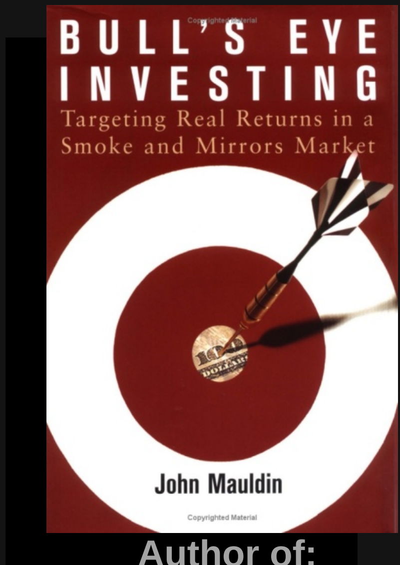


Author of:

Just One Thing

John Mauldin

The End Game

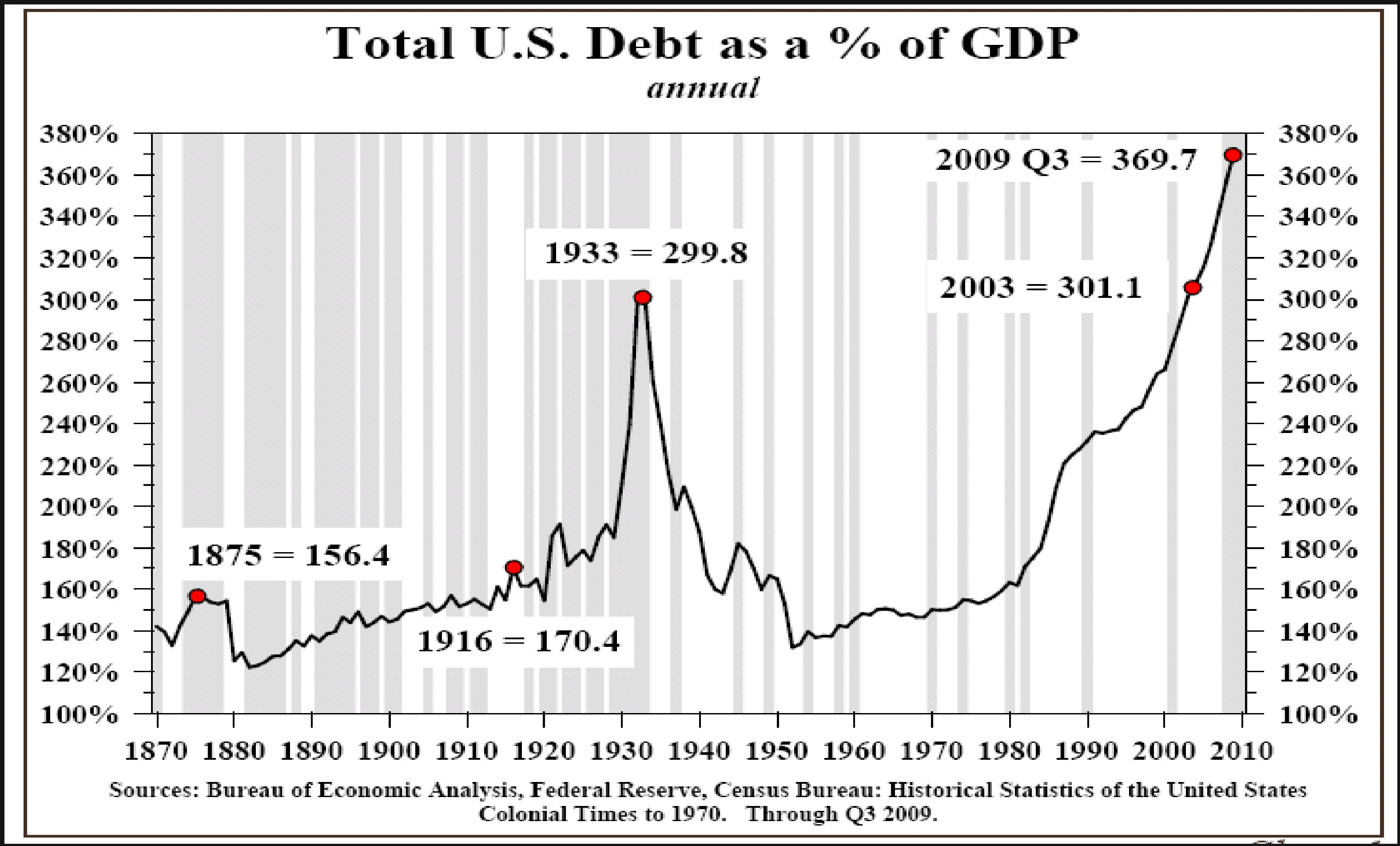
The End of the Debt Super Cycle

Seen in:

