Retirement Lifestyle Advocates

RADIO PROGRAM

Expert Interview Series

Guest Expert: Karl Denninger
Market-Ticker.org

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Dennis Tubbergen:

Welcome back to our RLA Radio. I'm your host, Dennis Tubbergen. Joining me once again on today's program is returning guest, Mr. Karl Denninger. Karl is a prolific author and commentator. You can read his work at market-ticker.org. And when you go to the website on the right-hand side, there is a link that reads, "CLICK what THE MEDIA does NOT want read." There's some good stuff there as well. Karl, welcome back to the program.

Karl Denninger:

Well, thank you very much for having me.

Dennis Tubbergen:

Well, Karl, let's just jump in here and talk about all the excitement, for lack of a better term. We've seen in the banking sector, Silicon Valley Bank, followed by Signature Bank, the Fed back stopped these depositors, so even the uninsured depositors are going to be made whole. What's your forecast? Is this an isolated incident or in your view, or are we going to see more of this?

Karl Denninger:

The Silicon Valley and Signature Bank, really two of the same things. Everybody tries to play these signal to the SVB thing as being a one-off out in Silicon Valley, and to some extent it was in that they were a funding conduit for startup firms. So, you need to understand how banking generally works and that there's a whole lot of banks. And so, you borrow money to buy a truck from one bank and you go to the car dealer, and you buy the truck, and the car dealer deposits your check in a bank, but it's probably not the same one that you've got the loan from. And so, this transaction flow happens millions of times a day, obviously from everything, from buying groceries to coffee to whatever, and all of this gets balanced out. And those banks that have an excess of cash lend it to the ones that have a shortage.

But over time, tomorrow the flow goes the other way because someone else borrows money from the other guy. And so, it all kind of evens out. But when you have your business concentrated in one place as a financial institution, which SVB did, there is no flow that comes back in except through new deals. And so, you are the checkbook, you're the place where the startup company has their cash account from which they pay wages, every Friday is payday. And so, these guys get paid, and they go spend that money. Well, that money leaves SVB, how does it come back in? So, unless somebody comes in, deposits and the people that work there, they don't have checking accounts with SVB. So, the local grocery store doesn't have a deposit account there. So as long as there are deals that are constantly being done, this flow is at least somewhat reasonable.

But otherwise, what ends up happening is this institution has to go into the overnight money market every night and has to borrow funds in order to make their books balanced so that they have the reserves, and they can make payroll tomorrow for the next company. Well, if you do that for long enough, you're going to go broke. I mean, because it's a one-way flow. You don't get any of that cash ever, you're constantly paying it. And it's like anything else. I mean, if you lose a penny of transaction on every transaction, no matter how much you start with eventually a zero. And then to compound the problem, the loans that these guys wrote were mostly to the insiders and all in very heavily over-levered real estate markets, like out in San Francisco and stuff like this. So, they had a 30-year paper that was written at when interest, you could get a 30-year mortgage at two and three quarters or 3%. Now that same mortgage is six.

And so, if there's the average mortgage prepays out usually in about seven years, but when rates go up, people don't move as often. So, they stick on your books for a lot longer. And if let's say you have seven years left of this note before, it is probably going to pay off and there's a 3% difference in the rate of today's mortgage and yesterday's mortgage, well, sometimes 3 is 21%. It's not exactly that because there, it's actually an exponential function, but it's close enough. So, if you want me to buy that mortgage from you that you wrote for $300,000 or 600,000 or out in California, good God, it might be a million and a half, right? I'm not going to buy it from you unless you'll give me that 21% discount because I can buy the 6% one and get the higher amount of interest.

Why would I buy yours? That would be stupid. Nobody in their right mind is going to buy a mortgage bond at 3% when they could have one at six, unless you give them the discount so that the total amount of money, they make is the same. Well, what happens when this bank has to go? People start withdrawing their money and the bank has to go and sell these bonds whether they like it or not, because that's their assets. And oops, they're worth 80% of what they were worth when they wrote them. Okay, so that's how that failure happened. The 900-pound gorilla in the room is that this was obvious if you looked at their balance sheets back in the third quarter of last year, that this was going to occur. And the law is that the government, the FDIC and the state regulators along with OCC are supposed to step in when that kind of thing happens and stop it and say, you must liquidate the stuff.

