Why The Great Simplification Entails a 30% Reduction in GDP

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For a while I've been referencing a '30% drop in global GDP' as the financial watershed that will begin 'The Great Simplification' for a lot more people. This is a very rough estimate, but here is an explanation of the logic. We've been working with some folks from a quasi-government agency who are experts on debt/finance. They have specific models and graphs of this 30% (midpoint) drop in GDP which I'm not allowed to publicly share. Here is the basic idea.

If you buy a house, for example, you pay $300,000 to the contractor who pays money to the builders, suppliers, plumbers, construction team etc who then take their money and pay their own contractors, etc who then pay for food, trips, etc. who pay for employment. There is a ripple effect on GDP and consumption. Since we now require e.g. 3-6 units of credit in OECD to generate one additional unit of growth, this credit pulse itself has a large multiplier effect on consumption and GDP.

Our base scenario is that, before 2030, we hit a 'too-big-to-save' scenario where e.g. France or Japan can no longer easily access unlimited sums in the global credit markets resulting in a situation whereby NO central bank or group of central banks is big enough to fill the country sized financial hole. This is when credit ceases to be available and when all/most banks in OECD fail. At that moment, we have a choice to a) keep people solvent (by governments printing more money to guarantee what people have in their checking accounts or b) keeping transactional capacity viable - making sure e.g. debit cards work so people can e.g. buy gasoline to go to work at nuclear plants etc. not a pleasant scenario, but one we're probably going to have to manage.

Given the average amount of credit in the developed world over the past decade, our work suggests a REMOVAL of credit availability would have knock on effects to the tune of ~21% of GDP. At this moment ALL of the built infrastructure and energy that was previously available still is, but at least a portion of it is either affordably - if not functionally - obsolete which would result in another 8-10% or so. If there are plans to keep transactions going then we might stop at around 30% (roughly). If no plans and international commerce totally breaks and there are systemic risks that pop up then the decline could go much further - very hard to say.

To be very brief, there are many variations and assumptions underlying this model. I think - because of previous cans kicked - we no longer will have a 5-8% drop if this happens. It is probably 20% minimum, 30% more likely, and more is quite possible - effectively we've been living beyond our means since the 1970s. This is the developed world I'm talking of but the GDP drop will happen globally to a lesser extent in e.g. India where the labor/energy relationship is not as stretched and where they don't use credit at the levels that e.g. Europe or Japan does. China is a real wildcard - they were late to the capitalist party and have used this model in spades. My friends who work there say they get funding to build a building and run out of money when the basement foundation is built, more than thousands of such offices around China - good for GDP - not good for the planet or well-being.

This is super complicated and I understand the above enough to know it's a BIG risk. I would have to spend all my time understanding specifically how big of a risk and all of the various dynamics. There are some (very few) who understand this completely in my opinion - there are MANY who understand debt overshoot and that we have a depression on the horizon.