An Infinite Amount of Money

By John Mauldin | March 6, 2013

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The three major blocs of the developed world are careening toward a debt-fueled denouement that will play out over years rather than in a single moment. And contrary to some opinion, there is no certain ending. There are multiple paths still available to Europe and especially the US, though admittedly none of them are bright and carefree. There are very few paths available to Japan, as they have skipped too far down the yellow brick road of debt. None of Japan's remaining paths have good endings. In the US, even as numerous voices declaim on the crisis that awaits if we don't act, there is seemingly no collective will to actually do anything as yet. Perhaps it will take… a crisis. In Europe, the peripheral countries can already be said to be in crisis.

This week we will look at the mindset that ignores warning signs, and reflect on a hard-to-believe comment from Mayor Bloomberg of New York. It is a teaching moment that does not bode well for my hopeful outcome in the US. Meanwhile in Europe, the risks have been heightened with the recent vote in Italy. We must remember that Italy is the world's third-largest issuer of bonds – its problems matter on the world stage. While it may all be *molto divertente* for those of us sitting on the sidelines, the potential consequences are anything but amusing.

But before we get going, if you are a qualified purchaser or an investment advisor in the US, I would like to invite you to listen in as I interview Jacob Gottlieb, CIO of Visium Asset Management, on Tuesday, March 26 at 12:00 p.m. EDT, 9:00 a.m. PDT. Visium is one of the premiere long/short multistrategy managers in the investment industry and of great interest to me. I will ask where they are finding alpha opportunities today, as well as share my own thoughts on the global economy and outlook. This discussion will be hosted by my partners at Altegris Investments. Please register for this exclusive webinar through The Mauldin Circle. If you are already a member of the Mauldin Circle and a qualified purchaser, you will receive an email invitation to the webinar. A replay will be available to registrants unable to attend. I apologize for limiting this discussion to qualified purchasers and investment advisors, but we must follow the rules and regulations. (In this regard, I am president and a registered representative of Millennium Wave Securities, LLC, member FINRA.)

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I am often asked, "How can anyone not see the problems of growing debt in the US? Why can't we get a consensus to change?"

Part of the problem is that too many in power just don't see the impending crisis that you and I see, or at least they don't see the need to act now. That is changing – or so I thought until I read a most inexplicable statement by the billionaire entrepreneur mayor of NYC, Michael Bloomberg. This is the sort of thing that causes me to despair. Here we have a supposedly (well, relatively) fiscally conservative politician, someone who is no stranger to financial circles, giving us these off-the-cuff remarks last week, commenting on whether sequestration will affect the NYC budget:

> "It depends on how long," Mr. Bloomberg said on his weekly WOR radio show with John Gambling. "If it lasts a few weeks, no. If it [lasts longer], yeah. We get 10 or 12 percent of our budget from the federal government, not all of that is going to be cut back, but there would be effects – not good effects. But in the context of, 'Is anything going to change tomorrow? Are we going to run out of money tomorrow?' I'm sure I'll get that question at the [next] press conference. No."
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> Furthermore, while saying the federal deficit does indeed need to be curtailed, **Mr. Bloomberg argued the United States could owe "<u>an infinite amount of money</u>"** and there is no specific amount that would cause the country to default.
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> "We are spending money we don't have," Mr. Bloomberg explained. "It's not like your household. In your household, people are saying, 'Oh, you can't spend money you don't have.' That is true for your household because nobody is going to lend you an infinite amount of money. **When it comes to the United States federal government, people do seem willing to lend us an infinite amount of money**.… Our debt is so big and so many people own it that it's preposterous to think that they would stop selling us more. It's the old story: If you owe the bank $50,000, you got a problem. If you owe the bank $50 million, they got a problem. And that's a problem for the lenders. They can't stop lending us more money." (Observer.com)

I am not sure what his understanding of the word *infinite* is, but I am pretty sure he is not using the word to mean "limitless or endless in space, extent, or size; impossible to measure or calculate." In the few times I have met him, he has seemed quite reasonable and in command of the English language. I think he was speaking in a metaphorical sense, as in, there is (to his mind) no practical limit. I certainly hope he was.