You must do it now because if you don't, you're bankrupt. And so, no, do not get to sit on this for another six months and see if it fixes itself. That's not how... We don't allow people to do that kind of thing. Well, they did allow people to do that kind of thing, and that's what happened. So, the Signature Bank out in New York was doing essentially the same sort of thing, but they were doing it largely with cryptocurrency-based projects. And so, again, it was a one trick pony. There was very little balancing flow that was going on and off. And as a result, when people wanted their money, they had to try to sell these assets, which were all at ridiculously large discounts as a result of just the fact that they were sitting on them. And what the regulator should have done was come in and said, as soon as rates started to go up, they should have said, "Okay, look, you take this loss now it's a 2% loss."

If you sit on this and rates go to 6%, it's a 20% loss. You take the 2% loss, you don't die. But that's not what they did. So, the failure is exactly the same thing that happened in 2008. They had plenty of warning, they didn't do anything about it, and these two institutions blew up as a consequence of that. In point of fact, I don't believe there's going to be any cost at all to the deposit insurance fund. The reason being, there was still a bid on the bonds at SVB, which means the capital stack of the corporation was not exhausted. So, there is no loss to the non-insured depositors, but it could take 6 to 12 months to unwind us. And of course, there'll be costs involved in doing that. The people who own the stock in the bank and that own the bonds, well, guess what? They got zero.

And that's what happens when you buy a company that goes bankrupt, is you get zero. So that's fine. It's the risk of playing in the markets in general. Is this limited there? No, there are plenty of other institutions that have similar exposures but not nearly as bad. There are a lot of people that have been making noise about, for example, Schwab. I can't tell you how many people said they think Schwab is going to get nailed like this. Absolutely no way. I've looked at the quality of the assets that they have. They of course, I mean, that's a huge brokerage, not just a bank. And that one caught my attention when people started flinging that around because that would be a truly nasty situation if it was to arise. And I just don't see any possibility that this kind of a situation can arise with those kinds of institutions. But are there other banks that are out there, including public or traded ones where this kind of imbalance exists? Yes, I'm sure there are because the regulators once again have not been doing their jobs.

Dennis Tubbergen:

So, Karl, do you... And if you're just joining us, I'm chatting to Mr. Karl Denninger. You can read his work at market-ticker.org. I'd encourage you to check it out. You mentioned a comparison to 2008. Are we headed down that same road again in your view?

Karl Denninger:

Well, I think we've probably in a worse set of circumstances than we were in 2008, simply because we went out and did, over the last three years in particular, we did a bunch of really stupid things from a fiscal in monetary point of view. And as a result, the conduits and some of them geopolitical, I mean, the war in Ukraine is part of it, but it's not solely there. The COVID medications that we did, and I'm not talking about the policy things per se. I'm talking about monetary things. The amount of money that was thrown around that we didn't have was all put on the credit card. The dislocation impact that that has had in the currency markets is extreme. And as a result, it has essentially slammed the door on being able to export our country's inflation, which we have been doing for the last 25 to 30 years.

And our Congress has gotten to the point that they honestly think that they can do this on an indefinite basis and spend money in excess of what they tax and not have it show back up in inflation in our economy. And it's never been true, but it's been hidden for a long time by trade balance. And it's just simply that international transactions take a long time to go through. You order something, it takes time to make it, it takes time to ship it. It goes on a boat, it goes on a whatever, and then you get paid for it. And during that period of time, if the value of whatever currency you transact changes on a substantial basis, you could get a windfall, but you could also be bankrupt. I mean, we've seen 20% moves in the value of the dollar in both directions over the last year and a half. And if you think about that, how many businesses have a 20% that make things like steel, copper wire, whatever. How many of those companies can absorb a 20% loss on their invoice and not be out of business?

Dennis Tubbergen:

Right, exactly.

Karl Denninger:

That's not going to happen. I mean, that would bankrupt almost anybody. And so, what you now have is these... You're increasingly seeing this. You're seeing it in the oil markets, you're seeing it in the commodities markets. You're seeing it across the world. People are saying, we do not want to be paid in dollars. We want to be paid in our local currency. Yes, we understand that our government is kind of stupid and they do dumb things, and we have an inflation problem here and da da da, da da. However, we're not going to be bankrupt overnight because there's a 20% change in the exchange rate in the period of time it takes us to make this coil a wire for you.

Dennis Tubbergen:

Well, I want to explore that more in the next segment, particularly the worldwide move away from the US dollar as I perceive it. I'm chatting today with Mr. Karl Denninger. His blog can be read and viewed at market-ticker.org. When you go to his website, there is on the right-hand side a link that reads, "CLICK what THE MEDIA does NOT want read." I'd encourage you to check that out as well. I'll continue my conversation with Karl when our RLA radio returns. Stay with us.

