The Exorcism of the United States

By The Mogambo Guru

05/08/06 **The Daily Reckoning PRESENTS:** Yes, it's Monday. And while we're sure you have more pressing matters to attend to, you won't want to miss today's offering from the Mogambo. It has it all: math equations, invaluable comments from an esteemed professor, and – a talking severed head. Now that we have your attention, read on…

THE EXORCISM OF THE UNITED STATES

I am happy to report that the U.S. Federal Reserve is not increasing Total Fed Credit with its usual disregard to the sheer economic insanity of constantly creating more and more debt, money and credit. Being down by $3.5 billion, last week, is nothing to write home about ("Dear Mom and Dad, It's been a swell week at camp! The Federal Reserve is tightening money by some insignificant little amount, and now, we are going for a canoe ride! Love, Tommy").

So, I was surprised to discover that the Federal Reserve's frantic, exponentially increasing of Total Fed Credit since 1997 has apparently paused, as I gather from the cold, cold chart. Looking this up in the Mogambo Economic Book Of Changes (MEBOC), popularly referred to as the Mogambo Ching, it reads, in its entirety, "Prepare to die!" This is a pithy MEBOC way of saying that with our stupid economic system of fiat currency created by debt, it takes ever-increasing amounts of money and credit to keep the whole stupid system from imploding.

In a closely related vein, Thorsten Polleit, a professor at the Business School of Finance & Management in Frankfurt, and author of "Sowing the Seeds of the Next Crisis" at Mises.org, says, "The income velocity of money – that is the relation between nominal output and the stock of money – declined sharply."

This velocity thing comes from the idea that the total value of goods sold must equal the total amount of money spent on those goods. This translates to the famous equation QP=MV, where Q is the amount of goods sold, and P is the price they were sold at. This must equal M, the total amount of money stock, multiplied by V, the velocity of money (the number of times each dollar is used in a transaction).

OK, then for the equation QP=MV to be true – to balance the equation with a falling velocity (V) – either the money supply (M) increased, the quantity produced (Q) has decreased, prices (P) have decreased, or a little of each.

As for the idea of prices decreasing, don't make me laugh! Hahaha! Look! I'm laughing, even though I told you not to make me laugh! The reason that I am laughing is because prices are going through the roof! So, jocularity aside, that means that either quantity of goods produced (Q) had to go down or money supply (M) went up. As it turns out, it was mostly the money supply, which increased all those years!

So, what is this actual value of the velocity of money? He says, “Velocity fell from around 1.65 at the end of 1994 to 1.25 at the end of 2005.” Yikes! I’m jumping out of my Freaking Mogambo Skin (FMS) at this! As I stared at those velocity numbers over and over, feverishly jamming them over and over into a calculator, I came to the terrifying realization that velocity went down by 24%! A quarter! Now you know how it is that while prices and the money supply both increased, the economy’s GDP did not increase as much as would be expected. The reason is that velocity went down! Money is not circulating as fast as it did and was, thus, involved in fewer transactions!

Mr. Thorsten remarks, “Taking into account the lessons learned from analyzing monetary matters from the point of view of the Austrian School of Economics, it becomes crystal clear that the very foundations of the monetary system on which economic prosperity of the industrial countries so heavily depends keep deteriorating at a rapid pace.”

Those who majored in Mogambo Economic Studies in colleges and universities know that any massive, sustained increase or decrease of Total Fed Credit is the very thing that consumes whole days in the life of The Mogambo, alternately crying in crybaby fear and screaming in stark, raving horror. It’s very much similar to when Linda Blair’s character in the movie The Exorcist sat up, spun her head completely around in a full circle, and then mockingly asked, with a hideous grin on her horrible green face, “How do you like your little girl, now?” Gaaah! Gaaah!

The reason that I bring this terrifying thing up is that I am trying to be real clever and make the current economic situation analogous to this memorable Linda Blair scene – except that this is real life, and the head that is being twisted around by the Federal Reserve is America’s. Instead of hearing Ms. Blair saying her immortal, blood-chilling line, all you hear is cartilage snapping, bones breaking, and then the head pops off.

And, as the severed head sits there on the ground, the camera pans in for a close up. You note with horror that the head is still alive! Its mouth is saying, “Ouch! That hurts!” Panning in for a closer shot, the talking head goes on to say, “And what hurts even more is that the loudmouth idiot Mogambo was right! We’re freaking doomed!”

The eyes in the head start to glaze, and yet, with a Herculean effort, the severed head startlingly continues, “Beware! Beware of a massive and massively expensive government, paid for by debt, financed by the Federal Reserve and the banks creating all that new credit so that someone could borrow it and use the money to buy government bonds, stocks and houses, and leveraging to borrow every scrap of equity that ever appeared in anything, including houses, stocks, bonds, receivables. God knows what else.”

And then, the drying, dying lips were barely moving now, “it was all securitized and sold back to us; we hold our own debt!”

With a final dying exhalation of breath, the eyes closed and the lips stopped moving. America was dead. Next, a dog walked up, lifted its leg, and peed on the lifeless head, which was both a nice touch of comic relief, and highly symbolic, given the subject matter.

The bigger news, and probably the cause of all the alarm bells in the Mogambo Bunker Of Wailing In Fear (MBOWIF) clanging, bonging, ringing and buzzing, is that the dollar fell in value. This may not mean much to you, right this very nanosecond, but it will mean a lot to you very soon.

But at least you are not Japanese, Chinese or European; they hold a lot of U.S. debt and equities. Now all have sudden, they have huge paper losses on their holdings in terms of their own currencies! Hahaha! Chumps! OK, in nominal terms, it wasn't that much, but when you consider the leverage that is being used, suddenly this is a huge chunk of money!

And puh-leeze, don't tell me how the brilliant use of derivatives is some kind of savior here. The total amount of money lost is the same either way. The only difference is that instead of a few guys getting slaughtered for being so stupid, the use of derivatives means that everybody took a tiny loss.

Until next week,

The Mogambo Guru
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Mogambo sez: If you are not buying gold, silver and oil, then don't come crying to me in the coming years. And if you are buying gold and silver and oil, then you will be rich, and I will soon be calling you up to ask to borrow some money. You only have to decide which is worse.