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Debt Bubbles Everywhere

By Dennis Tubbergen

The current economy is chock full of debt bubbles. One symptom of a debt bubble is an inflated price in an asset class. Inflated prices are fueled by easy money and easy credit.

Real estate values soar when easy mortgage credit exists.

Higher education tuition rates rise when student loans are easy to obtain.

The bottom line is this: a bubble in asset prices cannot exist without widely available easy credit.

Let's begin this month by looking at stocks, which are very likely in an asset price bubble.

Chart 1 (page 2, top) is a chart of an exchange traded fund that tracks the price movement of the Dow Jones Industrial Average.

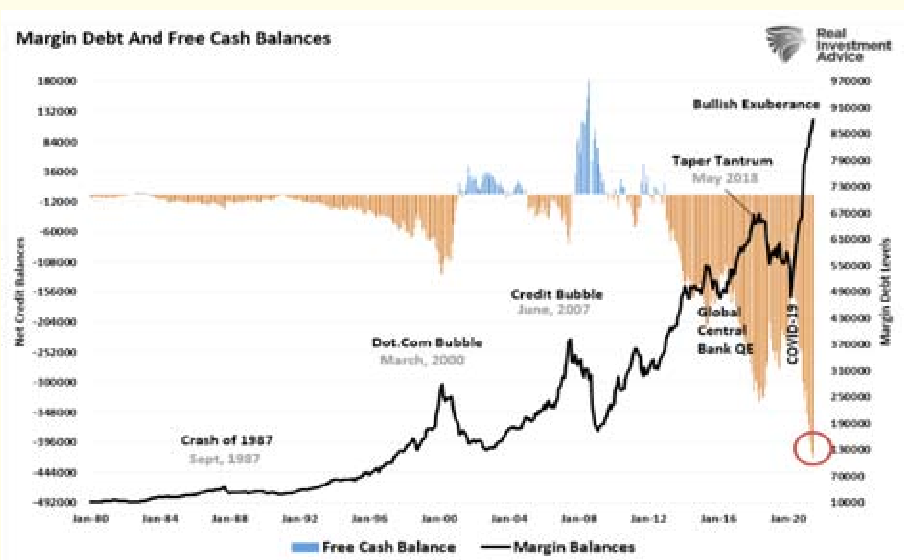
Moving from the left to the right, about a third of the way across the chart, you see the market bottom of 2009. Since that market bottom of 2009, you'll note that the market has rallied more than 400%, which is about three and a half times the average move in a bull market.

This stock market is very extended and, when looking at the facts, it's easy to make the argument that stocks are in a price bubble.

Chart 2 (page 2, bottom) is a chart that shows you the level of margin debt that exists.

Chart 1: SPDR DJ Industrial Average EFT

Chart 2: Margin Debt



If you're not familiar with margin debt, a margin loan is a loan that you'll take out using brokerage account assets as collateral. Current collateralization rules relating to mortgage debt require that you have at least 50% equity in your portfolio.

If an investor has a $1 million stock portfolio, he or she can borrow $500,000 against it. That leaves the investor with $500,000 in equity calculated as follows: gross value of the brokerage account is one million dollars less the $500,000 margin loan.

The $500,000 margin loan proceeds can be used to buy more stock. If the gross value of the portfolio continues to rise, the investor can increase the margin loan on the portfolio if equity in the account is maintained at 50%.

With that for context, let's look at the chart. It's easily seen that at the time of the dot com bubble peak, margin debt was about $310 billion. At the time of the financial crisis, margin debt reached about $400 billion. Presently, margin debt is approaching $1 trillion!

Another interesting thing to note is the relationship between the price of stocks and the total of margin debt. Notice that the level of margin debt and the price of stocks are very closely correlated confirming that much of the rise in the price of stocks is largely attributable to margin debt accumulation.

This same analysis can be applied to the real estate market. Chart 3 (this page, top) is a chart of the Case Shiller National Home Price Index from the St. Louis Federal Reserve. This is the home price index most commonly used to measure home prices.

