Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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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. Karl is a prolific commentator and writer. You can read his work at market-ticker.org. The website again is market-ticker.org. There are multiple sections on that site, and I'd encourage you to check them all out. Karl, welcome back to the program.

Karl Denninger:

Thank you for having me, Dennis.

Dennis Tubbergen:

Karl, you recently had I thought was a really interesting take, a great perspective on this really healthy jobs report that came out. Can you fill the listeners in? Or this allegedly healthy jobs report, should I say that?

Karl Denninger:

Yeah, I think we should say allegedly healthy. Last month's report was approximately in line with what you'd expect to see for that month. March is usually a hiring month. I do not look at the knob-twisted establishment survey that they put their little black box stuff to. I look at the unadjusted household survey, which is an actual survey, as the name implies. And the reason I use unadjusted is because Christmas happens at the same time every year, right? So, if I look at Christmas this year versus Christmas last year, well, December versus December, I'm going to have a pretty accurate picture of what's going on.

And what I saw there was the same thing we've seen for the last few years, which is a huge number of ads in healthcare. But these are not doctors and nurses. These are all people that are essentially in the business of extracting money from you. They're all administrative to some extent. I'm sure some of them are janitors. Somebody's got to sweep the floor, right? But they aren't doctors and nurses. And we know that because there's separate surveys on how many doctors and nurses have entered versus left the workforce. And this is a pattern that's been going on for a long time.

The other place that you have is in government, which of course is the same sort of thing. I mean, what do they actually do other than find ways to spend the money? And if you think about... There're 72,000 jobs supposedly last month added in healthcare. You think about this. You really think that we needed to add someone in that part of the economy for every 4,600 people in America? Because that's what the number is. Now that's not, "We

need a doctor for every 4,600 people," that's, "We need another person in healthcare for every 4,600 on top of what's already there." I don't believe that for a minute.

And if you look at the parts of the economy that actually make things that you want to consume and that you do consume, so mining, oreing, oil and gas extraction, manufacture and wholesale trade, transportation, warehousing, that sort of stuff, their employment was flat. It was basically nothing. No change. So in the areas of the economy that actually benefit everybody, it was a zero. It wasn't a negative number. That's the good news. But it wasn't a positive one either. And in the areas that add cost to your living, just add expense and not betterment, it went up substantially. Well, isn't that what we've seen over the last few years is that that's where all the costs... I mean, what is inflation? Pay more, get less. Well, there you are.

The other thing that I find rather interesting is that we have asset markets that all think that putting 300,000 jobs into the economy in a month means that there's imminently going to be rate cuts. Well, excuse me, the neutral employment gain rate is about 200. So we're 50% over that, and people think rates are coming down? I don't think so. Never mind that all the places that people are being hired are in places that cause inflation in your life. Maybe not in price necessarily, but in terms of expenses you have to have in order to keep on your feet. I don't see any way that this report supports the idea that there are rate cuts coming anytime this year. Didn't see anything in support of that at all. And in fact, Kashkari came out shortly after that and basically said, "Yeah, I don't see it."

Dennis Tubbergen:

So, Karl, you think the Fed's just going to stand pat this year even though we're looking at an election year, even though we might have an election year goodie bag, to use that term, passed? You think the Fed probably just holds pat?

Karl Denninger:

Well, I think if anything, if the Fed does anything, I think they're going to raise rates. I think they're going to have to. And the goodie bag thing, if that was to occur, would tend to force that outcome. The Fed has a loosely stated policy that they've more or less followed, except in extreme cases like in 2008 when there was an ongoing crash right into the maw of the election. Other than that time, once you get to about June or July, they tend to stay out of the game. And if they can, they'd prefer to. Because they certainly...

Anybody that thinks that they don't have a political element to what they do is, I think, a little crazy. But they certainly don't want to appear to be overtly attempting to either help or damage one candidate or another.

Dennis Tubbergen:

So, Karl, where is this economy headed? Before we started recording, you, I thought, made some interesting observations about the yield curve and really how unprecedented the length of time we've had an inverted yield curve is. Can you comment a little bit about that? What does that mean historically? And just share with the listeners what we chatted about.

Karl Denninger:

Sure. Well, I mean if you take a look at the ten-year and the thirteen-week T-bill. The ten-year's the TNX, the thirteen-week T-bill is the IRX. Those are really easy for anybody to get at that that has a trading console of any kind. If you're a retail trader. That ratio inverted. It went negative in October of '22. So that's been over a year now. We're a year and a half into this. That doesn't happen.

