Why We Will Have Hyperinflation

Over the past year I've heard from some people who doubt my claims that hyperinflation is in our future. I will try again to explain again why I believe massive inflation lies ahead.

First, for those who doubt my inflation claims, they should be reminded that since the creation of the Federal Reserve in 1913 the U.S. dollar has lost about 96 percent of its value. The $1.00 of 1913 is now worth about $0.04. Why? Because the feds have been printing worthless paper money for 97 years to cover their deficit spending. The term inflation comes from the process of "inflating" the money supply. Inflation is technically rising prices; inflation is the artificial increase in the money supply, which then causes prices to rise because there is more currency in circulation—but the same amount of goods and services.

In the last two years or so, Federal Reserve Board Chairman Ben "helicopter" Bernanke has inflated the money supply by about $2 trillion. (According to the National Inflation Association, the figure is $2.036 trillion since September 2008.) Most of that is still sitting in banks, which are reluctant to lend it because (1) the economy still sucks; (2) many borrowers—individuals and businesses—are over-extended and are poor credit risks; and (3) the banks are afraid of being excoriated by the feds for letting their reserve ratios get too low. The National Inflation Association states, "Excess reserves held by banks have grown by over 1,600% since September of 2008 to its current level of $1.045 trillion." (As of May 19, the total assets held by U.S. Federal reserve banks was a record $2.35 trillion. Why? Because the federal government had printed money to buy its own debt and to rescue lenders.) On the one hand, the Obama administration is pleading with the banks to lend more money to get the economy going again, yet it is warning the banks to increase the amount of money they hold in reserve so they will not fail and need to be bailed out by the FDIC.

At some point the cash that the banks have been sitting on will enter the economy. When it does, watch out. Keep in mind that banks actually lend more money than they keep "in the safe." Most of what you have in your bank account isn't really there, of course, because it has been loaned out to others (to start businesses, buy houses, buy cars, etc.) A bank might have only 10 percent of its assets in cash reserves. They can do that because it is unlikely that all their customers will show up on the same day to withdraw their money. If a bank kept 100 percent of its deposits locked up in the safe there would be no money for business loans, home mortgages, or auto loans. That is of course how banks function: They pay interest on deposits, while charging slightly more interest on loans. The difference covers operating expenses (loan defaults, salaries, rent, utility bills, etc.) and profits.

Most people have seen the movie, *It's A Wonderful Life*. Although the film has one significant flaw—the character played by Jimmy Stewart would certainly *not* be "off the hook" with the bank examiners simply because neighbors showed up and dumped cash in a basket to "save" him, any more than Bernie Madoff would be let out of jail if he now

wrote checks to pay back the people he defrauded—the point is that most of the money deposited in the bank is loaned to others. That multiplier effect is significant.

When the banks start releasing excess reserves of about $1 trillion into the economy, the result will be higher prices. *That is inescapable*. The reason, of course, is that more cash will be chasing the same amount of goods and services. If the Gross Domestic Product (GDP) is $14.5 trillion and $1 trillion is tossed into the economy, there is then $15.5 trillion chasing $14.5 trillion in "stuff." That equates to an inflation rate of at least 6 percent.

Technically we have already had the "inflation." That is, the money supply has *already* been inflated by Obama, Geithner, and Bernanke. We have not yet seen a dramatic rise in prices only because much of that "new money" has yet to be distributed.

Of course, inflating the money supply by 6 percent does not necessarily equate to price increases of 6 percent for all goods and services. Rising prices cause people to change their buying habits. An increase in the price of new golf clubs may prompt some people to postpone the purchase of those clubs, while an increase in the price of milk will not prompt parents to stop buying it for their growing children. And the people who get the new currency first benefit the most because they have access to the cash before prices rise dramatically.