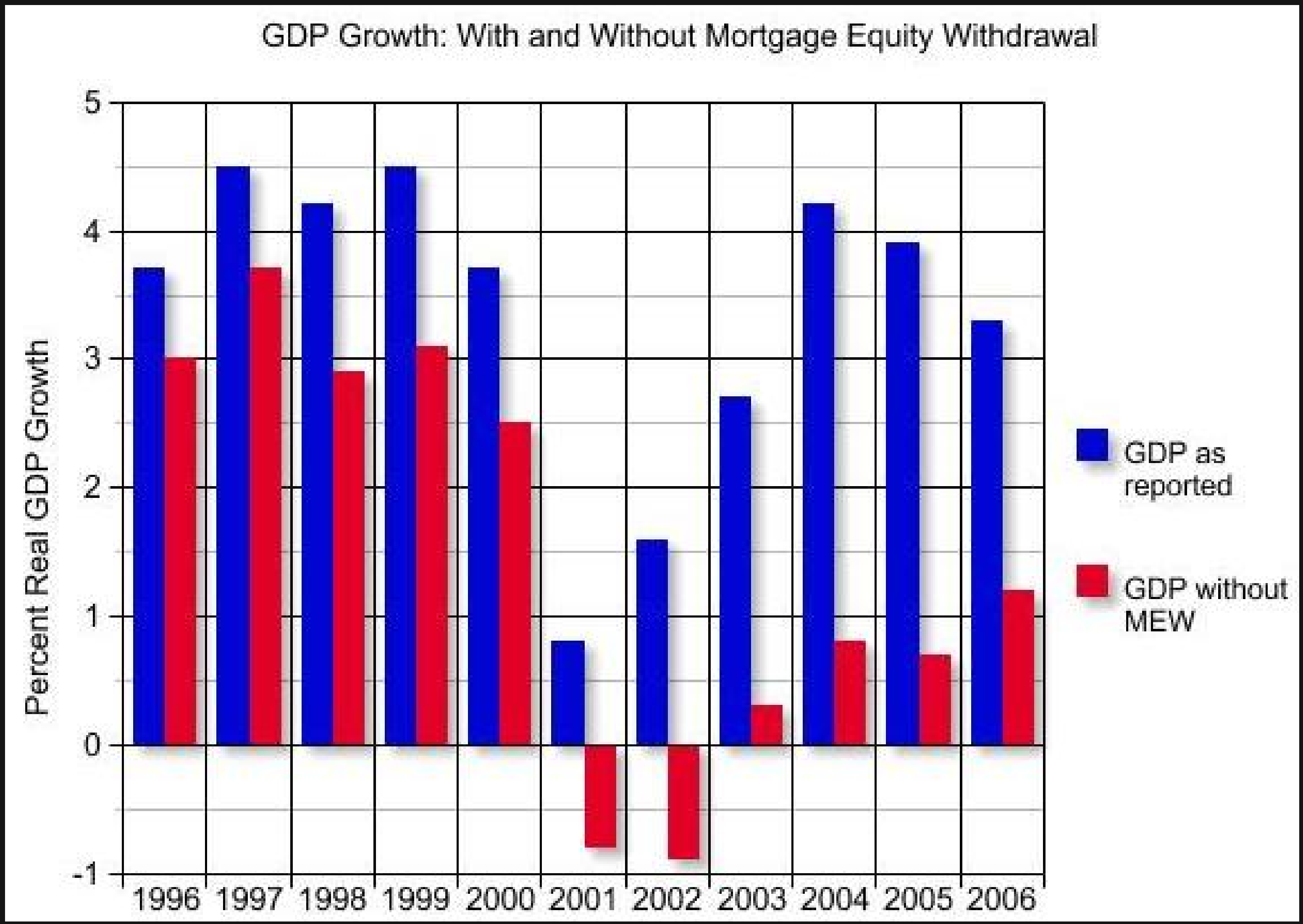
The Wall Street Journal (WSJ.com)
Wall St. Cheat Sheet – We've got the word on the street
InvestorsInsight – Financial Intelligence for the Informed Investor
Moody's
MSNBC
The Daily Reckoning
Bloomberg Television
SafeHaven – Preservation of Capital
Yahoo! Finance
Barron's
Reuters
MarketWatch
Morningstar
The Motley Fool – To Educate, Amuse & Enrich™
CNBC
Forbes.com
Fox Business
Business Insider
BusinessWeek
The Economist

Editor of Thoughts from the Frontline

The Debt Super Cycle



Mortgage Equity Withdrawal Fueled the Economy



The Great Experiment

Keynes

VS

von Mises

VS

Fisher

VS

Friedman

$GDP = C + I + G + (E-I)$

GDP is Consumption (Consumer and Business) + Investment + Government Spending + Net Exports (Exports – Imports)

If the Government “Dis-saves” then the difference must be made up by Consumers, Business and Foreigners.

