WHERE ARE WE NOW?
DON'S BLOG 2018.09.10

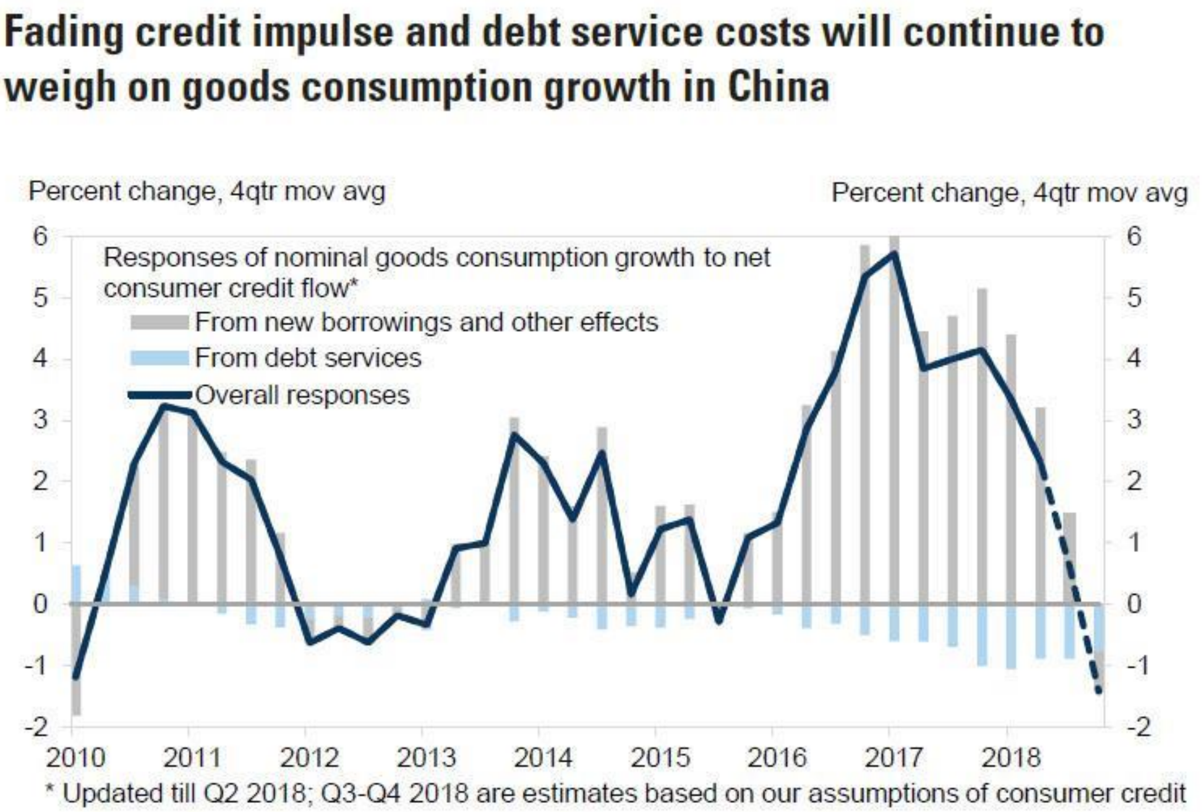
Just what do we think we know as things stand now? First of all, the most critical point is that the entire world economy is built on a mountain of sand called debt. Somewhere, sometime, the addition of one more grain of sand will cause a classic debt deflation, a la Irving Fisher and his classic explanation of the 1930's depression. Here are the worldwide numbers of total debt today versus ten years ago when Lehman Brothers went down—$247 trillion compared to $142 trillion. In other words, have we learned anything from the Great Recession? The answer is a resounding no; better stated, Hell No! Debt has grown at a compound rate of 5.7%, more than two times the rate of GDP. Now I fully understand that the days of "a penny saved is a penny earned" are well over. However, the use of debt must be prudent, and I would suggest what we have seen is nowhere close to prudent.

With the above as a background, let us now make a list of what I see today as trends and evaluate the outlook for the economy and financial markets.

1. It is quite possible that China, which has been the elephant in the room of world economic growth, may be on the verge of collapse. Please note chart #1 which comes from Goldman Sachs research.
2. Worldwide trade seems to have peaked. Please note chart #2 as per Bloomberg opinion. Trump's tariff scare doesn't help.
3. Remember when I mentioned today's 3% is quite like 6% of ten years ago? Note chart #3. The neutral rate is estimated to be when things are in equilibrium. Above this rate is trouble.
4. Take a look at Goldman Sachs' Bull/Bear Market Risk Indicator. Looks a little worrisome, note chart #4.
5. As noted in previous blogs, the world's emerging markets are in serious trouble. The strong dollar is hurting their financial stability. Please note chart #5. Note the emerging market debt rolling off 2018-2028. Are they going to be able to pay this debt? Will the market refund them? And at what price?

