First Trust
Monday Morning OUTLOOK

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Inflation, Debt, MMT, and Bitcoin

We can't possibly exhaust our thoughts on all these topics in one Monday Morning Outlook, but we thought we'd give it the old college try.

This year, 2020, has been exceptionally interesting for investors. Not only have stocks soared to new highs and mortgage rates fallen to new lows, but Bitcoin, after languishing since 2017, has surged. Since bottoming near $5,000 in mid-March, when COVID shutdowns started, it has more than quintupled to above $27,000. By the time you read that last sentence, who knows?

Bitcoin backers view it as protection against fiscal ineptitude and policy mistakes, which could lead to the devaluation of sovereign currencies. In other words, inflation! And if you followed government policies this year, you understand where they are coming from. But, it's not just crypto-currency investors that fret about inflation.

Gold bottomed at $1,471 in March and is now hovering near $1,900. Copper, silver, lumber, wheat, and soybeans have all soared this year, many to more than 5-year highs.

A Federal Reserve calculation of future inflation expectations, which is teased out of a comparison between regular Treasury securities and inflation-indexed securities, projects CPI inflation to be 2.0% annualized in the five-year period starting five years from now (so, roughly, 2026 – 2030). That's an increase from the 1.8% expected a year ago, and much higher than the 0.8% projected back in mid-March.

This is all understandable. The monetary base has expanded by $1.6 trillion since February, the M2 measure of money has grown 25% in the past year, and the Fed says it doesn't plan on lifting interest rates until at least 2024.

Meanwhile, the federal budget deficit soared last year, hitting $3.1 trillion in the Fiscal Year 2020, which ended in September, and looks likely to remain very large in FY 2021, as well. The United States, and other governments around the world, face huge fiscal issues in the years ahead.

It's more than just deficits and debt. Every penny of government spending is taxed or borrowed from the private sector. And these transfers of wealth and income from current and future taxpayers to the government distort the economy in massive ways.

Some think that Modern Monetary Theory (MMT) allows the Fed to print money to finance this debt with no consequences. This is delusional, and we agree with Mervyn King, the former head of the Bank of England who says MMT is neither modern, monetary, or a theory. It's been tried before, by the Romans, the Weimar Republic, Zimbabwe, Venezuela…all with disastrous results.

The question is timing. In the mid-2000s, people bought homes they couldn't afford with interest rates that were artificially low. Now, the government is doing this.

For the time being this is manageable. This past fiscal year, net interest on the US federal debt was 1.6% of GDP versus 1.7% in 2019 and about 3.0% in the 1980s and 1990s. Yes, you got that right: in spite of soaring national debt in 2020, as well as a plunge in GDP, the interest burden was smaller as a share of GDP than it was the year before, and roughly half of where it was 30-years ago.

As a result, although the yawning budget deficit is not good and not sustainable in the long-term, the US is not Argentina, yet. Just because the doctor tells you the problem with your thyroid isn't fatal, doesn't mean you wouldn't be better off without that problem.

For the record, even though we are upbeat on the economy and US equity markets for 2021, we don't support any part of MMT. What we are is realistic and pragmatic. We can't stop it, you can't either. The narrative of COVID and shutdowns, the denial of fiscal reality and the power of politicians and media mean for the time being this is our path.

However, eventually math wins. New York, Illinois, California and other states, are watching people vote with their feet. We will see how they respond. It may surprise all of us. After all, politics is often backward. Richard Nixon went to China. Bill Clinton reformed welfare. With massive current deficits, and future growing deficits due to entitlement programs, the stars may be starting to align for some historic and long-awaited reforms.

Imagine the very possible scenario where Republicans take the House and keep the Senate in 2022. Then imagine a President Biden deciding not to run for re-election in 2024 and seeking a legacy. Reforming entitlement programs could be his legacy, with a bipartisan compromise facilitated by a solid working relationship between Biden and Senator Mitch McConnell.

We hear every day about the breakdown of America…with both sides telling us "this is the end." As students of history, we don't buy it. The US has been in pickles before, but we always "work the problem."

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-30 / 8:45 am	Chicago PMI – Dec	56.5	**58.9**		58.2
12-31 / 7:30 am	Initial Claims – Dec 26	830K	**805K**		803K