GDP = MV = PT

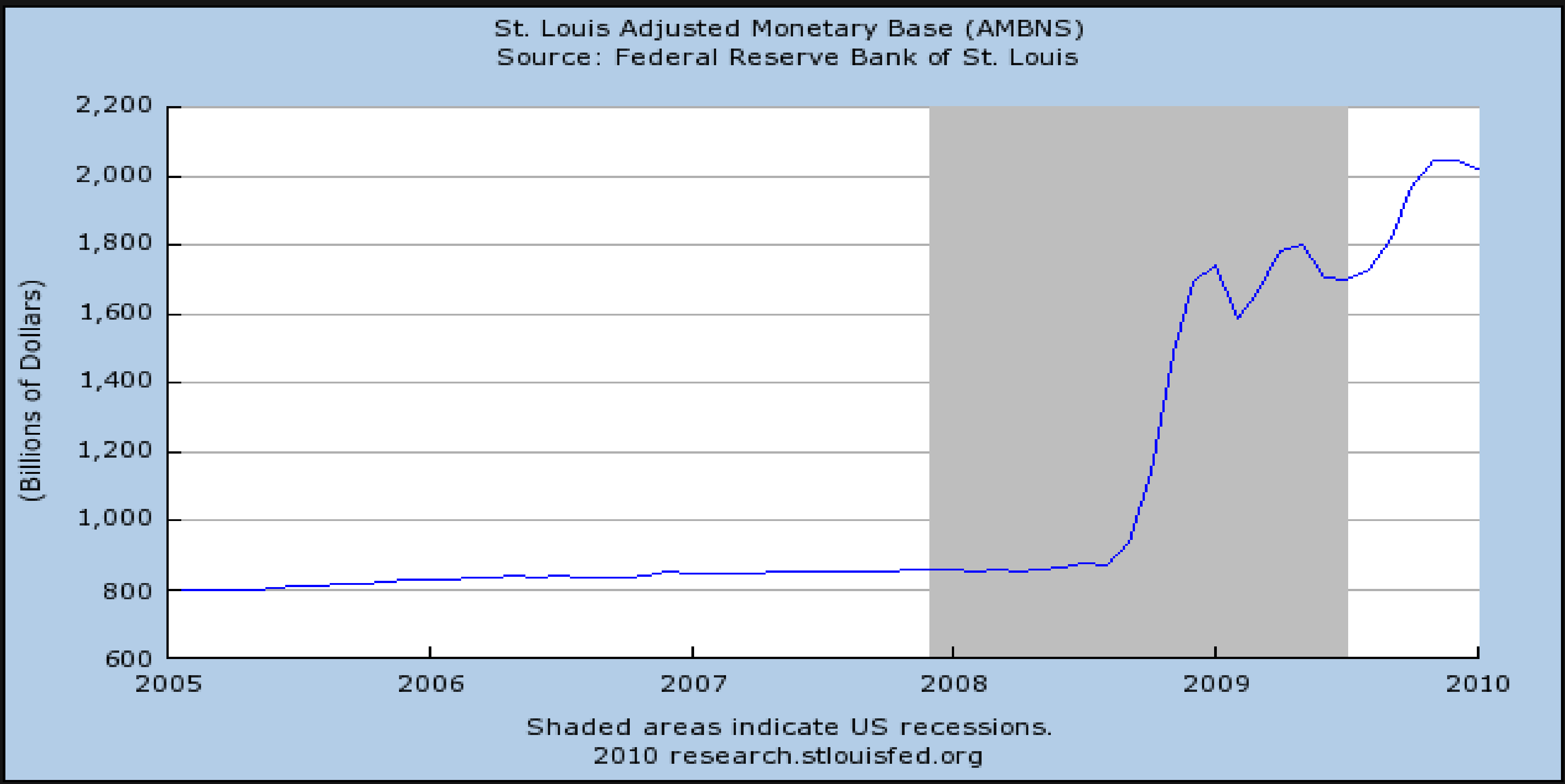
Gross Domestic Product is equal to

- M (the supply of money) times V (The velocity of Money)

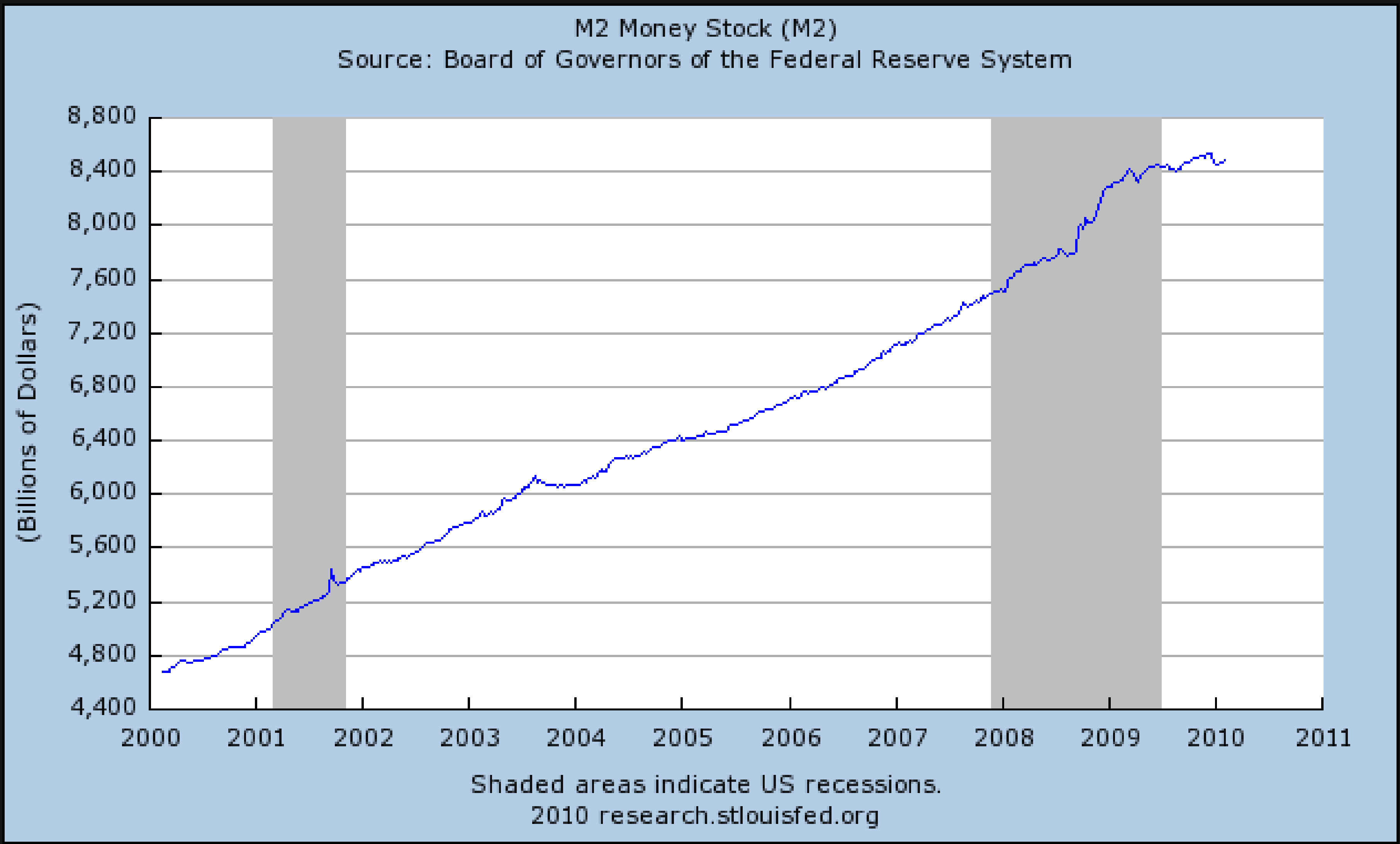
which is also....

