Washington, We Have a Problem!
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Fasten your seat belts and prepare for a good old fashion economic meltdown..!

Is it possible to defy the business cycle? Can we continue ad infinitum in a Pollyanna economic-boom environment? Let's reflect back to the late '90's for a minute… If …

- jobs were plentiful,
- unemployment was dropping,
- profits were rocketing to the moon,
- GDP was growing vigorously,
- tax revenues were pouring into government coffers,
- government deficits were rapidly moving into balance,
- wages were increasing faster than inflation,
- business investment was booming,

then, why couldn't things just continue getting better???

OK, OK ….. What was really happening?

- Central Bank **E**asy **M**onetary and **C**redit **P**olicies (EM&CP) signaled "green lights" to business investments that would normally be unjustified.
- EM&CP encouraged many consumer purchases (esp. cars and large homes) that would normally be unjustified.
- The EM&CP "puffed" corporate balance sheets due to the artificially monetary-stoked demand enhancement, thus empowering stock valuation Ponzi schemes.
- The unbridled aggregate stock market valuation increases reached levels never experienced in the history of the Republic!! The momentum play was in full swing. As a result, valuations grew far above their legitimate levels.
- Foreign investors did not want to miss out, so Foreign Direct Investment (FDI) surpassed historic records with hundreds of billions flooding into the U.S. market Ponzi scheme. This effectively strengthened the dollar, thus encouraging massive outsourcing and foreign goods purchases, which "gutted" American manufacturing in short order.
- Executive compensation is strongly correlated to stock prices. If stock valuations are unjustifiably high, the same goes for exec. compensation relative to labor's wages, only the exec's pay package increases rise much higher than the sustainable growth of the company and its profits. For example, a $1 billion company valuation doubling to a lofty $2 billion would likely more than double the CEO pay. In fact, the CEO could ask for say a modest 1 % of the company valuation increase ($10 million) in reward for his "skillful guidance". This could have increased a $1 million comp package ***ten-fold***. In reality, the EM&CP flooded the market with liquidity causing the aggregate "water level" to rise, thus disproportionately benefiting those whose compensation is strongly associated with stock valuations. It's not the fault of the CEO's, it's the EM&CP!!
- If stock valuations grow robustly, all professional investment managers and their governing boards tend to be very generous with increased benefit and future payout promises assuming the nirvana will continue. For example, most pension plans dolled out extraordinary benefit increases for years into the future at the same time they were reducing funding requirements.

What Happened from 2000-2005? … Briefly…

- The stock market experienced a "mini-crash" from 2000-2002, but still remained far above historically justified levels…. Because…
- Our government **pulled all stops** via even more EM&CP, and tax cuts to keep the stock bubble from fully correcting… Hence…
- We created the largest bond and real estate bubbles in the history of the Republic, and
- We enticed millions of people into many businesses unjustifiably expanding due to the EM&CP, which must eventually stop and reverse at some point in time.

SO… What's the problem??

- Stocks, bonds, and real estate are collectively more overvalued now than any time in the history of the Republic. That means the average investor thinks his home equity and investment portfolio will buy a future stream of real goods and services far greater than is possible.
- There is a greater number of employees working in market unjustified business enterprises than likely any time in the history of the Republic. That means, for example, we should not be building approx. one-third of the housing square footage we are today. That labor will be displaced, when the bubble illusion becomes apparent (bursts).

SO… Why Won't the Bubble Burst Today?

- Governments will do anything to stay in power.
- As long as the Boomer population bulge is still working, the bubble can exist because they are not yet attempting to cash in on their perceived riches. The bubble can continue to be puffed and puffed via EM&CP when economic stress seems apparent.
- Our US government and Central Bank are continuing with the EM&CP every day as long as the Federal Funds interest rate target remains below the natural rate. That target rate is approx. 3-4% too low today. This practice enables the continuing flood of liquidity and easy credit for unjustified purchases on credit, which keeps all bubbles levitated.
- Foreign central banks and investors continue buying our debt securities, which keeps our interest rates below a natural level. Why? They want to keep the giant American consumption machine buying their goods, which keeps their citizens employed and expanding. So, what's the problem with that? The exchange of their real goods for our "paper" (debt and equity securities) cannot last. At some point they will want to start cashing in their "paper" for real goods and services in return just as our own Boomers will do.

If Not a Burst Today, then WHEN?

- This may be the simplest of all answers…!
- We are now expanding our out of balance conditions so rapidly, along with the political spin offered in all countries to justify it, that there is no government willing to stand up and stop the music (e.g. start selling their holdings of US dollar reserves or bonds) for fear of catastrophic consequences, so the exponential debt expansion keeps getting worse. A stable growing economy would increase its Total Credit Market Debt approximately the same as its GDP increase. In 2004 our TCMD increased **$2.7 trillion** while our GDP grew approx. $763 billion (nominal). Not to be outdone, this year (2005) our TCMC is on track to increase **$2.9 trillion** with a slight increase in GDP growth!
- At some point a critical mass of CITIZENS will attempt to cash in on the inflated assets they own. That will happen when the Boomers begin to retire in mass in 2008-10. It is not the fact that the Boomers will burden those still working. That impact represents a manageable 0.49% increase per year. ***It is the discovery of the massive aggregate***

overvaluation that will send us reeling…! Fasten your seat belts and protect yourself from a very hard economic landing!

- It could, of course, happen sooner, if some significant investors or foreign central banks push the timetable up. If that happens, there will be an emergency summit of the G-7 plus China in an attempt to save the dollar. The meeting outcome will emphasize more of the same damaging monetary policy, which will make the imminent collapse even more severe.

Lessons?

- A gold backed U.S. currency and Austrian Economic Theory monetary policies would have prevented the irreversible out of balance conditions (bubbles) from building up in the first place.
- In the thick of the collapse aftermath, we need to remember why the swamp got up to our necks in the first place… **Fiat Currencies, Central Bank Monetary Intervention, and U.S. Government deficit spending were the primary culprits…!**

By Russell Randall, 11-15-2005