As noted from the chart, at the time of the financial crisis in 2007 and 2008, the index stood a little over 180. Today, it's more than 240 which is an increase of about 1/3rd. Despite what many analysts may state, housing prices today are significantly higher than housing prices were at the time of their collapse during the financial crisis.

What has driven real estate prices higher?

The answer is again easy credit.

Chart 4 (this page, bottom) illustrates total mortgage debt in the United States from calendar year 2000 to the present. Notice from the chart that mortgage debt is currently about $3 trillion more than at the time of the financial crisis.

If you're wondering what the primary driving force behind the real estate market is presently, look no further than easy credit in the mortgage market. To put mortgage debt levels in perspective,

Chart 3: *Case Shiller National Home Price Index*

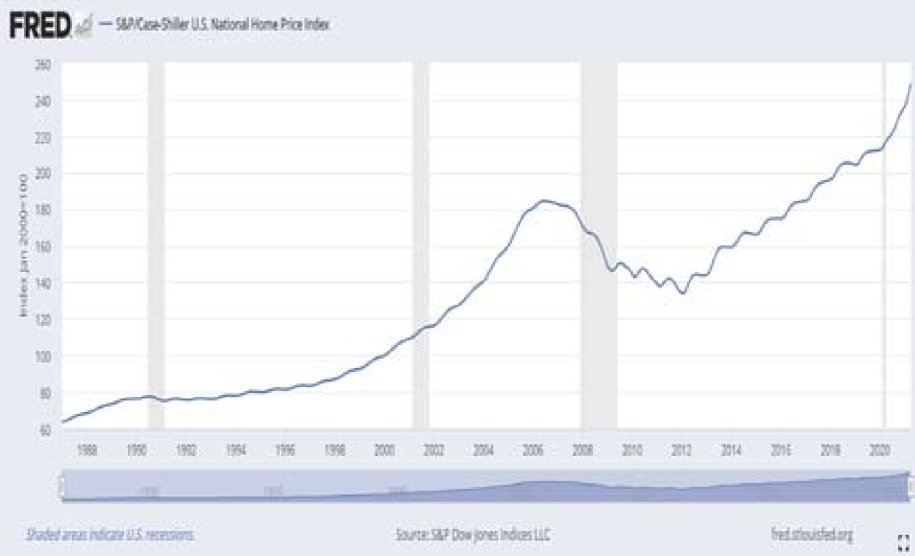


Chart 4: *US Total Mortgage Debt (2000 to present)*

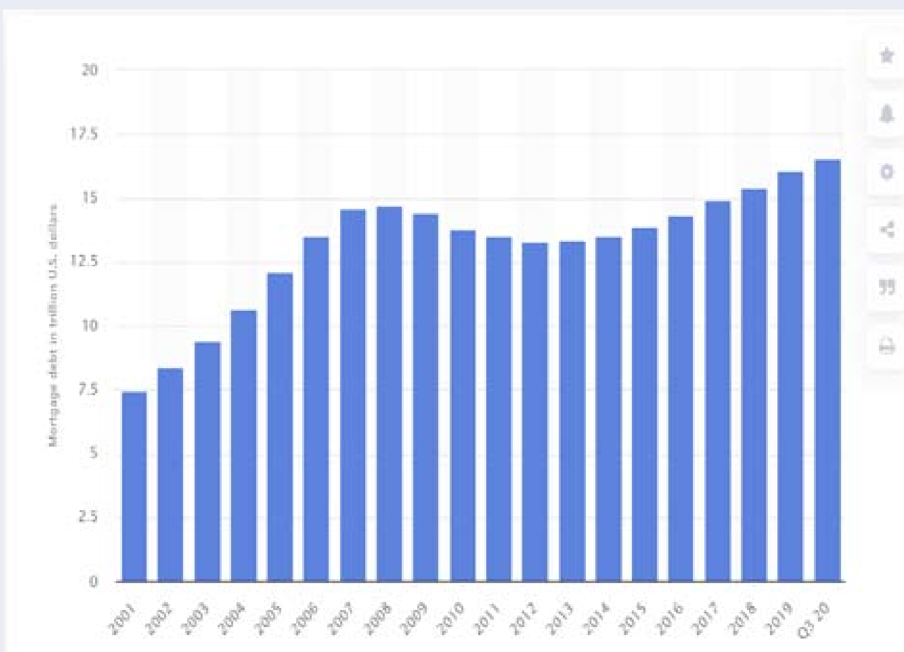


Chart 5: *Total Outstanding Student Loan Debt (2006 to 2019)*

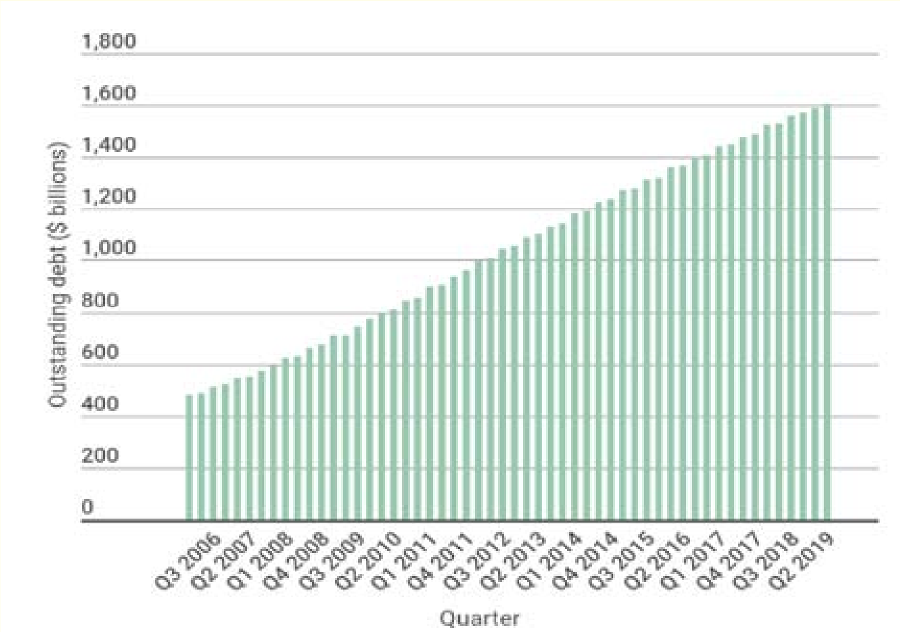
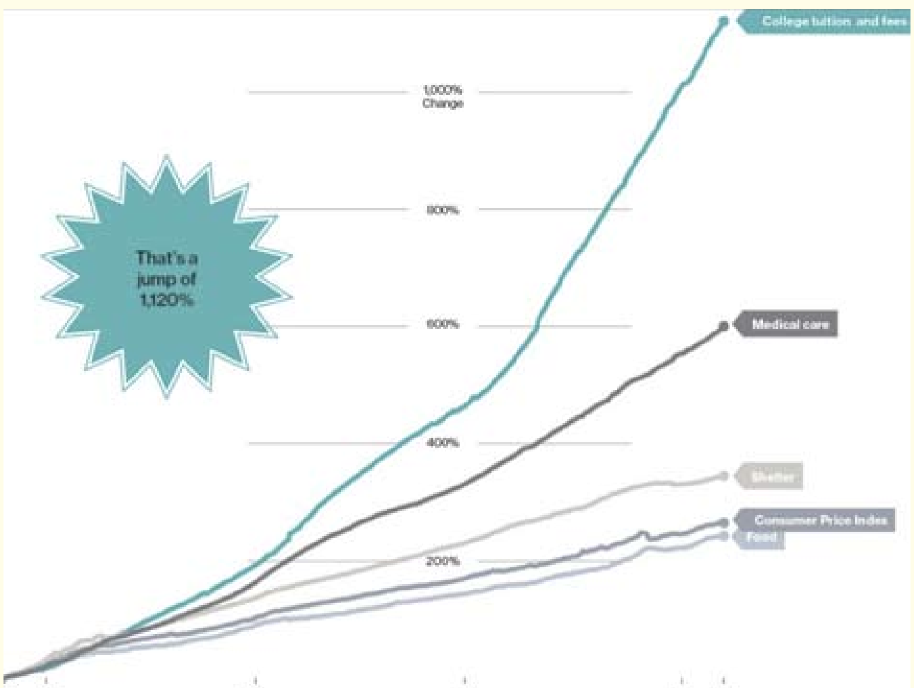