- Equal to P (price level) times T (The number of transactions)

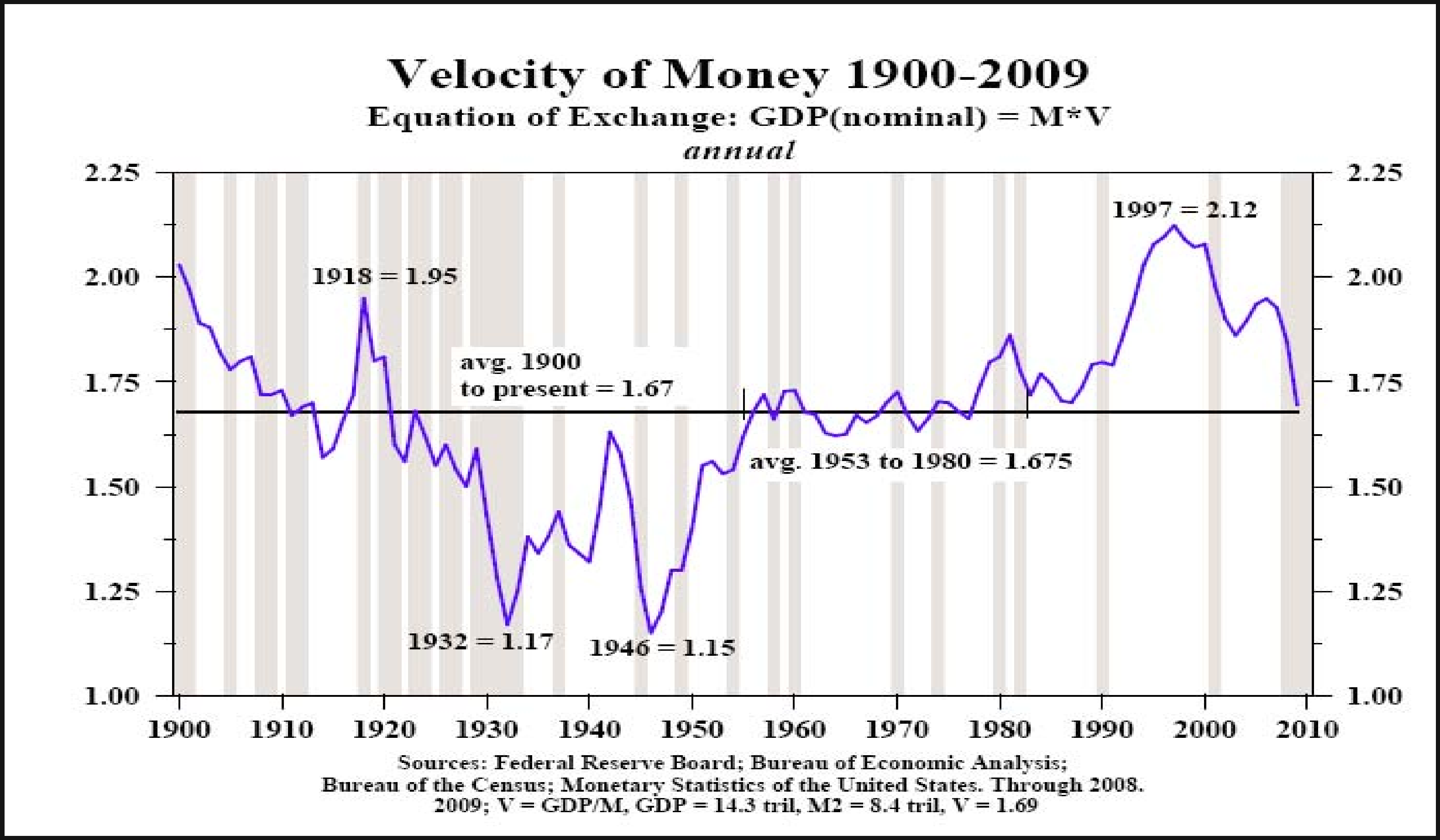
The Growth of the Adjusted Monetary Base



