Enter the Recession

By The Mogambo Guru

11/21/05 Most people believe that the way to respond to inflation is by tightening monetary policy – but that could turn out to be a very dangerous decision. The Mogambo Guru explains how the Feds are hurting economic growth…

Ben "Big Bonehead" Bernanke, the incoming new chairman of the Federal Reserve, is on record as being the champion of "inflation-targeting", which is the new code word for, "I'm going to kill you with inflation because I don't care about any of you American pigs."

This ridiculous philosophy may not work like he figures, if we can believe Randy Buss, of Der Invest Informant, who quotes Professor Antony Mueller, an adjunct scholar of the Ludwig von Mises Institute, as saying, "The size of the debt level relative to the productive base at the peak of the boom will make monetary policy ineffective once the contraction phase takes hold." Well, perhaps that is why the Fed is so desperately trying to keep this contraction ("deflation") from taking hold in the first place, by creating inflation, which will kill us just as fast.

Max Fraad Wolff, at Mises.org, has had enough of listening to me run my loud mouth and not making any sense. He stands up to explain, "Standard fiscal and monetary policy work to attack inflation by pushing economic activity toward recession. Likewise, fiscal and monetary policy introduces inflationary pressure to fight recession." Well, I gotta admit that he is a lot more succinct in his explanation, but without the use of screaming, swearing, breaking furniture or even vowing blood oaths of revenge. As such, it seems to lack that sense of, umm, mortal despair and homicidal outrage that it really calls for.

Inflation: Stagflation Lurks

So, in my snippy little childish way, I say, "So?" Without missing a beat, Mr. Wolff, with a momentary flash of exasperation at my abysmal stupidity, explains, "Stagflationary dynamics occur when a growth recession – or worse – occurs alongside upward price pressure, inflation. Policy markers face unique challenges and enhanced prospects of failure in such an environment. Given the normally poor record of policy makers, this is scary. As price pressures persist alongside rising trade and federal spending imbalances into 2006, stagflation lurks. Keep your eyes out for data that suggests cooling growth and rising prices. When it rains it pours."

None of this is lost on Jim Puplava, which I can prove by directing your attention to his essay "The Two Bens." It can be found on his www.financialsense.com site. In it, he contrasts Ben Franklin and Ben Bernanke, which I am sure, has Mr. Franklin rolling over in his grave at the comparison. It is sort of like I hate it when my neighbors compare me to a diseased sewer rat, only not as cuddly. Some things never change, and you can gather that from his writing. He says, "From the birth of this nation to the present, the government would from time-to-time resort to debasement of the currency in time of war or in time of economic duress. We find it always ends with the same consequences: debasement of the currency and concomitant inflation. Despite the best efforts of government alchemists, the result is always the same in the end – inflation. The only limit to the quantity of money created is the destruction of its value."

To prove the accuracy of his words, Mr. Puplava writes, "Through September, the PPI was up 6.7% year-over-year, while the CPI was up by 4.7% over the same period. Even worse for Americans, who now import more of what they consume, import prices are up 9.9% over the last 12 months." This level of inflation should have the Federal Reserve jumping out of the windows in shame, or jumping out of the windows to escape the incessant screaming of The Mogambo about this inflation conflagration – that they caused – that is destroying our money.

And now, the new report of producer prices showed that prices jumped 0.7% in October, which is worse than anyone (except you and me) expected. The so-called "core" inflation (minus the pesky volatile items like food and energy) was, I guess, relatively tame for finished goods. But intermediate goods had prices that were up a smoldering 1.2%, and intermediate goods were smoking red hot, up a full 3% for the month.

And it is even worse than that in actuality, as he suggests when he says, "Today the true rate of inflation is running well over 7%," which one can see when calculating the consumer price index, "as it was originally constructed before the government began to tinker with the index." When one undertakes this exercise, we realize that the CPI, "closely relates to what most Americans experience daily in their lives." And I don’t know what you are experiencing in your life, but around here, the bills are showing at least that much inflation!

Then he unleashes the bombshell: "Deflationists and inflationists do agree on one thing: the U.S. is headed for another recession. Given the under-reporting of inflation, which overstates GDP, we may already be entering one. The only difference between the two camps is how it unfolds. As the U.S. enters into recession, tax revenues will decline and government spending will increase as a result of rising entitlements. Deficits will get bigger and the U.S. will have to borrow and monetize more of its debt. War, entitlements, and lack of fiscal restraint mean more debt, more borrowing and debt monetization. Eventually the dollar is going to collapse through the weight of the twin deficits. Inflation – not deflation – will be the result."

Inflation: Hurting Growth by Fomenting Inflation

John Hussman, PhD, of the Hussman Funds, has a slightly different take on all this. Oh, he agrees with everyone else that I am a big stupid idiot, but where he takes exception is, "It seems to be taken as an article of faith that the Fed determines inflation, but in fact inflation is not so much a monetary phenomenon as a fiscal one. It is essentially a reflection of unproductive government spending. Moreover, the belief that you should respond to inflation by tightening monetary policy is in some cases very dangerous. If you look closely at the data, you’ll find that economic growth and inflation over the same period actually have a negative correlation." So, as the Federal Reserve starts trying to foment more and more inflation, they are actually hurting growth? Hahahaha! I was right! We are freaking doomed!

So, what does one do? With the agility of a lithe jungle cat, I instantly leap to my Stinky Mogambo Feet (SMF) and exclaim, "Buy gold!" And if you think gold is a great investment and that you ought to be out buying some more gold right now instead of sitting there reading the stupid Mogambo Guru while saying hurtful things like, "This guy's an idiot!" then Bud Conrad had an interesting article on the DailyReckoning.com site, entitled, "Measuring Gold's Link to Inflation." He notes, "PPI and gold move together. You can also see that the trend is currently in place for both higher inflation and higher gold prices."

Although the PPI has been going up, he cautions, "Of course, forecasting PPI inflation is no easy matter. But the chart does tell us emphatically that when we see growing forces for inflation – rapid expansion in the money supply engineered by the Federal Reserve, artificially low interest rates, growing government deficits, unsustainable trade imbalances and currency competition – we should expect rising gold prices."

And since we are speaking of commodities, the "commodities expert" at the DailyReckoning.com site, Kevin Kerr, says, "So while bonds and once coveted shares sink, commodity prices continue to explode with growth. Many analysts predict they will continue to rise, because of growth in demand and dwindling supplies." And not only that, but all the inputs into growing or mining commodities (energy, tools, materials, wages, governmental fees, taxes, etc) are all rising, too! The Computer-Like Mind Of The Mogambo (CLMOTM) instantaneously concludes that (to use the precise economic terminology) there is no freaking way in hell that commodity prices cannot go up.

Regards,

The Mogambo Guru
for The Daily Reckoning

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Mogambo Sez: All lease rates on gold have suddenly turned up after bottoming, and so it must be time for gold to rise, according to the new Stupidest Mogambo Timing System Yet (SMTSY). Buy!