

The Vicious Cycle

By [The Mogambo Guru](#)

02/19/04

Mogambo on Monday! In this week's episode, our fearful hero starts at the Fed and follows credit and cash whither it goes...sloshing from bank to bank, country to country...and back into the arms of the almighty American consumer.

Last week was pretty weird everywhere I looked.

The Fed was not called upon to issue any credit, and they only dabbled in monetizing existing Treasury debt, the usual \$202 billion or so, which is literally turning government debt into money by printing up the money to buy the debt, and then throwing the debt into the shredder. Which is such a blatant fraud that I am embarrassed by the ineptitude of the media who, although they like to run their mouths about everything, cannot recognize a blatant fraud when it is happening right in front of their eyes.

Uh-oh! It looks like I am ranting! Sorry.

Deflation: Yet Another New Record

But the big action was in the banks, as almost all line items changed pretty dramatically. I was especially enthralled by the revelation that they sucked up, like a huge, demented vacuum cleaner, a \$20 billion wad of government and agency debt. The Treasury Department itself only issued another \$6 billion in new debt last week, taking us, once again, to another new record, although I have been reporting this "new record" thing for so long that I am beginning to sound like a broken record broken record broken record.

"The banks have buried themselves in government debt certificates," explains Gary North. "They have bought government bonds. They have bought what economist Franz Pick called 'certificates of guaranteed confiscation.' Eventually, the debt will be repudiated. There is a universal long-run law of all government debt: creditors eventually get skinned."

And, as far as the Treasury acting like profligate children goes, it is not their most egregious effort by a long shot. And speaking of egregious efforts, as I write this the national debt has bumped up to \$7.043 trillion, which is up another \$29 billion, and the week is just getting started. "2003 will enter the financial history books," wrote Marc Faber in the Daily Reckoning last week, "as the year in which all asset classes – including equities in developed as well as emerging markets, government as well as any kind of corporate bonds, industrial commodities, precious metals, real estate, and art – increased in value."

To be fair, although he used the term "value," nothing actually increased in intrinsic value as far as I am concerned, because assigning value to something involves individual judgment about

"worth." And then when people hear we are talking about "worth," then that inevitably brings up how worthless I am as a human being, and I get so tired of hearing that over and over, day after day. But I gotta admit that all those things he mentions certainly increased in price. But if that is how you measure value, then, okay, they all increased in value according to Mr. Faber, and increased in price according to me.

And isn't the popular definition of inflation, and I am asking you instead of actually looking it up in the dictionary, something about how prices go, umm, up? And so how come this blistering inflation in prices was not enough to get the Fed to increase interest rates? How come the year-after-year double-digit increases in house prices, or stock prices, or the prices of oil, or commodities, or the rapidly rising prices of anything, is not enough to get the Fed to try and cool down the white-hot asset sector?

Deflation: The Fed Is a Bunch of Clueless Weenies

The answer is obvious, once you remember that this Fed is the most inept, corrupt, ridiculously pompous and smugly arrogant bunch of clueless weenies in U.S. history. They are worried about deflation, which is now defined as when something, even things that are already so grossly overpriced, goes down in price. Like stocks. And bonds. And houses. You know: Everything that that is currently waaayyyyy overpriced.

And why do they want to prevent this deflation in preposterously overpriced things? Wouldn't the U.S. consumer, namely you and me, be better off if things were cheaper? Wouldn't it be a big benefit to us pathetic bozos out here in the real world when our paltry incomes buy a bigger basket of things on payday? Without waiting for your answer, I answer my own question and say, "Yes, it certainly would be a benefit!" But Greenspan does not WANT us to be better off. Why? Because the whole U.S. economy is now totally dependent on things NOT going down in price. In fact, the whole U.S. economy is now dependent on overpriced things being more and more and MORE overpriced!

Namely, stocks, bonds and real estate. Weird, huh?

Dr. Steve Sjuggerud, also writing in the Daily Reckoning, pointed out that because of these price rises, there is a dearth of places to put money where there was a good possibility of making some profit, instead of having a good probability of losing your shirt and ending up in the gutter begging money to buy stale bread or another shirt. Sjuggerud quotes Jeremy Grantham: "Today we have substantially the worst prospects for long-term global investment returns of my 35-year career when all asset classes are considered, particularly for U.S.-centric investors." This is because things are all so overpriced, and this should not come as a surprise to you if you had been paying the least bit of attention to me, and don't feel bad if you have not, since nobody else does, either. And when things are overpriced, there is usually not a good chance that they will get MORE overpriced, which is where your profit should come in.

But how and why did they all increase in price? Because the Fed increased the amount of dollars in the system, and the Congress borrowed and spent those dollars. And so the system was

flooded with more dollars, but the amount of goods and services did not increase. Ergo – and don't you just love it when I use the word "ergo?" – the value of each dollar went down.

And don't worry if you do not understand this concept right away. The Federal Reserve has never understood it either, and they think they are smarter than all of us put together. They are not. In fact they are much more stupid than we are, QED. They just think that they are smarter.