Not only is the rate of inflation among different goods and services varied, the government cannot be relied on to accurately measure the overall rate of inflation. After all, it only measure prices of an arbitrarily designated "basket" of goods, like gasoline, food, medicines, etc. And it is in the best interest of the government to *undervalue* inflation because it then saves money when calculating cost of living allowance (COLA) increases in certain benefits (such as Social Security payments). As an example of government manipulation of the inflation figures, it may consider an increase in the price of automobiles not to be inflationary because this year's cars are "better" than last years' cars as a result of safety improvements like side air bags. That is, the government says, "Well, the car does cost more *but* the consumer is getting more *value* for his money so we won't count that towards the inflation rate. Or, the price of steak has gone up but consumers will not be worse off financially because they will instead buy the cheaper ground beef. The Bureau of Labor Statistics looks at the increasing price of seeing a movie and concludes that it doesn't "really" cost more because, after all, the experience is now 3-D. With such gimmickry the government is able to state that inflation is far less than what everyone knows from their trips to the supermarket. (The "official" government inflation rate of 2.02 percent does not reflect the reality of the actual 5 or 6 percent rate.) The truth is, to maintain the same standard of living costs more in 2010 than it did in 2009. Yes, in an attempt to "stay even" a family can eat less steak and more hamburger or rent a DVD rather than see the movie at the theater—but that doesn't mean prices are not increasing.

Of course the rate of rising prices can actually be worse than that calculated by comparing the amount of currency against the GDP. That is, increasing the money supply

by 6 percent can lead to price increases greater than 6 percent. The additional factor is the bank multiplier effect: a bank lends more than it actually has on deposit. A bank may have $10 million in its vault yet have $90 million in outstanding loans. That is because every depositor will not show up on the same day to withdraw all of their money. If they did, the bank would fail. That does not happen unless customers have a reason to doubt the bank's solvency. (Refer to http://www.lewrockwell.com/murphy/murphy169.html for a simple explanation of fractional reserve banking.)

As an example of "how to cause a run on a bank," on June 26, 2008 a letter sent by Senator Charles Schumer (D-NY) to the Office of Thrift Supervision (OTS) and the Federal Deposit Insurance Corporation (FDIC) was leaked. The letter expressed doubts about the solvency of the IndyMac Bancorp Inc., which specialized in mortgages. (IndyMac had made frequent "liar's loans," where a bank accepts the borrower's statement of job, assets, and income with minimal confirmation; IndyMac made over $80 billion such loans in 2006 alone.)

On June 27, Schumer told the *Los Angeles Times*, "I am concerned that IndyMac's financial deterioration poses significant risks to both taxpayers and borrowers," and the "bank could face a failure if prescriptive measures are not taken quickly." *Although the bank had been receiving net inflows of money from depositors, the release of Schumer's letter prompted a rush of withdrawals totaling $1.3 billion.* Within a few weeks (July 12), federal regulators seized the bank. It can be argued that the release of Schumer's letter caused the run on the bank—and prompted potential buyers of the bank to change their minds about acquiring it. Schumer's actions may have been illegal. Schumer denies having anything to do with the run on the bank, and instead blamed the OTS. (Some charge that Schumer intentionally leaked the letter in order to devalue IndyMac and help Democrat donors who planned to purchase the bank obtain a better sale price. Schumer would be serving prison time if such a charge could be proven.)

At any rate, a bank cannot survive if every depositor shows up at the same time to withdraw all of his money. Every dollar in deposits can represent many dollars in outstanding loans. It is faith in the system that keeps everything running. *There is no longer a dollar's worth of gold sitting in Fort Knox for every dollar bill in an American wallet or purse.* (The gold in Fort Knox—if it is still even there—wouldn't pay for even a few months of the federal government's deficits.)

Once the $1 trillion or so in excess reserves is loaned by the banks, the multiplier effect causes that amount to expand by 5 or 10 times—because the bank lends out more than it actually has, as explained above. That $1 trillion thus becomes $5 or $10 trillion introduced into the economy via bank loans. Suddenly, instead of an additional $1 trillion in new money chasing the nation's goods and services, there is $5–$10 trillion in "new money" in the economy. What is the effect of an additional $5 trillion in a $14.5 trillion economy? Hyperinflation. You cannot add $5 trillion (or more) to a $14.5 trillion economy without massive price increases, because there will be an additional $5 trillion chasing the *same amount* of goods and services. Unless the productive output of the

American worker increases by the same percentage as the increase in the money supply, there will be massive inflation. (If the money supply is increased by 30 percent and workers suddenly become 30 percent more productive, there would arguably be no inflation because the supply of goods and services would keep up with the supply of currency. But if the money supply is increased by 30 percent and productivity increases by only 5 percent, the inflation rate would be, on average, 25 percent. It is rare for the GDP to increase more than a few percentage points per year. It is therefore assured that if an additional $5 trillion enters the economy the result will be massive price increases.)

