Letters to the Editor: The Road to Zimbabwe

June 30, 2009

The following letters are in response to our article, The Road to Zimbabwe, which appeared last week.

Dear Editor:

Mr. Williams is 100% correct. I have been equating the US to Zimbabwe for years. Both have identically incompetent nitwits in charge of their respective banking systems and governments. What do bankers know how to do? They print money, swindle the population, and lie about their accounting.

Bernanke is at heart a Zimbabwean. He honestly thinks he can print his way out of anything. As Zimbabwe destroyed their economy with the printing press, their Zimbabwean Industrial stock index went to 45 with 18 trailing zeros. No one even knows what that number is - but it has been one of the better performing indexes in the world over the last couple of years. Of course, they finally had to eliminate 10 zeros from their currency as they released a $50 billion dollar bill (it bought three newspapers) in January, 2009. The moral is you can make the stock market go up if you print enough dough.

The point of this exercise is to keep the masses distracted and in the game while the banks fleece them of their assets. That which you own is a debt and not an asset when monetary debasement is the government’s strategy. Governments run this scam by artificially boosting the stock market at all costs through any means necessary.

Will we see hyperinflation? No, because our pathological lying government will always put out a CPI number that shows less than true inflation. Besides, the only tool the Fed has to control inflation is the Fed Funds rate. When inflation strikes, the Fed seeks to drain money from the system by selling Treasuries. Currently, our Fed is engaged in a debt enabling action of buying $300 billion in Treasuries from the Treasury Department as auctions come to market over the summer. In case you don't know, our Treasury needs to issue some $3.25 trillion in debt this year alone to keep the government operating at its stimulative pace. For round numbers, let's say the Fed winds up (in truth) with a trillion in Treasuries. How can the Fed govern monetary policy when they own the instrument of control? Selling Treasuries would inflict damage on the Fed's portfolio.

Raising the Fed Funds rate from its current level of zero to anything would likely erode the value of Treasuries. Would the CEO of the Fed bank intentionally destroy his bank's

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portfolio? Oh well - at least the national language in Zimbabwe is English. We won't have to learn a new word for bankruptcy.

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Sirs:

Mr. Williams is the latest iteration of the Paul Erdman (a la Crash of 1979), Howard Ruff, et. al. genre of doomsayers. Ruff recently resurrected his 1978 book, “How to Prosper During the Coming Bad Years” - not because it is relevant but because there are again legions of Chicken Littles ready to build financial bomb shelters after the bombs have exploded. Remember, around the time these books were published, (Erdman’s book was a NY Times bestseller) in January of 1978 the Dow was at 800. Ten years later, even after the 1987 crash, it was at 2,200, an 11% per year compounded return. Even after the recent decline, the Dow has returned 8% per year since 1978, a tenfold increase. Those who purchased gold in 1981 based on the advice of these doomsayers have yet to make their money back in real terms…after 29 years.

Williams is a one dimensional, formulaic numbers guy who ignores the fact that an interdependent global system cannot fail as long as the participants recognize the necessity of their interdependence and don’t all simultaneously demand that their deposits be returned. The numbers he cites regarding unfunded liabilities are not numbers that are due now, but rather are promises to pay over many years. Relatively small changes now could greatly reduce these numbers in the future. However, I am concerned that our dilatory politicians spend time arguing over the salaries of TARP recipients while ignoring the task of finding solutions to these pressing issues, as well as many other more important but politically delicate problems. Time and growth will solve the current set of challenges but other measures, including regulatory and tax reforms, austerity and government support primarily in the form of backstops are needed and will eventually appear.

Smart investors (and some economists who occasionally look up from their textbooks, spreadsheets and calculators) recognize that this crisis, like others before it, will pass; it is not the end of the world. If it were, then gold would be $2,000 an ounce. It isn’t.

While legions of pundits propound a variety of scenarios - many with opposite views - experts with equally impressive credentials are expressing diametrically opposite viewpoints. The whole punditry game is highly problematic. They should be ignored.

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In the final analysis growth, reflation and time will get us to a state of lower but sustainable rates of production of goods and services and ultimately to a better state of affairs. After 32 years in the business, I have an unshakeable faith in the future of a basic economic proposition: people will get up, put on their clothes and go to work, trying to do things better, faster and cheaper than those with whom they compete. This inescapable human condition supports the assertion of Bernard Baruch who said, "There are no bears on Park Avenue."

Regards,

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Dear Editor:

"Lenin was right. There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on the side of destruction, and does it in a manner which not one man in a million is able to diagnose." [Keynes, 1919]

There is no question that we are going down a path of greatly reduced purchasing power of the dollar. John Williams at Shadowstats provides a great service with more meaningful and factual data that provides insight into economic and market trends. However, the economics of inflation are far more complex than the relatively simple view he provides.