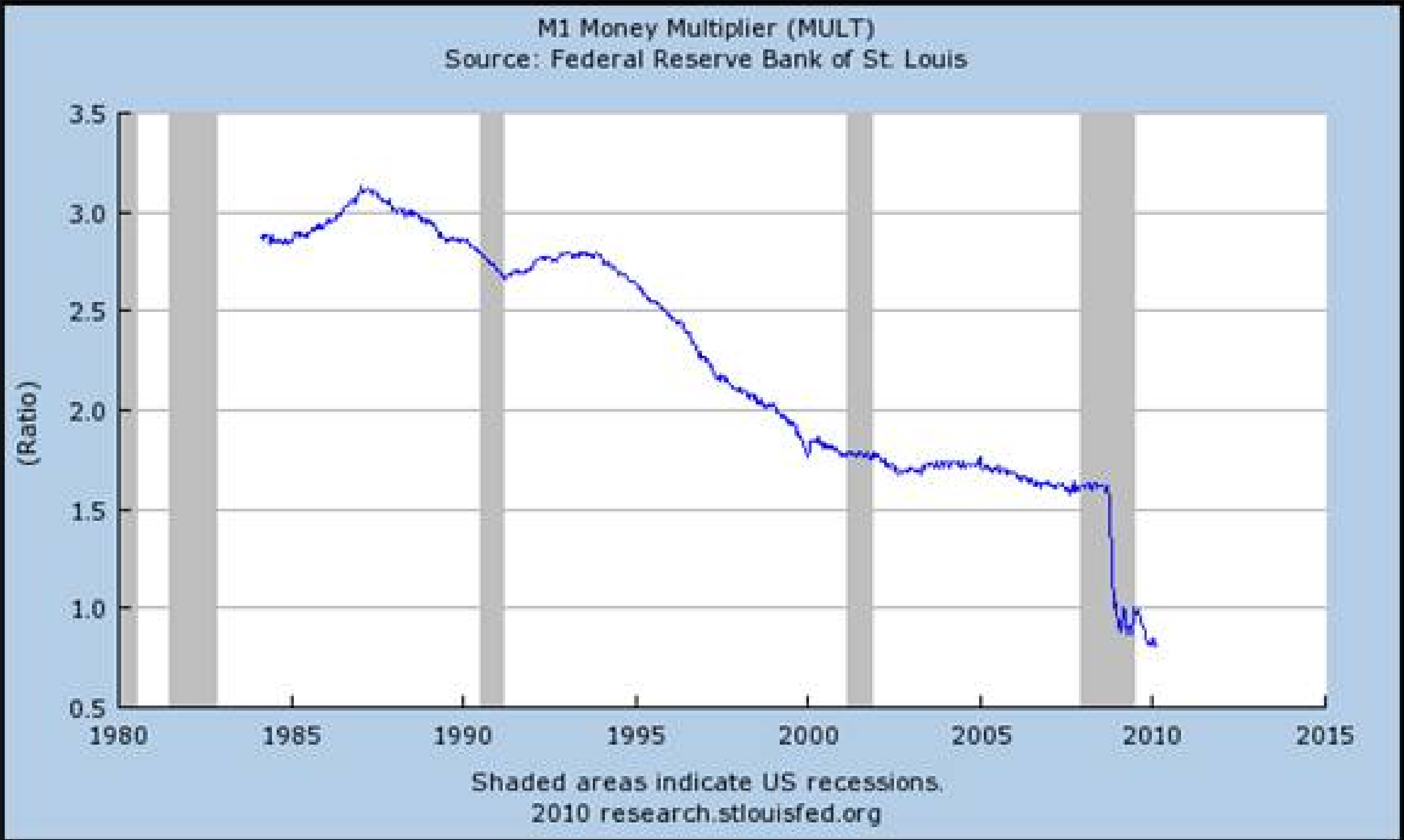
M2 is Flat or Falling Since the End of February



