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The 'real' cliff isn't just a metaphor

Hole left in economy from credit bubble implosion is so large that no increase in money supply could fill it

FINANCIAL FOCUS

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No, the end isn't near; it's already here. It's here in the sense that the debt-fueled, outsized economic growth of the last 30 years is gone, done and dead.

This will be replaced in the foreseeable future with the new norm of gross domestic product growth somewhat less than 2 percent. Actually, when the annual $1 trillion of government borrowing and spending is factored in, it's a lot less than 2 percent.

This is the stagnation component of the stagflationary economy we have been talking about for the last four years. It's an economy not technically in recession but growing so slowly it feels stagnant. Job creation is painfully slow, incomes are flatlining and retirees are trying to make it on 1.5 percent muni bond yields. Show me the money.

Unlike in past recoveries, "aging consumers haven't regained their lost net worth and aren't ready to load up on new debt," noted Jason Ma of Investor's Business Daily. They are still trying to climb out from under the mountain of debt they accumulated during the housing bubble. All those lines of credit used to accelerate consumption must now be paid.

This is why, despite its best efforts to the contrary, the Fed hasn't ignited real inflation yet. The hole left in the economy from the credit bubble implosion is so great that even a 300 percent increase in the money supply can't quite fill it.

However, that day is coming. With a new GDP growth rate of less than 2 percent, it is highly unlikely that we will grow our way to economic solvency. And as everyone other than President Obama seems to know, the idea of taxing our way back to prosperity is preposterous. The simple fact of the matter is the U.S. economy has been on unsound footing for years.

With both the government and consumers living far beyond their means since the mid-1970s, real economic growth has slowed to a crawl. Living standards have been preserved largely by excessive and unsustainable debt. This is now eroding slowly but surely.

It is a little appreciated fact that U.S. GDP minus government spending has flatlined in the 21st century. It grew from $9.314 trillion in 2004 to $9.721 trillion in 2010 – a gain of just 0.43 percent. At this rate, the private sector of the U.S. economy would need 167.4 years to double.

But perhaps this is how the Obama administration and like-minded individuals want things. The less the private sector can do, the more government must do. Socialism, anyone?

In turn, this will result in greater government spending financed by even more debt. Government debt has soared from $5.807 trillion in 2001 to $13.561 trillion in 2010, a surge of 133 percent. In other words, the national debt compounded 3,000 times faster than growth in the private sector.

At this rate, the U.S. government in the foreseeable future will "have no practical choice but to meet its obligation by printing the money it needs," according to John Williams of Shadow Government Statistics. Under such conditions, the U.S. dollar would suffer rapid debasement and inflation: As a matter of logic and arithmetic, the danger of runaway inflation or hyperinflation is becoming uncomfortably high.

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The longer that this situation persists, the greater the likelihood is that some unforeseen event or series of events will trigger an emergency that an essentially insolvent government will no longer be in position to respond to. In turn, this will mean widespread financial losses, hardship and, if history is any guide, political instability.

This may then result in Kirchner-style asset confiscations by the political class. They are always slow to accept responsibility and quick to find a scapegoat.

It should be clear by now to all clear-thinking individuals that debt stimulus no longer stimulates and time is running out. The real cliff looms nigh.

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