Now, most people are aware that when the yield curve's inverted, it is signaling a recession. And the reason is that people are expecting that it will be cheaper to borrow in the future than it is to borrow today. That's all it really tells you.

But the yelling that has been going on for the last year and change is that somehow a 5% short-term interest rate is unreasonable. It's extremely restrictive. It needs to come down. It's damaging the economy. It's this and it's that. And that's just nonsense. If you have a 2% inflation rate and about a 3% gain in productivity, which is... 3% is about the historical average on that over long periods of time. Assuming that you want to borrow money for a short period of time, so there's no time value involved, the expected rate would be about five. If there's no risk. And since... I'm 60. I'd love to have 20 years of my life back. I can never get them, of course. Time always has value. So, the idea that you would pay less to borrow for 10 years than you would pay to borrow for 13 weeks is nuts.

So that's the reason the signal means something to people in the markets. But the concept that somehow, assuming we had 2% inflation, and we don't, it's much higher. By the government's numbers, it's three and a half to four. By anybody who's had to renew their homeowners or car insurance, it's 20.

Dennis Tubbergen:

Right. It's crazy.

Karl Denninger:

Right. I mean, if you look at things from a realistic operating perspective, why would I loan you money for 5% if I'm going to see 20% of the value of my money destroyed? That would be crazy. I'd be out of my mind to do that. So I don't see any way for that to change, and that inflation is coming directly from government deficit spending. Right now, the government is running about a 30% fiscal deficit, so they're spending a third more approximately than what they take in in taxes. That's what has been driving the inflationary impulse that has gone on over all these years. And we reset that percentage considerably higher when COVID started, and it's never come back down, even though supposedly the pandemic's over.

So, the markets are correctly perceiving that that isn’t reality. Except you've got people in the stock market that are absolutely convinced, and in the real estate markets, that are absolutely convinced that the doubling or more of house prices that took place over that three, four year period is a new normal and it's fine and rates are not going to stay at 7% and you should buy a house and wait a year and refinance. If you think that's going to work out for you, I will see you in the bankruptcy court line. I think that's exactly where you're headed.

Dennis Tubbergen:

So, Karl, just since the first of the year, we've seen interest rates on the ten-year US treasury rise, and it just seems that in this environment that's going to have to be the trend. Would you agree?

Karl Denninger:

Yeah. I don't see any way that you see that change until Congress changes its pattern, and there's no evidence at the present time from either political party and no matter who wins. People that think that there's some kind of a put in essentially being put out there in the outcome of the election and that, well, if it goes one way, this is going to happen. It goes the... From a fiscal point of view, there's no evidence that either party is going to do anything. We have a Republican House, we have a Democrat Senate, we have a Democrat president. Even if the Republicans were to sweep all of the three in November, Trump gets re-elected and the House and the Senate both go red... And I see the Senate as going red as a fairly high probability simply because the numerics favor the Republicans in this particular two-year cycle of the six.

But even if that was to happen, you would get a clean sweep, I don't see anything that's going to slow down the spending pulse, and that's where the problem is. So, until that changes, I don't understand how a president or a set of congresspeople or whatever yelling at the Federal Reserve is going to do anything, because if they drop rates into that environment, inflation is going to explode.

Dennis Tubbergen:

I'm chatting to Mr. Karl Denninger. His website is market-ticker.org. I'd encourage you to check it out. The website again, market-ticker.org. I'll continue my conversation with Karl when RLA Radio returns. Stay with us.

Welcome back to RLA Radio. I'm your host, Dennis Tubbergen. Joining me on today's program is returning guest, Mr. Karl Denninger. I've been chatting with Karl about what's going on the economy, and we're going to talk a little bit more about that in this segment. If you're just joining us, I'd encourage you to check out Karl's blog at market-ticker.org. Market-ticker.org. Karl is a prolific commentator; I always appreciate his perspective.

And Karl, let's pick it up where we left off. You mentioned that government spending is the problem. Government spending is what's fueling inflation. And certainly, when you take a look at how consumers are reacting, there's a couple of stats I noticed. The big one being that credit card debt is now pushing $1.4 trillion, and the other stat is that personal savings is now near about a fifteen-year low. Those statistics tell us that inflation is kind of taking its toll, doesn't it?

