:

So Karl let's jump in at the beginning of the year. I believe the United States was projected to have a $2.3 trillion dollar deficit. That's before the so-called stimulus package of $1.9 trillion. Now they're talking about another $3 trillion dollar infrastructure package, but the New York Times says really only $1 trillion of it will go to actual infrastructure. So give me your take on this. The second part of the question is this will all be funded through more money creation. Is this the end of the road?

Karl Denninger:

Yeah, it probably is, but let's make sure that we define our terms correctly. Okay? So these two bills, well three bills, you count all three of them from the start of COVID until now, including this latest $1.9 trillion. Those are very different than the normal way that the government accounts for things. So all of that money that was printed and put into the system, for the most part it all happened in that current fiscal year. All right, now this is very different because this infrastructure package is being done under the usual rules for accounting. That's the impact and the spending over 10 years. So you got to be very careful because when these bills get passed and numbers get thrown around like, $3 trillion dollars, it's not $3 trillion now. It's about $300 billion a year over 10 years. All right, so this is very different.

Karl Denninger:

This is one of the things that I've had a lot of trouble with, with talking to people about this in the media and in the economics world. Is that these COVID related things that start from about March of 2020 all the way till this point, have been accounted completely differently. It has to do with the arcane rules of how the congressional budget office is required to operate because the CBO is of course, a generation of Congress, Congress makes the rules. They don't have a choice as to how they report things, and how they put things on paper, and what they say. They have to follow the guidelines and the rules that Congress put forward. So when Congress says "You have to account for this over 10 years." Well, that's what they do because those are the rules.

Karl Denninger:

So there's this $3 trillion or whatever it ends up being, is going to be about $300 billion on an annualized basis. The problem today is that I don't know that even a trillion of that is actually going to go to infrastructure. I've not seen yet an outline of what's in that. I don't think anybody has. I think it's still being written. Then there's another bill that apparently is behind this. There's two components of it. One that they're going to try to put through some reconciliation move. Then there's another one behind it that clearly will not qualify because it is not revenue related. So you can't get there from here, essentially. But there are issues with them doing that because if Congress uses reconciliation to do this, they will have used up their last reconciliation capacity within this Congress. Because each congressional term is two terms. You can only use it once per year so they can use up their second one now, but then they're out and they've only got 50 votes.

Dennis Tubbergen:

So let's just take a look at all the money creation that has been taking place. The Fed chairman Mr. Powell, came out and said that they're going to maintain an accommodative stance moving forward. So how long can this go on Karl? I mean, it seems that modern monetary theory is now the policy de jure.

Karl Denninger:

Well, the bond market is saying, "I don't think so."

Dennis Tubbergen:

Yeah. Bond yields are way up in the last year.

Karl Denninger:

Well, especially the longer end. Okay. The 10 year treasury is up substantially, and it's been up essentially in a straight line. So this is the reaction that you're going to get. The impact is already shown up in places like gasoline. Look at lumber futures, the price of lumber, just walk into Home Depot and look at what they want for 2 x 4's.

Dennis Tubbergen:

Yeah, crazy.

Karl Denninger:

Yeah. It's insane. That is the problem with doing this sort of thing is, that let's say that you want to build a house where you got yourself a problem. Okay? Because as the longer end goes up, as the 10 year goes up, the cost of money for mortgages goes up. At the same time the cost of building materials goes up. The poor sap that wants to buy the house gets it in both sides, right?

Karl Denninger:

I mean, there isn't anywhere to hide from that. The other inflationary pressure that's going to show up very shortly and it's already starting to is in foods. Of course food and energy are the two places where you absolutely do not want, it if you are the Fed or if you are an ordinary American, because those are things you cannot avoid buying. Then on top of that, you have the medical monster. Which is I mean, essentially trying to leverage itself into a permanent place in American society with tens of billions of dollars spent on quite possibly dangerous and worthless shots each and every year from here on forward. That's the scaremongering that's going on. I don't know if they're going to get away with it, but that's what they're trying to do.

Karl Denninger:

There's a pretty clean argument that's being made that the entire thing with Obamacare was about that segment of our economy that was about to collapse under its own weight. It had gotten about 20% of GDP. There is an argument to be made, not a lot of evidence for it yet, but an argument to be made that essentially everything that we did with COVID was round two of that. As it was about to collapse under its own weight again.