Deflation: Those Lovely Mountains of Dollars

Anyway, that flood of dollars sped hither and yon through the economy, and ended up in somebody's pockets, who spent the dollars on imports, which flooded foreign economies with dollars. But those foreign exporters did not want dollars, but instead they want their own currency, because their wives want to spend money, and the places where they shop do not want to go through the hassle of converting U.S. dollars into their own currencies. So the exporters were prone to dumping those dollars to get their own currencies with which to fill up the pocketbooks of their wives, and then the banks ended up with all the dollars. But the banks do not want the dollars either. So then the foreign central banks printed up some big wads of their own currencies, and bought up the U.S. dollars from the banks, who do not want, as we have seen, dollars. And then the boss of the central bank comes to work one day and wants to know who in the hell has been piling up all these dollars in the lobby and making such a big mess, and issues an order to get them out of here and get this placed cleaned up! So all those dollars, those lovely mountains of dollars that in the aggregate add up to more than a half a trillion dollars a year, were used to buy U.S. debt.

Which the U.S. government spent, continuing the viciousness of the cycle. And then they went into people buying things, like stocks, and bonds, and houses, and imports. And prices went up. And then, the next year, they went up some more. And then, the next year, they went up some more. And then the next year, they, but this is getting real boring, so to save time, we will hop into Professor Peabody's Time Machine and fast forward a decade or so, and when we step out of that time transporter we notice that I am still intoning, "And then the next year, they went up some more."

Then we are all happy that we are back in the present, and have finally stopped that "and then next year..." crap.

And sure enough, there is Jeremy Grantham saying that "today we have substantially the worst prospects for long- term global investment returns of my 35-year career when all asset classes are considered, particularly for U.S.- centric investors," which gives me an eerie feeling of déjà-vu, but is quickly explained by the fact that I just cut-and-pasted his original quote, but that doesn't change the facts.

And it is a truism that the mechanism of inflation is that the beneficiaries of excess creation of money and credit will be those guys who are first to get in line for it, and who buy the things that will soon go up in price. And it is another truism that after this initial bunch of winners will come another bunch, who will get in the parade and do the same thing, and prices will go up some more. And it is another truism that more and more people will take notice of the profits being

made, and then they will get into the swing of things, too, and then, finally, at the end of the parade, come the guys who think that they can arrive late at the party, and they will be buying those assets that are so high in price that there is nobody left to take the bag from them, and so they will be left holding the bag.

The big question (BQ) is: is anybody holding the bag yet? Yes. Lots of them. In fact, the whole American economy is now composed of people holding bags. Big bags (BB). Big, BIG bags (BBB). And the Other Big Question (OBQ) is: Is there another bunch of people who are willing to pay money to take the bag? Ahhhh. That's the REAL question (RQ)!

And the way to entice people into buying something that is ludicrously overpriced is to, and here we see the beauty of Modern Fiscal Policy, give everybody their money back! Yes! That's right! And how do we do that? Through the Tax Credit section of the 1040! The government will pay you back if you spend your money the Government Approved Way (GAW)!

Regards,

The Mogambo Guru,
for The Daily Reckoning
February 19, 2004

P.S. In a related vein, the IMF, given that they are as brain-dead as our own Fed, which is understandable since the Fed is the biggest of the creditors of the IMF, decided to give Argentina some more loans. I left off the exclamation point there, although normally that would rate at least one exclamation point. But I am cleverly setting you up for the punch line, to show you that the Mogambo has a humorous side, which I call the Mirthful Mogambo, with which to offset his dangerously angry and trigger-happy side.

The IMF gave them more money even though Argentina is pretty honest and blunt about saying that they are in pretty bad shape, and they are going to keep defaulting on loan payments! I put that last exclamation point in there to indicate the fact that this is the punch line, and now you should laugh heartily – Ho ho ho! – and say, wiping the tears of laughter from your eyes, "No! Really? No! What is the joke, oh Mighty Mogambo?"

The joke, and you are going to love this for all its cosmic ramifications, is that it is no joke. That is what really, really happened.

Now, anybody who knows me immediately deduces, correctly, that all of this is just too, too spooky for me, and I am grinding my teeth so hard that the friction is sending out a radio signal that is jamming radios and government communications for blocks around. I know this from looking outside my window and watching the government's Super Secret Agents spying on me as they try to talk to each other on their cell phones over the loud static I am producing, and I sneer at them "Chumps! This is one of those 'unintended consequences' from your reign of terror against me, the Magnificent Mogambo!" And, to give the government agent credit, he was fast on his feet when he replied, "Huh? Look, Mister, I'm just here to read the water meter! Honest!"

Well, I think that is what he said, but my Super Duper Central Computer System was activating a Perimeter Defense, Repel Boarders-type action, and what with all those machine guns cocking, and shells being loaded, and sirens blaring, it was pretty loud, and the super-powerful Klieg lights were illuminating the Fire Control Zone with a blistering glare and neighborhood kids were falling to their knees crying "My eyes! My eyes!" and he was in a hurry to leave. But he was one of them, all right. Trust me on that one.

Mogambo Sez: I wish I weren't so lazy, and then I would take the time to go back through precious issues of the MoGu and identify the guy who said that buying gold was an investment that was obvious, riskless, and a bunch of other swell things, all of which added up to suggesting, in the strongest of terms, that you ought to take a break from downloading pornography off the Internet, and go out and buy gold.

I shall merely paraphrase, and you must look deep into my eyes to discern my utter seriousness, when I tell you to quit trying to download pornography off the Internet and go out and buy gold right now. If not sooner. You'll thank me later when the investment pays off in spades, and you can hire somebody else, who did NOT look deep into my twinkling blue eyes and who did NOT buy gold as per my suggestion, to do the downloading for you, and then project it onto the giant plasma screen TV on the wall of your lovely beachside villa.