March 31, 2010

A Canary in the Mine

On March 26, 2010, former Federal Reserve Chairman Alan Greenspan said; "Remember that the bursting of the (housing) bubble by itself is not a big *catastrophe.* We had a dot-com bubble, it burst, and the economy barely moved." Unfortunately Mr. Greenspan had missed the point. The dot-com bubble was a stock market bubble within a single, relatively self-contained, sector. The housing bubble directly impacted the construction industry, effecting a quarter of our nation's work force; the financial sector; Main Street; and the individual home owner; resulting in a situation that left 17% percent of Americans unemployed. To the unemployed and their families, **this IS a big catastrophe.**

Financial deregulation, under Greenspan's watch, also contributed significantly to the financial melt-down on Wall Street and the ensuing *"Great Recession."* The failure and bailout of various Wall Street firms, along with the bursting of the housing bubble, forced massive governmental spending and borrowing. Increased government borrowing, as the recent experience of Greece has shown, must eventually lead to higher interest rates in order to compensate investors for increased risk.

Greenspan further commented that the recent rise in Treasury yields represents a *"canary in the mine,"* indicating a possible shift in interest rate policy. This policy shift – even though it is necessary for continued investor bond participation – may stifle the US economy by raising borrowing costs which will be detrimental to economic growth. The ripple effect of cheap money and the deregulation policies on the economy have yet to be fully played out. The economic stimulus and recent health care reform costs instituted by the government further intensify the upward pressure on interest rates.

Looking forward, we can anticipate higher fiscal deficits, increased taxes, fewer private sector jobs, higher long-term unemployment and a more expansive and intrusive government. As government spending increases, more private sector capital will be required to finance government spending resulting in fewer dollars for the private sector. Lower productivity and a reduction in industrial capacity is likely.

<u>Sometime in the future a significant rise in interest rates will end the canary's song.</u>

Roger L. Johnson