Dennis Tubbergen:

Karl, let me be cynical for a minute, because I'm sure you're familiar with some of the agenda items being put forth by the World Economic Forum, under the guise of a great reset. There's been some open talk recently by both Janet Yellen, the Treasury Secretary, and Jerome Powell that a digital dollar is now a high priority. Just from a cynical perspective, is all this money creation really accelerating this idea of a great reset?

Karl Denninger:

Well, it is, but I think people need to understand that there is a very severe problem that comes with any kind of digital currency. One thing that physical currencies all have is that the self validating. When you walk into the grocery store and you pull out a $20 bill, I don't have to consult some master list to know if that's valid. Now, if there's a question, yes, I can because the Federal Reserve and the Treasury know whether or not the serial number is legitimate, and if it has been seen somewhere else. In other words, if there's 10,000, $20 bills all with the same serial number on them, they're going to know, okay. Or one that has never been issued. On the other hand, you and I transact every day without anybody doing that. Without any tracking. So in theory, while currency is traceable in practice, it is not because in ordinary commerce it validates itself. I can look at a $20 and I can tell you whether or not it's any good.

Karl Denninger:

With digital currency that's not true. This is a huge problem because if the government decides to for example, confiscate your $20, and it's a digital currency, they can do that with push of a button. That $20 bill that you had is all of a sudden void. Think about the consequence of that. If you do something that the government doesn't like, it doesn't have to be illegal, just has to be something they don't like.

Dennis Tubbergen:

So Karl, the fact that China now has been testing a digital currency to go down this road a little bit further. And Jerome Powell said that it's a high priority for us, and Janet Yellen essentially said, we need to stamp out Bitcoin, which is not a central bank issued digital currency. They certainly seem to be headed in that direction. Would your opinion be that they're not going to be successful?

Karl Denninger:

My opinion would be that if they try it, they're going to stoke a Civil War and they're going to deserve it. Because what China has done has essentially, they implemented where this ends up always going. Which is a social score and the ability to restrict people's movement and economic activity, based upon their political leanings. Not based upon whether or not they've committed a crime or been indicted. I mean, let's face it if you commit a crime, you're getting indicted, you get convicted, you go to jail. You can't engage in much economic activity in jail, right? But we're talking about the ability to do that without any evidence and without a proof that you did anything wrong, no adjudication and no appeal. My opinion is that sets off the sort of social and civil unrest that ultimately destroys the nation. I do think they may attempt it, but it would be the dumbest thing that humans... Perhaps the dumbest thing we've done since rushing out untested vaccines into arms.

Dennis Tubbergen:

So Karl, we've got just maybe a minute and a half left in this segment. We can pick it up on the other side, but I want to go back and talk about the inflation piece. And then you had suggested that certainly, we're seeing inflation in lumber prices, agricultural commodity prices are up significantly. That will soon translate into higher grocery prices. Under what scenario do you think that the Fed Reverses policy? I mean, if we see significant inflation, do they reverse? And if they do, what exactly does it look like? And we can pick it up on the other side as well.

Karl Denninger:

I think the Federal Reserve is going to get backed into a corner and be forced to start tightening liquidity, and allowing the short end to rise sometime within the next six to 12 months. When they do every asset that is based upon short-term liquidity and debt is going to have a massive repricing in the downward direction.

Dennis Tubbergen:

So you would expect that the bond market would crash. We would see interest rates spike, you'd see the housing market crash, and it would be a chain reaction?

Karl Denninger:

Yeah. I think you're going to see perhaps a 50% re-rating in essentially everything.

Dennis Tubbergen:

Well, my guest today is Mr. Karl Denninger, we're going to pick it up on the other side and get Karl's forecast. We'll also talk a little bit of politics and a little bit of healthcare. That's when RLA Radio returns. Stay with us.

Dennis Tubbergen:

I'm Dennis Tubbergen. You are listening to RLA Radio. My guest today is Mr. Karl Denninger. Karl's blog is available at market-ticker.org. The website again is market-ticker.org. I would encourage you to check it out. Karl, we ended the last segment with you saying that you would not be surprised at all to see a 50% repricing. This essentially, what would be a deflationary collapse? What asset classes would you say would be effected? When you say everything? Do you mean everything?

Karl Denninger:

Yeah, I do. The more levered you are and the fewer actual hard assets, you have the worse you're going to get it. So there's sort of two distinctions in corporate life today, although they're less so than they used to be. Used to be, there was a group called the nifty 50. You're old enough to remember it. I'm old enough to remember it. It was essentially all industrials that had large installed basis. So steel mills, car manufacturers, things like that. Nowadays, everybody and their brother has gone to this asset light model where you don't even own your copier, it's leased. Okay?