In past blogs I have sung the praises of economist Steve Keen due to his game-changing analysis of debt acceleration. He is one of the few who understand that money growth—or lack thereof—is the determining factor concerning the direction of the economy and financial markets. In that regard, note chart #6. The question becomes: is private debt growth topping out? If it is, look out below. What do I think? 60/40% it has.

Chart #1



Source: Goldman Sachs Global Investment Research

Chart #2

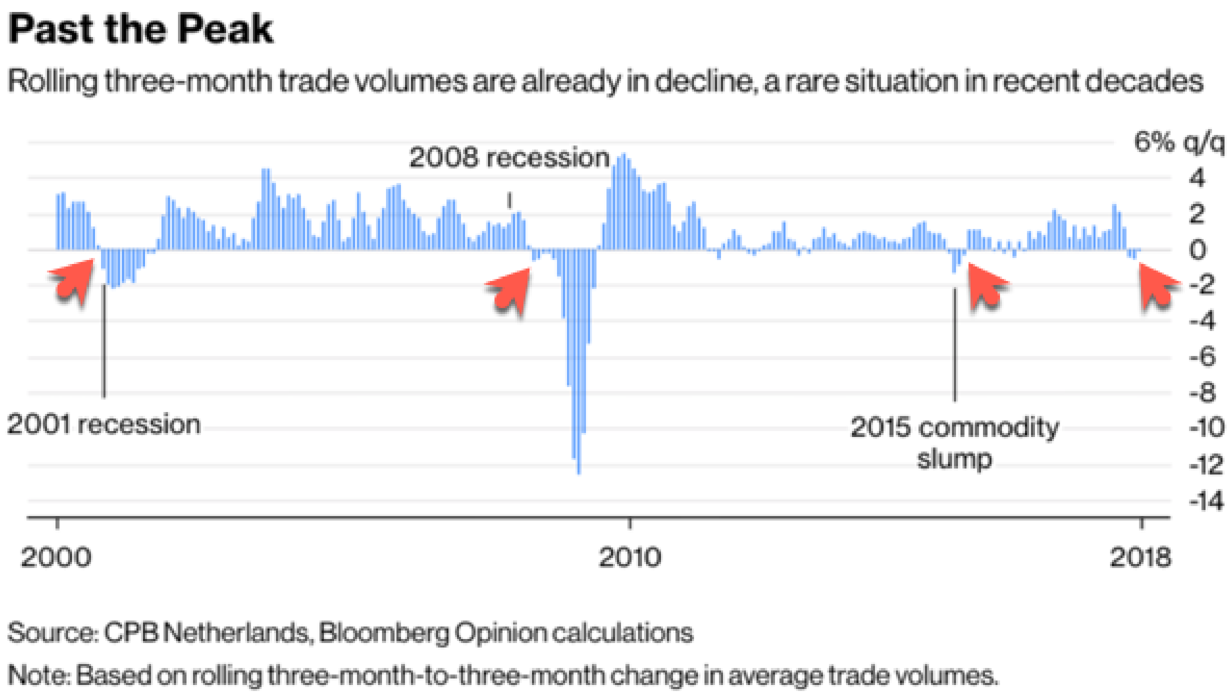
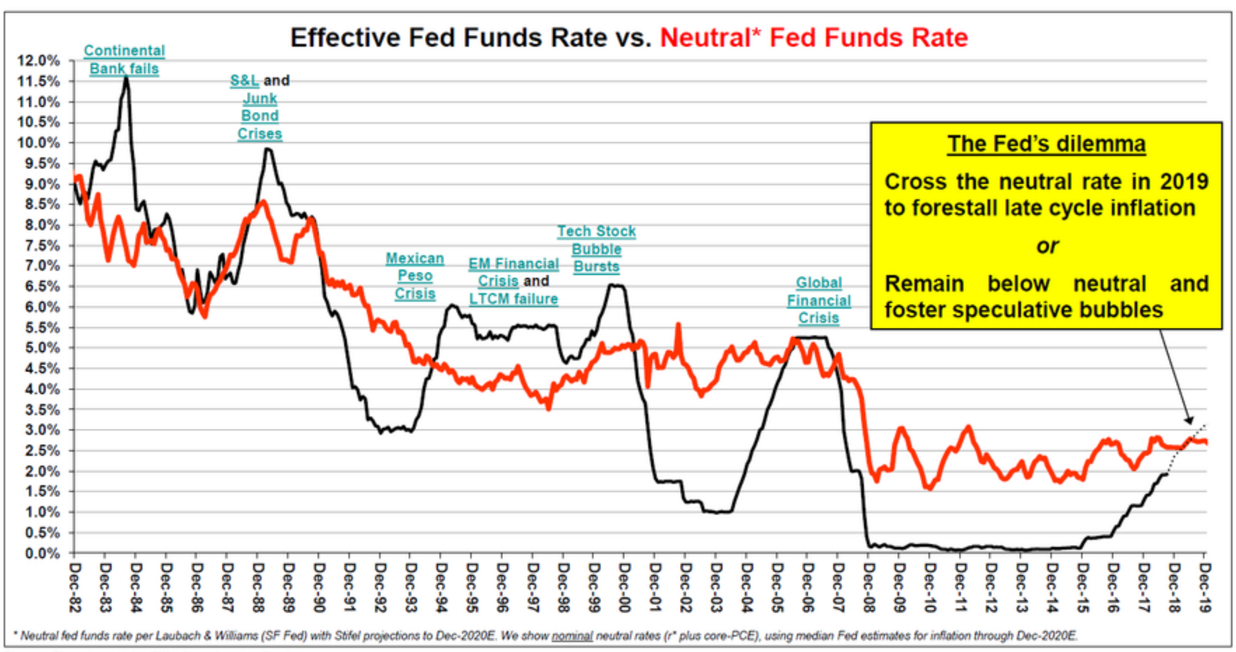


