Macroeconomics
The GME Connection

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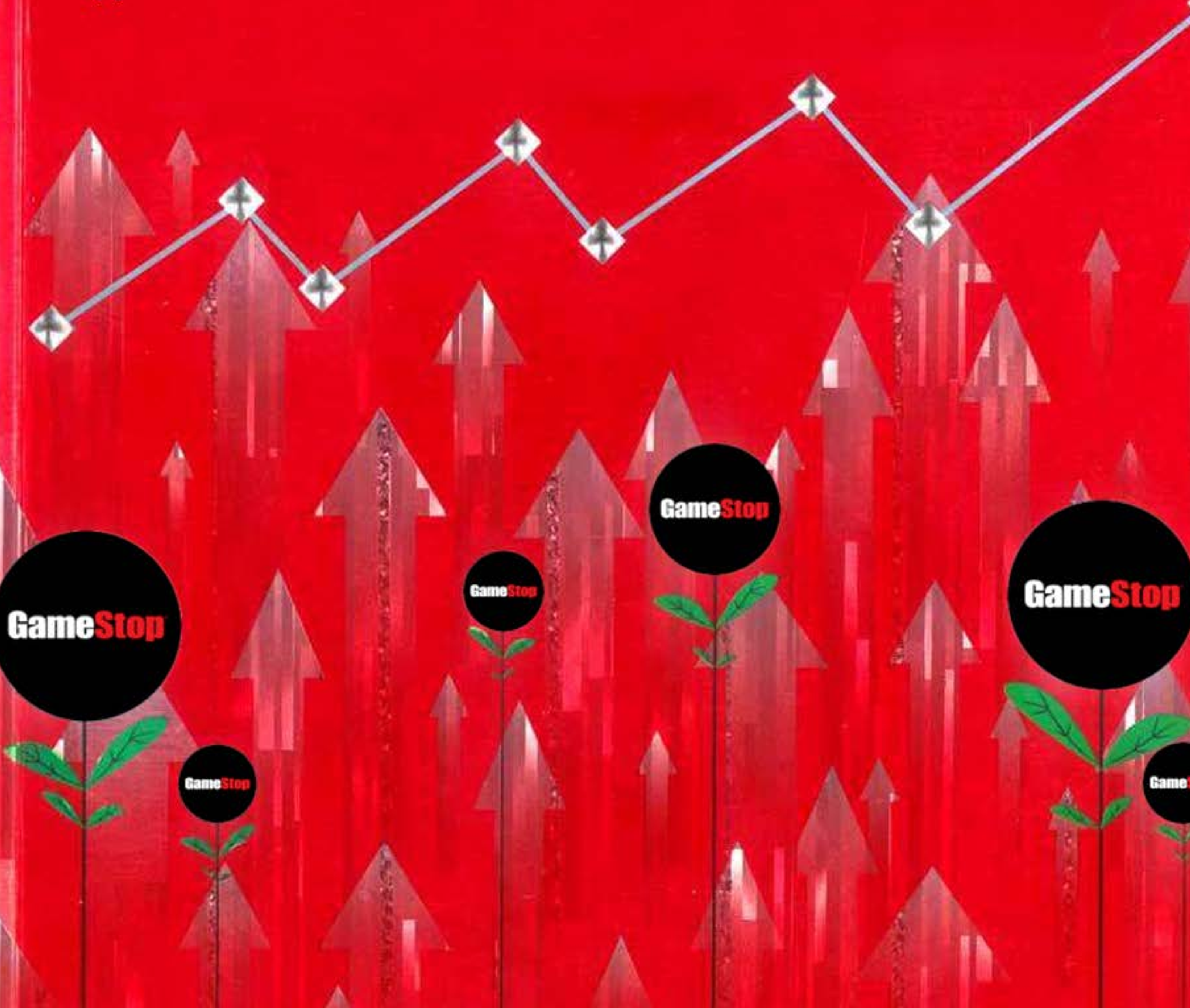


You ever wondered what the connection between macroeconomic talk on our sub and GME is? I got you covered.

DD

What better day than the weekend for some educational DD into how inflation affects markets? Let's put the dots together between macroeconomic talk on our sub and GME.

In light of inflation remaining high (i recall a certain group of investors talking about this non stop for the past 6 months), Let's go through how the Fed *could* fix inflation. However, as the saying goes, there’s no free lunch - as such, the Fed will have to sacrifice something.

The following are the large ones they'll need to consider when making their decisions:

1. The USD
2. Stonk Market
3. Housing Market
4. Government & Businesses

Let’s start with how the Fed functions, in particular when it comes to rates.