I'm Dennis Tubbergen listening to our RLA radio. My guest on today's program is Mr. Karl Denninger. If you're a longtime listener, you recognize Karl as a frequent guest. I always appreciate Karl's perspective and you can learn more about his perspective by checking out his work at market-ticker.org.

If you're just tuning in, there's a link on the landing page on the right-hand side that reads, CLICK what THE MEDIA does NOT want read. I'd encourage you to check that out as well. So Karl, we started to talk about this at the end of the last segment Worldwide, there certainly seems to be a move away from the US dollar that is accelerating. There are a number of trade agreements bypassing the dollar. India has thrown the rupee out. Now as for consideration as a currency to be used in international trade, the BRICS coalition is growing. Is this the beginning of the end dollar as the world's reserve currency?

Karl Denninger:

Well, if it is, it's a result of our own actions. And I don't know that this whole reserve currency thing is such a... I mean, it's chivalrous of a sort and I have always found it to be a rather foolish way to look at the hegemony that developed around the dollar. Yes, certainly some of it is because we like to swing our weight around, especially when it comes to foreign policy and particularly with oil and things like this. Okay, fine. But the reality of it is that when you look at sovereign wealth, when you look at actual government involvement as opposed to global trade between private businesses, the government side of it is just not the big enough piece to swing the narrative. It doesn't change outcomes. What changes outcomes is the time and value preferences of merchants. And that's what we've destroyed, and we did.

It isn't that the BRICS or somebody else has decided that they're going to spank America. It's not a set of governance that have done this. It is the fact that we have put a volatility into the dollar that has not been there on a historical basis. We caused it and as a result of our causing it, people in the practice of international trade, which an awful lot of the stuff that we buy here in the United States has some origin overseas and this is just the nature of trade. It's always been that way. They want to know when they place that order and they agree to pay. They want to know how much they're actually going to have to pay and what they're going to get if they're the person doing the producing. And if they can't get that in dollars and we don't have superior stability, why would they not take it in rupees or pesos or whatever their particular currency is their own currency because they have some control over that. They have some influence over what their government does. They have no influence over what our government does.

Dennis Tubbergen:

Karl, I was reading, speaking of BRICS, Michael Mahari wrote a piece that there is talk anyway, that the BRICS are developing a strategy that would be a currency rather that would be pegged to gold or some type of tangible asset. And that actually came from, I believe Alexander Babakov, who was previewing this BRICS Summit that's going to happen this summer in August. Is this just talk or do you think we're on the verge of seeing some world currency that has a link to gold and we kind of restore that gold exchange standard system?

Karl Denninger:

No chance in Hades.

Dennis Tubbergen:

I don't even have to ask you what you're thinking or what you mean by that.

Karl Denninger:

Yeah, no, we're on the radio. If we were sitting in a pub with a couple of pints between us, you'd get some colorful language. It was not suitable for polite company, zero chance of that happening. But boy oh boy, are all the gold bugs and the other metal monitor is out screaming about this stuff and they do it about every 5 or 10 years and they've never been right before and they're never going to be right. The basic problem with it is that if you think about the global supply, if you're going to do this kind of thing, you have to have a supply base that these people could draw upon. Okay, so where is the global supply of minable gold? Where is it? And oh, by the way, that's not among all the BRICS. Who would be the ones who would use this? So maybe you can explain to me why any country would put its monetary base in the hands of, oh, I don't know, some dictator in the Congo. That doesn't seem very intelligent, does it?

Dennis Tubbergen:

Well, let me play devil's advocate here for just a second because I'd love to hear what your perspective is when you look at the price of gold, arbitrarily said, at $20 an ounce, which went away for the most part in 1933 here in the States with Roosevelt's executive order. And then when Bretton Woods actually reestablished the link between the dollar and gold, the price was arbitrarily set at $35 an ounce. Why couldn't the price be arbitrarily set at some big number? And I haven't done the research, but just say $10,000 an ounce or whatever the number is.

Karl Denninger:

Why would somebody do that? Well, now, wait a minute. Think about what you just did if you did that. Okay, let's say that you happen to be the dictator of a country that happens to have a nice little gold deposit under your feet and that kind of act takes place. That's about five times the market price today. You just made those people rich beyond the dreams of address. That's insane, nobody's going to do that. It's not going to happen.

Dennis Tubbergen:

Let me along these lines, get your take on another topic, Karl. There's a lot of talk and China's been testing it. Central Bank issued digital currencies. What's the future of a Central Bank issued digital currency here in the United States in your view, if you have a view?