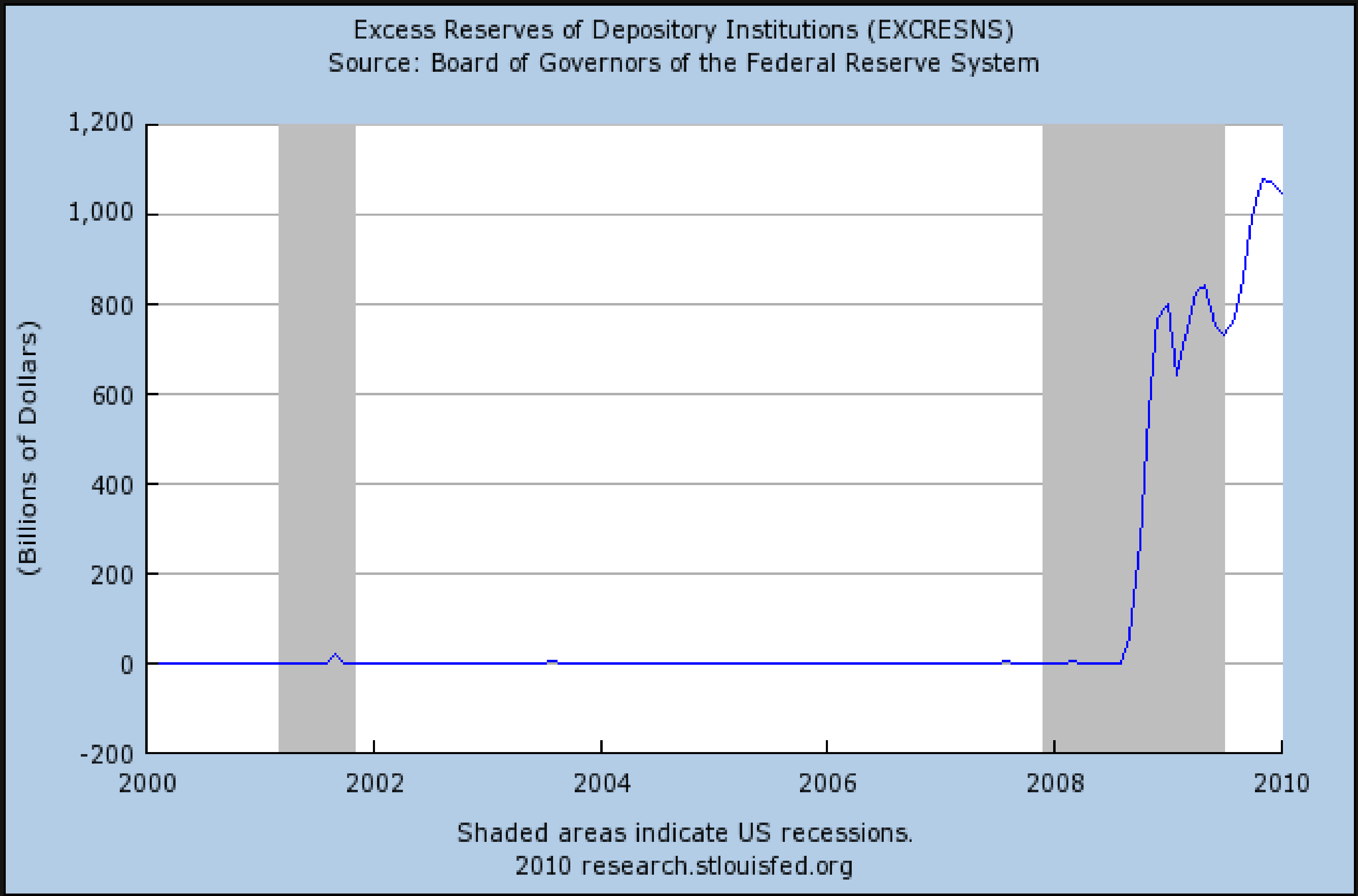
The Velocity of Money is Slowing
Y=MV



The Money Multiplier is Falling!!



Where Did All the Money Go?



Δ GDP = Δ Population + Δ Productivity

The Change in Gross Domestic Product

is equal to

the Change in Population

plus

the Change in Productivity

The Multiplier Effect

- The most extensive research on tax multipliers is found in a paper written at the University of California Berkeley entitled The Macroeconomic Effects of Tax Changes: Estimates Based on a new Measure of Fiscal Shocks, by Christina D. and David H. Romer (March 2007). (Christina Romer now chairs the president's Council of Economic Advisors).

- This study found that the tax multiplier is 3, meaning that each dollar rise in taxes will reduce private spending by $3.

It Gets Worse

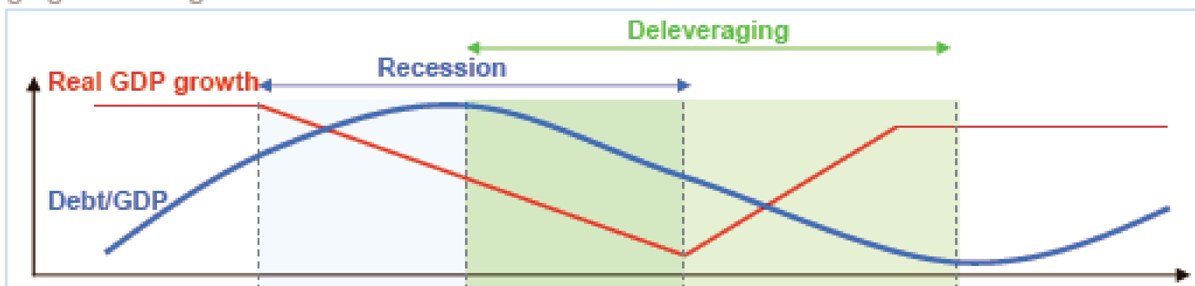
Barro (Harvard) and Perotti (Universita Bocci) Independently say that

Each $1 increase in government spending reduces private spending by about $1, with no net benefit to GDP

Impact of Deleveraging on GDP Growth

Real GDP growth is significantly slower in the first 2-3 years of deleveraging

Impact of deleveraging on GDP growth



	10 years	1-2 years	2-3 years	4-5 years	10 years
	10-year historic trend	Economic downturn starts as economy still leverages up	Downturn continues during the first years of deleveraging	Economic "bounce-back" while deleveraging continues	10-year trend post-deleveraging
Average annual real GDP growth, %					
1 "Belt-tightening" n = 16	4.7	0.6	-0.6	4.8	3.2
2 "High inflation" n = 8	4.3	-1.7	-1.4	4.1	4.2
3 "Massive default" n = 7	4.3	-1.8	-3.0	5.7	4.8
4 "Growing out of debt" n = 1	7.9	0.8	← 12.8[1] →		2.3
Total n = 32	4.6	-0.5	-1.3	5.1	3.8

1 Deleveraging driven by off-trend growth is not linked to a recession.

SOURCE: International Monetary Fund; McKinsey Global Institute analysis

This Time Is Different

- Reinhart and Rogoff looked at 66 countries and 250 financial crises
- Key is whether debt is excessive relative to income as Fisher first said was the most important factor in 1933.

Further:

- Government actions, even involving sizeable sums of money, are far less helpful than they appear. As the book states, “Infusions of cash can make a government look like it is providing greater growth to its economy than it really is.”

- Further increasing leverage to solve the problem only leads to greater systemic risk and general economic underperformance.

