Optimism in the Face of Inflation

By The Mogambo Guru

12/26/07 No matter how much "Fed speak" we listen to, we can’t help but see that inflation is beginning to swallow us whole. And believe it or not, the Mogambo has done his best Robert Ripley impression, and has discovered something truly amazing given the circumstances – an optimist.

If there is one thing you can say about Bill Gross of Pimco, it is that he is an optimist. He starts out by saying that the Federal Reserve is a bunch of morons who have no idea what in the hell they are doing, and that The Mogambo is right, and that we ought to storm up there with flaming torches and pitchforks, dragging Ben Bernanke and his lowlife Fed buddies out into the street to exact some kind of awful Revenge of the Sheep.

Okay, he did not say that exactly, but he said essentially the same thing when he said that "What we are witnessing is essentially the breakdown of our modern day banking system, a complex of levered lending so hard to understand that Fed Chairman Ben Bernanke required a face-to-face refresher course from hedge fund managers in mid-August." Hahaha!

I am stunned that the chairman of the Federal Reserve has to bring in hedge fund managers to explain to him, maybe using short, easy words and hand puppets, that they are selling what they claim is a free lunch to a bunch of gullible, ignorant, greedy "investors" who are so damned stupid that they think that there IS such a thing as a free lunch and are actually forking over real money to own them! Hahahaha!

In this case, the free lunch is higher yields on riskier debt, but (and this is the important point) without higher risk! Hahaha! This is too, too rich! I am laughing so hard that I can hardly catch my breath, made harder by the fact that my teeth are tightly clenched in a blinding outrage, which makes my usually Musical Mogambo Laugh (MML) sound like a sick rat retching, sort of like "Huh, huh, huh."

Mr. Gross says that his associate at Pimco, Paul McCulley, calls it a "Shadow Banking System" because "it has lain hidden for years–untouched by regulation–yet free to magically and mystically create and then package subprime mortgages into a host of three-letter conduits that only Wall Street wizards could explain." Magically and mystically! Perfect! Hahaha!

So, the question is, can they explain it to Ben Bernanke so that he can use some more magic and mystery to set things wonderfully aright? Hahaha! They can explain how the whole system of bonds and debt has seized up, hundreds of billions already lost and hundreds and hundreds of billions, maybe trillions more, that will be lost, and they can explain it? Hahaha! I gotta hear this! Hahaha!

Well, Mr. Gross is far, far too smart to be drawn in to a childish, screaming hissy fit with me, as there is no point in it, and I always get so mad and scared that I end up curled into a fetal position under a desk or table, crying like a baby and screaming, "We're freaking doomed!", and if anybody tries to console me, I kick at them.

Well, he obviously doesn't want any of that! Instead, he cranks up some of that famous Bill Gross optimism and says that everything is going to be fine, as "history would point out that Fed easing cycles during prior recessionary or near recessionary economies have invariably dropped to 1% Fed Funds rates when calculated on a 'real' or inflation-adjusted basis. Such a history should produce the real Fed Funds level required to keep the economy growing at a reasonable non-inflationary rate typical of the last decade – a logic quite similar to that incorporated in the Taylor Rule."

So, there I am, curled up under his end table, whimpering and crying, mostly because I don't know how the stupid Taylor Rule mandating that interest rates be lower and lower and lower, so that people can go into debt more cheaply, is going to fix anything, especially at this point, when the whole problem is the towering, crushing, backbreaking total amount of debt already being shouldered in the system!

My hands are clenched into fists at my frustration as to how in the hell making debt cheaper to get into, in order for debtors to make interest payments on the debt already owed, making the total debt bigger and bigger and bigger and bigger forever, is going to fix the problem of too much debt?

Maybe it is because I am too embarrassed to admit that I can see how it delays bad things happening, and I can see how the problems of too much debt are thus allowed to get worse and worse, but I'm thinking to myself, "How freaking much money do you have to create, and how much freaking debt do you have to create, to not only make up for a trillion dollars in losses, but make a profit, even while bearing such a huge, staggering debt? I don't know! I just don't know!"

I know I can't ask Mr. Gross, as he is pretty disgusted with me and my whimpering, crybaby cowardice, but I can see that this is going to be some big numbers, and I am going to need all my fingers and toes to help count it up.

So I start taking off my shoes and socks to expose my toes, which I use to count the numbers 11 through 20, and my head involuntarily jerked back as I caught the first whiffs of that familiar, pungent stench. I already told you how smart Mr. Gross is, so it is not surprising that he immediately tried to forestall me by soothingly saying, in effect, that everything will be fine, and there is no need for me to count anything or take off my shoes, for the love of God don't take my shoes off!

I could almost hear the pleading in his voice when he said, "Standby for a tumultuous 2008 as the market struggles to move from the shadows back into the sunlight of sounder banking and financial management, accompanied by Fed Funds levels at 3% or lower."

Optimism! Like I said: He's got optimism!

Not quite so cheery is Ambrose Evans-Pritchard at telegraph.co.uk, as I gather from his article titled "America Faces Day of Reckoning with Debt."

He says, "The seven pillars of global demand over the last year – measured by current account deficits – have been the United States ($793bn), Spain ($126bn), UK ($87bn), Australia ($50bn), Italy ($48bn), Greece ($42bn), and Turkey ($34bn). Most are facing a housing bust. All are in trouble."

As a result, "In Europe, not a single junk bond has been issued since August. Spreads on Euribor – the rate used to price mortgages in Spain, France, Italy, and Ireland – reached 93 basis points last week, a new record. This is tantamount to four rate rises." Yikes!

And who is responsible for this misery? I shout out, "The Federal Reserve and Alan Greenspan, whose constant creations of excess money and credit made it possible!" Mr. Evans-Pritchard acts like he doesn't hear me, but then agrees with me! He writes, "The root cause of this debacle lies in errors made by the Federal Reserve and fellow sinners. They inflated the credit bubble by holding interest rates too low for too long and lulled nations into suicidal levels of debt." Exactly! Suicidal, indeed!

Naturally, I decided to jump into the conversation and get a little attention. Alarmed at the thought of dumbing-down the conversation with my participation, he quickly continues, "The strategic failure of a whole generation of economists, bankers, and policy-makers has been so enormous that it may now take a strong draught of socialism to save the Western democracies."

Suddenly, I felt a bigger urge to participate in the discussion, since he not only repels me with the prospect of more socialism to bail everybody out, but that he completely left out the "strategic failure of a whole generation" of some other guilty parties, such as the entire public school system, which is always an embarrassment of incompetence and obsession with ridiculous touchy-feely social issues, and the quisling newspapers/news media, which have completely shirked their First Amendment duty to investigate and expose wrongdoing in the government!

And there will be nobody to stand in the way of the central banks creating hyperinflation in pursuit of this socialism, which is surely the next step, which is what I gather from the words of Thomas Mayer, and economist for Deutsche Bank, who said the European Central Bank is compelled to cut rates immediately, regardless of the threat of inflation. "This could," he said, "go beyond just a normal recession. It could turn into a real economy-wide crunch that we cannot stop."

In that case, everyone is in apparent agreement that, like the cavalry arriving in the nick of time or like heroic armored knights on horseback saving damsels in distress by slaying dragons, the central banks must arrange irresponsible, insane infusions of infinite credit and money!

Therefore, it is proved that central banks believe that death by inflation is preferable to death by deflation. And now you know why I cry myself to sleep muttering "We're freaking doomed! We're freaking doomed!"

Until next time,

The Mogambo Guru