Seeing It All Come Together: Months of Predictions Closing in on Quick Economic Collapse

Description

Sometimes weeks happen in a day, and we seem to be living in such times. In my latest Patron Post I laid out how Putin's War and the sanctions imposed by the West and other nations will cause a tectonic shift in the new world order. It's already happening.

Many articles have said in the past week or two that globalism has been breaking down and that the break between the West and East caused by Putin's War has shattered the trend in recent years toward a globalized economy and globalized governance. I argued the opposite — that it greatly accelerates globalism while cracking it into a new kind of bi-polar globalism.

Only a couple of hours after publishing that Patron Post this morning, I read the following statement:

> ***We're at an inflection point, I believe, in the world economy,*** not just the world *economy*, the ***world***, that occurs every three or four generations…. [A general told me that] 60 million people died between 1900 and 1946 and since then we've established a liberal world order, and it hasn't happened in a long while…. ***Now is the time when things are shifting and there's going to be a new world order out there, and we've got to lead it. We've got to unite the rest of the free world in doing it….***
>
> *— President Joe Biden at a business roundtable on Monday (Real Clear Politics)*

You could hardly ask for a stronger confirmation from the "leader of the free world" that we are headed exactly where I said we were going in that post. Sometimes it doesn't take long to see it in the news.

Bond yields and inflation swing their scythes like the Grim Reaper

Only days ago, I had also written in the introduction to my latest series of Patron Posts,

> We slid in economic meltdown toward a covert recession few saw coming in the last few months of 2021 as the Fed merely tapered its QE, which it had to do because we were roaring back into the hottest inflation since the seventies and early eighties (which I had also assured everyone was coming)…. The Fed's taper gave rise to bond vigilantes (as I predicted it would) and a slow stock market crash that has taken two major indices down more than 20%, and now the world is facing a global crisis due to Putin's War and the greatest economic sanctions of all time!… ***In the past few weeks — as the taper ended Fed control of the curve, and the sanctions began, and the Fed started tightening — the front end of the curve shot up….***
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> ***I would put the probability of a recession starting in this quarter at 95% because the yield curve is inverting now. As I've already stated several times, we could expect the yield curve inversion to be the late arriver to the party this time, entering after recession already began because the Fed froze it out with two years of absolute yield-curve control which it has only just finished backing out of.***
>
> *"Epocalypse Revisited: The Recurring Nightmare of Economic Collapse"*

My main thesis last year claimed the Fed had been exercising total yield-curve control for the past two years with its massive bond purchases along all maturities along the curve. Obviously, the Fed decided for itself how many treasuries to buy at each inflection point to set the curve where it wanted it as it undertook this massive money printing. Why wouldn't it if it is buying all along the curve in numbers sufficient to change bond yields?

I gave all my readers a key for understanding the events that would come at the start of 2022 (Patrons first, of course): realize that the Fed would inevitably be relinquishing all of that control over bond yields when it stopped its QE bond purchases, which would allow the bond vigilantes to price in the inflation that the yield curve had been incapable of showing for the past two years.

For over a year, a few people on other sites than my own argued with me that there could be no massive inflation coming and no recession because bonds were not showing it, and bond yields *always* rise to keep up with inflation, and bonds are the Fed's most preferred gauge for judging when a recession is coming. I argued that bonds couldn't show any of that because the Fed had shunted the meter because its massive bond purchases took all price discovery out of the bond market.

I referred to the Fed as the whale in the bond pool — a whale so big it took up the whole pool. Thus, the water level of the pool (bond prices) would fall quickly when the whale got out of the pool. (Falling prices amount to the same thing as rising yields).