Karl Denninger:

Well, I do. We already have a central bank issued digital currency called the dollar. What percentage of the dollars in circulation today are in the form of paper? Basically none. I mean, okay, there's a fair bit of paper out there circulating, but when you go use a credit card or you electronically pay your power bill from your bank on a webpage, that's digital money. Now, what these people are talking about is essentially a blockchain based thing where these ledger entries, instead of just being ledger entries are digitally signed. There is a tremendous privacy problem there if you get rid of paper currency and small anonymous transactions in that now, the providence of every transaction that has ever been committed by anyone all the way back to the beginning of whenever this thing is formed can be traced and there's no longer a thing called the statute of limitations, it doesn't exist.

It can be looked at 100 years from now when you're dead and be eaten by worms. I wonder whether or not the efficiencies make sense there. And the reason is we already have this kind of a transactional system in the United States. It's called Fedwire. It is if you wire money to buy a house or whatever, that's where it goes through, it's all digital. There's one in general in Europe called Swift. And so, you have those two systems, the Fed is testing an enhanced version of this that is supposed to be faster and more secure. This is probably a good thing from a standpoint of clearing transactions in the United States.

And that right now, the security on Fedwire is essentially physical. And then it's old school stuff, goes back to the days of teletypes and telegraph machines. So, I mean, if that gets brought into the modern world, I don't think is anything all that interesting. But a ledger-based system that is cryptographically controlled has the potential to become very invasive. Because now all of a sudden, we don't need an IRS to actually look at tax returns anymore. They have an instant view of every single transaction that everyone has ever committed within the United States.

Dennis Tubbergen:

So, in the time we have left, as you look around the world at countries that are using currencies, other than the dollar in trade, do you see any currencies that stand out as potential alternatives at this point?

Karl Denninger:

Not really. And one of the biggest reasons for that is that the one that everybody would like to argue could be there would be China with the yuan or the renminbi, depending on how you could characterize it. China's biggest problem is that there really are two Chinese currencies. They're the same, but they're not the same. Try to take a large amount of money out of China and you'll find out all about that. And you won't like the way that you find out about it either, especially if it's something that the central government doesn't want you to do. So, there's real problems with stability there. The Euro, I don't see it as a real stable. The Euro is a poorly conceived currency union without political union. That has never made sense, that it's still more or less survives as surprising. I mean, we all know what happened with Greece and Italy and all that, right?

But they haven't solved the basic problems there that you have wildly disparate funding situations between the users of that currency. So, I don't know that you're ever going to see an international coalition that will coalesce around something that is actually designed in a way that's reasonably stable. Because at the end of the day, if you're going to have multiple political entities that are doing this and it's not one country's currency, then you need to have hard caps on the fact that neither of them can basically siphon off wealth from the other, which is what has happened with the Euro. And that has to be absolutely prohibited, and that means nobody can run budget deficits. Okay, now, well, good luck with managing to get that to work. How'd that work out over in Euro land?

Dennis Tubbergen:

Right. Well, you mentioned budget deficit and we've got maybe a minute and a half or so left in this segment. We have this debt ceiling issue that always seems to get resolved at the last minute. Do you see anything different happening this time here in the States?

Karl Denninger:

Well, history would say the correct answer is no. I will say that Kevin McCarthy has made clear that he will not bring a standalone debt raise to the floor. Of course, we've heard this before, right? How's that going to work? Biden has said he's not going to negotiate the debt ceiling based upon policy. Okay, well, those are two diametrically opposite positions. One of them is going to change, or we're not going to raise the debt ceiling, in which case the government now has to live within what it taxes. That would be a dramatic shift on an overnight basis in the United States. It would be very severe. It would not be the end of America.

And for those people who think it would be, no, it would not. But we have logistics as one example, fully one third of the money the federal government spent last year was spent by CMS. That's Medicare and Medicaid. That's one third, it's over 2 trillion. If you chop out the debt, if you were to stop that, we would be running a huge surplus. So the idea that this problem is unsolvable as fault, it is absolutely solvable. But neither political party wants to do it.

Dennis Tubbergen:

Well, we're going to have to leave it there. My guest today has been Mr. Karl Denninger. His website is market-ticker.org. I would encourage you to check it out. Karl, amazing how fast, almost a half hour goes with you. Thanks for taking time out of your schedule today to talk to us, and we'd love to have you back down the road.

Karl Denninger:

You bet, anytime. Take care.

Dennis Tubbergen:
We will return after these words.