Why the Government Hates Deflation

By The Mogambo Guru

11/26/10 Tampa, Florida – Being the naturally cynical type of guy that you would expect from someone so angry, so depressed, so outraged, so paranoid and so "Howard Beale" ("I'm as mad as hell, and I'm not going to take this anymore!") as I am, people want to know "what is with" all of this "deflation" stuff that the Fed is worried about.

Some of them write to me, some beginning, "Dear Mogambo" or, "Dear Moron." These are the ones I immediately delete without reading, as they did not have the proper opening salutation.

On the other hand, if the email is properly addressed, I will immediately read it, such as this latest one here that correctly begins, "Dear Handsome And Wise Mogambo (HAWM), What is with all of this fear of deflation? It is being portrayed as a dread so fearful that the treacherous, foul Federal Reserve feels somehow justified in using monstrous monetary policy to target inflation in prices to be at least 2% per year, which is the most horrifically terrible thing that the treacherous, foul Fed could do except target 3% inflation in prices, which is the most horrifically terrible thing that the treacherous, foul Fed could so except target 4% inflation in prices, which is the most horrifically terrible thing that the treacherous, foul Fed could do except target 5% inflation in prices, a point at which I assume it is unnecessary to continue along this obvious and tedious continuum because you get the point by virtue of your being as smart as you are handsome and wise! (signed) A Fan Of The Mogambo (AFOTM)."

Firstly, let me say that I am pleased to see that fawning and groveling has not gone completely out of style, and let me say that that obvious, sniveling, servile and undeserved flattery is always appreciated.

My pervasive bad mood got the better of me, however, and my answer was, "Dear AFOTM, Deflation is a fall in the money supply. Thanks for asking me instead of looking it up, you moron! –Mogambo"

Well, AFOTM immediately wrote back, using our sudden familiarity to eliminate the use of an unctuous salutation, saying, "Screw you moron! (signed) Former Fan (FF)."

Former fan! I viciously think to myself, "Two can play at this game!" and replied, "Dear FF, you treacherous little backstabbing moron, Deflation is a fall in the money supply, but it is always associated with falling asset prices, which is why that is also called deflation, too, which is when a lesser total money has to be spread among the same (in the short run) amount of actual assets, which means that the pro-rata money available for each asset goes down, which makes some prices go down, which hands losses to the owners of the assets, which they don't like, which are thankfully netted against gains when paying taxes, which means less tax revenue to the government, which the government doesn't like!"

Helpfully, I did not expand into bogus mathematical terms, which is that the ratio of Money Supply to Actual Assets (MS/AA) obviously goes down when the Money Supply goes down, which it can do for a variety of reasons, one of which is when any creditor has to take a loss, because fiat money is created by a bank at the instant that someone borrows money from a bank.

Therefore, then, money also literally disappears when the debt, underlying the fiat money, disappears when being defaulted upon because the guy who owes the money to the bank decided to default, jumped into his snazzy new car in the middle of the night and headed out of town and across state lines to start a new life, in a new place, with a new name, and an even snazzier, newer car.

Of course, unless you are a dealer of snazzy new cars, it is worse than this, as the losses are not constrained to being one-to-one with the number of dollars created! Oh, no! Losses are in huge multiples of the original money created, thanks to the outrageously out-of-control fractional-reserves insanity in the banks that the Federal Reserve, under the horrid Alan Greenspan, was allowing and abetting, and the huge financial spider web of derivatives so that we could have a gigantic stock market bubble, and a bond bubble, and a derivatives bubble, and a housing bubble, and huge, cancerous bubble in the growth of government, which is not to even mention a whole asset-management/retirement-account industry of such greed and corrupted ethics that it makes 40% of all the profits of America, and for doing very, very little except enriching itself, its friends and Congressional lapdogs.

It got so bad around the end of the housing bubble that that changes in bank reserves were, literally, zero, as nothing was held against the banks literally lending out as much new money as they wanted, whether they had additional deposits or not! Infinite leverage!

It's not quite that way now, although bank reserves are still a piddly $68 billion, while the M2 money supply is up over $400 billion, to $8.76 trillion, from this time last year, which is an increase of about 4%.

And the Fed is already launching QE2 to create another $600 billion ($1.2 trillion annualized) so that the federal government can deficit-spend it in the next six months! I howl – Ahhooooohhh! – in outrage!

Hooper and Bandit, two animated characters at thewallstreetshuffle.com who do a very good job of discussing Austrian economics, note that "When the Fed finishes buying the $600 billion of US Treasuries and other debt, that they will be the largest single holder of US treasury debt in the world." Wow! Wow and yikes!

They sum it up as, "This is just plain and simple gross monetization of our federal debt," and that "the result will be a 'financial Chernobyl' with dollars spreading like radiation around the world."

Dollars as radioactive death is an interesting metaphor, and should be alarming to those who hold dollars, but not to those buying gold, silver and oil as ways to save themselves against the predations of the Federal Reserve and the government.

To the buyers of gold, silver and oil, “dollars as radioactive death” means, “Whee! This investing stuff is easy!”