The key for you to see what was coming was to understand *why* the Fed's favorite meter was broken, *what* it would take to fix it, and *how* quickly it would respond once fixed. I *re*-explained those dynamics in a Patron Post last month and share it all here as reminder:

> One … insidious aspect of the bond bubble blowing up is that the yield curve for bonds is now rapidly flattening as bond vigilantes seize the reins on the bond market that the Fed is releasing. That flattening presages a recession. I don't think a flat and then inverted yield curve, in itself, causes recessions, but simply that it is a sign that is regarded by the Fed as its most reliable indicator of recessions; so, when the yield curve inverts, it creates recessionary sentiment throughout all financial markets. In that sense, it is an amplifier that makes it somewhat of a self-fulfilling prophecy. It's almost like a guarantee or a seal on the recession to follow. ***This time it is a delayed indicator because of how tightly the Fed held the reins on bond pricing, restricting its own best indicator like a broken gauge to where the Fed doesn't even see recession is already at the door….***
>
> [Here's] the key that I've laid out in past Patron Posts for understanding the significance of the changes that are now arriving. ***By backing away from bond purchases (as is now seen happening in various places around the world simultaneously), central banks are liberating interest-rate curves all over the world. That means markets will start pricing in the inflation that they were locked out of pricing by massive CB interference; so, expect the repricing of bonds to happen quickly (in a realm of normally glacial moves in interest) and yield curves to flatten quickly and all of that to roil a lot of markets….***
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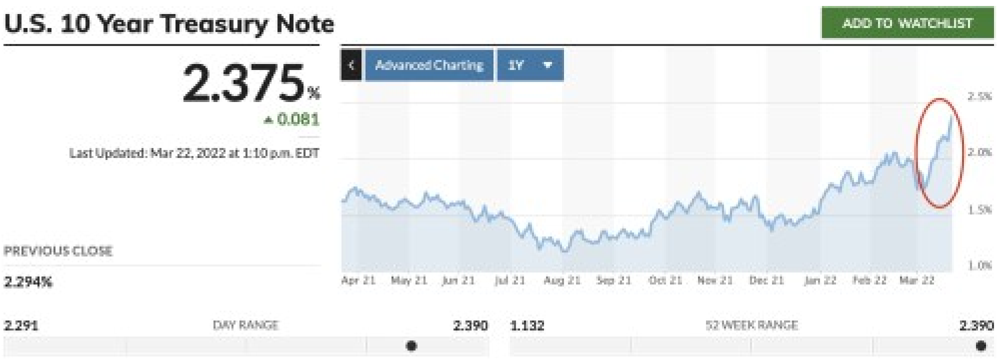
> I explained that ***the yield-curve indicator is behind the curve because the Fed exercised its tightest control ever over the yield curve during the last two years, which is why the curve is rapidly changing now, AND why it is can be expected to be a late arriver in predicting the recession because it would have priced this in months ago (the amount of time before a recession when it usually turns negative), if the Fed had not been exerting total control***.
>
> *"**The Everything Bubble Bust Pt. 3: The Big Bond Blowup**"*

That, I warned last month, puts us close to the bursting of the bond bubble and likely already in a recession because the curve this time was restrained from showing all of this until released by the Fed's taper. One important factor, in terms of how the change in bond yields affects other markets, is how *quickly* bond yields rise and the yield curve flattens and then inverts to show a recession. Rapid change in a normally slow-changing indicator spooks markets.

Well, we're here. It's all happening this week and last. Look at what has happened to bond interest rates and the yield curve since the Fed finished its tapering:



Compare that to all the incremental moves over the past year when the Fed had the meter shunted, as I say, and you see bond yields have come alive and are changing to show inflation at a rate of rise we haven't seen in a long time. The 10YR bond/note has gone from 1.95% on March 9, *when the Fed ended tapering with its final QE purchase*, to 2.39% today — 46 basis points in less than two weeks, and in the last *two days* alone it rose 24 of those basis points.

