Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
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Retirement Lifestyle Advocates
961 Four Mile Road, NW
Grand Rapids, MI 49544

Phone: (866) 921-3613
Email: info@plplanners.com
Website: www.RetirementLifestyleAdvocates.com

Dennis Tubbergen:

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Karl Denninger. Many of you who are longtime listeners to the program recognize Carl as a prolific writer and a commentator. His website is market-ticker.org. I'd encourage you to check it out as I do frequently. And Karl, welcome back to the program.

Karl Denninger:

Well, thank you for having me on.

Dennis Tubbergen:

Well, Karl, we are just now recording this on Friday the 25th. This will begin to air on the 27th. So, we have a relatively short time lag. The BRICS Summit in South Africa is just finishing up, and I've not had a chance to research it in depth yet, but it seems that Saudi Arabia, Iran, Ethiopia, Egypt, Argentina, and United Arab Emirates are now part of the BRICS Coalition, and they seem to have a bit of a defiant attitude toward the United States and the US dollar. What do you make of all this?

Karl Denninger:

Well, I'm not surprised. As I pointed out, when the whole Russia-Ukraine dust up started, however you feel about the particulars of that war that's going on and who you want to hold responsible for the events that led up to it, the reality of it is that we sanctioned a bunch of entities that had absolutely nothing to do with going to war. It's one thing to sanction Putin and his cabinet, if you will, or to sanction the Russian government. The Russian government was they're waging the war, right? But we sanctioned a bunch of other people, and we did this in the name of, well, these are oligarchs, and they make their money in Russia, and therefore we're going to seize their yachts and sanction their funds and everything else. It made people stand up and say, hey, wait a minute. This isn't Iraq. This isn't some little rinky-dink nation, so to speak.

Now, if I'm a manufacturer of goods or services in one of these other countries, and I have to take my trade settlement in something because I'm exporting my products outside of my country to other countries, but what do I want my payment to be in? The answer for a very long time has been US dollars. And the reason is not that we're a shining beacon of light on the hill. It's just simply that we have a more politically stable and more stable currency than the other options. The person doing the selling is the one that gets to make the decision because they say, well, you pay me in this or you're not getting my stuff. So that changed, and two things did it. One was the Ukraine and Russia dust up. And the second was the fact that our government during the pandemic put 50% on the federal budget in one year, which was an enormous inflationary impulse and something that the United States has never done before outside of a declaration of formal war.

Certainly, we did it with World War II. Well, yeah, we just got the bejesus blown out of us at Pearl Harbor, right? So, there are times that you can look at something like this and say, yeah, okay, you got to do what you got to do. There's a bunch of people dropping bombs on our ships, but that's not what happened in this case. We had a pandemic. The response to it was to do that, and then the pandemic waned and was officially declared over, but the budget was not contracted back to its former size. So, if you're a foreign trade interest, you look at this and say, well, wait a minute. This is going to produce a crazy amount of inflation.

Do I want to be paid in a currency that, before I can convert it back, is going to take a valuation hit? The answer to that's no. When you're dealing with international trade, the lead times are long. I build a bunch of heavy equipment; it has to go on a ship. You order it, I give you a price, I have to make it. I have to put it on the ship. The ship has to sail to wherever it's going to go. It gets unloaded. You get the goods and then you pay me. During that time in the middle, the value that you give me had better not change by enough in a negative direction that I can't make the next bunch of stuff. If it does, I'm out of business. But it's not because I'm a schmuck and I don't know how to run a company. It's because of an externality that I don't have any control of. So, you have companies and governments that have rightly said, well, this is not an acceptable situation. We're going to change it. That's what they're doing.

Dennis Tubbergen:

So, Karl, you talked about the fact that federal government spending in the United States expanded at the time of COVID, but hasn't contracted. Talk about, if you would for our listeners, the link between federal deficit spending at such a high level and inflation.

Karl Denninger:

Well, that's what causes inflation. That's all inflation. Milton Friedman famously said that inflation is always everywhere, a monetary phenomenon. The Federal Reserve doesn't control the amount of credit admitted into the economy on a gross basis. To some extent, private banks do in that they grant loans. However, if private banks make loans that are unplayable, then they eat them. And that contracts the amount of credit in the economy. If I give you 20 grand to blow on a credit card and you don't pay me, I'm out to $20,000.

Dennis Tubbergen:

That's deflation.