The economy is far too complicated for anyone to predict an exact inflation rate. Please don't waste time writing to tell me that Bernanke printed "only" $1.753 trillion (or whatever amount you have read) or that the GDP is actually a little lower or higher than $14.5 trillion. The actual numbers are not important; it is the *concept* that is critical to understand. And the concept is that because the paper currency is *not* backed by gold—or anything else for that matter—it is not inherently "worth" anything. Similarly, your house is not "worth" $200,000 just because you believe that is what it is worth. *It is "worth" only whatever someone else is willing to pay for it.* You are free to believe that your house is worth $1,000,000 but if you put it on the market and the highest offer is $375,000, then it is only "worth" $375,000 at that moment in time. The U.S. dollar is the same. *It is, after all, only a piece of paper*. In 1913 the dollar was "worth" a lot more than it is worth today. (As a child in the 1950s I could buy a Popsicle for $0.07. Today it might cost $1.00. Is the Popsicle now more expensive because the icy treat is "worth" more? No, it is more expensive *because the dollar is worth less*.)

Money is nothing more than paper that you trust others will accept as something they can, in turn, exchange for something of value. And the federal government has to keep printing it because the deficits are too high to sell enough Treasury bonds to China and other nations to finance the government's budget deficits. The more dollars the government prints, the less they are worth—and the more expensive that Popsicle becomes.

What China isn't financing—or you aren't financing by purchasing U.S. Savings Bonds or T-Bills—the Federal Reserve is "financing" by printing money. Well, it's actually not printing it. It is merely making bookkeeping entries. The banks are sitting on that cash to prop up their balance sheets. (The Federal Reserve is currently paying those banks 0.25 percent interest on their reserves.) That is angering Obama, who desperately wants the banks to lend that money to get the economy moving. But the banks are reluctant to do so.

But when those banks start passing out the new cash in the form of loans, prices will go up. *That is inescapable*. People can argue with me all they want, but I have 97 years of history on my side. The creation of "funny money" by the Federal Reserve has caused inflation since 1913. It cannot be avoided. The reason a house used to cost $15,000 and now costs $250,000 has nothing to do with the house being "worth" more. It merely costs more because more cash has been printed and tossed into the economy. (Granted, over the years the house may have had some improvements like the installation of central air

conditioning, etc., but that doesn't account for the dollar dropping from $1.00 to $0.04 since 1913.)

Foreigners now hold about $10 trillion in U.S. dollar assets of one form or another. If they start exchanging those assets for gold, the price of gold will skyrocket and the value of the U.S. dollar will plummet.

We are at a turning point in the history of our nation. The federal deficits are now so enormous that it is *impossible* to balance the budget without drastic spending cuts, drastic tax increases, drastic borrowing, printing more money, or defaulting on the debt entirely. And *any* of those options will harm the economy and negatively affect the lives of 300 million Americans.

The politicians (of both parties) do not have the guts to cut spending, because too many voters rely on that spending. Who will dare reduce Social Security benefits? Medicare? Medicaid? Salaries of federal employees? The politicians do not even have the courage to eliminate useless agencies, such as the Department of Education, let alone entitlement programs. (For a list of spending targets, visit: http://www.colony14.net/id377.html.)

Not only can they or will they not cut spending, the politicians cannot raise taxes enough to cover the deficit—because there is not enough earned income for that purpose. If you taxed everyone who earns $250,000 or more at *100 percent* you would still fall far short of balancing the federal budget. (And you certainly cannot tax people at 100 percent—even though some Obamatons may believe that is the solution.) The wealth of Bill Gates, Warren Buffet, and Oprah Winfrey combined could not even cover the deficit for even one month. It is pointless to waste time arguing about whether the top federal income tax rate should be 35 percent or 39.6 percent—or 99 percent.

The next available "solution" is more borrowing. But that is becoming a major problem because everyone has figured out the game everyone else has been playing. (This is due in part to the Internet, which allows tens of millions of people to be informed—rather than relying on the pabulum they are spoon fed by the mass media.) It is all a house of cards, and everyone knows that pretty much every "civilized" nation is simply printing worthless paper currency. And because so many nations are broke (Greece, Ireland, Italy, the United States, Great Britain), we are running out of people with money to buy the debt. In total, China probably holds less than $1 trillion in U.S. debt; it certainly cannot afford to buy $1 trillion in U.S. bonds every year forever. (China is in the midst of its own housing bubble; when that bursts it will be more worried about feeding its growing population than bailing out the United States government.) Greece is being bailed out with loans from other European nations. But those nations are *also* running annual deficits, so the money being loaned to Greece is still more borrowed money. Some is coming from the International Monetary Fund (IMF), which gets a portion of its cash from the United States. But the United States is running massive deficits and must borrow to stay afloat. (The United States is therefore borrowing money from China to give to the IMF to lend to Greece. And Greece is broke because too many of its citizens

are living off the government in the form of welfare payments and early retirements. Americans will therefore have to work harder so that the Greeks can work less.)