They have a number of different rate tools they can use, to simplify we will focus on the Discount Rate here (Refer to another post i wrote [here](), which goes into more detail on the different levers they have).

https://fred.stlouisfed.org/series/INTDSRUSM193N

If a bank wants to borrow money from the Fed, they will be charged the discount rate, flip it around - if the bank wants to deposit money with the fed, they get paid the discount rate.

So, this means, if the Fed raises the discount rate, it becomes more expensive for the bank to borrow from the Fed, which means it’s also more expensive for us to get cash (higher rates on loans) - Hence:

Fewer people being able to borrow money = Less money circulating in the economy = Inflation lowers

Simple right? Nope. Sadly Nope.

Housing Market

Let’s focus on Real Estate as the first topic given it’s an interest-bearing liability many of us have (or at least try to have, but the housing market is so fucked it takes 10 years to save for a 20% deposit - fuck Sydney.)

The easiest way to show this is through a bank's borrowing calculator, for an income of $100k AUD annually before tax, at a rate of 2% we’re able to borrow $779,900 on a 30-year term.

You may be able to borrow up to

$779,900

$10,000 $779,900

Principal and interest repayments

$2,883 Per month Loan over 30 years

Based on a

2 % p.a. Back to CommBank rates

Let's say the Fed (or the RBA for my Aussie homies out there) has gradually lifted the rate by 2.5% over a year, and that the banks have directly passed this rate increase onto its customers, that means our home loan rate is 4.5%.