Karl Denninger:

I had people trying to do that with me when I ran my internet company. They're like, "Oh, you ought to lease this Karl." "No, I want to buy it." "Well, why?" "Well, it's an asset. Why would I leave something that I'm going to use for the next 10 years? That's stupid." But that's the kind of thing that is going on. As a result for example, Amazon, all of there... As a middleman, they own basically nothing, all of their warehouses are leased. Their data centers, they lease the building. They own the equipment in some cases inside however, that computer equipment's worth 10 cents on the dollar, six months after you buy it. These are firms that all have essentially no hard asset value. There's still a few places that do. General Electric has some of, course, Steel Company's, X, and a handful of others. But the majority of firms today, everything is not just financed, but it's not actually theirs.

Karl Denninger:

The problem with that is that what you were trading on there, the entire price is some multiple of operating cashflow, which is discounted by interest rates. So as rates go up that operating cashflow discount goes down and so does price. That's just the way it goes. So even assuming that these firms don't find themselves in a trap where they have their building on a lease, the lease comes up, it gets renegotiated. Commercial property is typically not financed like your house, right? It doesn't have a 30 year mortgage, and then you own it. Those continually get rolled over. So your lease comes up for this office space and Oh, by the way, the cost of the money to roll that note has gone up by 50%. What do you think happens to your rent?

Dennis Tubbergen:

Exactly.

Karl Denninger:

Yeah. Then you've got the other side of it, which was the glut pressure that is happening from all these people who went to work at home during COVID, those buildings are empty. You've got a substantial number of those tenants that are saying with these distancing measures that you have in place, masks, you got to stay six feet apart, all this stuff. You have essentially rendered our office space uninhabitable because our people can't get up the elevators into the office to work under those rules. Therefore they're refusing to pay. That stuff is all going to go through the courts, it will all get sorted out. But in the meantime, well, it was same thing with the rental moratoriums. Okay? You can't throw somebody out of their residence that isn't paying their rent?

Karl Denninger:

Excuse me, the guy who owns the building has to pay the mortgage and the property taxes. All right. At some point, this comes apart and we keep cranking this spring, tighter and tighter. It is going to break, and it will break into an increasing rate environment. Which is the absolute worst possible place for it to happen. So, yeah, I see a major dislocation coming in real estate and in the common stock market, I think it's going to be bad.

Dennis Tubbergen:

Karl, will you look at stocks. Just for example, I recently read a piece that you'd take a look, for example, just at Coca-Cola, which is just one example. Their earnings over the last 10 years are down 30% on a per share basis. Their longterm debt has tripled, and yet their stock has doubled. None of this makes sense.

Karl Denninger:

It does when you consider, see, it's all discounted cashflow versus the return that you can get in fixed income and where you can use leverage. So the treasury market, you can use essentially unlimited amount of leverage because there's considerably no default risk. So the large institutions do that. They buy a bond, then they use that as collateral to borrow more money. They buy another bond. The problem with this is that of course, the price of that bond is the inverse of the yield. So when rates go up, if you've taken on leverage to do that, you will literally get wiped out. You'll have nothing left. That is the preference though, is that's driven people into common stocks because the rates have been so low that the number of turns of the crank that you've had to make in order to be able to get some kind of return has been obscene.

Karl Denninger:

People said, "You know what, the risk of this going bad on us"... Historically, everybody predicted that Japan was going to blow up for 20 years and it never did. So the risk looks relatively low, but if it does we're done. So we're just not going to go there. We can look at the chart on Amazon. Good Lord.

Look at what's happening with the price. "We will buy that." That works right up until it turns around and goes the other direction. You have people that are willing to clip coupons and take that. The Fed ran this repression game. People think this is the first time it's ever happened, it isn't. The Fed ran this repression game after the World War II through the 1950s and into the '60s.

Karl Denninger:

Everything seemed fine right up until about the time Nixon got in the office, right? Then of course, who got the blame for it? Carter. But Carter wasn't really responsible for it. It was what the Fed and the government had done in the years after world war II, over an extended period of time. We've been doing the same thing now for the last 20 years, since the crash in the dot-com space.

Dennis Tubbergen:

So Karl, for our listeners, maybe that aren't familiar with how that policy evolved after World War II through the early '70s, give them some detail.