And this is a global phenomenon. Here is what those rising bond yields (globally) have meant in terms of bond prices:

> **"This Is Now The Worst Drawdown on Record for Global Fixed Income"**
>
> ***Global bond markets have suffered unprecedented losses since peaking last year, as central banks including the Federal Reserve look to tighten policy to combat surging inflation…. [It's] the biggest decline from a peak in data stretching back to 1990, surpassing a 10.8% drawdown during the financial crisis in 2008. It equates to a drop in the index market value of about $2.6 trillion, worse than about $2 trillion in 2008….***
>
> ***Rising inflationary pressure around the world is fueling concerns about the ability of the global economy to weather any sustained period of higher financing costs….*** "The safe haven attributes of Treasuries have been undermined when one adds duration risk to the equation," said Winson Phoon, head of fixed income research at Maybank Securites Pte. Ltd. That's a blow to money managers accustomed to years of consistent gains, backstopped by loose monetary policy….
>
> Corporate bonds are particularly vulnerable to mounting stagflation threats, as slowing economic growth also raises credit risks….
>
> ***The meltdown in global debt markets is a reminder of the Fed's tightening cycle in 2018***, though the broad global bond index wound up losing only 1.2% for that full year. But unlike four years ago, price pressures are now much stronger and the global supply chain is beleaguered.
>
> *Yahoo!*

Yield curve inverting at lightning speed screams "recession"

Bonds are also repricing in the pattern that flashes "recession" now that they have been released from Fed control. We have witnessed the fastest moves into inversion of the yield curve one can imagine as prices rise disproportionately toward the front end of the curve:

> ***Last week Ethan wrote that the* horrific performance *of US Treasuries was something of an inevitable return to normal after they were placed into a policy-induced economic* coma *during Covid.***
>
> [Financial Times]

There we have someone else using the term I was using to describe why bond yields weren't pricing in anything for all the months prior. Bond yields were in a FedMed-induced "coma":

> The Fed created a codependent economy to which ***I said, as soon as you remove life support, the* comatose *patient will begin to die.*** It has proven out that, every time the Fed has removed life support, the patient has declined to such ill health that the Fed had to rush back in with greater life support.
>
> "[Epocalypse Revisited: The Recurring Nightmare of Economic Collapse]"

> Across the curve, Treasury yields are returning to their pre-pandemic levels — even if in fits and starts. Even the stubborn 30-year yield is back where it was in early 2019 . . . Epic fiscal, monetary and epidemiological interventions transformed the US economy overnight. ***A bear market in Treasuries [meaning this present bear market] mostly represents things returning to normal,*** though high inflation and Russia's war have made for a bumpier ride….
>
> ***The ride has only become rockier in the past few days. As the FT markets team reported on Monday, Treasuries have now had their worst month since 2016.***…
>
> ***The worry is that returning to normal at the same time the Fed digs in for a fight against inflation might trigger a recession. That, at any rate, is the worry being flagged by the yield curve.***
>
> [Financial Times]

> ***Sharp moves in the U.S. Treasury market are increasingly pointing to the risk of an approaching recession, with "bond vigilantes coming out of the woodwork"*** and markets doubting the U.S. Federal Reserve's plan to engineer a "soft landing" for the economy as it hikes interest rates to fight inflation, market experts said….
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> ***"The yield curve does look ominous,"*** wrote Christopher Murphy, Co-Head of Derivatives Strategy at Susquehanna Financial Group….

> Melissa Brown, Global Head of Applied Research at Qontigo, said… '"The market perhaps is assuming that they can't thread that needle … it's going to be tough to not drive us into recession…."
>
> ***"Bond vigilantes have come out of the woodwork,"*** Brenner said, adding he saw a large amount of selling in the futures market, particularly concentrated in five-year futures.
>
> *MarketScreener*

That is the drum I kept beating last year — that when the Fed tapered, you'd see bond vigilantes coming out of the woodwork (I think I even used that clichè) to reprice bonds to show inflation and a recession all at once. Of course, the most critical part of the curve, which the Fed says is its most reliable indicator is the 2Yr v the 10Yr, and that has not quite inverted yet, but it is very close:

> "**The Yield Curve – Only 17 Basis Points To Zero**"
>
> ***The difference between the 2-year and 10-year note is now just 17 basis points….*** . ***Every recession in the past 40 years was preceded by an inverted yield curve*** – where this spread turned negative before the recession…. Even the 2020 recession, which had nothing to do with the Fed but a mandatory COVID shutdown, also saw an inverted yield curve in the summer of 2019
>
> *Seeking Alpha*