Chart 6: *Tuition Costs Relative to Other Costs*



total mortgage debt now exceeds $15 trillion!

While there are many other debt-driven bubbles that exist in the economy today, we'll look at one more area that has been affected – tuition rates at colleges and universities are a lot higher than in the past. This dramatic increase has been driven by easy credit.

Any student that is enrolled in an institute of higher learning has had easy access to student loans without regard to any other factors.

Chart 5 (this page, top) shows the total outstanding student loan debt from 2006 to 2019. In the third quarter of 2006, student loan debt totaled just over $400 billion. Today student loan debt exceeds $1.7 trillion and, according to the Federal Reserve, that amounts to an average of $86,000 per student!

As noted, as student loans have become more available, tuition costs have risen. Chart 6 (this page, bottom) illustrates the rise in tuition costs relative to other costs like medical care, shelter and food.

Tuition costs have risen twice as fast as medical costs, four times as fast as the cost of maintaining shelter and nearly six times the increase in food costs.

These tuition increases, like stock price increases and real estate prices can be largely attributed to easy credit.

Why Taper Talk is Probably Just Talk

There is growing talk of the "taper", or the Federal Reserve slowing the rate at which currency is created. Recently, at the close of the Federal Reserve's annual Jackson Hole, Wyoming symposium, Fed Chair, Jerome Powell, mentioned that the Fed may be poised to change policy course sometime in the future. This[1] from "Zero Hedge":

> *All that angst and jitters heading into today's Jerome Powell speech, with so many fearing that the Fed Chair would finally make good on urgent warnings from a growing number of Fed speakers that the Fed's easing is causing bubbles across all asset classes - including housing and certainly stocks - and warns traders that the big, bad taper is coming, and... **nothing.***
>
> *Instead, Powell was far more dovish than almost anyone had expected, barely mentioning the upcoming taper (and only in the context of what the Fed said in the recent Minutes), while reserving the bulk of his speech to discuss why inflation is transitory.*
>
> *Predictably, Powell's dovishness sparked a waterfall in the dollar and yields, with the 10Y and the Bloomberg Dollar index both sliding.* [Chart 7, page 6, bottom left.]
>
> *With the dollar free-falling, both gold and silver surged. (Noted by the chart below.)* [Chart 8, page 6, bottom right.]
>
> *As did oil.*
>
> *As did crypto's.*
>
> *After pushing higher earlier in the week, yields promptly collapsed after Powell's dovish commentary.*
>
> *And just one day after 30Y yields finally caught up to stocks, today we observed a sharp divergence in yet another manifestation of the QE trade where everything – except the dollar – was bought.*

Seems that markets are continuing to react to taper talk as they always have, buying anything that is not the dollar.

Evidently, market participants are of the belief that taper talk is just that – talk.

So, what did the Federal Reserve Chair have to say about slowing the rate of currency creation?

This[2] from "The Wall Street Journal" (emphasis added):

> *Federal Reserve Chairman Jerome Powell **reaffirmed the central bank's emerging plan to begin reversing its easy-money policies later this year while explaining in greater detail why he expects a recent surge in inflation to fade over time**.*
>
> *At the Fed's meeting late last month, "I was of the view, as were most participants, that if the economy evolved broadly as anticipated, it could be appropriate to start reducing the pace" of the Fed's $120 billion in monthly asset purchases this year, Mr. Powell said Friday.*
>
> *Since that meeting, the economy has seen "more progress in the form of a strong employment report for July, but also the further spread of the Delta variant" of the Covid-19 virus, Mr. Powell said Friday morning at a virtual symposium hosted by the Kansas City Fed.*
>
> *Markets rallied Friday, with the S&P 500 hitting a fresh record. The index gained 0.9% to its first close above 4500. In the bond market, the yield on 10-year Treasury notes fell to 1.311% after Mr. Powell's speech, from 1.342% Thursday.*

Stocks rallied as did bonds.

