

DEBT IS THE PROBLEM

WEB BUZZ 2009.12.07

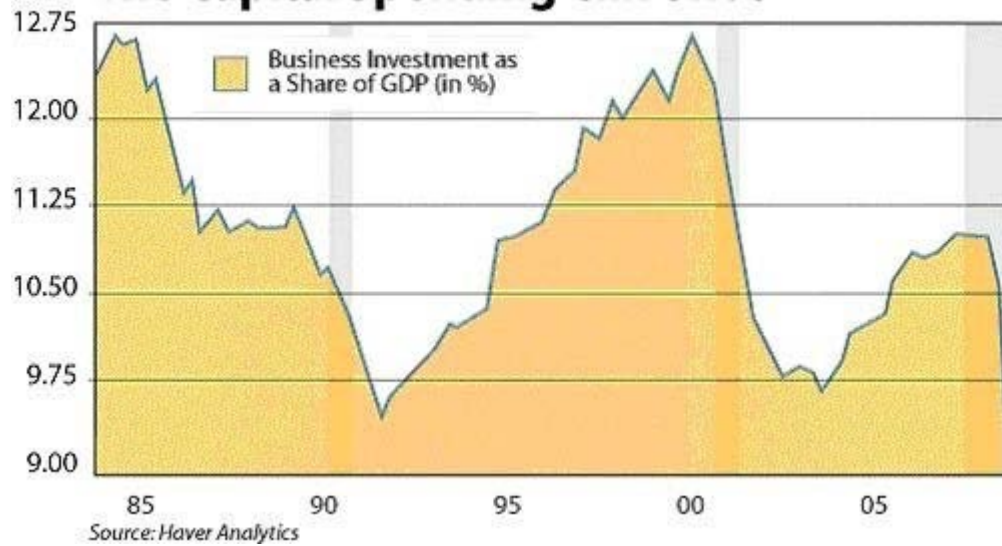
According to what we have seen, i.e. consumer credit has declined from \$2.59 trillion in 2008 to \$2.47 trillion as of September 30, 2009 - a decline of approximately 5%, the private sector continues to pay down debt (the Fed's flow of funds statement will be published December 10th for the third quarter ended 9/30/09). Two thoughts come to mind concerning this: (1) the consumer has a long way to go before his balance sheet is restored, and (2) the federal government's increase in debt swamps anything the private sector can do in the opposite direction. Please remember this - we cannot solve our collective debt problem by issuing more debt. It's a fool's game that will no longer work. Why? At some point, and we think it's not far away, we, as a nation (private and public), will not be able to service our debt. Look at the following hypothetical example:

Debt	Interest Rate	Total	% of GDP
\$50 trillion	@ 3%	= \$1.5 trillion	5%
\$50 trillion	@ 6%	= \$3.0 trillion	10%

The approximately \$50 trillion in total debt is 350% of our annual income (nominal GDP). If the gold bugs are correct and we end up in hyperinflation, what might interest rates be? On the other hand, if we have high interest rates (say 1981 rates of 21%), what would that do to our economy? As you know, we remain confident that deflation is now underway, but then debt becomes much more difficult to pay. Its value goes up under deflation as opposed to going down under inflation. Let's face it - debt is the problem and only by paying it off will our economy be restored.

When will we know the recession is really over? It will be when the following chart moves upward.

The Capital Spending Cliff Shot



Adapted from DailyReckoning.com.au

Capital spending is the economy's multiplier and to date it remains dormant.