Chart #3



Source: Bloomberg data, Stifel format and estimates.

Chart #4

Exhibit 43: Our GS Bull/Bear Market Risk Indicator (GSBLBR) is at its highest level in 10 years
Average percentile (in US) for ISM, slope of yield curve, core inflation, unemployment and Shiller P/E

Source: Shiller, Haver Analytics, Datastream, Goldman Sachs Global Investment Research

Chart #5

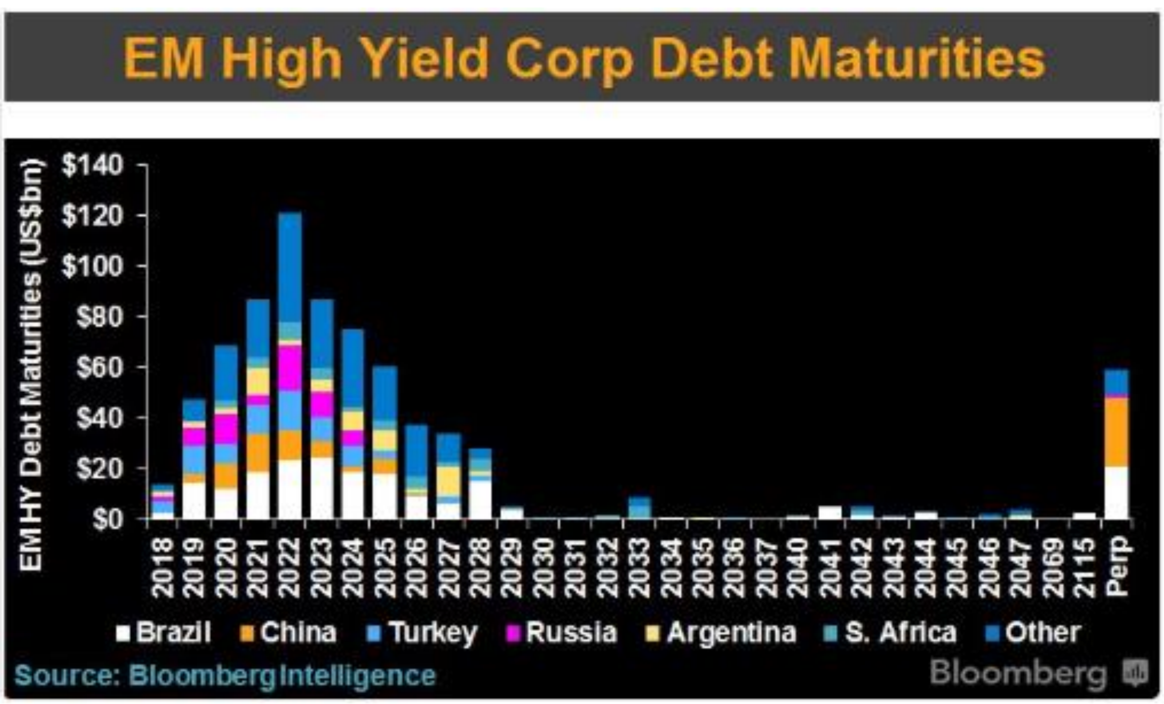
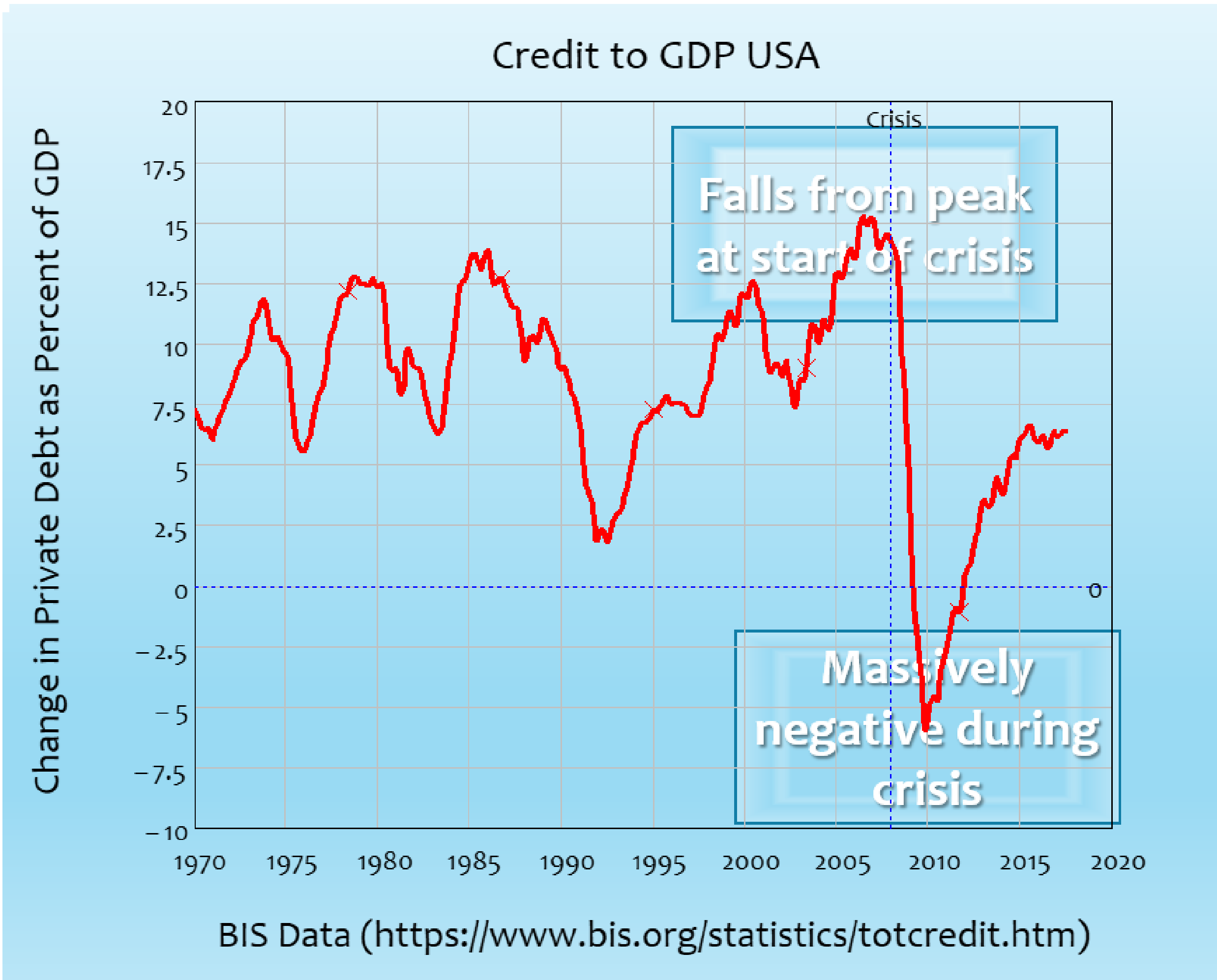


Chart #6



Credit to GDP USA
Change in Private Debt as Percent of GDP
20
17.5
15
12.5
10
7.5
5
2.5
0
−2.5
−5
−7.5
−10
1970
1975
1980
1985
1990
1995
2000
2005
2010
2015
2020
Crisis
Falls from peak at start of crisis
Massively negative during crisis
0
BIS Data (https://www.bis.org/statistics/totcredit.htm)