I am reminded of former Vice President Dick Cheney's comment that "deficits don't matter." He is right, if the deficit never grows past the rate of the growth of the country (nominal GDP). It might not be wise to approach that limit, but it would not necessarily be a disaster. And, to be charitable to Cheney, I'm sure it never occurred to him that the US could run a deficit close to 10% of GDP. Such a notion would have been preposterous to him. Unthinkable. The US government would pull back from anything even close to that. And that remained true – until it happened and we didn't pull back.

And that is the problem. Too many of our leaders do not yet think we have approached the limit – hey, we're not to infinite yet! The political and economic repercussions of restraining ourselves are just too difficult for some of us to resist pushing the limits a little further. Too many in the current administration appear to truly believe that even minor spending cuts (and I mean just cuts to the increase in spending, not actual cuts!) will bring about calamity.

Spending cuts will indeed reduce potential GDP in the short run. And for most politicians, the short run is the world they live in. But at some point, the short run gets longer, and as infinity approaches the bond markets get very antsy.

Greece protested against the austerity imposed on it. But what choice did it have? If it did not cut its budget, the rest of Europe would not fund the new debt the country needed. It is not a God-given right for Greeks to expect Germans (and the rest of Europe) to fund their lifestyle. So the bond markets simply stopped funding Greek debt. Unless the Greeks had agreed to austerity (known in some circles known as "reality"), the budget cuts would have been far larger, as Greece cannot print its own currency. The rest of Europe gave Greece money to avoid the potential debacle of a disorderly exit from the euro, but they did extract a price. The object of the process was to get Greece back to a place where it could fund itself with a smaller government budget. (More on that subject later.)

Austerity is not fun. Ask any teenager whose parents have set limits where previously there have been few or none. Tantrums ensue. It is kind of like the five stages of grief: denial, anger, bargaining, depression, and acceptance. Except that when you are talking about seriously over-indebted governments, the depression (pardon the pun) can last a lot longer than any other stage.

Bloomberg and those who think like him project our current experience into the far future. "Look at interest rates," they say; "they are telling us the markets are just fine with the levels of US debt and the deficit." And they are right; there are no bond-market issues now. But those of us with an eye on history know that is not unusual. Bond markets are typically sanguine right up until the ***BANG!*** moment. Then they are not. Bloomberg is right to say that there is no specific amount of debt that would cause the markets to cease funding us. Would that there were some convenient, unmistakable line we could see as we approached it. But the experience of over 250 debt crises over the past few hundred years tells us that there is no specific point when the markets lose confidence in a government's debt. When it happens, though, it is ferocious in its intensity.

That is why I and others are so deeply worried about Japan. The level of denial is majestic. The newly nominated governor of the Bank of Japan, Haruhiko Kuroda, has openly espoused the printing of money and monetization of debt. And Kikuo Iwata, one of the government's nominees for central bank deputy governor, said the Bank of Japan should buy longer-term bonds to help it achieve a two-percent inflation target.

They both suggest that the monetization planned for 2014 under the old regime could be accelerated into the present. As if to reinforce the perception that Japan can borrow an infinite amount of money, the yield on Japan's ten-year bond has fallen to 0.585%, the lowest in a decade.

If the bond market is so compliant in the face of imminent massive monetization, what could possibly go wrong? The amount of debt Japan has amassed has now topped one quadrillion yen. Not trillion with a "T" but quadrillion with a "Q," which coincidentally also begins the word "questionable." You can see for yourself how confident bond buyers are, in this chart:

Japanese Ten-Year Bond Rates: Down 2/3 in 4 Years

Infinite means "without limit." If Japan can borrow such sums at a 240% debt-to-GDP ratio, the thinking surely goes, the US can borrow a few trillion more – or perhaps even an infinite number of trillions. And we have such a long way to go before we even get to a quadrillion!

