Corporate-Muni Bond Yield Gap: The Sign of Another Crisis?

By The Mogambo Guru

08/12/10 Tampa, Florida – The jillions of dollars in municipal bonds issued by cities and states over the last half century are getting a lot of attention lately, mostly because a lot of people own municipal bonds, either directly or indirectly, and now cities and states seem to be sliding, sliding, sliding towards an obvious and unavoidable default, like everyone else, sort of like how my wife noticed my decades-long slide into lazy worthlessness and irritability, reducing my value as a husband and father to zero, thus wiping out all her stupid "investment" in me.

She was, and still is, angry about it, which is instructive in that muni bonds falling in price normally means that the bondholders suffer, who would likewise make a big, angry stink about it, resulting in the wholesale ouster of such incompetent politicians as bondholders put some of their remaining money to work accomplishing just that.

Ah, but those are the "good old days" of fiscal prudence and intelligent management, and now all long-term debt to fund states and cities giving eye-popping salary, benefit and retirement plans to government workers, plus funding millions of ridiculous programs and projects, has been leveraged, probably a hundred-fold or more for all I know, with derivatives financed with short-term debt, which is debt that needs to be constantly rolled over by issuing new short-term debt! We're freaking doomed!

Mark Lundeen, in his weekly *Race to the Bottom* newsletter, looks at the surprising new yield gap between municipal bonds and Wall Street's best-grade bonds since 1937, and writes, "Since 1937, Muni Bonds have paid less than Corporate Bonds because of lower risks," but now, for the first time since 1937, "seeing Muni yields spike up above best grade Taxable Corporate Bonds is telling us that someone is selling their Muni Bonds, while they still can."

So, given the fact that "the current yield gap between muni bonds and best grade corporate bonds is historic," having never happened before since 1937, his interpretation of the facts suggests, "another American default credit crisis and derivative blowup is not far away." Yikes!

Then, after I am terrified by this "for the first time since 1937" thing for a few days, my stupid boss has me come to her stupid office so that she can tell me that the way I have been behaving lately is "bothering" her, and it's eliciting more grievances from my idiot co-workers who are also, I gather, "bothered" by my behavior, and if I have any explanation.

Naturally, I reply, with a look of incredulity on my face, "With the Federal Reserve creating So Freaking Much (SFM) money and the horrid Obama administration deficit-spending So Freaking Much (SFM) money, the only thing that 'bothers' you is the way I act? Is that what you said? Answer me, woman!" I imperiously commanded.

Well, she sits there with this big, stupid look on her stupid face, stunned at this sudden change in the interpersonal dynamic, stuttering and stammering, as I hit her again with, “You could be more profitably ‘bothered’ by the St. Louis Fed Bank’s report of the monetary base, which shows that it is still falling, in fits and starts, and has been for almost an entire year, although, oddly enough, the M2 money supply is rising, just like always, which is a worrisome enough paradox without the additional news that the M3 money supply, which is the broadest measure of the money supply because it includes everything that could possibly be considered as ‘money,’ is going down, too!”

By this time she recovered her senses, and she angrily reminded me who is boss around here and who is definitely not. I deftly parry her vicious attack by telling her that she is boss only because of being a woman and management is under pressure to hire more women, not because of any particular talent of hers, and maybe she is just too ignorant to understand the horror of the money supply moving up and/or down like that.

With a snarl, she easily parries my argumentative thrust and delivers a telling riposte by reminding me that she is smarter, more competent, younger, more educated, better liked, better dressed and better looking than I ever was or ever will be. Ouch! I didn’t expect the Full Frontal Assault (FFA)!

Instantly recognizing the need for a different Mogambo Plan Of Attack (MPOA), I tell that I, for one, am at least smart enough to be “bothered” that consumer installment debt is still falling as consumers are “paying down debt” which sounds good, but which is actually bad because everything about the Modern American Economy (MAE) depends on people always borrowing more money with which to buy more things. And now they ain’t! Oops!

She easily brushes away my new attack and comes back at me with the fact that consumer installment debt hit a record of almost $2.6 trillion September 2008, and the beleaguered consumers still have a whopping $2.4 trillion of personal debt on their credit cards here in August 2010, having spent since October 2008 – almost two years! – paying down a measly $200 billion!

Instantly, I was confused and completely disoriented by her blindsiding me with this because this is exactly what I have been arguing! Huh? I am attacking myself? What? Huh? What is going on here?

So, with such a distracted foe, I was easily defeated and ordered out of her office and back to my stupid little desk, to do my stupid little job, where I was to somehow find a way to stop “acting weird.”

Then, by surprise, I found that just thinking about how gold, silver and oil will protect me against the predations of the government and the Federal Reserve actually calmed me down!

And then I found that when I looked at how easy it is to profit by betting against the competence of the government by just buying gold, silver and oil, I just muttered to myself and said, “Whee! This investing stuff, and not acting weird, is easy!”