Seems the markets don't believe Mr. Powell.

And, with good reason.

***Chart 7:** 10Y and the Bloomberg Dollar index*

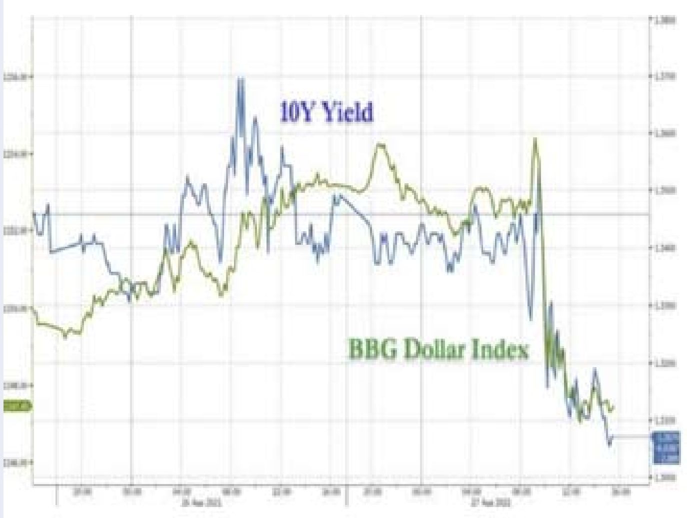


***Chart 8:** Silver & Gold Prices*

Economic Realities versus Political Realities

Ryan McMaken, of the Mises Institute, wrote an interesting piece[3] that discussed the political realities of Federal Reserve policy. For those who are still of the belief that Fed policy decisions are based on economic factors, it's an eye-opening read. (Emphasis added.)

> *Much of the discussion over the Fed's policies on interest rates tends to focus on how interest rate policy fits within the Fed's so-called dual mandate. That is, it is assumed that the Fed's policy on interest rates is guided by concerns over either "stable prices" or "maximizing sustainable employment."*
>
> ***This naïve view of Fed policy tends to ignore the political realities of interest rates as a key factor in the federal government's rapidly growing deficit spending.***
>
> *While it is no doubt very neat and tidy to think the Fed makes its policies based primarily on economic science, **it's more likely that what actually concerns the Fed in 2021 is facilitating deficit spending for Congress and the White House**.*
>
> *The politics of the situation—not to be confused with the economics of the situation—dictate that interest rates be kept low, **and this suggests that the Fed will work to keep interest rates low even as price inflation rises and even if it looks like the economy is "overheating."** If we seek to understand the Fed's interest rate policy, it thus may be most fruitful to look at spending policy on Capitol Hill rather than the arcane theories of Fed economists.*
>
> *Why Politicians Need the Fed to Keep Deficit Spending Going—at Low Rates*
>
> ***Federal spending has reached multigenerational highs in the United States, both in raw numbers and proportional to GDP.***
>
> *If all this spending were just a matter of redistributing funds collected through taxation, that would be one thing. But the reality is more complicated than that. **In 2020, the federal government spent $3.3 trillion more than it collected in taxes. That's nearly double the $1.7 trillion deficit incurred at the height of the Great Recession bailouts. In 2021, the deficit is expected to top $3 trillion again.***
>
> *In other words, the federal government needs to borrow a whole lot of money at unprecedented levels to fill that gap between tax revenue and what the Treasury actually spends.*
>
> *Sure, the Congress could just raise taxes and avoid deficits, but politicians don't like to do that. Raising taxes is sure to meet political opposition, and **when government spending is closely tied to taxation, the taxpayers can more clearly see the true cost of govern-***

ment spending programs.