Karl Denninger:

That's deflation, right. So, there's a balance to this and that if you do stupid things, it blows up in your face and you eat them. But the government doesn't have this constraint. So, when the government spends $6 trillion and two trillion of it is essentially created out of thin air in a $20 trillion economy, that's a 10% inflation rate, and that's an extra $2 trillion. You didn't make anything for the $2 trillion. They just invented it and handed it out to people. You saw the wild-eyed, crazy side of this during the pandemic and that they were paying people $600 a week to sit at home and drink beer. Well, those people were producing nothing, and yet they were spending all this money. Well, the same thing happened when we had rent moratoriums, we had student loan moratoriums. These people had debts, part of their budget that they had to be paying.

All of a sudden, I don't got to pay. Well, okay, I'm going to go blow that on whatever. Okay, well, that's inflation. That's demand and the ability to pay that is chasing supply. People talk about the distortions in the housing market and the fact that markets basically locked up right now, and they say, but there's so much demand and there's no supply. Well, that's a lie. Econ 101 tells you that demand and supply is how price gets determined. The price is the arbitrator between those two things. But demand for something that you can't pay for is not real. It doesn't exist. I can demand a $400,000 house, but if I can't come up with money to either buy or finance a $400,000 house, there's no demand for that 400,000 house. It doesn't exist.

Dennis Tubbergen:

So, Karl, I've made the argument, and I'd like your comment, but I've made the argument that we will not get inflation fully under control until the federal government gets its budget at least under control to a lot greater extent. I'd like your take on that opinion. Do you agree? Do you disagree? Then secondly, what's the end game here? I spared myself watching the debates the other night, but I don't think anybody stood up and said, if elected, I'm going to balance the budget. So, what's the end game here?

Karl Denninger:

Well, Dennis, remember we had this. The ECB, back just before the '07-'08 blowup, remember we had this thing called BRICS? And we had the PIGS, Portugal, Italy, Spain, Greece. What did the ECB tell all of the ECB member states? That they expected them to run a 3% primary surplus. Why? Because that's a primary surplus. Then you put in the social spending deficits and things like that, you end up with a mild deficit, which is a mild amount of inflation. Oh, geez. Isn't that exactly what all the central banks say that they're trying to target is this 2% thing, which by the way is nonsense, but that's what they say.

Dennis Tubbergen:

I agree. It's nonsense. Yeah.

Karl Denninger:

But they actually came out and they said, you guys have to run 3% primary surpluses in your budget. Well, notice how nobody said a word about that for the last 10 years. There hasn't been a single sentence where that has shown up, and yet it's absolutely true. Donald Trump was the one that put 50% on the budget in concert with Congress because the president by himself cannot spend anything. He has to have the appropriation going through the house in the Senate. But then Biden gets elected, and he hasn't taken any of that back out. None of the candidates in the debate said they were going to take it back out. The opposition piece, softball laden pile of nonsense that Trump put up, that was run ... the interview we did with Tucker Carlson that they released right on top of the debate to try to steal some of the thunder from it wasn't a word about it in there. So yeah, we have a bunch of unserious clowns when it comes to this. What you're seeing in other parts of the world is a very justified pushback against that.

Dennis Tubbergen:

How does this affect the US economy moving ahead? I believe that a recession is inevitable, probably imminent. We might even be in recession now. Doesn't this just exacerbate everything?

Karl Denninger:

Well, yeah. You now have Jackson Hole, which is on the table, and you've got people thinking that maybe Powell is going to throw another bone out there. Well, the Federal Reserve for the last 20 years has played Pavlov's dog with the markets. Anytime you hear the grill sizzling, oh boy, there's got to be a steak coming. Well, that's how it's, and anytime that the fire of the economy starts to die down a little bit, here comes the Federal Reserve with a 10 gallon can of gasoline to throw on there. That's been the pattern for the last 20 years. But Powell understands that when you have a 30% operating fiscal deficit, if you continue to do that, you end up with a fiscal collapse. Because you look at what's happening in the housing market right now, you have a locked-up market.

The reason is that the people who have 3% mortgages who refinanced during the COVID time, they cannot move except under extreme duress because you can't take that 3% mortgage with you. The new one is seven. And oh, by the way, the price of the house has doubled. So as a result, your payment's going to go up by 40%. They don't have that. They just don't have the money. So, the only transactions that are taking place, a cash transaction's a cash transaction. If I sell a bubble house and I buy a bubble house, I haven't lost anything because I got an excess amount of money for what I sold, and I paid an excess amount of money for what I bought. So those kinds of transactions can take place, and they are. But for the most part, in the single-family housing area, that's not the reality.

Most people are buying a payment. They're not buying a building. And that part of the market is completely locked up. Then you have the insanity that went on during the pandemic in areas that were not locked down with the Airbnb’s and the other short-term rentals that have driven prices to the stratosphere. I happen to live in one of them. What these people think they're going to get for these things is just flat out crazy, and traffic levels ... I am sitting right now in a vacation place as we're recording this, and I can tell you right now, there's nobody here.

