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In this week's recap: Stalemate in the Capitol; Powell says inflation may stay longer than expected.

Weekly Economic Update

Presented by Ed Papier, October 4, 2021

THE WEEK ON WALL STREET

Higher bond yields and a legislative stalemate in Washington, D.C., added up to losses for the week. The Dow Jones Industrial Average declined 1.36%, while the Standard & Poor's 500 lost 2.21%. The Nasdaq Composite index fell 3.20%. The MSCI EAFE index, which tracks developed overseas stock markets, shed 2.58%. [1,2,3]

AN UGLY WEEK

The reality of a more hawkish Fed finally hit the bond market, sparking a sell-off in bonds that sent yields higher. Higher yields hurt technology and other high-growth companies, and that weakness spread to the broader market. (Higher yields can reduce the value of a company's future cash flow, which may reset valuations.)

Congress added to the market uncertainty. It was unable to advance an infrastructure bill, and it made little progress on the debt-ceiling agreement. After a sell-off to close out September, stocks surged on Friday on news of a potential Covid-19 oral therapeutic, an easing of yields, and reports that President Biden was traveling to Capitol Hill to help break the logjam on legislation.

POWELL IN THE NEWS

Fed Chair Jerome Powell was at the center of two news developments last week. The first was the announcement by a prominent senator opposing Powell's renomination, heightening market uncertainty over the leadership transition when his term expires in February 2022. [4]

Powell later made comments at a European Central Bank event, admitting that the current bout of inflation may last longer than he and many other central bankers have previously expected. But he remained steadfast that inflation would be transitory, attributing much of today's price pressures to temporary supply bottlenecks. Powell also said that he saw little evidence of building inflationary expectations from consumers or businesses. [5]

THE WEEK AHEAD: KEY ECONOMIC DATA

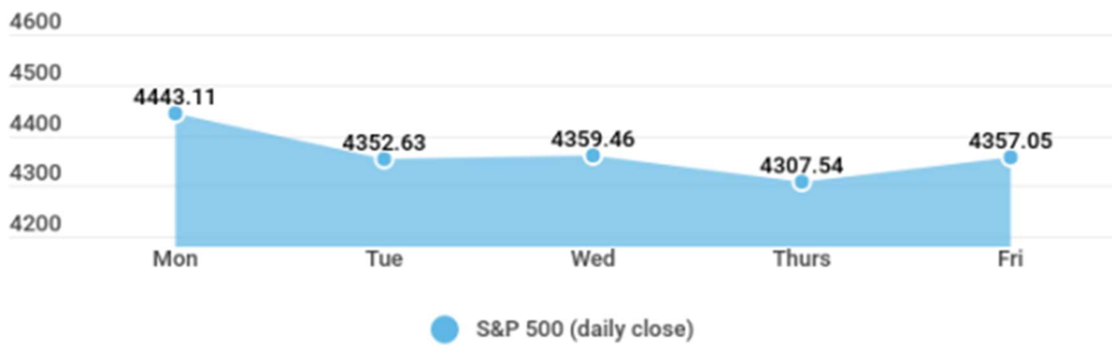
Tuesday: ISM (Institute for Supply Management) Services Index.
Wednesday: ADP (Automated Data Processing) Employment Report.
Thursday: Jobless Claims.
Friday: Employment Situation.

QUOTE OF THE WEEK

"All power corrupts, but the desire for power corrupts even before it is ever achieved."

THEODORE DALRMPLE

Market Index	Close	Week	Y-T-D
DJIA	34,326.46	-1.36%	+12.15%
NASDAQ	14,566.70	-3.20%	+13.02%
MSCI-EAFE	2,281.29	-2.58%	+6.23%
S&P 500	4,357.04	-2.21%	+16.00%



	Treasury	Close	Week	Y-T-D
	10-Year Note	1.48%	+0.01%	+0.55%

Sources: The Wall Street Journal, October 1, 2021; Treasury.gov, October 1, 2021
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, September 24, to Friday, October 1, close. Weekly performance for the MSCI-EAFE is measured from Friday, September 24, open to Thursday, September 30, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

With Thursday's passage of a continuing resolution that funds government operations until December 3rd, Congress dodged one fiscal cliff, but a bigger one looms ahead. The federal government has maxed out its credit, and if Congress doesn't raise the statutory debt ceiling by October 18, the Treasury won't be able to cover all of Uncle Sam's obligations.

