

EXTREMELY WELL SAID DON'S BLOG 2019.02.26

I often find articles which state in a more articulate fashion my long-held belief concerning the outlook for our economy. The following is an excerpt from such an article.

Negative Interest Rates? Inconceivable!

FC Advisors - 06/2016

<http://www.fcadvisors.us/wp-content/uploads/2016/06/Negative-Interest-Rates-final.pdf>

The chart below from David Rosenberg at Gluskin Sheff shows that the US has been increasing its borrowing faster than the economy has been growing for decades.

CHART 3: DELEVERAGING? WHAT DELEVERAGING?

United States: Total Nonfinancial Debt
(percent of GDP)



Shaded regions represent periods of U.S. recession
Source: Haver Analytics, Gluskin Sheff

Back in the 80's & 90's lowering interest rates was a very effective tool for spurring growth because the US had plenty of capacity to take on more debt. Just like when the first price cut at the Interest Rate Café spurred additional consumption. The financial crisis led to a small correction in the US total debt, which was mostly achieved through defaults on mortgage debt. In our Interest Rate Café example, these defaults are the economic equivalent of throwing up, in order to create more capacity to consume. Just like at the Interest Rate Café, lowering price of debt stops working once the customers run out of capacity to consume. Unfortunately, the rest of the world is in a very similar situation. In Europe, Japan and even (gulp) China, charts like the one above look very similar.

There are only three solutions after we have over borrowed. 1) Work it off gradually over time leading to low or zero economic growth. 2) Default, this is a very painful way to correct the problem with serious deflation & recession risk. 3) Debt forgiveness, this is a rather seductive option, but it can create some serious inflation risk if market participants believe more debt forgiveness will be forthcoming.

The full article can be found at:

<http://www.fcadvisors.us/wp-content/uploads/2016/06/Negative-Interest-Rates-final.pdf>