Dennis Tubbergen:

Yeah, I've seen in other reports the VRBO revenue, at least the big tourist destinations, is down like 50% year over year. So that is all starting to fall apart.

Karl Denninger:

Yeah. Think about what happens when you paid a million dollars for something that can't possibly ever cap out and make the payments when the revenue goes down by half.

Dennis Tubbergen:

Yeah, that's where we are. So, we are out of time in this segment. Stick around because Karl Denninger is going to hang out for another segment. Glad you're with us today. We'll be back after these words.

You are listening to RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Karl Denninger. Karl's perspectives are terrific. I would encourage you to check out his blog at market-ticker.org as I do frequently, market-ticker.org.

Karl, prior to the break, you had mentioned that there's all these student loan moratoriums and payment moratoriums, and starting here in October, those moratoriums and the payments will start in a consumer spending dependent US economy. Isn't that just one more straw on the proverbial camel's back leading to recession?

Karl Denninger:

Well, yeah, this is the problem that you basically have with the economy is that production and price in particular, price has reset for this idea where people can essentially take another $20,000 line credit card and blow it without having to make any payments on it. We've spent three years at this. If you think about how crazy that really is and the other side of it, especially the bars, the restaurants, the vacation places and things like this, but also, good lord, take a look at the price of a new truck today. I would really like to get a three-quarter ton pickup, a work truck with vinyl seats and absolutely stripped down, 50 grand. What are these people smoking?

Well, obviously, as long as people are buying them, they're going to ... why would you not charge 50 if you can get, or you put a little bit of tart on there, a little bit nicer interior, a little bit of paint. It's not plain white, got a bedliner, got a few other ... All of a sudden, it's $70,000 and people are on drugs. But as long as someone will sign for that payment coupon, which they can do, when they don't have to pay their student loans and they don't have to pay their rent. Well, why would GM and Ford and Stellantis not charge that? Of course, they will. What happens when they have to start making those payments again? Well, somehow, I have a suspicion that I'm going to be able to get a 2022 or 2023 three quarter pound pickup for about $30,000 in another year or so because a bunch of these are going to get repossessed.

Dennis Tubbergen:

Well, and when you look at delinquency rates on auto loans, on credit card debt, delinquency rates year over year are up. Depending on the numbers, I've seen anywhere from 25 to 35%.

Karl Denninger:

Yeah, and this is just starting because the student loan repayments have not restarted yet. Most of the other people are still running around thinking that this is just never going to change. Honestly, I really would love to know ... in Michigan, marijuana may be legal, but boy, whatever they're smoking, it ain't weed.

Dennis Tubbergen:

So, Karl, we talked about stocks and housing. You elaborated a bit on that in the last segment. I'd like to go there again, because typically when we enter a deflationary environment, historically stocks and real estate are the two asset classes that are most dramatically affected. What's your outlook ultimately for housing? How much downside do we see here in residential housing? Then what's your take on where stocks go?

Karl Denninger:

Well, let me just put a marker on the ground here. Residential housing over the last ... This is national, so in some places it's even crazier than this. National in three-year periods, up 40% in the index. To put some perspective on this, in the run-up to the crash in '07 '08, it was up 14% and that was enough to produce what we had happened in 2008, 2009. It's 40% this time in less than three years. All that's going to-

Dennis Tubbergen:

The bubble is three times as big using those numbers.

Karl Denninger:

That's right. And that's all going to come back out plus a little more. So, would I be surprised to see 50% draw down? No, not at all. Would I be surprised to see a 50% drawdown in equities? Actually, that's on the low end of my expectations because equities are subject to more leverage than residential housing. The bigger problem though, from a standpoint of fiscal sustainability, is that the work from home paradigm that got embedded into everyone's mind during the pandemic companies are trying to reverse this to some extent. It's not just firms that want this reversed, it's cities. If you take a look at all those nice skyscrapers without offices in those buildings, what happens to their property tax revenue? And oh, by the way, that's how they fund all their city services. So, you've got the retail in those towns, you have all of the other services, police, fire, everything else.

There is a huge crunch coming and how far it goes, well, we overshot terribly on the upside. I expect we're going to overshoot terribly on the downside on this as well. We may be on the cusp of this beginning. There are plenty of people who say that, once again, Jerome Powell and the Fed will come to the rescue. I don't think so. I think Powell is well aware of what happens if he allows this to continue. We have people who cannot afford to buy basic rental housing. Some of the distortions I see in tourist areas, I'm in one right now, are just crazy. Everybody that's working here is an H2B visa holder, and these guys have figured out a cartel. They say, well, college kids won't take these jobs. Well, the reason is there's nowhere for them to sleep. They used to do two to a cruddy hotel room that was a hundred bucks a week.

