Even Trump's Tax Plan Couldn't Get Us out of Our Hole of Debt

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LONDON – By the time you read this, we'll be giving a speech to an investment group in London.

Investors will want to know what's a. Will prices go up? Or down?

"Yes," we will answer.

At best, we will help connect a few more dots…

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Trump's Tax Puzzle

The big dot we've been looking at this week is Team Trump's proposed tax cut, now causing indignation and puzzleme
throughout the nation.

Who will benefit? Who will pay?

At first, we considered the proposal beneath contempt and beyond contemplation. It was silly and inconsequential.

What's more, it could never pass. So why bother to think about it?

But the more we looked, the more it seemed to take on a kind of gravity, drawing other big dots toward itself into a kind
planetary system… with orbiting moons in cyclical patterns… comets and asteroids appearing suddenly without warnin
swirling dust confusing everything.

That's the universe we live in!

And the tax cut proposal helps us see it.

Black Hole of Debt

Why can't Congress pass a serious tax reform measure?

Because the feds need money. They can only get money from the people who have it – the rich.

But the rich control the government and its tax-writing committees. So, the feds are stuck. And so is the entire economy

Like the ancien régime in France before they started cutting off s, the Deep State cannot reform itself. And the mob still appeased… with pensions, pills, and welfare payments – which cost money.

This contradiction can only be reconciled – temporarily – with credit.

This is why every major economy runs big deficits… and why there's a black hole of debt that is sucking all the world's economies down… closer and closer to a debt disaster.

But let us pick up where we left off yesterday. Although U.S. government debt was going up 20 times, since 1980, there sign of "crowding out" in the debt markets. (The "crowding out effect" describes how increases in government borrowing up interest rates for everyone.)

How come?

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Elastic Credit

Yesterday, we explained that the new fake money… made available at the Fed's ultra-low rates… meant credit was alm completely elastic.

When it began to get tight – as it did in 1987, 2000, and 2007 – the Fed stretched it out even further.

The U.S. added almost $10 trillion to its debt since 2007. But thanks to the Fed, which provided all the money the syste required – and then some – interest rates didn't go up. Instead, they went down again.

That was former Fed chairman Alan Greenspan's conundrum.

But here's the bigger conundrum: How could it be that total outstanding U.S. debt – consumer, government, and busine – compared to GDP, could go up some $35 trillion since 1980?

That's $35 trillion of private-sector spending that wouldn't have happened had the "crowding out effect" – the old conne between real money, output, savings, and debt – been respected.

And how come all this new buying power, based on credit, didn't send prices soaring?

It has to go somewhere. But where?

Two Economies

The simple answer: It went somewhere… but not to Detroit, Michigan, or Donora, Pennsylvania.

There is a Main Street economy and a financial economy. There are consumer prices and capital prices (stocks, bonds estate, etc.).

Consumer prices didn't rise for two reasons.

First, households didn't have the money to spend; earnings were flat.

Second, when they did spend, they bought gadgets and gizmos from China. The U.S. money supply was increasing, bu of it was going overseas, where it was creating a boom in manufacturing, infrastructure, and real estate.

The tsunami of new credit also created a boom on Wall Street – the home office of the financial economy – where stock prices rose 22 times since 1980.

That's a 2,200% gain. A dollar's worth of stocks in 1980 now will cost you $22.

If home prices had gone up as much, the median house in America today would cost $1,320,000. Instead, it's about $3

Only in a few areas – Wall Street's bedroom communities, for example – do you find houses selling for an average of $1,320,000.

And if Detroit's automobiles had risen as much as Wall Street's stocks, your next set of wheels would cost you about $1

But a new car today costs only about $30,000. And go to Detroit today and you can buy the median house for only $40, which is less than the nationwide median in 1980.

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Janet Yellen's "Mystery"

And now Fed chair Janet Yellen is puzzled…

It's a "mystery," she says. With the U.S. supposedly at full employment (suggesting that the economy is operating near capacity)… and the Fed's key rate still below zero in real terms… consumer prices ought to be going up.

But the latest consumer price inflation figures show prices rising at a yearly rate of only 1.5%… not the 2% that Ms. Yel wants.

Why?

Because the system is rigged up with phony money… and now depends on it.

There is no crowding out of private borrowers because the supply of fake savings is, theoretically at least, infinite. So, in rates don't rise… and don't automatically correct excesses in the capital markets.

And consumer price inflation doesn't go up either. Because it's credit that is flooding the world, not real money.

The credit boosts Wall Street and China. It doesn't have much effect on consumer prices. It doesn't go to Detroit home or Donora steelworkers.

So, the Fed doesn't see higher inflation or higher yields. It never corrects its mistake, because it never gets the messag

At least… for now. But that is about to change in a big way.

Now, the Fed promises to push on with raising short-term interest rates. Instead of its quantitative easing (buying bonds newly created cash and adding them to its balance sheet), it has begun a policy of quantitative tightening (letting that ba sheet shrink).

Instead of the EZ money – the only kind of money a generation has known – it promises a new policy.

Hard money, it says, is the new thing. Starting this month, the Fed says, it will gradually reduce the bond pile it built up Greenspan began to back up the capital markets in 1987…

And when new credit begins to tighten… when investors get their first hint that the EZ money is over… worlds collide.

The financial economy – tricked up by Fed credit for the last four decades – will run right into the real Main Street econo

Both will be smashed.

And then, and here we don't think we're going very far out on a limb: then, the Fed will get the message…

And once again… react inappropriately, of course. More to come.

Regards,

Bill