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HYPERINFLATION OR HYPERDEFLATION?

The Quantity Theory of Money

James Turk's article *Hyperinflation Looms* dated April 20, 2010, is based on Quantity Theory of Money (QTM). It draws an analogy between Weimar Germany of 1923 and the United States of 2010. Both precepts are invalid. As far as the QTM is concerned, it suffices to point to the very fact, admitted by Turk, that it is possible to have a shortage of money simultaneously with the overworking of the printing presses. Hyperinflation is not the same as the ultimate inflation of the money supply. It is the ultimate depreciation of the currency unit. The two concepts are far from being the same, QTM notwithstanding.

The reason why QTM fails is that money is not one-dimensional. It is in fact two-dimensional. Quantity is one, and the velocity of circulation is the other dimension. Central banks control the former, and the market firmly controls the latter. As long as fair weather lasts, velocity may be ignored. But as soon as the weather grows foul, velocity returns with a vengeance. If it increases, we talk about inflation. If it decreases, we talk about deflation. In the extreme case the increase in velocity may start feeding upon itself and velocity could grow beyond any limit. People buy anything they can lay their hands on because they expect prices to rise further. This is hyperinflation, wiping out the value of the currency unit. It is an irreversible process: once fiat currency loses its value, it is lost for good. The pendulum has stopped swinging. If there is a bounce, it is the dead-cat bounce.

But it is also possible that, at the other end of the spectrum, the shrinkage in the velocity of circulation refuses to stop and starts feeding upon itself. People postone buying indefinitely because they expect prices to fall further. This is hyperdeflation. It manifests itself in the ever rising value of the currency unit. It is important to remark that *it can happen while some prices are still rising*. Other than gold, food and energy are two important exceptions. People have to eat, and they want to keep themselves warm and mobile, no matter what. Paradoxically, this may reinforce deflation. Because of rising food and energy prices people will have that much less to spend on other goods, accelerating price declines in other sectors. This defeats the arguments of Turk and others who try to refute the case for deflation by pointing to high or rising cost of food and energy.

The point in either pathology of money is that the government is helpless. Once the point of no return is reached, there is nothing governments can do to convince people that the process will end — short of opening the Mint to gold and/or silver. As far as people are concerned, the feedback from their experience tells them to expect more of the same.

I am not trying to adjudicate between the two schools of thought, one asserting that hyperinflation and the other asserting that hyperdeflation of the dollar is inevitable and imminent. I am merely trying to point out certain facts about deflation that most people are unaware of, or tend to ignore.

Let me state first that it is not impossible for the dollar to go into hyperinflation during the next 12-month period. For example, consider the case of a shooting war between the U.S. and Iran in the Persian Gulf. After an initial euphoria the American military could start suffering setbacks on the ground, in the sea and in the air, simply because of the longer lines of communication from the home base, and also because of the disadvantage of the aggressor in face of patriotic zeal on the part of the defenders (c.f. Vietnam). In this scenario hyperinflation of the dollar could be a possible outcome. But short of war threatening to destroy supplies and producing facilities the word 'hyperinflation' rings hollow in the ear.

Post-World-War I Germany *versus* Post-Cold-War U.S.

To draw a parallel, as Turk does, between Weimar Germany and present-day U.S. is, to say the least, grotesquely unrealistic. In 1923 the once mighty German army was defeated and disarmed, the navy was scuttled, the territory of the country was badly truncated by the peace treaty of Versailles, the Rhineland was under military occupation while the rest of the country was still under a partial blockade. No speculator would touch the falling Reichsmark, except to short it.

By contrast, the United States in 2010 has an army, navy and air force that can be put on high alert in a matter of minutes. Its military bases pockmark the face of the globe. The over-riding fact is that the whole world is still anxious to sell its wares on the American market, and is happy to lend back to it the proceeds of the sale in order to finance future U.S. purchases. Furthermore, it is a fact that the bond market trading U.S. Treasury debt is still the largest and most liquid in the world. Significantly, it still has room to go up — thus offering speculators juicy profits at a time when the bloom is off the stock and the real estate markets. How can you compare the circumstances of a beggar with those of the emperor — prodigal and bankrupt as though the latter may be?

All the signs around us point to deflation. The money supply is being pumped up on an unprecedented scale, but all it does is pushing on a string. You cannot make a case, as Turk is trying to do, out of the fact that the price of crude oil doubled as compared to its recent low. Another fact, more startling, is that the price of crude oil has declined 45 percent as compared to its all-time high. We must see the general decline in world prices, even though in some cases they may be disguised as a loss of pricing power of the producers. True, list prices have not declined, but nobody trades them. They are for window-dressing only.

