Short Discussion of our three articles on corporate debt, plus commentary on the social and political views of the author of this week's article on Chinese debt, Tom Luongo.

After last week's report on corporate debt in the U.S. and in Europe, I thought to find something a bit lighter for this week. However, this topic is too important to gloss over, as no matter what ends up being the "spark" that brings the world economy down, the real reason why the next recession will be one for the ages will be debt, and especially corporate debt. Of course, European government debt will certainly end up sharing some of those headlines.

I had been surprised to find the article on European debt we included last week with our report on US debt. You really probably cannot get the full impact of what that article on Europe is describing if you haven't spent the last 20 years constantly studying, buying, and selling bonds. Their entire bond market has literally been destroyed. To remove the concept of risk from your entire debt market is monumentally stupid. Either they are insane or they are acting for purely political reasons (not sure there is a difference?), but as a representative of the bond market, I hereby guarantee you that removing the concept of risk from the calculation as to which companies should be able to borrow billions of dollars at 2% rates will lead jaw-dropping losses in Europe's corporate bond market. The European Central Bank under Mario Draghi tells us they are going to stop buying corporate bonds by the end of the year. But nobody else in the world would consider buying a corporate bond in Europe at anything close to today's prices if Draghi wasn't buying every one for sale in the Eurozone. And who else will buy Italian government bonds to try to keep Italy afloat?

The coming losses in Europe are likely to dwarf those in the United States, and my article last week on this topic shows us likely to suffer 30% or more in losses than we did in 2008-2009. Unfortunately, in order to complete this horrifying debt story, I knew we would need to explain what's going on in corporate debt in China. Fortunately, later that day I found the accompanying report from an economist named Tom Luongo. The report is entitled "Is China's Day of Reckoning Coming?"

This report basically explains China's debt markets like last week's explained those in the U.S. and Europe. The details are quite different, but it's the exact same big picture. China has funneled as much or more debt as they have in Europe toward companies who aren't going to pay it back. The real message of this article is Mr. Lugongo's statement:

"The question now is whether or not China has a way out of this finger-trap of escalating corporate debt?

The answer is no, but the better question is how bad will it be for them relative to everyone else dependent on China's sustained growth?"

I'm not sure why any question could be more important than whether or not China is doomed to have an historic debt crisis. In China, we could see corporate loan default rates of 40%. That's basically what financial Armageddon looks like. Yet that is the upper range of the coming losses as determined by several of the best Chinese debt analysts in the world. Still, I suppose Mr. Luongo's belief the main concern should be how much China's coming losses will harm the rest of us, makes some sense. China has been the driver of global growth since 2010. During the last crisis, in 2008 China had its banks open up the spigots and start loaning out massive, and I mean massive, amounts of money to any company with a name.

The end result is almost exactly the same in all three economies we've been discussing. The largest increase in corporate debt in history has occurred in the United States, yet the extreme is significantly more pronounced in Europe. Then we have China which has had the largest growth in corporate debt in world history. This means, all else being equal, their losses will be largest. What happens when the three largest corporate debt piles in history come toppling down at the same time? That's the real question, though it is a bit scary to think about.

There is a caveat to share. I just looked at Mr. Luongo's web site a few moments ago, as I've only previously seen the occasional article of his reprinted at other sites. Looking at his own web site, I quickly saw he has, I believe I can safely say, some highly unusual political and social thoughts. I don't endorse any of them, or Mr. Luongo, with one exception. Mr. Luongo's description of China's debt situation is one of the best I've read, and I've probably read well over 500 of these types of articles on the topic since 2010.

Mr. Luango's article begins with a very wide view, and the article may be fairly difficult to comprehend for many people. His economic perspective is definitely out of the mainstream at this time, though it is quite similar to mine. He is a very good economist, and any objective person could prove most of what he says with some research. His economic views are on solid ground when it comes to the facts.

Each coming from our own perspective, all three of these articles are describing the exact same thing. All three see jaw-dropping losses coming. The ugly scenario coming is so big economists can see it from 100 angles. For example, last week we shared the views of Mary Callahan Erdoes, the CEO of JPMorgan Asset Management, on European corporate debt. Now I have no idea what theories or other economic perspectives Ms. Callahan holds. The debt situation is so large, any economist with a shred of awareness can see what's going to happen, regardless of their differences in other areas of economic theory or practice.

When this whole corporate debt situation is finally resolved and the losses have all occurred, most will end up basically saying, “Who could have seen that coming?” This week we can add Tom Luongo as an economist who clearly saw it coming.