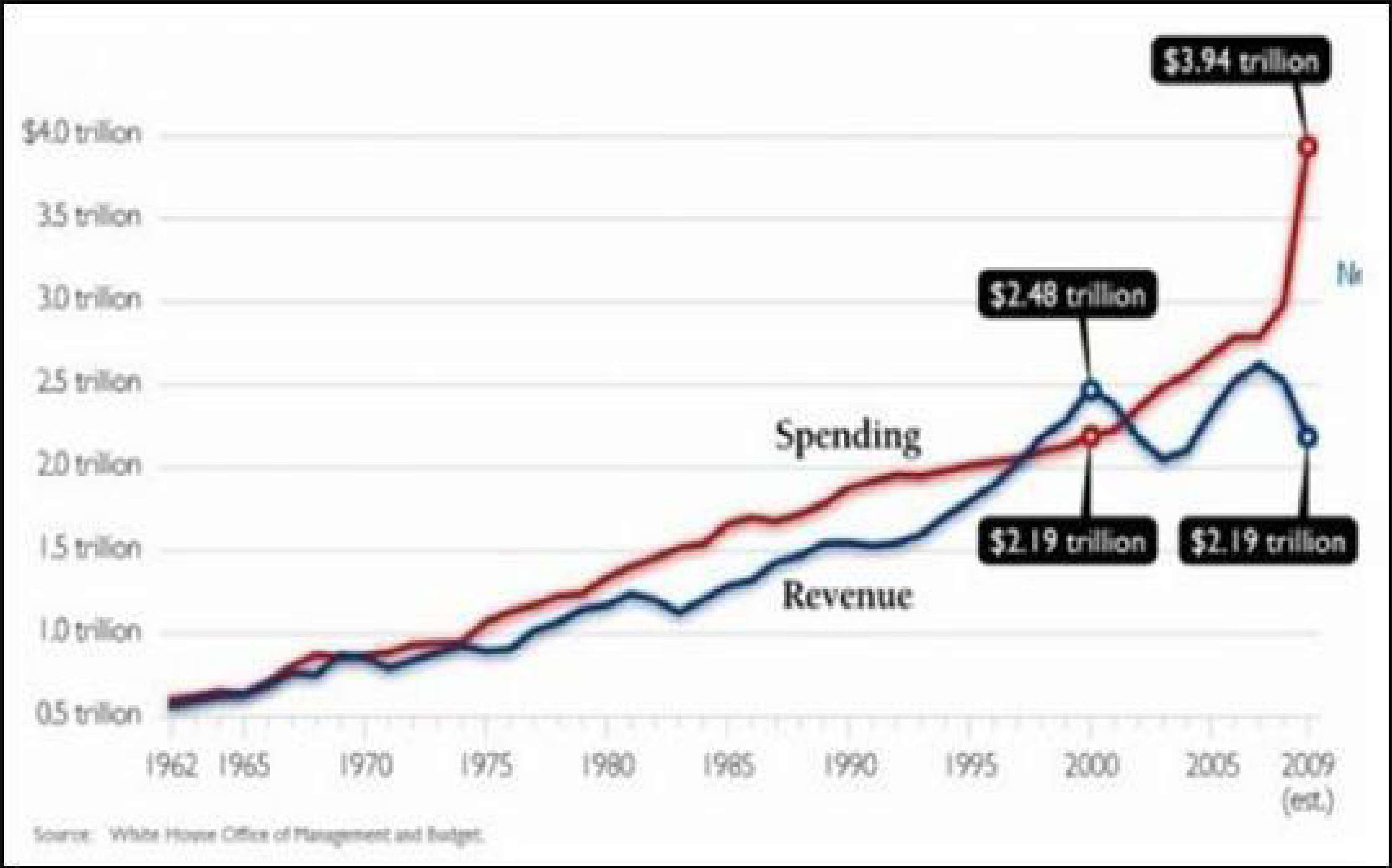
Conclusions

- Financial crises occur when debt is excessive relative to income, whether public or private or both
- It doesn’t make any difference who the debt is owed to