Karl Denninger:

Well, essentially what the Federal Reserve did is they announced a policy. They were going to what they called repression, and they were going to clamp the long end of the bond curve. They did it as a "We're coming back from a war. We need cheap money available to... Well, look at the Eisenhower expressway system. All right, we have to be able to build expressways. We have to be able to do these things." Everybody, all the economists at the time told everybody, "You can do this. It's a free lunch. There won't be a consequence for this." It seemed to work out for quite a long period of time.

Karl Denninger:

During that time you had the entire Great Society System, all those programs came into place. You had the expansion of the welfare system, you had Medicare, you had Medicaid. You had all of these social programs that appeared to be free, that all were put into place. Then as time goes on, "Oops." All of a sudden it doesn't work that way. We have an oil embargo. We have some Arabs that get mad at us and the entire thing essentially unraveled all at once.

Dennis Tubbergen:

Karl, when you take a look at what happened in the early '70s, a lot of this really led to the link between the U.S. dollar and gold. It was a quasi gold exchange standard system, that being eliminated. Now for the last 50 years, there's been absolutely no restraint on the part of the Fed. That wasn't the case for the most part from World War II through 1971. So does this mean this crash has to be worse than the one we saw back in the '70s?

Karl Denninger:

Well, I don't think it's a question. I don't think it's a question here when it comes to this being unprecedented or anything like that. You have to remember, it's not the Federal Reserve. Congress is the source of every dollar of all of this. The Federal Reserve does not have anything to transact in if the treasury does not emit credit beyond their taxation. So, I we need to stop calling this a Fed driven thing. It's not. This is driven by the 535 clowns in Washington, DC, who we keep sending back to office.

Dennis Tubbergen:

So Karl, just your opinion on this, when this unraveling occurs, how do you think the political landscape will change?

Karl Denninger:

Well. I really don't know. I just don't know. It's very difficult to know where we are with that. Part of the problem with this is that the government is not going to turn around and say, "Oh, by the way, we're going to cut our expenditures by 50% to come back within the power to tax." Right? When I started writing my column, that was about a 10% or 15% requirement and now it's not. They say a structural deficit was 2% or 3% back in the early 2000s, and 2005, 2006, 2000... That's just total nonsense. You have to add in the unfunded spending that was coming from Medicare and Medicaid. That deficit was running around, 10%, 11%, in the mid 2000 timeframe. Now with what we've done with COVID, there is a reasonable estimate that this fiscal, it could be 30 that's Argentina style stuff.

Dennis Tubbergen:

Yeah. 4000% inflation stuff.

Karl Denninger:

Well, and it also, however, means that if you wanted to put this back to where it ought to be, remember if you cut off that spending what's going to happen is your tax receipts are going to go down dramatically, not a little bit, a lot. So what's going to end up happening is that you don't have to cut back 30% of Federal spending. You have to cut it half. Now how are you going to do that?

Dennis Tubbergen:

Yeah. That's a good point. Ultimately, Karl, we've got a couple of minutes left in this segment. If somebody's listening to this and we're talking about the magnitude of these problems, that literally seem like they're unsolvable, what advice would you have someone who's thinking about, "Hey, I'd like to retire. I'd like to have the same retirement my parents did."?

Karl Denninger:

Well. I don't think you're going to have the same retirement your parents did. The unfortunate reality is that if you are in today's world and you're not retired today, your parents... especially over the last 20 years have essentially stolen your retirement. This is an argument I got into with my father years ago, before he passed. Was that he already spent the money. He voted for policies that spent the money that was supposed to pay for these things. You can't spend the money twice. Once it's spent, it's spent. So, you decided you wanted these policies within your government, you got them. You voted for them and you got them. Now you need to shut up and deal with it.

Karl Denninger:

Of course, he didn't like that very much. But that's the reality of it. So, we're stuck with the consequences in the outcome. I think the real question is how do we manage... What I would tell the people is figure out how to live comfortably on less, be happy with less. Figure out how to do that. Just deal with the fact that's how it is. Because the only other alternative you have is pretty ugly stuff. I don't think anybody in this country wants to go there and I hope we don't end up forced into it.

Dennis Tubbergen:

Well, the clock says we're going to have to leave it there. My guest today has been Mr. Karl Denninger, his blog can be read at market-ticker.org. The website again is market-ticker.org. Karl, always a pleasure to chat with you and appreciate your perspective. We'll certainly have you back down the road.

Karl Denninger:

Anytime, thank you much.

Dennis Tubbergen:

We will return after these words.