January 2022 Volume 6, Issue 1

THE "YOU MAY NOT KNOW REPORT"

A PUBLICATION OF RETIREMENT LIFESTYLE ADVOCATES

Inflation Followed by Deflation

By Dennis Tubbergen

Back in 2011, when I wrote the book "Economic Consequences", I suggested that the Federal Reserve's 'temporary' program of quantitative easing or currency creation would be permanent and would eventually lead to price inflation to be followed by a period of deflation like existed in the 1930's.

That is still my forecast; however, as I also often openly admit, the 'what' is far easier to predict than the 'when'.

It is becoming increasingly obvious that the 'when' is almost upon us.

Consumer price inflation is here, and it is NOT transitory. Federal Reserve Chair, Jerome Powell openly admitted as much calling inflation persistent and suggested the term transitory be retired. This is the equivalent of the Fed Chair admitting the Fed was wrong when it came to analyzing inflation.

Now, the Fed is suggesting it will taper, or slow the rate of currency creation to attempt to get consumer price inflation under control. While the Fed may quit buying as many US Treasury's or mortgage-backed securities each month, it is my belief that the Fed will have to continue to provide liquidity (cash) to the federal government to fund record deficit spending.

Matthew Piepenburg of Matterhorn Asset Management had this to say on the topic[1]:

> *Perhaps more "exciting" was his not-so-subtle announcement that the Fed plans to begin a discussion at its next meeting to accelerate the Fed taper by a few months.*
>
> *Hmmm…*
>
> *Despite the fact that any Fed Taper will in substance be a "non-taper" given backdoor liquidity tricks from the Standing Rep Facility and FIMA swap lines, the optics of such continued taper-talk will be negative for almost all assets save for the USD, the VIX trade, so-called "safe-haven" Treasuries and possibly gold.*

In other words, the Fed may be talking taper but they aren't doing it. This will lead to more inflation and perhaps even a 'crack up boom' first discussed by economist, Ludwig von Mises. (More on this event momentarily).

Policymakers don't like to report unfavorable economic data including high inflation rates, so they often change the calculations to make the reported data appear more favorable.

It's happening again.

Beginning this month, the way inflation is calculated will change.

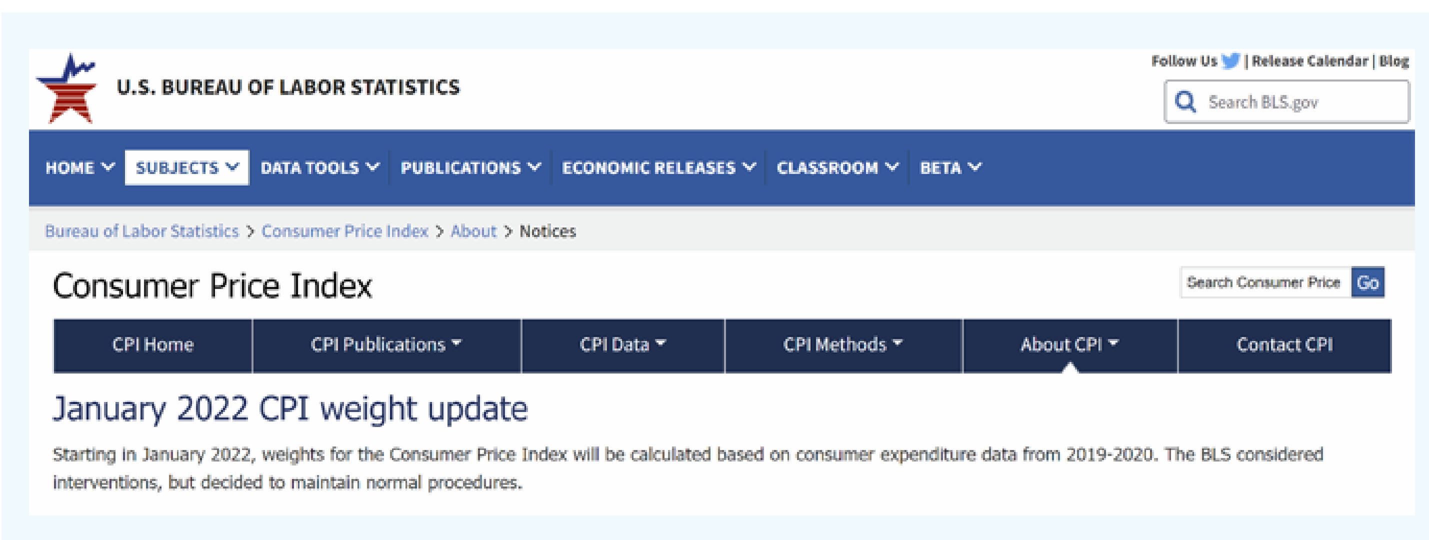
Below[2] is the announcement of the change from the Bureau of Labor Statistics.