The United States government is beginning to have difficulty selling its Treasury bonds—its debt. Why? Because the interest it is paying is too low to attract buyers. To make U.S. bonds more attractive to investors, the feds have to raise the interest rate. Buyers are saying, "No, I want more interest or I won't buy your bonds." That puts the government in an even worse position, because as interest rates go up, more and more of the federal budget must go to interest payments. At some point the house of cards will collapse. It is like paying off your Visa credit card with your MasterCard, your MasterCard with your American Express card, your American Express card with your Discover card, and your Discover card with your Visa card. At some point it catches up with you—and that time arrives more quickly when the interest rates increase. The U.S. government is now nearing that disaster point.

The federal government's next option is printing even more money to cover the debt it cannot cover by selling bonds. The problem now is the sheer enormity of the debt. Over the years, people have been tricked into accepting a little bit of inflation. (They *should* have started screaming in 1913.) But at some point all Hell will break loose; at some point they will angrily gather their pitchforks and throw the bums out. That's what happened to Jimmy Carter. He was not personally to blame for the nation's massive inflation; he just happened to be the poor soul in the Oval Office when many of the bills fell due and money had to be printed to cover the massive spending of LBJ's "great society" and the Vietnam War. (Carter made it worse with his actions, of course, because he increased federal spending—just as every president in the last 100 or more years has done.)

A $450 billion deficit—the approximate final deficit in the Bush administration—covered by borrowed and worthless, freshly-printed, paper currency is bad enough. But now we have *$1.5 trillion* deficits facing us… year after year after year. No one in Washington is willing to cut federal spending enough to make any dent in the problem—except perhaps Ron Paul, Paul Ryan, Eric Cantor, Michele Bachman, John Thune, James DeMint, and a few others—and aside from some of the Tea Party candidates most politicians either do not realize the extent of the problem or are simply kicking the can down the road for someone else to deal with.

That is what Obama will do. He will kick the can by printing money, while paying lip service to deficit reduction. He is not fully to blame, of course. Like Carter, he came into office with many decades of deficit spending preceding him and trillions in accumulated debt. But, like Carter, *Obama is making it worse* with his additional spending. In Obama's case he is making it *much* worse. He has added so much to the deficit that the house of cards is now collapsing. He has piled on so much debt that *no matter what course he takes the result will be a disaster for America.*

In the short run many will argue that I am incorrect. They will point to the dollar gaining against the euro currency, and a (more or less) rising stock market. But the dollar is only

going up because the euro is collapsing. The dollar looks better only in comparison—it is merely “less worse” than the euro at the moment. The dollar is also collapsing. And the stock market has risen only because people have nowhere else to park their money. Putting it in the bank is useless because, after taxes and inflation, Americans lose money in the process. (That, after all, is why people were so eager to invest in housing. They saw housing prices rising faster than inflation, while money in the bank was losing value to inflation and taxes. Irresponsible federal deficit spending therefore encouraged people to make unwise investment decisions. When the only “sure thing” is a bank deposit that *loses* value, people will gamble with housing they cannot afford but which they believe will pay off in the long run.)

The politicians and the wealthy know that hyperinflation is on the way. That is why they are buying commodities like oil, minerals, gold, and silver. They know that money will continue to be printed and that inflation will be the result. They won’t care that milk will go from $4.00 to $15.00 per gallon any more than they cared when it went from $0.69 to $4.00 per gallon—because they will have taken inflation into account with their investments and made millions. Their millions will certainly be worth less because of inflation, but they will still be better off than everyone else.

With anticipated inflation, the key is to invest in whatever will increase in value faster than anything else. Many would argue that means investing in commodities. That is, rather than invest in what is *manufactured* (like iPods or automobiles), invest in what things are made *of* and *with* (like oil, copper, aluminum, coal, silver, and gold). People will postpone the purchase of a new electronic gadget or a set of golf clubs before they will ignore their electricity and heating bills. (More than a few may not skip the golf clubs unless their credit cards are maxed out, but their day of reckoning will eventually arrive—as will the federal government’s.)