I disagree that the facts he points to imply that we will see such rampant inflation in the next 12 months or less. There could be other facts that do, and we might well experience something extreme, but I don't follow the conclusion from what's presented.

As Keynes says, inflation is very complex and barely one person in a million will be able to properly diagnose and/or predict its effect with any degree of certainty. Points that need to be considered:

- The government's unfunded liabilities are astronomical, but that's discounted over the next 75 years or so. How does that factor in to the next 12 months specifically? If we print only the money we need next year, what causes inflation to accelerate faster than it has in, say, the last year or so?

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- All historical currency collapses that necessarily result in hyperinflation have been accompanied by speculative shorting of the currency in a targeted coordinated attack by well-financed investors with access to large pools of capital. The printing of currency by a sovereign government generally cannot result in what we would call hyperinflation in and of itself. Who will mount a speculative attack against our currency with the requisite amount of US dollars? I don't think it's possible to leverage enough pools of capital to short the dollar with enough vigor to drive it down into hyperinflation as happened in Zimbabwe, the smaller Asian currencies in the late 1990s, in Latin America, or as Soros famously did with the British pound. No doubt, as reality sets in on the dollar, foreign dollar holders will divest themselves of bonds and dollars, reducing their long positions, but is this enough to hyperinflate the dollar in a way that damages US consumers' purchasing power? I don't think it's possible, even if we can divine the intentions of notoriously secretive sovereign wealth funds.

- As the dollar weakens, all other nations' currencies will inflate. They cannot afford to see their exports to the US collapse any more than we can tolerate a collapse of the dollar. So the question has to be asked: against which currencies will the dollar collapse? Hyperinflation implies it collapses against the price of bread, gasoline, everything, if not other currencies as well. If it doesn't collapse relative to other currencies, what does that look like? Will it collapse against all commodities and precious metals? Probably. Will it collapse relative to real estate? Maybe. Who knows? Inflation shows up in various asset classes at wildly different rates. What if gold skyrocketed in value to $5000/oz.? Could the US government exchange gold to sop up enough of the money supply to mitigate inflation? It might be able to if it wanted. The velocity of gold is much lower than currency. Devaluing the dollar against gold has been theorized as a mitigating mechanism to shore up the economy, as FDR did in the thirties. This is a complex scenario that is not beyond the realm of possibility and its impact would be hard to predict.

- Inflation calculations necessarily must include the velocity of money. The higher the velocity, the faster and the greater the inflation. What if the money supply increases dramatically, but the velocity of money continues to decline? What if the vast majority of consumers continue to see their wealth decline and either hoard cash, or the increased money supply can't find its way into the right hands to create demand in prices across the board? If the vast majority of consumers don't see increasing dollars in their hands, either through increased unemployment or declining real wages, it's hard to say what the results will be. All it takes will be a single asset class to sop up the extra dollars (like gold above), the way foreigners have been sopping them up for the last decade or more in the form of US bonds for the apparent effect of inflation to be mitigated, even with accelerated government spending. Could we have another asset bubble that sops up excess cash so it does not flow into consumer prices? This is more likely if the increased money supply stays in the

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hands of only a relatively small number of parties with a low velocity of money. Will Ben drop it from a helicopter or will banks sit on it to bolster balance sheets? Who can predict?

- The vast majority of the money supply comes not from the government. printing excess cash but from bank loans and free flowing credit. This is probably still in the process of contracting, although eventually inflation may overwhelm this effect. Since a dollar on deposit can eventually (maybe years later) contribute to a 10x increase in the money supply, how are we going to increase the rate of bank loans from what we've already seen? Loans are getting tighter, Americans are trying to save more and businesses are taking on less risk. All are factors that will continue to mitigate inflation in the near to mid-term.

The other historical case of hyperinflation that the current U.S. situation is frequently compared to is Weimar Germany, where wheelbarrows of cash were used to buy bread or as kindling. Ellen Brown has an excellent article on the causes of this hyperinflation and a comparison to our current situation at her blog She also points out that hyperinflation was only partially from government debt/spending for post-war reparations. The Weimar currency commissioner, Hjalmar Schacht, said, "What actually drove the wartime inflation into hyperinflation was speculation by foreign investors, who bet on the mark's decreasing value by selling it short."

I agree with Marc Faber's view of hyperinflation here on CNBC: http://www.cnbc.com/id/31450173. It's probably coming, but it won't come as fast as the dollar bears predict. It's a much more complex situation with powerful contrary forces in place which any one person cannot accurately predict.

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