You may be able to borrow up to

Principal and interest repayments

$3,280 Per month Loan over 30 years

Based on a

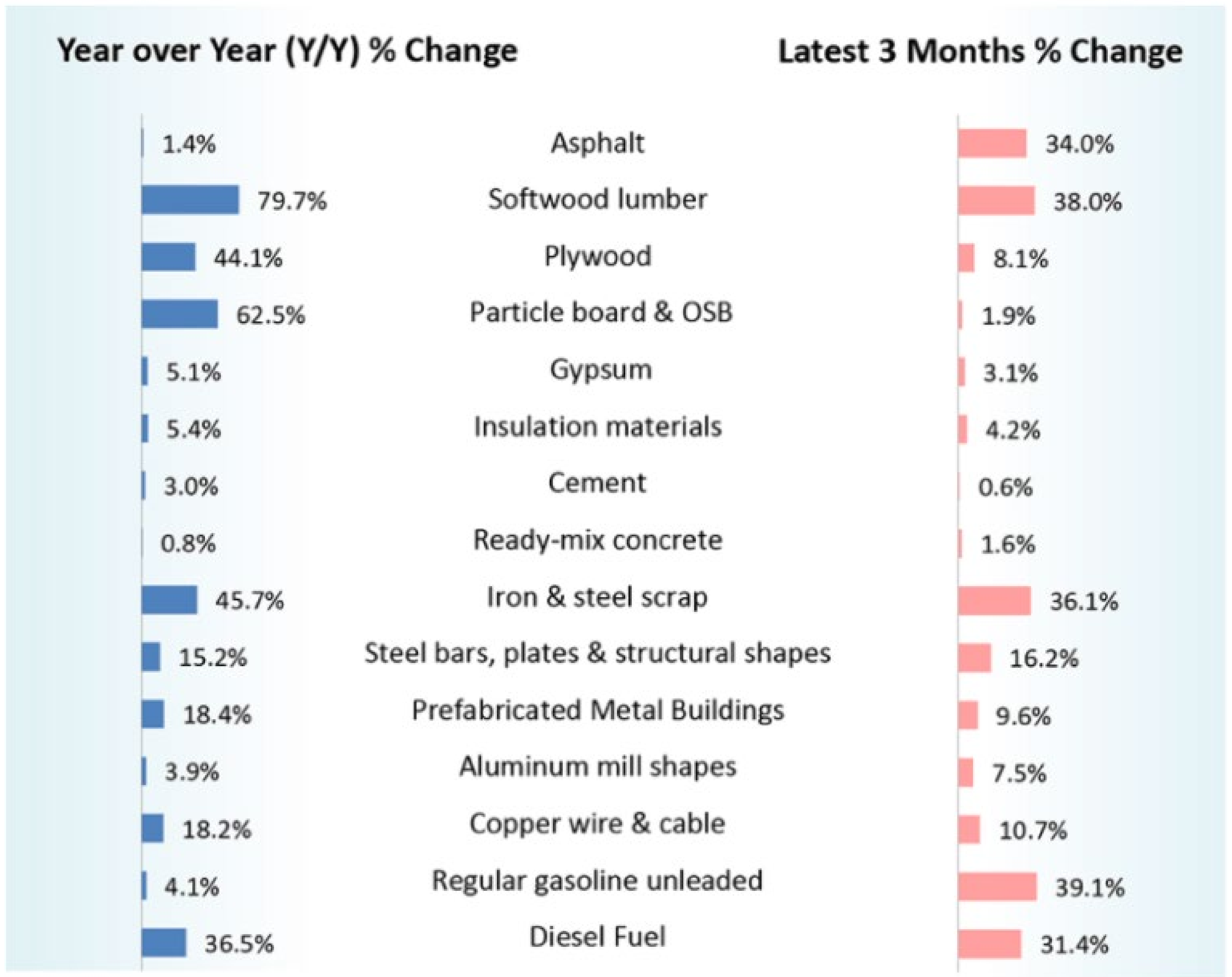
4.5 % p.a. Back to CommBank rates

This has **decreased** the borrowing power to $647,300 (**~17% decrease**) due to affordability in repayments changing while income has remained static.

This 17% decrease flows through into house prices (it won’t be 17% directly, as not everyone is in the same position - but you get the point I'm trying to make).

Let’s Put this into Today's Context

1. Building supplies costs be going through the roof



1. Rental moratoriums looking shaky as fuck
2. Housing in general across many OECD countries being correlated with consumer confidence
3. Other things i cbb finding data on, e.g. the many people who rely on the housing industry

So from this, you can start to piece together why the Fed is delaying increasing rates as much as feasibly possible. There are however other tools the Fed has available, some of which we talk about on this sub.

The Government

Welp, we don’t want to fuck over the housing market (too much), what other tools we got?

The Fed Open Market Operations.

https://fred.stlouisfed.org/series/WALCL

So, the fed can chuck up a convo with a bank and say, hey - we'll buy your assets and give you $$, usually this is for treasury bonds, among other things - but they can actually do it with anything (recently they've been buying up shady junk corporate bonds) - which is why we see point 2. In the graph shoot up when COVID hit when they went into damage control.

Quantitative Easing

Why did they do this when COVID hit? By doing this they give the bank essentially "free" new cash for them to play with, which they can then lend out to the government and businesses as required (it was - because pandemics cause businesses to be tight on money).

Quantitative Tightening

This is the opposite of easing, and is relevant to point 1. In the chart above. It's them selling off the assets they bought up in 2008 in this case. But because they sell the assets off into the market, it's essentially taking away the money it "poofed" into existence when they were enacting quantitative easing. This causes less demand, less inflation but governments and businesses won't be happy chappy.

The government will pick up the phone to the treasury and say hey, we need $$, they'll say "the Fed fucked us - as they are selling off T-bills, it's caused the market to tank which means we gotta offer higher interest rates to make them attractive". This is applicable for businesses as well in the open market when it comes to raising cash through bonds (bonds rate will also have to increase). Fucking Fed.

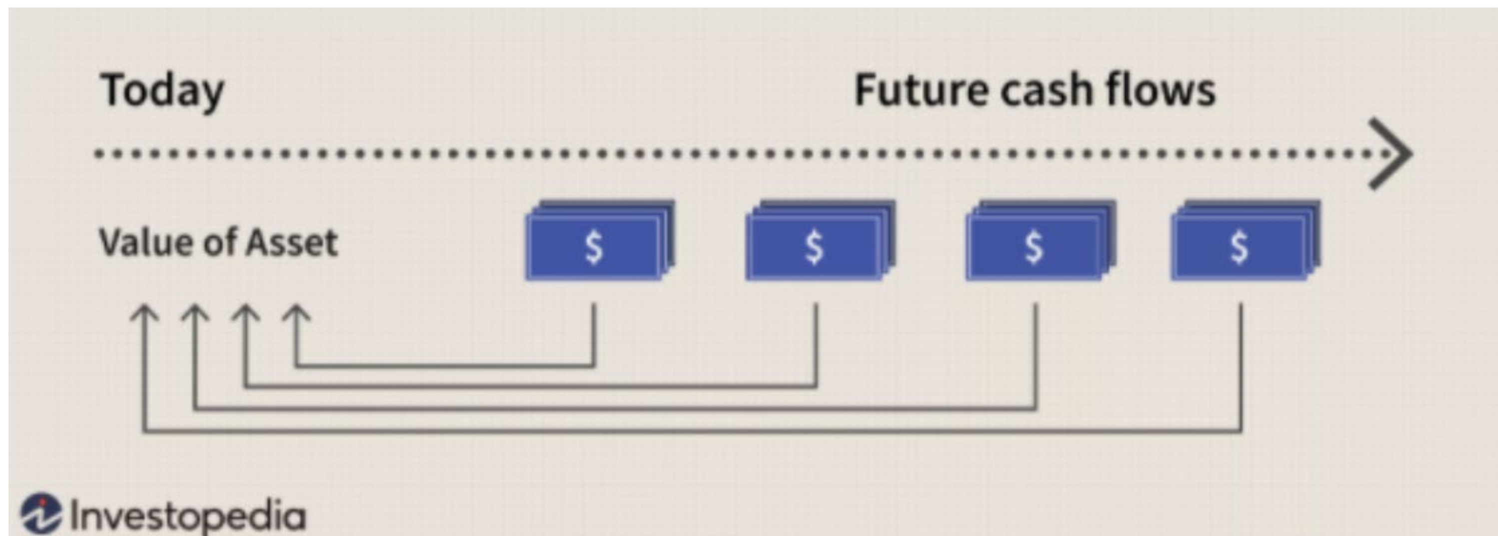
Why is this Bad Now?

