Watch the Gauges!

By The Mogambo Guru

03/22/04 Mogambo on Monday! The PPI is rising… oil, gas and energy costs are pushing multiyear highs… is something brewing? The Mogambo Guru takes a reading of the gauges, and shouts: INFLATION!!!

The most unsettling news of the past week, to me, is that Treasury Secretary John Snow has apparently requested a meeting with all 12 Fed governors. The Treasury Secretary and all of the Fed governors in the same room… at the same time. This cannot be good.

What will they discuss, one wonders…

Perhaps it has something to do with foreign central banks who gobbled up another $8 billion of U.S. debt last week and stashed it at the Fed. Are the chickens coming home to roost? Or maybe it has something to do with the fact that Fannie Mae has more than $900 billion of debt, more debt than either of the British or French governments. Perhaps estimates by the Bank for International Settlements – that global derivatives now total $208 trillion, roughly 700% of global GDP – have Snow on edge.

Or maybe the fact that the stock market is now so over valued, more than any other point in US history, is causing some concern. Or the meeting may have something to do with inflation. It is roaring like an unchecked bush fire – and that means US bonds, which are paying negative real interest rates, are now so overvalued that there is no way that anyone holding American debt can possibly SEE value, even standing on tiptoes and using the Hubble telescope.

Monetary Inflation: John Snow and the 12 Dwarves

Whatever the case… John Snow and the 12 dwarves from the Fed are going to meet. And something is going to be done. My prediction: whatever they do will be so horrible that future historians are going to have a field day with it. Trust me on this one.

The part that is so tragic is that everybody knows the end result of this kind of money-madness excess. Nobody even disputes it. Nobody even tries to hide the truth, because the history of the world is littered with the inescapable evidence. You will end up with, and you might want to write this down, because it will soon seem very important to you, high and ruinous price inflation caused by high and ruinous monetary inflation.

Robert Prechter still sees deflation on the cards, and points to the action in the money supply, which, when I look at the chart, is one of three possible scenarios: 1) slowing, 2) lacking in marked advance, or 3) stagnating, which are all de facto proof of monetary deflation. So, classically, we have less money chasing more goods, and prices should fall.

But not all prices will fall under deflation, just as some prices do not rise during inflation. I can easily see why houses, stocks, bonds, and collectibles, and other such things would go down in price – because demand will fall. And because they are being supported at these lofty prices by the rampant monetary goosing by the Fed, these prices would seemingly fall a long way if demand faltered.

Monetary Inflation: Food, Oil, and Everything Else

On the other hand, I can also see inflation on the cards. We are a nation that imports a lot of the stuff it consumes, and a falling dollar equates to the rising price of imports, ceteris paribus. I am thinking specifically of oil, which has gone up dramatically in price, oh and food as well, and since we are talking about it, just about everything else.

"The stagflationary 1970′s provide an important precedent in recent American financial history," opines Bill Fox, "particularly since I believe the decade ahead will echo the 1970′s, only worse."

"This type of inflation typically means an expansion of the money supply and bank credit ahead of gains from productivity and asset growth. More money and credit chasing fewer goods and services typically means higher prices over the long run." This is the kind of inflation that we have been subjected to by Greenspan and the Fed for as long as I can remember, and I ain't no Spring chicken.

Inflation destroys consumer purchasing power. The creation of money and credit does not create prosperity, any more than a counterfeiting ring would. It's a form of taxation on the consumer. "Stimulus spending typically creates the short-term illusion of prosperity at the long-term price of distorting the economy and debauching the currency."

Fox has also looked at the historical record and notes that "Price inflation may also remain initially muted because excess liquidity can first find its way into stock, real estate, or bond asset bubbles. It may experience a prolonged delay in running up commodity and consumer prices."

Well, take a look around! Sound familiar? This excess liquidity has already found its way into stock, real estate and bond prices. And now it's finding its way into commodity prices, too, although the government wonks who are supposed to be looking at this kind of thing are all asleep, or lying, or both.

Monetary Inflation: Hyperinflation

"The magnitude of America's trade deficits and indebtedness suggest that the US will eventually wind up with double-digit interest rates and hyperinflation." Check out that "hyper" in "hyperinflation." Scary stuff indeed.

"This is the kind of environment where gold often outshines all other asset classes," Fox concludes. "This is the overall underlying environment I believe we have been in since the Nasdaq top in March 2000, and it could last for many more years." So, and this is the important point, a guy who has been careful to look at the historical precedents figures that the bull market in gold could last for many more years…very interesting.

But it's not just cranky newsletter editors who've taken notice of the trend. Cranky financial journalists are on the case, too. "For the second straight month a forecasting outfit called Economic Cycle Research Institute said its inflation gauges have risen," John Crudele of the NY Post observes. "Federal Reserve Chairman Greenspan keeps close tabs on ECRI's numbers – first because he trusts them and, second, because the organization was founded by one of Greenspan's beloved former professors. And, I'm told, ECRI will start worrying about inflationary pressures – and convey that concern to the Fed – if there is a jump in this month's numbers, which will be reported in early April."

So this ECRI bunch says its "inflation gauges" have, and let me check to make sure of the correct word, "risen." In other words, there has been a rise, which I derive from the root word "risen," that has been detected by some monitoring sensors equipped with readout functions, otherwise known as "gauges." And these aforementioned "gauges" have, thus, "risen."

Yet, and you gotta admire their patient courage, as they are waiting and worrying, and Alan Greenspan and the Fed are walking around unaware! They do not know of the gauges! The ECRI did not tell them, and are waiting instead 'til next month.' The poor Fed! Rushing towards the waterfall on the log, and completely oblivious to any peril! But listen to the soundtrack, trumpets blaring and kettledrums pounding, it's ominous!

Mr. Crudele goes on to say "The most worrisome thing is that the inflation is occurring even though the U.S. economy is showing only modest growth and very little job creation." This I interpret, as far as I can make out, to mean that if the prices of things go up, but there are fewer people with jobs who are thus able to BUY the things, then it is "worrisome?" You're damn right it worrisome!

Crudele has also taken a look at the budget deficit. "If the government didn't have its own accounting method and had to record costs like businesses do, the deficit would probably be more than $750 billion. For one year." And this ignores the gigantic wad of accumulated deficits from years gone by, which is, using Official Public Debt as a minimum, now over seven freaking trillion dollars (SFTD).

"These sort of numbers will be a big problem for the financial markets when they start paying attention," he says.

There are many intelligent people who are predicting a long, long and a painful, painful economic recovery, because it's not just the house that is flooded. It is the whole damn neighborhood, stretching to the horizon in every direction, because it was the dam that burst.

"For many people," Mr. Prechter continues, "the single biggest financial shock and surprise over the next decade will be the revelation that the Fed has never really known what on earth it was doing. Make sure that you avoid the disillusion and financial devastation that will afflict those who harbor a misguided faith in the world's central bankers and the idea that they can manage our money, our credit or our economy." Bravo!

"The ultimate consequences, will be more severe and more confounding that the consequences of the 1929-1932 crash."

Regards,

Mogambo Guru,
for The Daily Reckoning
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P.S. While Mr. Prechter has been fairly bearish on gold, in Conquer the Crash, he also said that: "If gold were to move above $400 per ounce, I would probably be convinced that a major low had passed." Next time I see him, I will ask him if he is convinced that the "major low had passed." In the meantime, you can use the MoGu as a rough proxy, who says: "Gold will almost certainly never be cheaper in dollars than it is RFN."

Mogambo Sez: Things are seriously amiss, and getting more amisser by the hour. You should be scared. You should be buying gold, and silver, and commodities, because that is what the future will look like very soon.