Karl Denninger:

Yeah. You have to be a little careful with personal savings rate. That's a number that a lot of people in the media love to trumpet one way or another. The economists in DC define personal savings a little bit differently than you and I do. You probably think of personal savings as how much money you stick in the bank every month after you pay all your bills, or in the stock market or whatever you do with it. But money that doesn't get spent, that's how most of us think of personal savings. That's not how they define it. If you pay debt down, that counts as savings. So, when you make payments on your car. I mean, you really can't make this stuff up, but it's income minus personal consumption expenditures is the definition. So that's a little odd.

But yeah, the credit card outstanding balances are particularly troubling. A lot of people don't seem to have a very long memory, because both in 2000 and in 2008 when we had both of those financial events occur, credit card issuers went around and started slamming balances down to the outstanding amount in terms of your credit line. At any hint of financial instability, they were doing that. And they will do it again. They have the right to do it in your card agreement and they will do it. And if you need to use your card to finance your daily expenditures, you're going to get a rude surprise when you go the grocery store, and the card comes back declined. And they don't necessarily give you much in the way of notice when they do it either. The other thing is... And by the way, that gets really ugly if they start ratcheting it down every time you make a payment, which they've also been known to do.

The other thing that's interesting, and I saw this in 2008, and it's one month so far, so I'm always a little careful with one-month changes, because a trend is not made in a month. But that is last time around when we were all being glad-handed and told that subprime was contained and it wasn't going to be any kind of a serious problem, there was a fairly significant and statistically important re-rating that happened within the credit agencies. FICO scores for an awful lot of people that hadn't had any change in their financial situation at all, spending patterns, income, whatever have you, all of a sudden 30, 40 points disappeared. Sometimes 20, 30, 40.

Now, for somebody that has an 810 or an 820, having 20 points disappear doesn't change anything for you. You're still considered an exceptional credit risk. That doesn't mean anything. It's not going to result in any adverse consequences on your insurance costs or anything like this. But for somebody that has a 650, that 20 points is the difference between having something that is going on and not. I mean, that's a very serious problem for people in the lower economic strata. And I'm starting to see some evidence of that. It's not everywhere. And like I said, it's one month so far. But if that gets confirmed over the next couple of months, I'm going to get very concerned.

Dennis Tubbergen:

Well, Karl, doesn't it make sense that banks, obviously, when there's loose money policies, they tend to go too far, and then as always happens, the pendulum swings too far one way and then it swings back too far the other way. Don't you expect in this environment that we're going to see more banking failures and you're going to see a pretty significant credit contraction across the board, maybe not even just credit cards?

Karl Denninger:

Well, yeah. I mean, the other place that I think you're going to see some really serious problems is in autos. The insurance problem that people are running into right now, and it's everywhere. I mean, I have no claims, I have no tickets, and as it turns out, it looks like I'm about average seeing about a 20% increase. Okay. Oh boy, is that nuts, right? I mean, these are six-month premiums. Who knows what the next six months will be. But they've been very stable for quite a while, now all of a sudden, it's up 20%. And I haven't changed vehicles or anything.

Now, I know what's driving it in some of the newer cars, a headlight is $2,000, whereas a headlight for one of my vehicles is the plastic housing's 50 bucks. So that's part of the problem is that we've got all these doodads and this fancy stuff on these newer vehicles. They get damaged in relatively small collisions that really aren't otherwise a big thing. But all of a sudden, this fender bender that would cost you a few hundred dollars to have the bumper cover taken off and repainted and put back together, all of a sudden, it's 2,500 bucks because one of your headlights got smashed, and that's what it cost to buy another one. And so, that kind of thing is ridiculously driving up claim rates. And of course, the insurance company has to respond to that.

And then people, they love the housing price ramps. They don't love it so much when their homeowner's insurance goes up by 25% because hey, guess what? If your house burns to the ground, well, the loss is now larger than it would've otherwise been because you have to rebuild. And the building materials went up in price too. So did the labor.

Dennis Tubbergen:

Yeah, I think costs have been going up across the board. And then of course, you look at California where... What is it? Proposition 103 or something that capped rates, and now insurers are just pulling out of the state. So, there there's a lot of layers to that onion.

Karl Denninger:

Yeah. Well, part of the problem you have is just due to the human condition. People love to live in places that are beautiful and whatever. Well, they also happen to have higher risk. And the way that we used to deal with this, when insurance was not so easily available and cheap and distorted by low rates, was that if you wanted to have a house on the beach in Florida, it was

probably a cinder block thing with some low-value furniture and stuff like that in there. And the hurricane came, and it got flooded. Well, you threw everything out, you got the pressure washer out, you cleaned it out, and life goes on. If it got completely destroyed, well, you were out 50 grand. I mean, the foundation slab is still there. You put up some more blocks and put another roof on it.

