ARMSTRONG ECONOMICS™

by MARTIN A. ARMSTRONG

Behind the Curtain, there is a far better understanding of interest rates and inflation that you will never read about. The traditional reasoning is that interest rates rise with expectations of inflation. Some use money supply growth and then argue inflation lags behind by typically 3 years. The anti-inflation crowd point to M2 growth being 1% for the last 12 months to boost their claim of no-inflation. Common sense clashes with this view and the result is confusion.

The problem as always comes down to the Western nonlinear thinking that just has this need to reduce everything to a single cause. Everything correlates to everything else. Building the largest computer model that ever existed mapping the entire World Economy, enabled me to see things at a much deeper level. I had a front row seat to observe what was going on. Correlations go through their own cyclical movement so the problem boils down to the fact that no correlation is permanent.

The unsound finances began in 1962 and that led to a continued trend toward higher interest rates for a 17.2 year trend that culminated in the April 1981 high with a low in the dollar. As rates declined, the dollar rose to record highs into 1985, but rates bounced back for 1987 and then moved progressively lower into the final low using the 10 year T-Bond in December 2008, a 27 year decline. Only upon close inspection will you find that the core reasoning has flipped numerous times. The thrust into the low for 2008 had nothing to do with inflation, but with a flight to quality. That same view in its opposite drove the dollar down into 1981 not because of inflation, but because the US Nat'l debt hit $1 trillion as did the Eurodollar market that sparked fears the US would create a two-tier currency replacing external dollars with a new color worthless than the green domestic. That flight to quality caused cause deposits to flee overseas and buy domestic dollars driving the greenback to record highs in 1985 where the pound fell to par and that would put the Euro in theory at 48 cents back then, when the DMark hit 25 cents. The moves of rates only at times have reflected inflation. There are other times it has been a confidence factor just as there is a default risk in Greece creating a premium not related to inflation.

On a chart of 10 year rates, taking the mid 1970's high and tieing that to the 1985 low, we create the long-term Break line which we fell below and now stands at 4%. Once the 10yr Rate moves above 4% and supports on that level thereafter, we will be changing Trend, Long-term. This will NOT necessarily have anything to do with inflation, but country risk. That is the fear behind the curtain. Breaking above 5% will warn sovereign debt fears are rising.

A monthly closing on the 10 yr T-Bond below about 109.40/64, will be the bell ringing. Inflation has not shown up because the deleveraging with the 2007 high in Real estate (the biggest investment market) has been massive. The banks are reluctant to lend and borrowers are cautious. Adding $2 Trillion did not create inflation because of it has only matched the deleveraging.

The inflate-your-way-out fears are real. But that comes with the sovereign debt crisis. As capital flees bond and goes to the private sector, we will see asset inflation, but this will NOT be created by a booming economy. It is possible to see rising unemployment and assets just as took place between 1932 and 1937.

The TWO primary movers-and-shakers are (1) inflation in normal times, and (2) the flight to quality in times of turmoil but the quality is at times government and at other times the private sector. It is NEVER a one dimentional relationship. It is a dynamic swing back and forth. This is why the pundits offer more confusion than real insight. These ideas of reducing everything to a flat one dimentional correlation does not hold water.

We are headed in a collapse of socialism. Not that creating a safety net was wrong, but the management of borrowing to fund deficits has propelled the debt cycle leading to a collapse in confidence that will lead to civil unrest as we see in Greece. Our way of life is coming apart and government thinks throwing me in the hole will prevent the trend. You cannot silence a trend.

America's #1 Political Prisoner
Martin A. Armstrong