Bill Gary's
PRICE PERCEPTIONS
40 YEARS
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Inflation or Deflation?

"We must always think about things, and we must think about things as they are, not as they are said to be."

- George Bernard Shaw

The word credit was derived from the Latin verb *credere*, which means "to believe." When you deposit money in the bank, you are extending credit to the bank. You believe the bank will return the money when you need it. Conversely, when the bank loans you money to buy a car, they are extending credit or belief it will be paid back.

Taking the concept of credit one step further... Have you noticed the dollar bill is a Federal Reserve note? It is a credit instrument that states: "This note is legal tender for all debts, public and private." It does not state it must be accepted as payment for goods and services, only payment of debt. Therefore, *our financial system is based on credit... A system of belief and trust debts will be repaid*.

Before 1990, we went to the bank for a car loan or to the mortgage company for a home loan. The loan officer would check our employment and examine our net worth to be sure we were capable of repaying the loan. In those days, it was normally the bank's capital we were borrowing. Therefore, they had a keen interest in making certain the loan would be paid back.

In recent years, a subtle change has occurred in the concept of credit. Today, banks, mortgage companies, and credit card issuers bundle loans together and sell them to endowments, retirement funds, hedge funds, government agencies, or to Wall Street. In past years, actually being repaid by borrowers was a critical element for lenders. Now, consumer debt is bundled into securities and repayment is less important than the fees and charges generated on the loan.

Lenders have found multiple ways to squeeze profits from borrowers. Credit card companies routinely charge as much as nineteen percent on outstanding balances and up to twenty eight percent for those with poor credit records. Late fees and charges for exceeding credit limits are added monthly to the balance owed. Mortgage lenders charge fees for loan processing, appraisals, credit checks, title searches, document preparation, couriers, and even e-mails, adding the charges to the loan balance. Julie Williams, chief counsel of the Comptroller of Currency recently stated: *"Today, the focus for lenders is not so much on consumer loans being paid back, but on the loan as a perpetual earning asset."*

Ford, General Motors, department stores and other large companies now generate more income from financing sales than their primary business. Adding fees to outstanding consumer loans has contributed to huge corporate profits in recent years and outlandish management bonuses. However, the reality of borrowers ever paying the principle has been discarded.

At the end of last year, American's mortgage debt totaled \$10.5 trillion, up from \$4.8 trillion in 2000. Average household credit card debt is now \$8,600 and college graduates carry an average of \$20,000 in debt. Years of spending more than we earned have left American consumers with a mountain of debt they cannot afford to pay back.

Somehow, we came to view compounding of debt as earnings. A breakdown in belief and trust may be unfolding. By definition, this would be equivalent to a breakdown in our financial system. Traders should monitor financial markets closely in weeks and months ahead for signs of whether this leads to inflationary or deflationary trends in commodities.