This is the End

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The Daily Reckoning

"People just have no margin," explained Dennis Gartman, whom we met in Vancouver. "I have a friend who is a mortgage broker. He tells me that clients will figure out their monthly budgets to within $5. That's how much they have left over after their foreseeable expenses."

When a credit bubble expands, the lenders make a lot of money. But when it contracts, the loan business goes sour.

Countrywide Financial and Capital One are two of the biggest lenders in America. Their stocks are falling - down 15% to 20% from their peaks.

We are seeing - we think - a "Farewell to ARMs," as we put it on Friday in our speech to the Agora Wealth Symposium. Rising rates, and the threat of rising rates, is killing the lending industry.

Friday's papers also brought news of two trends that may be destined to increase the destruction far beyond the credit business. Inflation was reported rising at the fastest rate half from the first quarter to the second. These twin trends are heralds of stagflation, the first in 12 years. Meanwhile, GDP growth is declining - the rate of economic growth fell in scourge of central banking.

We remind readers how stagflation comes about (and why Ben Bernanke is doomed:

The Keynesian economics practiced by governments and central bankers depends on deception. As more money and credit is introduced into the economy - as stimulus" - it is mistaken for real wealth. Consumers think they have more money to spend; businessmen think they have more customers; investors think they see more profits. Deceived, they happily expand the economy. As time goes on, however, prices catch up to the funny money and the consumer wakes up to the fact that he or she is no better of than before. The businessman finds that though he has more customers, he must also pay his workers more. And his supplies cost more, too. The investor sees that he did not really make any money; profits disappeared as costs rose and the gain on his stock barely equaled the general loss of purchasing power of the dollar.

So, gradually, the old trick stops working. Money and credit may pour in, but no one is fooled. Instead, prices rise, while the economy goes limp.

This was what Paul Volcker faced when he step d into the Fed back in the late '70s. He had to whip inflation - or more precisely, pflation expectations - before any further monetary stimulus would work. And this he did, by pushing lending rates up over 15% and bringing about the worst recession since the 1930s. People were so upset with him they burned him in effigy on the capital steps.

Now, what will Ben Bernanke do? The poor man finds a different world from the one his immediate predecessor ruled over. Alan Greenspan took the post after Volcker had already raised rates. Greenspan could ride them down for the next 15 years. But now rates are low, and who wants to ride them up?

If present trends continue, Bernanke will need to raise rates to fight inflation. But he will also need to cut rates to fight the incipient slump.

The man is trapped. He's spent his career studying how to avoid a Japanese-style slump - an off-again, on-again deflationary recession extending over a long period of time. And now, he has one staring him in the face. He desperately wants to cut rates to head Lit off. But then, what about inflation?

And if he tries to pull a Volcker - jacking up rates to squeeze out inflationary expectation- the lumpen are likely to burn him for real!

We think again of Alan Greenspan. The man must have to back into elevators and shave in the dark. How can he bear to look himself in the eyes? His easy money policies have wreaked havoc on the landscape of the United States. Gone are the sturdy independent homesteads. In their place are shaky plastic lean-tos and flimsy vinyl shacks held up by debt. And debt of the worst sort: ARMs -- adjustable-rate debt.

Adjust the rates upward just a couple percentage points and the things will collapse in a heap.

Oh those ARMS! If Bernanke hikes rates to fight inflation, the ARMs go up.

And then the hands go up, voting for a change in government. Finally, the stakes and tinder are prepared. Bernanke must smell the smoke already...