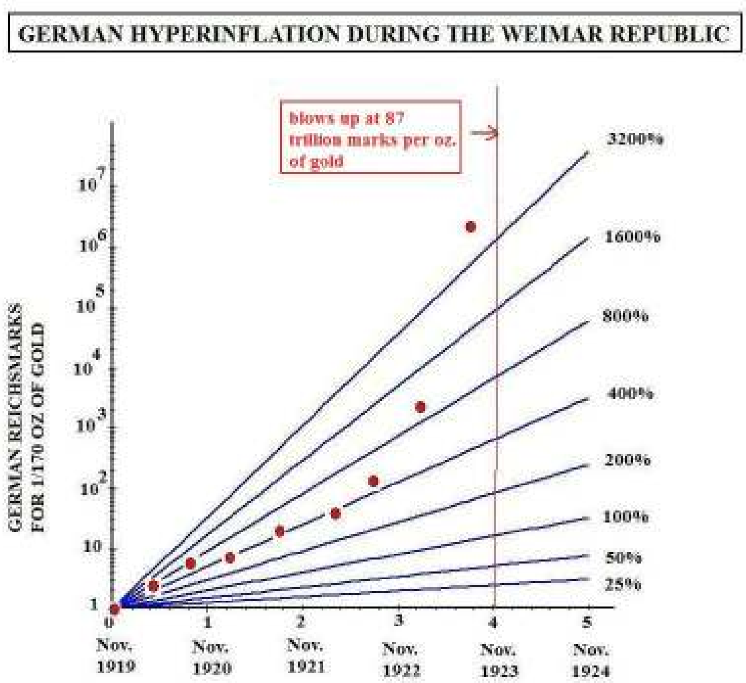
COULD THE UNITED STATES EXPERIENCE HYPERINFLATION?

A question being asked more often these days is "Are we and much of the rest of the world headed for increasing inflation rates and possibly hyperinflation as experienced in recent years by Zimbabwe and in the 1920s in Germany"? The answer is that increasing inflation is an almost certainty considering the rising government expenditures for defense, infrastructure and social services accompanied by an insufficient tax revenue base to pay for these services. The fact that money is no longer backed by material things such as gold has given the central government and especially the Federal Reserve in the United States an almost carte blanche opportunity to create money out of thin air in order to pay for mandated government needs. This trend has been on the increase and has recently reached a dangerous level due mainly to the recent actions by Fed Chairman Ben ("Just print more Dollars and drop them from Helicopters") Bernanke. His attempts to stimulate a flagging economy with several quantitative easing efforts involving the creation of trillion of un-backed dollars of paper currency have raised the specter of increasing (and possibly uncontrollable) inflation in coming years. To demonstrate the seriousness of this situation, I show you a graph of the United States Adjusted Monetary Base over the past 25 years as reported by the Federal Reserve Bank of St.Louis-

ADJUSTED MONETARY BASE-St.LOUIS FEDERAL RESERVE

Note the sharp jump in the monetary base starting with quantitative easing QE1 and followed by QE2. This increase in dollars floating around the economy here and in the rest of the world needs only the spark of increasing velocity of money exchange to trigger a major inflation period. Note the fact that the stock market has nearly doubled in the last two years is a direct consequence of this increase in available money. There is actually no increase in real wealth produced by this rise since it does not match the factor three increases in the monetary base. The stimulus money being injected here and abroad also accounts for the recent rapid increases in commodity prices for wheat to gasoline to metals such as copper, silver, and gold. The only thing which has been holding back an accelerated rate of inflation in the United States is decreasing home prices and high unemployment rates. Once these improve, major inflation rates are guaranteed to accelerate. Whether this inflation will be as bad or worse than the "not worth a continental" of revolutionary days and “greenback dollars” during the later stages of the civil war, remains to be seen. Even without accelerated inflation during the past two years, the policy of quantitative easing has kept interest rates artificially low and therefore **deprived people who saved all their lives of getting a positive return on their savings**. In effect, it has reduced the value of their savings to about half the value in three years due to the sharp increase in the non-backed monetary base and the stock market drop of 2008. Europe is not much better off. The richer countries are in the process of bailing out weaker countries such as Greece, Ireland, Portugal, Spain and Italy, just like the US government has been doing with our larger banks. It is clear to me that the only way the economically stronger European countries can keep their inflation rates low is to dissolve the European Union. The only way the US can avoid inflation is to immediately stop quantitative easing while simultaneously introducing an austerity program including reducing military spending, decreasing Social Security and Medicare payments and also increasing tax rates for all including the 50% who now pay no federal tax.

To show you what could happen if such measures are not taken, I have made a graph of the time progression in the early 1920s inflation of marks during the Weimar Republic in Germany. There the government was trying to reduce the size of WWI reparations payments by in effect inflating their currency. It led to an uncontrollable hyperinflation as shown-



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The red circles give the estimate of the number of Reichsmarks required to buy 0.006 oz of gold. At the peak of the run-away, it took about 87 trillion marks to buy one ounce of gold. I remember my mother telling me about living through this inflation period as a child in Leipzig , Germany. It wiped out the majority of the life savings of millions of families and laid the track for the rise of National Socialism. Her family, who where in the manufacturing business, survived the period by having most of their assets in land and buildings. The same kind of run-away inflation could happen here. The rise of the price of gold to near $1500/oz for the first time today and yesterdays warning of a possible downgrade of US debt by Standard and Poors are clear signs that **things are not right with the US economy.** Ben Bernanke seems to be fighting deflation with Keynesian methods when the real culprit is inflation or more correctly stag-flation. It must always be remembered that printing more money without proper backing by a commodity such as oil, silver, or gold inevitably leads to undesired inflation. Look back at the monetary history of Hungary, Zimbabwe, Germany, Argentina, Bolivia, Brazil, among many other countries to confirm this. A good measure of just how far the value of the dollar has already dropped in the last 34 years is gotten by noting that I paid $170 for a one ounce Krugerrand gold coin back in 1977 and I can sell the same coin today for $1550. The intrinsic value of this coin sitting in my bank's safety deposit box hasn't changed but what the dollar will buy has.

I witnessed the beginning of a run-away inflation in Bolivia back in 1982. We arrived late one night in LaPaz and were staying at the downtown Sheraton Hotel. Having no local currency with me, I went early the next morning to the nearest bank across the street to exchange some dollars. When arriving there I noticed that the locals where queued in a long line trying to withdraw their savings. On inquiry I was told that their currency was inflating at nearly 100% a year and that it therefore made no sense to keep it in the bank instead of spending it. Thus, I was here seeing a clear example of an accelerated increase in the velocity of money where people begin loosing faith in their currency and try to spend it as fast as possible. They were right in their actions since the Bolivian inflation accelerated by 1985 to ridiculously high levels forcing a devaluation at one million old pesos for one new bolivian peso. Most Bolivians ended up loosing their life savings. The US dollar may be close to were the Bolivian paper currency was in 1982. All it would take to destabilize the world financial system would be for China to dump the trillion plus dollars it holds in the form of US treasury bonds. An ominous sign is that the US Treasury Department under Tim (" What number comes after a Trillion?") Geithner has recently been buying a large fraction of its own treasury bonds in order to finance the government. This is like lifting yourself by your own bootstraps**. It won't work, it debases the dollar, and history teaches us that such a scheme always ends badly**.