Obviously, you need a theory to explain what is happening other than the QTM. I have offered such a theory. I have called it the Black Hole of Zero Interest. When the Federal Reserve (the Fed) is pushing the rate of interest down to zero (insofar as it needs pushing), wholesale destruction of capital is taking place unobtrusively but none the less effectively. Deflation is the measure of wealth in the process of self-destruction — wealth gone for good. The Fed is pouring oil on the fire as it is trying to push long-term rates down after it has succeeded in pushing short term rates to zero. It merely makes more wealth self-destruct, and it makes the pull of the Black Hole irresistible.

But why is it that the inordinate money creation by the Fed is having no lasting effect on prices? It is because the Fed can create all the money it wants, but it cannot command it to flow uphill. The new money flows downhill where the fun is: to the bond market. Bond speculators are having a field day. Their bets are on the house: if they lose, the losses will be picked up by the public purse. But why does the Fed under-write the losses of the bond speculators? What we see is a gigantic Ponzi scheme. The Treasury issues the bonds by the trillions, and promises huge risk-free profits to the bond speculators in order to induce them to buy. Most speculators believe that the Treasury is not bluffing and they buy. Some may believe that the Fed is falsecarding doubts and they sell. But every time they do they only see foregone profits. What we have here is a rare symbiotic relation between the government and the speculators.

When he was forced out of business by the courts, and his customers lost everything they invested, Charles Ponzi declared that he would have paid them to the last cent as contracted if they had let him. There is no reason to doubt his sincerity. Now, 90 years later, Charles Ponzi's dream has come true. The US government is duplicating Ponzi's scheme in the bond market. The only difference is that the stake is much higher: it is the national, nay, the world economy! And, most importantly, this time there is absolutely no danger that the courts will stop the racket. The world begs to be fooled.

Calendar of Events

European Bankers Symposium, 9-10 June 2010, Hall, Tyrol, Austria.
Professor Fekete will be a keynote speaker on June 9, at 13:30. The title of his talk is: *(Gold) Architecture for a New World Finance System.* For more information, please see: www.financetrainer.com .

ANNOUNCING THE ESTABLISHMENT OF THE AUSTRIAN SCHOOL OF ECONOMICS IN BUDAPEST. The first ten-day, 20-lecture course offered is entitled: Disorder and Coordination in Economics — *Has the world reached the ultimate economic and monetary disorder?* The lecturer is Professor Fekete, with the cooperation of Mr. Rudy Fritsch (Canada), Peter van Coppenolle (Belgium), and Mr. Sandeep Jaitly (United Kingdom). It will be held in Budapest, Hungary, from August 9-20, 2010. Participation is limited, early registration is advisable. For more information and registration, contact Dr. Judith Szepesvari at: szepesvari17@gmail.com. Inexpensive dorm-type accommodation is available for students (shared bathroom, shared kitchen); a three-star hotel is next door. Extra-curricular consulting with Professor Fekete can be arranged for an extra fee.

The school is meant for all students (including beginners) interested in the Austrian theory of money, credit, and banking. Its program plans to cover the whole spectrum of Austrian economics, with special emphasis on developments that took place after the death of the greatest 20th century economist, Ludwig von Mises, including the Real Bills doctrine and social circulating capital; the theory of money, credit and banking; and the theory of interest and discount.

Completion of this course will earn participants one credit towards a four-course, four-credit program that has been submitted for accreditation to the Adult Education Accreditation Board of Hungary. Participants will receive a certificate signed by Professor Fekete. The follow-up credit courses will cover these areas:

Adam Smith's Real Bills Doctrine and Social Circulating Capital.
The Austrian Theory of Interest and Discount.
The Austrian Theory of Money, Credit, and Banking.

Some of the future courses may be offered in Martineum Academy in Szombathely, Hungary, where we have had four successful conferences already in the past. A special cordial invitation is extended to all Martineum alumni and their family members and friends!

It is not well-known that Budapest is one of the foremost spas in Central Europe with a dozen or so medicinal thermal springs. Participants of the course could stay on afterwards and savor the superb spa and cultural offerings in the city. Make it a family holiday! Eating and shopping facilities, as well as a swimming pool are nearby. Spectacular excursions can be arranged in the surrounding hills, and boat trips ont he River Danube!