If things get *really* desperate we may reach a point where people will engage in barter rather than trust paper currency. In that environment the winners will not be the people with money in their wallets, but the people with items of value that they can trade. At that point even owning shares of a gold trust may be meaningless if the feds swoop down and confiscate the gold (as FDR did in 1933). But coins hidden in your home are more difficult for the feds to confiscate—especially with the Second Amendment (which some leftists may suddenly start to believe in after the manure hits the fan).

What you want is “stuff” of value that you can trade—after people realize that their paper money is worthless. (Don’t think it can’t happen in the United States. It happened in Germany and the resulting societal chaos brought Hitler to power, and in Zimbabwe recently. And it happened because those governments were printing money non-stop.) What will be most valuable in a disaster scenario? Who knows? Maybe gold coins, maybe silver coins. Maybe candles, matches, guns, ammunition, cans of soup, bottled water, toilet paper, or batteries. Perhaps knowing how to bake a loaf of bread from scratch will prove to be incredibly valuable, and you can trade a loaf of bread for some candles—keeping “money” out of the equation altogether.

More important than the items of value you can trade will likely be where you live. Living away from the big cities with large welfare populations may be wise. When bread costs $14.00 per loaf and millions of people become more hungry, frustrated, and angry than they have ever been in their lives, you will want to avoid them at all costs. The most civilized people on earth can be expected to do anything when they become part of an angry mob. You will be better off living in a small rural town where everyone knows everybody else and they also know how to grow crops and raise farm animals. The last place I would want to be is a wealthy area that is near a poor area. (Those familiar with the Chicago area are probably thinking of the suburbs Oak Park and Evanston.) When the poorest of the poor riot, they'll ransack the nearby homes looking for food and anything else of value; they won't be marching to a town in Iowa with 532 residents—many of whom have guns and ammunition.

To avoid the worst case scenario the federal government has to cut the deficit and start steering the ship of state away from the icebergs. The solutions mentioned so far have been cutting the budget (the only valid solution, but it requires political courage), raising taxes (which will further weaken the economy), borrowing more money (which further increases the deficits and the national debt), and printing more money (inflation). There will be reliance on all four, but the heaviest reliance will be on printing money because it is the easiest and the simplest politically. (Kick that can down the road.) That is why I predict massive inflation. Obama knows it is coming (unless he is an idiot), but he is hoping it comes *after* the 2012 elections.

The only remaining solution is defaulting on the debt. That is, the federal government essentially declares bankruptcy and says to anyone who holds U.S. debt: "Sorry, suckers. We can't pay you back." If you ever bought a U.S Savings bond, too bad." (Use it to light a fire.) If you have $10,000 in U.S. Treasury bonds, they are worth zero. Those hundreds of billions China loaned us? Sorry, we can't pay you back. (The state of California may actually be a proving ground for default, because it has horrendous debt levels that cannot be sustained and it does not enjoy the option of printing money to pay its expenses. But look for Obama to bail out California because he needs its electoral votes in 2012. Of course, that will prompt Illinois, New York, New Jersey, and dozens of other states to line up for their handouts. And the feds will print even more money to satisfy them.)

A federal default of the national debt is actually a somewhat attractive solution. It is akin to filing personal bankruptcy. The down side is that the holders of U.S. debt will lose upwards of $13 trillion. And that includes just about everyone. On the other hand, a default would force the U.S. government to finally balance its budget *because no one in their right mind will ever again be willing to lend it additional money in the future*. No one will buy its Treasury Bills or Savings Bonds because they will anticipate being burned again. Cutting the budget to keep it in balance would force the government to stop the handouts. People on the dole would have to get back to work. But jobs would be available because the economy would be growing by leaps and bounds—with more cash in the *private* economy and far less in the *government* economy. But even with a default, people's confidence in paper money might plummet and the nation would still experience

hyperinflation. (How much would you charge your neighbor for a loaf of bread you just baked today if you didn't know what a gallon of milk will cost tomorrow?)

Of course, a default would never happen. If we got even close, the government would start World War III to keep us all preoccupied.

That's my take on it. Reject or accept my opinions as you see fit. But don't say I didn't warn you.

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