This is nothing new, it's an often used play out of the economic data reporting playbook. One has to wonder what 'interventions' were considered though?

Changing the inflation calculation methodology doesn't change the real inflation rate. No matter what the officially reported inflation rate is, I expect that in the near future consumer price inflation will continue to worsen and at some point, the deflation will kick in, perhaps after a 'crack up boom'?

Thorsten Polliet of the Mises Institute explains[3] (emphasis added):

> *People hold money because money has purchasing power (which people desire, given the fact of uncertainty as an undeniable category of human action), and the purchasing power*



U.S. BUREAU OF LABOR STATISTICS

Follow Us | Release Calendar | Blog

Search BLS.gov

HOME | SUBJECTS | DATA TOOLS | PUBLICATIONS | ECONOMIC RELEASES | CLASSROOM | BETA

Bureau of Labor Statistics > Consumer Price Index > About > Notices

Consumer Price Index

Search Consumer Price | Go

CPI Home | CPI Publications | CPI Data | CPI Methods | About CPI | Contact CPI

January 2022 CPI weight update

Starting in January 2022, weights for the Consumer Price Index will be calculated based on consumer expenditure data from 2019-2020. The BLS considered interventions, but decided to maintain normal procedures.

of money is determined by the supply of and demand for money.

If a rise in the money supply is accompanied by an equal rise in money demand, overall prices and the purchasing power of money remain unchanged. Once people start to exchange their increased money holdings against other goods, however, prices will start to rise, and the purchasing power of money will fall. That said, it is rise of the money supply relative to the demand for money that brings to the fore the obvious effect of an increasing money supply: rising prices.

Mises saw that money demand plays a crucial role for the possibility of an unfolding hyperinflation. If the central bank is expected to increase the money supply in the future, people can be expected to rein in their money demand in the present — that is, increasingly surrendering money against vendible items. This would, other things being equal, drive up money prices. Mises noted that "this goes on until the point is reached beyond which no further changes in the purchasing power of money are expected." The process of rising prices would come to a halt once people have fully adjusted for the expected increase in the money supply.

What happens, however, if people expect that, in the future, the money-supply growth rate will increase to ever-higher rates? In this case, the demand for money would, sooner or later, collapse. Such an expectation would lead (relatively quickly) to a point at which no one would be willing to hold any money — as people would expect money to lose its purchasing power altogether. People would start fleeing out of money entirely. This is what Mises termed a crack-up boom:

> *'If once public opinion is convinced that the increase in the quantity of money will continue and never come to an end, and that consequently the prices of all commodities and services will not cease to rise, everybody becomes eager to buy as much as possible and to restrict his cash holding to a minimum size. For under these circumstances the regular costs incurred by holding cash are increased by the losses caused by the progressive fall in purchasing power. The advantages of holding cash must be paid for by sacrifices which are deemed unreasonably burdensome. This phenomenon was, in the great European inflations of the 'twenties, called flight into real goods (Flucht in die Sachwerte) or crack-up boom (Katastrophenhausse).'*

Summers: Markets at Risk of 'Spontaneous Deflating'

To be totally transparent, it's not often that I find myself agreeing with Larry Summers, former US Treasury Secretary and current Harvard University professor. But I believe Mr. Summers made some valid, salient points in a recent interview[3] (emphasis added):