> **"From geopolitical risks to rising interest rates, U.S. Stocks face unique risks that lead to bear markets"**
>
> It's a unique moment for the U.S. stock market, which is staring down a distinct set of circumstances — from geopolitical risks to rising interest rates — that when combined have historically led to a bear markets….
>
> First, the Federal Reserve is starting to raise interest rates…
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> Then there's Russia's war with Ukraine…
>
> Meanwhile, oil prices are soaring past $100 a barrel…
>
> It's rare for the Fed to raise rates at a time when markets are under pressure and geopolitical tensions are bubbling.
>
> *Financial Express*

For free, I handed everyone the key for understanding in detail the massive financial collapse that was coming in the first quarter of this year due to the Fed's taper (with Patrons, of course, getting the most and earliest details, but I made sure everyone got the minimum they needed to see what was coming because it is important to all). Such exasperating times for the Fed are exactly the corner I've said they were painting themselves into where the inflation they helped create forces them to tighten a Fed-dependent economy with all of its Fed-dependent markets when they can least afford to do so — backs against the wall.

I had also noted a number of times that the broken meter would be showing what it would have shown 6-9 months ago *if it had been able to*. That meant it would only start predicting a recession *after we were already in it.* That is why the meter is rising so rapidly now. It's catching up to realization of what should have been priced in last summer.

That leaves you with a key many others *still* don't grasp. They now suddenly talk of a recession coming later this year or early in 2023, but what you know is we're just now getting last summer's reading, so the recession is likely already here.

> **"The S&P 500 Index Will Face More Pain as Rate Hikes Continue"**
>
> ***When the Fed tightens the money supply, it often leads to an economic slowdown. And indeed, the credit market is now heading toward inversion, which has an almost perfect track record of predicting recessions and, thus, stock market declines.*** As such, traders should be careful with SPY and other such index ETFs here. Last week's rally in no way guarantees that a bottom is in.
>
> *InvestorPlace*

In fact, be very careful because things are going to reprice quickly now as we saw the moment the taper ended and even before Powell announced his first interest hike. Even Powell practically admitted the situation is looking like it's run out of control, though he assured us, of course, that it has not out of control because it is his job not to alarm markets:

> "***But inflation is* far above *our target. And, you know, the help we've been expecting, and other forecasters have been expecting, from supply-side improvement, labor-force participation, bottlenecks, all those things getting better* — it hasn't come.** And so we're looking now to using our tools to restore price stability. And we're committed to doing that."

In other words, nothing has come in to rescue the Fed from rising inflation as they expected when they kept saying it was all transitory and I kept warning it was NOT. Had they been reading here, they would have expected differently. (Alas, I have never been able to impress upon them the value of doing so ;)

> ***The Federal Reserve chair rarely gets directly to the point.***
>
> ***However, as Powell bluntly noted, that anticipated help simply "hasn't come." So now the Fed has to take matters into its own hands with a sharper policy response to get inflation under control.***

"Sharper policy responses" are not what markets like. They don't like surprises. On top of all that, my latest Patron Post series was intended to lay out — as one of the comments above also notes as a contributing factor *but not the primary cause* — how Putin's War exacerbates the entire Everything

Bubble Bust I wrote about in my Patron Posts the month before, which *Bloomberg* now seems to be leaning toward in agreement:

> As Bloomberg's Cormac Mullen writes, the bond market suggests that ***"the chance the Federal Reserve can engineer a soft landing is fading by the week, with the war in Ukraine* exacerbating *the inflationary pressures.***…" As Mullen concludes, "Even Powell himself acknowledged the severity of the test the Fed now faces, withdrawing stimulus as inflation accelerates at the fastest pace in four decades."
>
> Zero Hedge