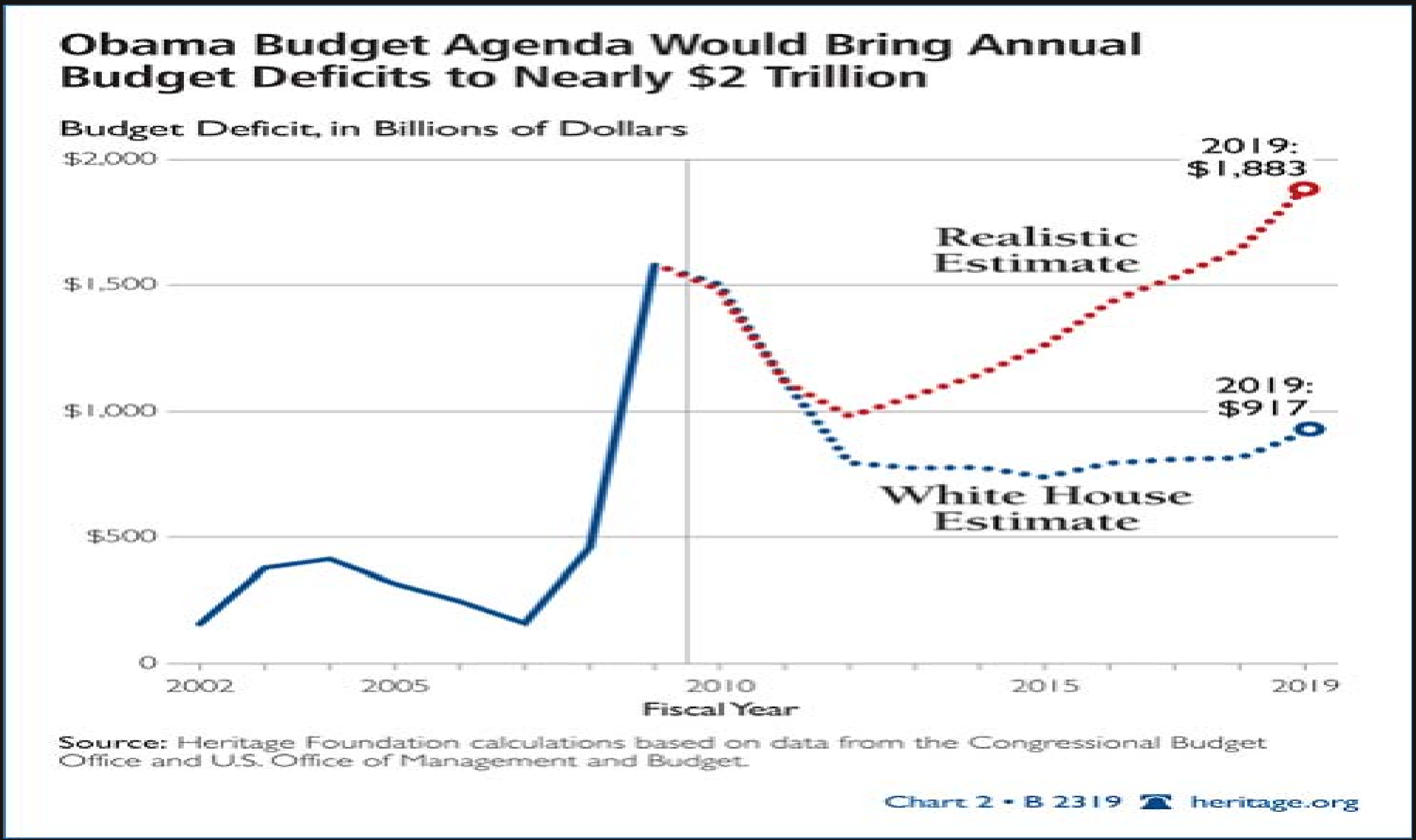
The Limit of Debt on Growth

- Rogoff and Reinhart recently showed that when government debt rises to 90% it seems to reduce potential GDP by about 1% annually.
- This is not theory, but simply observable fact

An Unsustainable Debt



Nothing But Trillion Dollar Deficits as Far as we Can See!!!!



GDP = C + I + G + (E-I)

Basically, Savings equals Investments

If the Government "Dis-saves" then the difference must be made up by Consumers, Business and Foreigners.

*But government spending has a multiplier of essentially nothing, and taxes have a multiplier of 3! And if you raise taxes?!?!?!

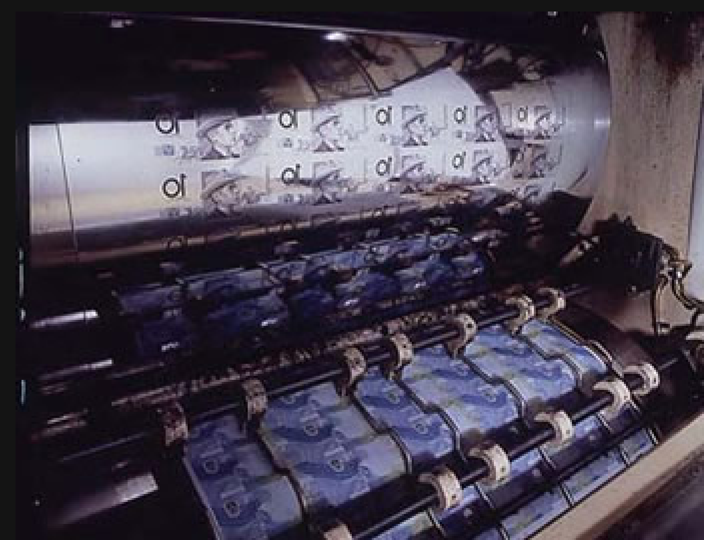
What is Money?

M-1, M-2, gold? – Misleading Measure

- Money is CASH + Credit
- Cash is $2 Trillion
- Backed by Credit of $50 Trillion

Re-Inflation?

It may take up to $2 Trillion in new printing press money to re-inflate



The Elements of Deflation

If you add:

- Rising Unemployment and
- Wealth Destruction and
- Reduced Borrowing and Lending and
- Decreased Final Demand and
- Increased Savings and
- Low Capacity Utilization and
- Massive Deleveraging and
- $2 trillion in Bank losses and a
- Very Weak Housing Market and
- Slowing Velocity of Money

You Get

Deflation

and

Nothing But

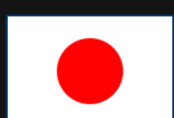
Bad Choices

Which path for the US economy?

- Argentina: Hyperinflation

- Austrian School: Cut government spending

- Eastern Europe: Structural Change



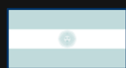
- Japanese Disease: Large deficits, no growth

Japanese Disease?

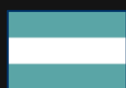
- Total Japanese debt to GDP is about where it was 20 years ago, but the government debt to GDP has risen from 51% to 200% and rising fast.

- What did they get for all that debt? The Japanese have not added any jobs for two decades, and their nominal GDP is where it was 17 years ago

Which path for the US economy?



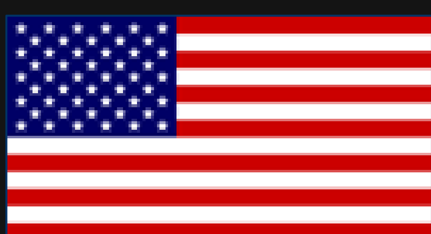
- Argentina: Hyperinflation



- Austrian School: Cut government spending

- Eastern Europe: Structural Change

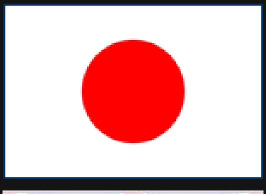
- Japanese Disease: Large deficits, no growth



- **The Glide Path Option:**
- **High unemployment**
- **Tax increases**
- **slow-growth**

The Prospects for the Rest of the World






- Greece – Between Very Bad and Disastrous
- The Pain in Spain
- Japan – A Bug in Search of a Windshield
- Britain – Things that make you go hmmm
- Emerging markets