With Democrats controlling the House, Senate and White House, Republicans have declared they're leaving it entirely up to the Democrats to raise the ceiling through the budget reconciliation process.

However, if past experience is a reliable guide, we can expect a couple weeks of harsh rhetoric, media hype and hand-wringing that culminate in the debt ceiling being modified for the 99 th time in its 104-year history.

That said, amid all the attention paid to the Capitol Hill debt-limit poker game that not only pits Democrats against Republicans but also progressives against moderate liberals, it's easy to lose sight of a hard truth about America's $28 trillion debt: As a burden that will fall on future generations, government debt is a form of taxation without representation and is therefore profoundly unethical.

"No taxation without representation" was a rallying cry of the American Revolution. Even in today's divided country, the notion is still embraced as a bedrock principle of fair government by people of all political stripes.

Too few, however, appreciate that government debt is taxation without representation. The federal government has racked up more than $28 trillion of debt—that's more than $86,000 for every citizen alive today. With huge annual deficits now considered normal, there's no hope it will be repaid any time soon. That means every deficit dollar is a burden that will be forced on future Americans who didn't elect the spendthrifts who are shackling them to it.

Though debt has been a steady fixture in American government, it's at an alarmingly high level today and projected to skyrocket even higher over the next 30 years—which is as long as the Congressional Budget Office makes projections.

Note the official $28 trillion of debt greatly understates the true peril—by omitting something that's required on any private firm's balance sheet: unfunded liabilities. Add promised Social Security, Medicare and other government benefits, and the real US debt is somewhere between $113 trillion and $239 trillion.

Now that they've lost control of the legislative and executive branches, Republicans who fell off the debt-hawk wagon during the Trump administration are urging fiscal restraint. The reverse phenomenon can be seen across the aisle. During the Trump administration, former Federal Reserve chair Janet Yellen said "the US debt path is completely unsustainable." Now that she's Secretary of the Treasury in a Democratic administration, she's recommending the debt ceiling be repealed altogether.

The millstone that today's government is tying around the necks of our children, grandchildren and great-grandchildren is multifaceted:

Higher taxes: When the income tax was launched in 1913, the maximum rate was 7%. Today, it's 37%, and we've already seen rates well north of that over the last century. Expect marginal rates to rise and deductions to fall.

New taxes: Those who foolishly wish for a "wealth tax" on the richest Americans are oblivious to the reality that— just as we saw with the income tax — would inevitably expand to hit the middle class too. That Trojan horse isn't the only possible menace: politicians may pursue a value-added tax or national sales tax too.

Higher interest rates: The less confident borrowers are in Uncle Sam's ability to repay, the higher interest rates they'll demand on Treasury debt. Since interest is an ever-larger component of government spending, that creates a vicious circle. And since Treasury rates serve as a market benchmark, higher Treasury rates mean higher rates on consumer and business loans too.

Inflation: The Federal Reserve aids and abets deficit spending by buying Treasury debt with money created out of thin air. That, in turn, feeds price inflation of the sort now emerging in the wake of the Feds' unhinged pandemic spending spree. Diminished buying power thus acts as a stealthy form of taxation.

A drag on the economy: "Assuming we never face a full-on debt crisis like the one we have seen play out in Greece, we'll then face the unfortunate yet increasingly likely scenario of becoming not-much-growth Japan," writes senior George Mason University research fellow Veronique De Rugy at Reason. "At least 40 academic studies published since 2010 observe the debt-growth relationship."

While it will create plenty of grist for next year's election advertisements, Washington's debt-ceiling theatrics will likely do little to change the government's long-term debt trajectory. That would require something neither party has shown a meaningful appetite for: real spending cuts. Meanwhile, mainstream media messaging will continue conditioning Americans to view huge deficits as perfectly acceptable, with the MMT becoming more acceptable and therefore discourse centered on just how huge they should be. In turn, that distorted framing will further inhibit citizens' realization that today's government debt is a growing tax unfairly imposed on Americans who haven't even been born yet. [6]

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CITATIONS:

1. The Wall Street Journal, October 1, 2021
2. The Wall Street Journal, October 1, 2021
3. The Wall Street Journal, October 1, 2021
4. CNBC.com, September 28, 2021
5. APNews.com, September 29, 2021
6. zerohedge.com/economics/government-debt-taxation-without-representation