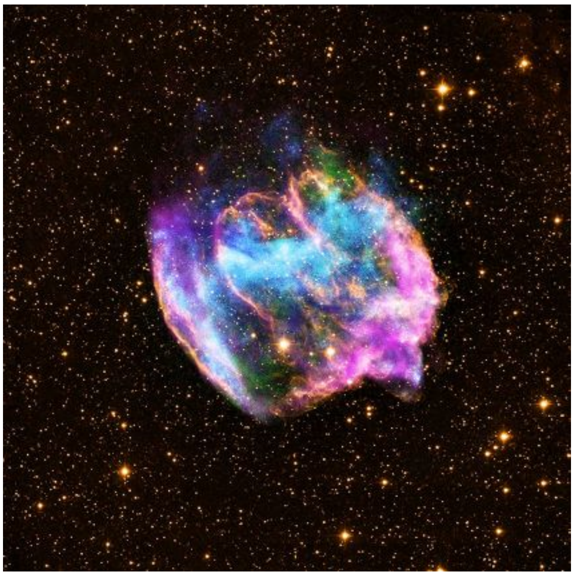
Yeah, that'll land about as smoothly as a 747 in the Himalayas. Picture Captain Powell, fingers clenched around the yoke, leaning forward, eyes squinting to see through the clouds around Mt. Everest, trying to find an airstrip where he can set down his 747. That's the ride I want to be on. And, if you think he's got the skill to do it, remember 2018, which was nothing compared to this Fed episode.

The Big Bond Bubble Breakdown

In the bond realm, the interest trajectory shown above is a rocket ride. I've also said that the point where rapidly climbing bond interest is likely to cause serious trouble for stocks was in the 2.25%-2.5% range. Well, we've clipped almost to the top of that range in the space of one day; so, we'll see what happens as that fact gets digested by stock investors; so far they seem to be in a state of denial about what they are seeing; however…

> ***If there are laws of gravity in finance, the equity market is in for a big hurt. That's because monetary policy is a blunt instrument. As policymakers use traditional and non-traditional monetary policy tools to kill the consumer price inflation cycle, it will hit asset prices hard. Moreover, given the scale of over-valuation, the potential decline in equity prices could rival the "big" ones of years past.*** So investors should take note: history sometimes repeats itself in the world of finance.
>
> Zero Hedge

That is the scenario I said we'd likely find ourselves feeling this March as soon as the Fed taper brought QE to a close, but it is the bond bubble that I said in last month's Patron Posts would be the really big deal. The importance of the bond bubble is that all other bubbles attach. In that Patron Post, I described its importance this way:



> No one has ever seen a universal bond bubble collapse at the center of the entire financial solar system of little and large orbiting nations; so, this is not something we have a clear concept about in terms of its danger, but ***it is really bonds that are the epicenter (core) of the exploding Everything Bubble.*** While we are used to stock market crashes being the biggest financial events we've seen, they are mere solar flares compared to the core implosion of a global bond bubble. (In a supernova, the core collapses, then the whole, suddenly-compressed star explodes away the solar system around it.)
>
> ***The collapse of the Everything Bubble will be an economic supernova. Think Lehman Bros. and Bear Stearns and all the rest of what happened to cause the great recession, then raise it an order of magnitude*** because most of that developed just out of mortgage-backed securities.
>
> *"The Everything Bubble Bust Pt. 3: The Big Bond Blowup"*

The bond bubble is the core collapse. Bond rates set mortgage rates, so mortgage rates rise rapidly if the treasuries rise rapidly. Rapidly rising mortgage rates will deflate or collapse the housing bubble. If treasuries reprice rapidly, corporate bonds will reprice because they cannot have lower yields than far safer government bonds. So, then the corporate bond bubble collapses. With the rapid upward pricing of corporate bonds comes the collapse of the corporate zombie bubble because zombie corporations (businesses that only make enough money to cover the interest on their debt) suddenly cannot refinance at the higher interest rates, so they go bankrupt.

Since those corporate bonds were used predominantly to fund stock buybacks, which have been the main fuel for the rapid rise of the stock market for years, then the stock market bubble collapses because buybacks become too expensive to justify compared to when money was practically free. Stocks will fall for other related reasons: The withdrawal of Fed QE that allows bond yields to rise is also the withdrawal of major new money every month that was seeking a place to park and finding that place in stocks. The new money has to go somewhere until it isn't there anymore to go anywhere. I've also pointed out how rising bond yields are an *attractant* that tends over time to draw money out of stocks (the pump that I've mentioned that moves money from the stock pool to the bond pool).

