THE INFLATION TSUNAMI

Are we about to be hit by an inflation tsunami? Already, exuberant markets are taking a step back from the Trump victory to assess the reality of what may be ahead. During the post-election honeymoon; stocks rose, subsiding fears halted the rush into safe-haven bonds, and the prospects of a Fed rate hike increased. Now the honeymoon is over as bond gurus, Fed officials and a host of economists and business leaders begin to weigh in on the realities ahead. Let the tug of war begin.

Now, connected by a giant rope and positioned on either side of a fiscal canyon, each side is determined to prove that its plan will not be the one that allows the economy to be dragged over a fiscal cliff.

Pulling from one side are those who ignore the realities of the challenges created by past policies.

On the other are those who remind us that policies of the past have created a wall of debt that can never be scaled or skirted by more spending and ballooning deficits. The more things change the more they stay the same.

REALITIES POSED BY POLICIES PAST

To say the challenges posed by past policies are daunting, would be like calling Niagara Falls a rushing creek. Let's examine some of these realities.

Debt per Taxpayer – The amount of national debt per taxpayer now exceeds **$165,000**. Currently, only 46.7% of the nation's population works.

Federal Benefit Recipients – More than half the population **(nearly 163 million people)** now receive some form of federal benefit. That number increases steadily as nearly 10,000 baby boomers per day reach retirement age.

Non-Discretionary Spending – Currently, **86% of all Federal Tax Revenue** is allocated to the payment of entitlements, federal pensions, federal welfare and interest on debt.

Medicare and Medicaid Payments – Combined, these current annual payment obligations, totaling **$1.125 trillion**, now exceed all of the **$1.119 trillion** in current projected annual payroll taxes collected. In addition, projected annual social security payments of **$915 billion** remain totally unfunded by payroll tax revenue.

Unfunded Liabilities – The total obligations of federal government to fund Medicare, Medicaid, social security, federal welfare and federal pensions now exceeds **$104 trillion.**

Total U.S. Debt – The total U.S. debt to include, household, business, state and local governments, financial institutions, the federal government and unfunded liabilities now exceeds **$170 trillion dollars.**

Derivative Debt – Now totaling **$585 trillion**, derivative debt is essentially an insurance bet that must be paid off in the event the underlying financial instruments default.

(Data above derived from USDebtClock.org at the time of this writing – December 2016)

American Dream Dashed by Unfunded Liability Nightmare

The financial burden placed on working citizens today by unfunded liabilities is so large it is unimaginable. Politicians don't dare discuss it for fear of losing votes. Economists have no clue how to deal with it in the normal sense of funding the debt. And, accountants remain silent for fear of reprisal against the messenger. But, make no mistake, the current unfunded liabilities of the federal government have rendered our country all but bankrupt.

Let me illustrate how an unfunded liability comes into existence. Let's say I borrow $1,000 per month from you and tell you that I am going to invest it for you in order to fund your retirement. Each month I take another $1,000 and each month my liability to pay you back increases by $1,000 plus interest on all of the $1,000 payments you have made.

Month after month the routine continues. Little do you know, however, that each $1,000 I have taken from you has gone to pay back someone else who began giving me $1,000 per month years prior. In simple terms, the $1,000 per month you have given me has not gone into a fund to be saved and invested to pay you back. Because I collected it from you to pay someone else back, it created an unfunded liability.

Today, that unfunded liability amounts to $872,000 per taxpayer. That is the amount of money government would have to collect from each taxpayer to make good on all the money taken from citizens in the past to invest for their retirement. Clearly, past policies of more spending and increasing debt have brought us perilously close to the edge of the fiscal cliff. Will more of the same finally drag us over?

The Tug of War Begins

Reluctantly, both sides appear to have resigned themselves to the reality that there will be an enormous increase in government spending. While many purport to know exactly how much increased spending there may be, the estimates range from an additional $5.3 trillion to $10.1 trillion over the next decade. Coupled with proposed tax cuts, some estimate our national debt could increase by as much as $15 trillion over the same period of increased spending.

A Path to Default

One side insists this will lead us to a point of no choice. We will finally have to default on debt. There is evidence that fear of this is growing among foreign investors. China and Russia have been dumping U.S. Treasurys for months. Since the election, bond prices have plummeted while yields have made a violent move to the upside, suggesting the rate at which foreign investors are dumping bonds has dramatically increased. If fear of our default is truly the motivating force behind this accelerated rate of bond dumping, then more spending and more debt is sure to seal our fate. One could argue that by the time we reach a point where we must borrow money just to pay for entitlements and interest on our debt, (non-discretionary budget obligations) is in truth a de-facto default. Hence, the position that more spending must be accompanied by higher taxes.

The Inflation Tsunami

On the other side are those who believe that, this time, massive new spending accompanied by lower taxes will work. Unlike policies past where money was printed to bail out big banks, big business and big insurance, the spending proposals under the new President will be geared toward creating jobs for the under-employed and the middle class. We will rebuild the economy from the bottom up instead of the top down. No more bailouts and bonuses for the rich. The anticipated byproduct of such effort will be an inflation tsunami, now affectionately dubbed Trump-Flation. Hence, the position we can inflate our way out of debt.

Which side will win?

The reality is, for those trying to choose an investment direction, it does not matter. If more spending leads to default; stocks, bonds, and the dollar will collapse and destroy the purchasing power of your savings and retirement accounts. If it leads to massive inflation, that too will rob your savings and retirement of purchasing power.

In 2009, at the height of the last crisis - or depth if you prefer - inflation ran as low as -2.1% according to official inflation data. In 2011, inflation-driven by government stimulus, peaked at the official rate of 3.9%. Unofficial data suggests real inflation was much higher. Regardless of the numbers you want to rely on, during this time [2009 – 2011] we saw gold prices double and silver prices quadruple.

The intent of stimulus then was the same as it is today: let's inflate our way to growth and recovery by increasing spending and raising debt. The question now is no longer ***"Which side will win?"***; the question is ***"Will you win if the inflation tsunami hits?"***.

Resources

http://www.multpl.com/us-gdp-growth-rate/table/by-quarter

http://www.usinflationcalculator.com/inflation/current-inflation-rates/

USDebtClock.org