I warned in *Endgame* two years ago that the markets could lose patience in 2014 if they do not see a serious attempt to curtail the US deficit. The recent gold standard for a bearish mindset, my friend Nouriel Roubini told me he thinks I am being too pessimistic – we can probably get through to 2015.

If we do indeed see some movement toward deficit reduction, then our date with destiny can be postponed for quite some time. If over time we can bring the deficit back to below nominal GDP, a true debt crisis can be averted. If pressed, I am sure Mayor Bloomberg would now express regret at using the words *infinite* and *debt* in the same sentence. I doubt he actually believes what he said; rather (I generously assume), he was trying to make the point that the current sequestration will not bring on a debt crisis.

Until we get enough leaders to press the point, leaders like Simpson and Bowles, *et al.*, we will dig an ever-deeper hole for our children; and if we don't stop digging pretty soon, we will find ourselves in that hole. Past performance is not indicative of future results: it is not preposterous to think there might be limits.

Et Tu, Italy?

Only last year I was a mild-mannered euro skeptic. My default position was that the eurozone would break up, at least partially, due to economic strains and the unwillingness of nations like Germany to write checks and endure outright monetization. If Germany *et al.* relented, then I would have to change my position.

Germany has clearly gone along with monetization (while protesting all along the way). I now assume that the eurozone will somehow stay together unless and until we see a political event that creates an exit crisis for some country. The will of European leaders to keep the euro experiment alive at all costs is impressive. Now, the cost of a breakup is almost unfathomable. A breakup is not impossible, but oh dear gods, what a cost. It is now probably cheaper just to continue to bump along, forcing austerity where one can. That is certainly the default political position in most of Europe.

For now, "austerity" is a bad word. It has been openly forsaken in France and Spain. There are massive demonstrations in Portugal. Greece has gone about as far as it can politically for the time being. The Dutch government finally conceded on Thursday that it would not meet the budget-deficit target set by the European Union this year, due to its weak economy and a reluctance to make more cutbacks.

I see two threats to the euro. The first is France. Its budget deficit and economy are getting worse, and so far all French attempts to maintain the EU deficit target have been cosmetic, much to the frustration of Germany, which has brought its deficit down to 1%. However, Merkel does not want a crisis before her elections in September, so she is giving a pass to France and Italy. But that is a topic for another letter.

The second threat is the possibility of a political crisis in a country where an anti-euro government takes actual control. Right now that seems unlikely to happen, but the recent election in Italy has given European elites a case of indigestion.

Some German leaders (pointedly not Merkel) spoke openly and derisively of the success of those they called the Italian "clowns," speaking of aging comedian Beppe Grillo and his Five Star Movement and the even more aged (76) conservative leader, playboy, and billionaire Silvio Berlusconi, he of "bunga bunga" notoriety, who has refused to go away, to the consternation of much of the rest of Europe.

Italian politics are always difficult to fathom, even for Italians. When I am on vacation there and ask the locals questions about what is likely to happen, I am met with confused shrugs (at least in Tuscany). I don't get the passionate lectures I heard in Greece or Spain.

The center-left coalition "won" the lower house with 29.6% of the vote. Berlusconi's coalition won slightly less, at 29.2%. Under the Italian Constitution, which makes the US electoral college scheme appear sane, the party with the most votes gets an automatic 55% of the lower house. So with less than 30% of the vote and a win of just 0.4%, the center-left now controls 55% of the votes in parliament. But the Senate, which has equal power, is not apportioned the same way, and there Berlusconi won control. Unless some grand coalition can be finessed, there is no government that can be formed. Anatole Kaletsky writes at GaveKal:

> This is not to say the situation is not pretty messy! The big winner of the Italian election is obviously the protest vote, as illustrated by a 5% rise in abstention, and, much more importantly, a super strong 25% score for Beppe Grillo's Five Star Movement, a new party founded by geeks and bloggers with an anti-everything discourse (anti-Monti, anti-Berlusconi, anti-euro, anti-establishment, anti-debt repayment, anti-markets, etc.). Ex-comedian Grillo (who is not himself a candidate) has succeeded in gathering protest votes that were usually spread between the extreme-right and the extreme-left.
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> While the center-left party of Pier Luigi Bersani took 29.6% of the vote (with more than 99.9% of ballots counted) in the lower house, a touch more than Silvio Berlusconi's 29.2%, Italians have sent a clear message of protest against fiscal austerity, and against tax hikes in particular. Mario Monti's new party got just 9% of the vote in the lower house, and Berlusconi and Grillo's combined vote is roughly 55%.
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> These split votes mean the emergence of a new government in the eurozone's third largest economy is going to be extraordinarily problematic. Moreover, new elections cannot be called before late May at the earliest, since the president of the Republic (elected for seven years in May 2006) does not have the right to dissolve during the last six months of his mandate. In any case, new elections may not be what the establishment would want (Berlusconi included) since it would fear an even higher score by Grillo.
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> One possibility is a Bersani/Berlusconi grand coalition. This seems crazy, but after all the two parties "governed" together in 2012, since they were the two main supports to Monti's technocrat government – until Berlusconi's party withdrew its backing in a well-calculated move to campaign on an anti-austerity theme in the elections. Another possibility is a coalition between Bersani and Grillo's Five-Star Movements – bizarre, but who knows with Italy? Whatever the solution, nothing will come easily – and there is the risk that a new market crisis might be a pre-condition for a coalition to be formed.

Anatole's lifelong friend and partner, Charles Gave, sees the Italian elections much differently. He points out that a majority of voters selected parties openly anti-euro as well as anti-austerity. And I agree with him: that is the apparent outcome. However, when you look at polls, the 25% that Grillo won was clearly a youth protest vote. The vast majority of the Five Star Movement's voters were under 50 and many under 30. The message was one of protest against the corruption of the current system as well as frustration with the technocrat government (which Berlusconi initially supported, before his polls numbers rose and he decided to stand in an election that he came within a hair of winning). The current prime minister, Mario Monti, got just 9% of the vote – a resounding rejection.

Grillo is an odd character. He refuses to talk to journalists. Italian reporters who have telephoned him and asked to speak to the general secretary of the party claim he has told them, "Hang on, I'll just pass you to my 12-year-old son." He said Italy was in such dire economic straits that "In six months, we will no longer be able to pay pensions and the wages of public employees." He has called for a total repudiation of Italian debt (otherwise known as default).

In an interview with a German magazine, Grillo warned that "if conditions do not change" Italy "will want" to leave the euro and return to the lira. I refer those who are interested in the lurid details to a [story in the *Telegraph*].

Like the Greek Syriza Party, which had to back off its earlier positions with regard to leaving the euro, Grillo may find that he cannot hold his coalition together if the real possibility of his governing ever materializes. He has refused to entertain being part of any coalition government, calling the center-left winner Bersani a "dead man talking." Not exactly the stuff of which coalitions are formed. One young lady responded by starting an online petition to demand that Grillo not "waste" her vote, and work with Bersani to form a coalition government. In just a few days, she has already had 150,000 5SM voters sign her petition. Waiting six months for another election without a government would not exactly make for inspiring theater, and while no one likes the current government, the voters apparently like chaos even less.

If a grand coalition cannot be formed, it appears another election will be held this summer. And while the concern in Europe is that Grillo might even get more votes, it is also possible that his intransigence and unwillingness to capitalize on his surprise upset will cost him voters.

Throughout Europe, where austerity has been the order of the day there have been protest votes. But will the anti-euro forces actually be able to muster a firm majority? Not so long as Merkel allows relaxation of the Fiscal Compact, as she apparently has. The impetus for protest will wane and find another focus besides withdrawal from the euro.

But we need to keep an eye on these nationalist movements and an even closer watch on France. President Hollande has slumped in the polls to a 30% approval rating just ten months after his election, making him the most unpopular president in 30 years. He seems to feel that France can borrow an infinite quantity of euros. It will be a race between Hollande and Japanese Prime Minister Abe to see who can lose the confidence of the bond market faster. From my perspective, they are both running hell-bent for leather.