Deficit spending, on the other hand, is often more politically feasible for policymakers, because the true costs are moved into the future, or they are—as we will see below—hidden behind a veil of inflation.

That's where the Federal Reserve comes in. ***Washington politicians need the Fed's help to facilitate ever-greater amounts of deficit spending through the Fed's purchases of government debt.***

Without the Fed, More Debt Pushes up Interest Rates

When the Congress wants to engage in $3 trillion dollars of deficit spending, it must first issue $3 trillion dollars of government bonds.

That sounds easy enough, especially when interest rates are very low. After all, interest rates on government bonds are presently at incredibly low levels. Through most of 2020, for instance, the interest rate for the ten-year bond was under 1 percent, and the ten-year rate has been under 3 percent nearly all the time for the past decade.

But here's the rub: larger and larger amounts put upward pressure on the interest rate—all else being equal. This is because if the US Treasury needs more and more people to buy up more and more debt, it's going to have to raise the amount of money it pays out to investors.

Think of it this way: there are lots of places investors can put their money, but they'll be willing to buy more government debt the more it pays out in yield (i.e., the interest rate). For example, if government debt were paying 10 percent interest, that would be a very good deal and people would flock to buy these bonds. The federal government would have no problem at all finding people to buy up US debt at such rates.

Politicians Must Choose between Interest Payments and Government Spending on "Free" Stuff

But politicians absolutely do not want to pay high interest rates on government debt, because that would require devoting an ever-larger share of federal revenues just to paying interest on the debt.

For example, even at the rock-bottom interest rates during the last year, the Treasury was still having to pay out $345 billion dollars in net interest. That's more than the combined budgets of the Department of Transportation, the Department of the Interior, and the Department of Veterans Affairs combined. It's a big chunk of the full federal budget.

Now, imagine if the interest rate doubled from today's rates to around 2.5 percent—still a historically low rate. That would mean the federal government would have to pay out a lot more in interest. It might mean that instead of paying $345 billion per year, it would have to pay around $700 billion or maybe $800 billion. That would be equal to the entire defense budget or a very large portion of the Social Security budget.

So, if interest rates are rising, a growing chunk of the total federal budget must be shifted out of politically popular spending programs like defense, Social Security, Medicaid, education, and highways. That's a big problem for elected officials, because that money instead must be poured into debt payments, which doesn't sound nearly as wonderful on the campaign trail when one is a candidate who wants to talk about all the great things he or she is spending federal money on. Spending on old-age *pensions and education right now is good for getting votes. Paying interest on loans Congress took out years ago to fund some failed boondoggle like the Afghanistan war? That's not very politically rewarding.*

So, policymakers tend to be very interested in keeping interest rates low. It means they can buy more votes. So, when it comes time for lots of deficit spending, what elected officials really want is to be able to issue lots of new debt but not have to pay higher interest rates. And this is why politicians need the Fed.

The Fed Is Converting Debt into Dollars

Here's how the mechanism works.

Upward pressure on rates can be reduced if the central bank steps in to mop up the excess and ensure there are enough willing buyers for government debt at very low interest rates. Effectively, when the central bank is buying up trillions in government debt, the amount of debt out in the larger marketplace is reduced. This means interest rates don't have to rise to attract enough buyers. The politicians remain happy.

***And what happens to this debt as the Fed buys it up? It ends up in the Fed's portfolio, and the Fed mostly pays for it by using newly created dollars. Along with mortgage securities, government debt makes up most of the Fed's assets, and since 2008, the central bank has increased its total assets from under $1 trillion dollars to over $8 trillion**. That's trillions of new dollars flooding either into the banking system or the larger economy.*

*For years, of course, **the Fed has pretended that it will reverse the trend and begin selling off its assets—and in the process remove these dollars from the economy. But clearly the Fed has been too afraid of what this would do to asset prices and interest rates.***

*Rather, **it is increasingly clear that the Fed's purchases of these assets are really a monetization of debt. Through this process, the Fed is turning this government debt into dollars, and the result is monetary inflation. That means asset price inflation—which we've clearly already seen in real estate and stock prices—and it often means consumer price inflation, which we're now beginning to see in food prices, gas prices, and elsewhere.***

Shrinkflation is one of the most-used words of 2021. Rather than raise prices of consumer goods to adjust for rising wholesale prices, some manufacturers are simply making the package sizes smaller while maintaining prices. Known as 'shrinkflation', consumers end up paying the same price for less product.