COVID. Businesses are already troubled around the world when it comes to staying afloat, if the Fed makes it even harder by raising borrowing costs through Quantitative Tightening - then well - inflation occurs - lose lose situation. Businesses go out of business, supply for various sectors continues to be restricted, item value increases as a result of decreased supply = inflation. Fuk.

Stonk Market

How about stocks? How the fuck would inflation effect them?

This generally comes down to how stocks are valued, take the discounted cash flow (DCF) method. DCF values the investment based on future cash flows, calculating the present value of expected future cash flows by applying a discount rate, then arriving at a valuation.



What's this discount rate based on? Surprise surprise, the Feds discount rate. Increasing the rate will cause a lower present value of future cash flows, resulting in a lower valuation of the company in question.

This is the type of stuff that can affect growth stocks, growth is generally defined by low cash flows currently - but based on their plans expect to generate $$$$$ in the future. Compare this to value stocks, they have established cash flows - the further into the future a cash flow occurs, the lower the present value of that cash flow will be.

When we then see interest rates **and/or** inflation, growth stocks will be hit harder than value due to their mature cash flows (as their valuations will be discounted more).

How about GME?

Personally, if you miss the tie between GME and the wider economic talk in this sub, you can start to make the connection here. We talk about liquidity and margin calls. If we see inflation rise and rates rise - the natural expectation is for stock prices to decrease, which in turn could very well trigger the rocket IF stock prices actually price in this information (and margin usage does not skyrocket in step as inflation increases)

Sadly, it's not that straightforward by any means . DCF used as the example above is but one valuation method. BUT it's entirely realistic as a stock's price in the short run can be affected in the following ways:

- Short term revenue and profit reduction causing stock prices to decrease
- General economic slowdown (refer to the sections above, e.g. housing market scenario) and consumer spending in

general

- Monetary policy, higher short term interest rates means investors can and will likely start switching parts of their portfolio from stocks to lower-priced bonds
- Returns, returns, returns. As we're in an inflationary environment, investors gotta make higher returns to make an actual positive real return

Hopefully, if you did not see the connection before, you can now - when it comes to wider macroeconomic talk on our sub and its connection to GME poppin' off.

Public Relations

There are tonnes of us here who’ve realized that JPOW does not dare mention inflation is getting worse. There’s a reason for this, not some conspiracy theory, just pure logic, and human behavior.

Imagine I’m JPOW, I go on TV and tell you inflation is about to fucking explode (or it already has). What do you do next?

You start thinking, huh, my money is about to be worthless and savings rates are shithouse - I may as well spend my money whenever I get it *buys 3 new Nintendo switches*.

This basically triggers a psychological domino effect that becomes self-fulfilling. JPOW triggers mass spending, the demand causes prices to rise, inflation punches its arm through the fucking wall - inflation has now become an overriding concern in consumers. This is called Demand-Pull Inflation.

Generally, short-term bursts are not a concern, but if it persists, which it likely will in this scenario (IMO), it spreads itself across the economy and raises costs for other goods due to the dollar being worth less than it was yesterday.

Through this example, hopefully, you can see why JPOW tippy-toes around the word inflation so much.

I actually made a meme