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The Recession is Late to the Party

- Carol Roth

In this informative newsletter, Carol covers why is there so much disarray and why so many economists have gotten their predictions wrong; how central planning has made historical economic benchmarks irrelevant; why rate hikes aren't working in the way they were anticipated; how the government is hurting the Fed's efforts and enabling consumers; how to prepare for what's ahead; and more.

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The Recession is Late to the Party

Just because it hasn't arrived yet, it doesn't mean the recession will be a no-show, either.

As we await the Federal Reserve's decision and guidance from next week's meeting, there is growing concern from investors, economists and commentators that the Fed will continue their rate hikes to a higher terminal rate, something you probably aren't surprised about if you have been reading my commentary and newsletters for Goldline.

The markets are aware that while failing to combat high inflation, the Fed's actions also haven't yet brought us to the brink of recession as many had expected.

Why is there so much disarray and why do so many economists have it wrong? Does this mean that we are going to be able to avoid a recession and that the Fed will achieve a "soft landing"? Or is the recession perhaps just being fashionably late to the party?

More festival than party…

As I have mentioned in my commentary, with the unusual economic scenario we face as a result of central planning decisions, there aren't a lot of benchmarks to consider. The Fed bringing the proverbial punchbowl to the party and refilling it- aka nearly a decade and a half of suppressed interest rates- was unprecedented. As was turning off a third of the economy in 2020. Not to mention the excessive money printing that juiced up the Fed's balance sheet to around $9 trillion. You have to look at and evaluate this historic economic situation in context.

The Fed has been using its policy tools to try to bring down inflation. Its tools are demand-side oriented and therefore, don't address the major undersupply issues that we are seeing across the economy. Policy decisions that have led to less investment in the traditional energy industry and barriers to building more in-demand housing. These policies that have created massive dislocation in the labor market aren't magically fixed by Fed tools.

The Fed can't print oil, labor or housing like they do with dollars, so these undersupply issues remain systemic and will be here for the long-haul unless they are addressed. More on that below.

Trying to shut the party down

The Fed, who started the easy money and warped economic party, are now trying to turn the lights off and force people to go home. But consumers, businesses and the government are still dancing as the music plays on.

This party continues because the Fed has to overcome a number of barriers in terms of truly quashing demand. Given the Fed's role in erecting these barriers, you'd think they would understand this better.

First, the Fed artificially suppressed interest rates with their easy money policy for around 15 years, with more than half of those years having their target interest rate at or near zero (aka "zero interest rate policy" or "ZIRP"). Debt was cheap and plentiful. Businesses with debt financing needs took full advantage of this easy money environment.

Consumers also took advantage of it, locking in low-cost interest rates where they could.

After nearly a decade and a half, basically every entity that needed or wanted debt had access to lots of it at deeply discounted pricing.

With debt needs locked down, the Fed's raising of interest rates, which in a normal environment would engender meaningful blowback from increasing the cost of capital, won't have the same impact coming out of this extended easy money environment.

So, today, the Fed's impact on businesses and consumers from raising rates is much tamer and will take longer to cycle through the economy.

Also, the undersupply in the labor market has been like a coating of Teflon over consumer demand- aka spending. As long as people have jobs and they believe they can find a new one if needed, they aren't going to pull back materially on their spending. This is true, even when it means taking on extra debt.

Layered on top of all this is the cost-of-living adjustments (or "COLA") that took place for 2023 to help Social Security recipients keep up with inflation. That is the equivalent of a consumer stimulus program for around 70 million Americans. The 8.7% bump is going to provide extra money flowing through the economy.

And, the Fed isn't getting any help from the government either.

The government is still spending like drunken sailors (with no disrespect meant to drunken sailors). Their spending puts more money into the economy and sends a signal to consumers that things are fiscally stable. If the government were to practice some austerity, not only would that come out of the GDP calculation directly, but it would also send a signal to individuals that maybe they should be a bit more frugal here, too.

The Fed and the government should be pulling in the same direction, but the government has gone financially rogue (once again). They keep partying like its 1999 (or, rather, that their fiscal position is the same as it was back then).

The strongest Fed policy would be saying, "We don't have the tools to fix this inflation. We need the US government to pull its weight and do its part. We need them to reduce their deficit spending. We need them to stop creating barriers to supply in energy, labor, housing and other areas...We're out!"

But the Fed doesn't have the backbone to do that, and the government isn't going to stop their runaway fiscal train until it completely derails.

When does the party end?

This all doesn't mean that the Fed gets its "soft landing" and gets to avoid another recession. The recession may just be fashionably late to the party unless something foundationally changes. The plentiful debt that has been taken out will eventually run out and more will be needed, and there will be a bigger impact on working capital. Productivity lags in the labor market will force businesses to make tough choices. Consumers will run out of savings and debt, and COLAs will be priced-in to baseline spending.

The wealth gap will again be exacerbated, with those in the working/middle class taking a hit to their net worth and not being well-positioned to take advantage of the next upcycle.

Make sure you keep your financials tight for the short and the long term, as we never know exactly what catalyst may change the macroeconomic environment. If you haven't had an opportunity to hedge your own portfolio, or haven't hedged enough, consider giving my friends at Goldline a call to help you (they are the only place from which I personally get my precious metals). And don't wait on this; hedges should be continually evaluated and adjusted on an ongoing basis, dependent on your current portfolio, your risk tolerance, your objectives and of course, the changing economic backdrop.

The economic environment at home and abroad has been historic and the outcomes don't have great benchmarks and parallels to draw from. Be prepared for all outcomes and know that just because the party continues today, it doesn't mean it will continue tomorrow.

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