Incidentally, Anatole Kaletsky and Charles Gave will both be at my 10th annual conference, May 1-3 in Carlsbad California, cosponsored by my friends and partners Altegris Investments. Louis Gave will join them on a panel that I will moderate. Having appreciated the vigorous disagreements between Charles and Anatole, and knowing how passionate Louis is, I think that will make for a fascinating panel. To my knowledge, it is the first time they have appeared together other than for their own client conferences. I am honored.

They will be joined by Kyle Bass; Ian Bremmer; Mohamed El-Erian; Niall Ferguson and his wife, Ayaan Hirsi Ali; Lacy Hunt; Jeff Gundlach; David Rosenberg; Nouriel Roubini; and Gary Shilling, plus a few surprise guests. This will indeed be the macroeconomic event of the year – you seriously need to think about coming. The conference is getting close to capacity and will likely sell out, as it has the past four years. I always seem to have people frustrated with me when I can't find them a spot, but we really do have a hard limit on attendance, imposed by the size of the hotel. Next year we will move to larger quarters, but if you want to come this year you need to stop procrastinating and register.

We offer an early-bird registration, which is about to run out. Because of security regulations, we do have to limit attendance to accredited investors and those in the securities/investment business. You can start the process by going to the [Strategic Investment Conference page]. I hope to see you there.

Oh, and I have just arranged for registrants to have access to the private research of many of our speakers for the two months prior to the conference. That in itself is worth the price of conference admission.

Moving, Argentina, and Sonoma

My bags are packed, kind of. The movers come this Thursday to empty my house and put everything in storage while we wait for the new digs to close. Apparently, my loan for the new place has been approved, which is a good thing, as I am committed to moving. Hopefully I will not be in a local hotel too long before I can move in, though I know I will be there for at least a few months, until we can combine two apartments into one more comfortable place. The process is longish, but I think the result will be worth the hassle.

I leave Thursday night for Cafayate, Argentina, to be with my friends and partners and a fun group of their friends. As a special treat, I will finally get to go to my old friend Bill Bonner's (he of *Daily Reckoning* fame) estancia in the Andes near Cafayate for a few days. I am excited about that, and it will be nice to catch up with Elizabeth as well. It has been too long.

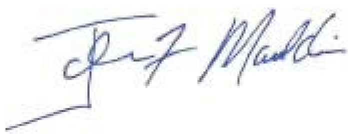
I will be speaking at a special one-day event in Sonoma, California, on April 5. My friend Mike Shedlock is holding a charity fundraiser to support research into ALS (Lou Gehrig's disease). Sadly, Mike's wife died last year of ALS, and his commitment to a cure is worthy of support. John Hussman, who is among the notables that are speaking (your humble analyst is there as comic relief), has generously offered to match up to $100,000 in conference registration fees. I have often exchanged notes with John and really look forward to meeting him. You can find out more at Mish's Conference.

I am going to take most of the next two days to try and reduce the pile of things that I keep moving from place to place. Over the years, we all tend to accumulate stuff we somehow just can't let go of. My closet is filled with clothes I have not worn in five years, or even in three. Shelves sag with so many books I will never even have time to touch again. Drawers are stuffed full of items I couldn't imagine parting with at the time. Knickknacks I just don't need are perpetually on the increase. I keep trying to get the kids to take more, but they know extraneous material (otherwise known as junk) when they see it.

The hard part will be to stay focused as I stumble on memories I don't want to lose, in the form of treasured relics of an event or time past. That first card from one of the kids. Photos. Handmade gifts that are priceless. My intention is to leave with less than I came in with for the first time in decades of moving. We will see how my resolve holds up. I mean, I might want that sweatshirt someday. And that suit and tie might come back in style; you never know.

Have a great week. I look forward to a night in Buenos Aires before flying to Salta and driving through the majestic canyon that leads to Cafayate. I intend to finish my part of a book, lose a little weight, and enjoy my time with friends. And I will write next week, as always.

Your ready to move on analyst,



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