This from WCPO[4] (emphasis added):

> *One of the hottest words in 2021 is "shrinkflation," and it's where consumer companies cut product sizes instead of raising prices. Either way, consumers pay more.*
>
> *According to consumer guru Ed Dworsky of MousePrint.org, more items are falling victim to this.*

Remember all the warnings earlier this year that paper towels were supposed to go up in price this summer? Prices stayed relatively the same, but producers shrunk their products, according to MousePrint.

Items getting smaller in 2021

Other examples include:

- *Bounty paper towels: The triple pack has shrunk from 165 sheets to just 147*
- *Costco's toilet paper: A large pack was 425 sheets last year, but is 380 now*
- *Dial Body Wash: Reduced from 21 ounces to 16 ounces, a 25% reduction*
- *Ziploc freezer bags: 54 bags last year, but just 50 bags this year*
- *Quaker Instant Oatmeal: 10 packs last year, but 8 this year for some varieties.*

Family size can hide smaller box

There are also some cases of shrinkflation that make consumers think they are getting more, when really they are getting less.

According to MousePrint, family-size boxes of Cheerios have shrunk from 20 ounces to 19, the equivalent of a 27-cent price hike.

People see "family size" on products and think they are getting more than before, but really they are getting less. And that stinks.

Are Your Dreams of a Secure, Stress-Free Retirement at Risk?

How to Use a Simple 4-Step Process Designed Especially for Today's Economy to Help You Maximize Your Benefits from Social Security, Divorce Yourself from the IRS in Your IRA or 401(k) and Achieve Your Dreams of a Comfortable Retirement in a Crazy, New World

The world has **dramatically changed** over the past couple of years. What was once considered 'normal' is now a distant memory.

With this massive level of change in nearly every area of our lives, **retirement planning rules have also changed radically.**

Whether you are aspiring to a comfortable, stress-free retirement or you are already retired, today's retirement is not your Mom's or Dad's retirement, far from it. If you plan for your retirement using the same strategies your parents did, **you may fail and find that your retirement dreams are never realized**. Or even worse, **you may retire thinking everything is O.K., only to find that your finances fail you**.

A 3-night, virtual educational course will reveal retirement's new rules in the new economy and lay out a simple 4-Step process to achieving a successful retirement. This course, formerly taught at a university, is now being offered virtually. You need only a computer with an internet connection to participate.

The Federal Reserve, the central bank of the United States, has been creating currency at a pace that can only be described as reckless. Inflation is emerging as a result. **Anyone who is retired, or who is contemplating retirement is being affected.**

Combine that fact with the fact that current debt levels compared to the size of the economy **are 50% higher than at the beginning of The Great Depression** and it becomes **painfully evident** that the economy is different now than at any time in recent memory.

If you want to succeed in retirement, you may need to consider a different approach. Full details about this course are available online at **www.RevenueSourcingCourse.com.**

Resources to Help You Stay Informed

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You can download the YOURRLA app for free by visiting the app store (either Google or Apple) and searching under YOURRLA.

The app will get you access to our weekly "Headline Roundup" Webinar, the podcast versions of the RLA radio program and our weekly newsletter.

You can also participate in the "Headline Roundup" webinar live on Mondays at Noon Eastern time.

If you know of someone who might appreciate getting this information during these challenging times, feel free to have them download the free app as well.

If you have questions when downloading the app or would like assistance, feel free to call the office. Our office phone is **1-866-921-3613**. Our office phone is answered 8 to 5 Monday through Thursday and 8 to Noon on Friday.

Sources

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