So that was kind of like a dorm, a cinder block dorm room. No, that's not how it works now. Now these guys have figured out a cartel kind of situation where they recapture a huge percentage of the wages by hot racking them in these same crappy hotel rooms. There's not two people in there, there's five. So, they say, well, Americans won't take those jobs. Well, no, they won't take that job when it pays minimum wage. But at the end of the day, after you get the recapture, the person who is paying you is getting back 80% of the wages and they have 25 bucks at the end of the week left. No, they won't take that job. Nobody in their right mind would take that job. So, what are we doing? We're importing foreigners to do it.

Dennis Tubbergen:

So, Karl, I want to go back to what we've seen earlier this year. When you look at history and you look at what happened during the panic of 1837 prior to the long depression of 1873, 1933, those deflationary timeframes were preceded by banking failures. And already this year we've seen Silicon Valley Bank, Signature Bank, First Republic Bank, Heartland Bank. To my knowledge, there's four already that have needed bailouts. Is there more on the horizon? And is this the canary in the coal mine again?

Karl Denninger:

Well, maybe. Those failures, SVB in particular, and Signature, which was the other one, both were doing wildly uneconomic unsound things. They should have been closed years earlier and had no flexibility in their mix. Their business was extraordinarily concentrated, which is a recipe for disaster when something goes wrong, and it did. How badly does that infest the rest of the system today? I think the answer is not as bad as it used to prior to the '07 '08 debacle. I don't anticipate failures of banking institutions such as Bank of America or Wells Fargo, even though with all the things that Wells Fargo's pulled over the years and many scandals as they've been involved in, they should have been put out of business a long time.

But that has nothing to do with their financial stability. It just has to do with how they are as businesspeople. I don't see it going there. What I do see though, is at the commercial level and at the business level, I see a massive, massive wave of bankruptcies of entities and individuals that have gotten way out over their skis. This is inevitable at this point. I don't see how you get out of it because, at the end of the day, how do you sell $50,000 trucks when nobody has $50,000?

Dennis Tubbergen:

Well, and Karl, when you look at just bankruptcy numbers, as far as corporations are concerned, I think corporate bankruptcy so far in 2023 are higher than at any point since 2010. So, I mean, arguably that's starting.

Karl Denninger:

Yeah. But what you have so far is much needed compared to where we are because of the contraction that has to happen within the federal government spending, you think about a 50% operating deficit. The government has to either stop spending a third of the money it spends, or it taxes across the line, to cover that 30% hole. Well, neither one of those is going to be very politically popular. So how are you going to close that gap other than by force? The force comes when the economic contraction takes hold. Then the other problem with that is if you try to raise taxes to do this, well, as the tax burden goes up on people that forces more bankruptcies, well, you don't get anything from someone who's not working, right? They don't pay any taxes.

So, there is a compounding effect that folds back into the government as well. You can look at just the mathematics of this and say, this is where their balance is. But that's ignoring the fact that, as that contracts, revenues also go down at the government level. So, I think this is going to get a lot deeper than most people would think and it’s going to be necessary to restore balance.

Dennis Tubbergen:

Well, and Karl, tax revenues are falling at this point already. In my view, that signals that we might already be in a recession.

Karl Denninger:

Yeah, there's a high frequency data sequence that comes in very rapidly, which is payroll tax collections. It used to be that you filed those, if you were a small business, they went in quarterly. Well, now they go in with every pay period. So, this is extremely current data. This isn't lagged by six months or whatever have you. Those numbers are down. So, for all the people that are saying that employees are making out like bandits, well, you know what? If you're earning money, you're not paying those taxes April 15th. That's being withheld from your check, and it goes into treasury the next morning.

That is in decline. So, the idea that we have this roaring economy, I don't care what the BLS puts out in terms of employment numbers and supposedly hourly earnings and things like this. If I'm earning a paycheck, I'm paying taxes. They're going into the government every week, every two weeks. Whenever I get my check, those figures are showing a decline. That is real data, and you can't game it.

Dennis Tubbergen:

Well, my guest today has been Mr. Karl Denninger. Karl's website is market-ticker.org. The website again is market-ticker.org. I'd encourage you to check it out. Karl, it is always a pleasure to catch up with you. I hope you enjoyed the rest of your time away. Thank you for joining us on your vacation to give us your perspective. I'd love to have you back down the road.

Karl Denninger:

You bet. Anytime.

Dennis Tubbergen:

We'll return after these words.