But then we turned around and we took these places and refinished them into palatial looking joints that sell for a million dollars. And all of a sudden, that's not really an option. Now people want insurance on that, but the fact of the matter is that the storm is still going to come whenever it decides to come. But now instead of having a $100,000 piece of property in the way, there's a $1 million dollar piece of property in the way. And at some point, that becomes a problem.

And then in those coastal areas, particularly in Florida, one of the reasons I left the state, is that there's an awful lot of fraud. And all of that ends up reflecting back into everybody's premiums. So, you had situations, and I'm personally aware of a few of them where I used to live, where there would be somebody that had a fifteen-year-old roof on their house. There's a nasty line of thunderstorms or a mild tropical storm or hurricane that comes through. It's nothing major. Doesn't really flood anybody, doesn't do a whole lot of damage. All of a sudden, they claim that the storm destroyed the roof. And what really destroyed the roof was the 15, 20 years’ worth of age. But if they can manage to find some corrupt contractor that will say, "Oh, yeah, yeah, yeah, that was storm..." Well, now that's a claim instead of ordinary maintenance. And as a result, that ends up reflecting back into rates.

And when it happens too many times, the insurance companies, nobody's going to pay what they want to charge. And so they just say, "Well, we're done with this. Nobody ever goes to jail for this kind of thing." And so they leave.

Dennis Tubbergen:

Karl, we've got just a few minutes left here. I'd like to go back and maybe revisit something we talked about earlier. You mentioned at the end of the first segment that we recorded that really this inflation is driven largely by government deficit spending. How do you see this ultimately ending? Don't we have to have a reset point at some future time? And what does that look like in your opinion?

Karl Denninger:

Well, within the government, within the federal milieu, and it's somewhat different in the States, but within the federal area, the only place that we can take this on is within the medical system. And that means CMS. That means Medicare and Medicaid. And it either happens or the government and its fiscal stability collapses because the acceleration rate there is utterly obscene. Last fiscal year, it was over $2 trillion. Roughly a third of the entire federal spend was there. You cannot solve the federal government's fiscal problems without fixing that. And most of that is in one way or another felony-level illegal and has been for over a hundred years because it violates antitrust law. So, we need to have people within the government that are willing to stand up and say, "Okay, if you do this stuff, you're going to jail. We mean it. We're not fooling around." The problem is neither party wants to do that because obviously you get ads run against you that you're going to throw granny down the stairs and stuff like this.

But that is the only way you're going to see this problem resolved. And I am quite skeptical that we have the wherewithal within our government apparatus and our people to go ahead and get this done. But it needs to happen. And if it doesn't, then it continues onward with one in five people in the economy working in this area. Most of them are not actually helping people. They're just shuffling money around. And eventually the government runs out of the ability to pay for it. And you either see an inflationary spiral that forces the Fed to put rates at Volcker levels, and then Congress has to stop because they can't fund it. The Treasury auctions, they just can't pay the interest. Or the other alternative is that the federal government literally collapses.

Dennis Tubbergen:

So, Karl, how far down the road... I know this is a difficult question to answer, but from a timing perspective, can we see this continue business as usual for another 10 years, or do you think that we're going to have to have a come-to-Jesus moment, to use that term, before then?

Karl Denninger:

No, I don't think it goes another two years. I would be surprised if we don't see a market reaction, a recognition that this is not going to play out the way people are believing that it will, this year in the equity markets and in housing. And whether or not that draws the kind of reaction that we got when COVID hit, where the government tries to spend even more, which it might, or whether we have our esteemed Fed chair walk into the Speaker of the House's and Schumer's offices and say, "Look, guys, bottom line is this.

You either cut this out or you're going to see rates ratchet higher, whether I want them to or not."

Because the truth is that the Fed doesn't set rates, it follows the market. If you look at the thirteen-week bill and the Fed funds rate, the thirteen-week bill moves first. So, if you believe that the Federal Reserve is actually setting rates, you're wrong. And Congress and the public, boy that's a good boogeyman. That way you can point your finger at them. But that's not where the issue is. And if this does not get addressed, the market is going to eventually say, "All right, that's enough of this." And that's when it ends.

Dennis Tubbergen:

Well, my guest today has been Mr. Karl Denninger. His blog, you can read at market-ticker.org. The website again is market-ticker.org. Karl, always get terrific feedback when you're on the program. Thanks for joining us today. Love to have you back down the road.

Karl Denninger:

Anytime. Thank you very much.

Dennis Tubbergen:

We'll return after these words.