All of that I said was coming before there even was a war; so, it is not caused by the war, but the war certainly will make it all worse. Undoubtedly some — especially the Fed — will be inclined to blame it all on the war, but you've read it for months here, so you know it was seen coming long before Putin started promising he would never invade Ukraine.

And, of course, all of this eventually leads to sovereign debt troubles to. In the first Patron Post in this month's latest series, I wrote,

> Putin's War has certainly increased the number of sovereign debt defaults we are going to see….
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> Because we keep putting off the pain with new mountains of debt but no structural repairs or redesign to the fundamentals of our complex modern economies, everything I said about bankruptcies and defaults on debts in my Patron Posts about the Everything Bubble Bust has been intensified by the sanctions that have been laid down globally in response to Putin's War.
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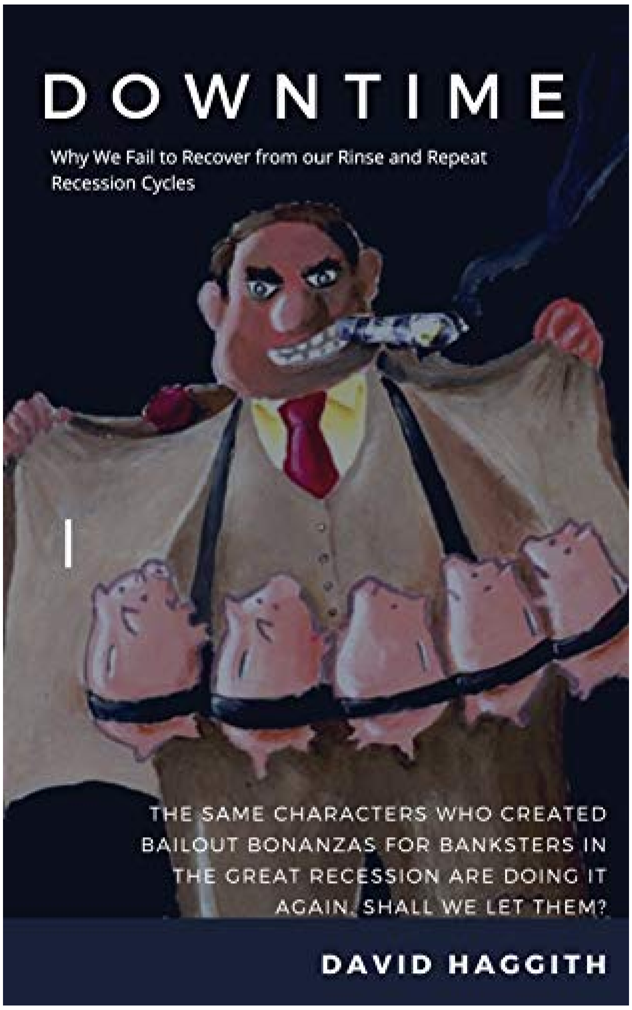
> Sovereign-debt defaults are now more likely, not less, in nations that will be impacted the worst by these sanctions because they have less capacity to add more debt to carry the burden of the sanctions, especially as some see their credit ratings downgraded due to the collateral economic damage caused by the sanctions.
>
> "*Epocalypse Revisited Part One: Sanctions Will Intensify Shortages, Spread Starvation and Inflate Inflation All Over the World*"

What could be worse than all sovereign debts starting to see a rise in interest because nations have ended their QE happening at a time when those nations will be pressed by sanctions to lean more heavily on debt. Now, their need to take on more debt will force their central banks back to QE in order to keep interest rates from killing them, but that just, once again throws them back into those endlessly surging massive debt cycles I wrote about in my little book *Downtime* and into a hyperinflation trap.



As go bonds, so goes the financial world.

All of this I laid out in detail, explaining the connections, in these Patron Posts. And now we see the big risk of the Big Bond-Bubble Breakdown arising rapidly because the Fed stepped out of the QE bond market this month, and already the mess is piling up in news articles everywhere!

By David Haggith

Category

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Date Created
03/24/2022