> *Former U.S. Treasury Secretary Lawrence Summers warned of the risk of a "spontaneous deflating of financial markets" that have been pumped up by retail buying and exuberant investors.*
>
> *There is "a lot of euphoria," Summers said at an American Council for Capital Formation webinar on Tuesday -- pointing, among other things, to cryptocurrencies, so-called meme stocks and technology shares. "Super-excited retail is usually a sign of trouble to come," he added.*

> ***"There are many who are chasing yield by taking on extra risk," he said. "Highly sophisticated endowments and pensions funds are behaving in that way. In so far as that is happening, it points to something that may or may not be sustainable."***
>
> *Summers, who has been warning of the dangers of elevated inflation for months,* ***said it would be very hard for the Fed to rein in excessive price gains without also damaging the economy.***
>
> ***"The Fed will have a very difficult time organizing a soft landing," he said, noting the long and variable lags between monetary-policy actions and their impact on the economy. "All the efforts at disinflation that we have had historically, where it was clearly established that inflation was too high and the Fed acted, have ended in recession."***
>
> *He called on the Fed to immediately stop buying mortgage-backed securities and wind up its purchases of Treasury debt "probably by the end of February."*

Summers states that 'highly sophisticated endowments and pensions funds are behaving in that way', referencing that these funds are taking extra risk to try to get more yield. In my weekly "Portfolio Watch" newsletter, I recently reported that CalPERS, the nation's largest pension fund, had made the decision to borrow money using pension assets as collateral to attempt to boost yields.

This is a side effect of the Fed's longstanding near-zero interest rate policy. Gone are the days that a pension fund could buy a laddered portfolio of bonds and some select, blue-chip stocks to achieve its investment objective.

Of course, these actions are reckless and make the market bubble even larger which will make the ultimate market bust even more damaging.

Summers also states that 'the Fed will have a very difficult time organizing a soft landing'. I agree.

Summers also called on the Fed to slow the rate of currency creation by stopping purchases of mortgage-backed securities and US Treasury debt by the end of February.

Sounds like the responsible thing to do, but here's the conundrum. If the Fed stops creating currency to purchase US Government debt, who steps in to subsidize the deficit spending of the United States?

In last month's issue of this publication, we did an analysis of US Government finances and concluded that of there is no other entity that will step up and loan the US Government money then there are two choices:

One, balance the federal budget. This would require spending cuts of about 41%. Every category of federal spending would need to be cut by 41%. Medicare, Social Security, education, military and every other category of spending would need to be cut by 41%.

Fat chance.

Two, continue currency creation since the Fed is the buyer of last resort of US Government debt.

Much more likely.

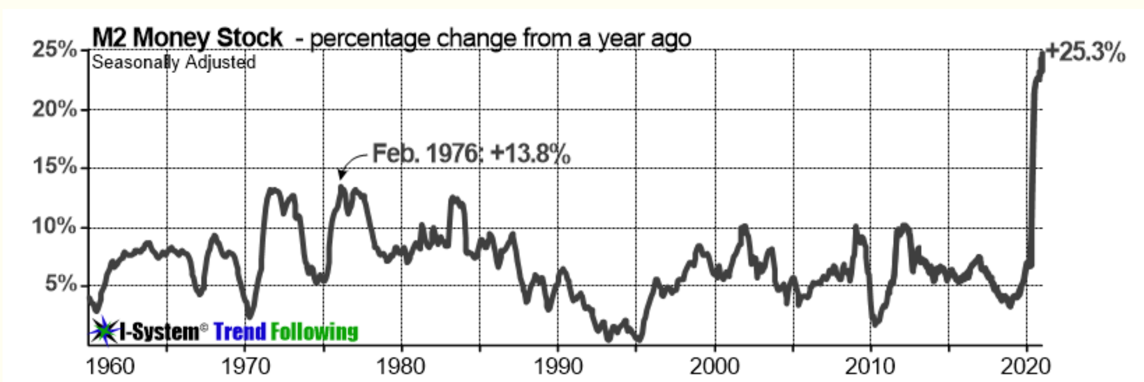
I have forecast that this will continue until it can't and then the recession that Mr. Summers predicts will occur. Given debt levels, the recession will have to be severe.

Inflation Explained

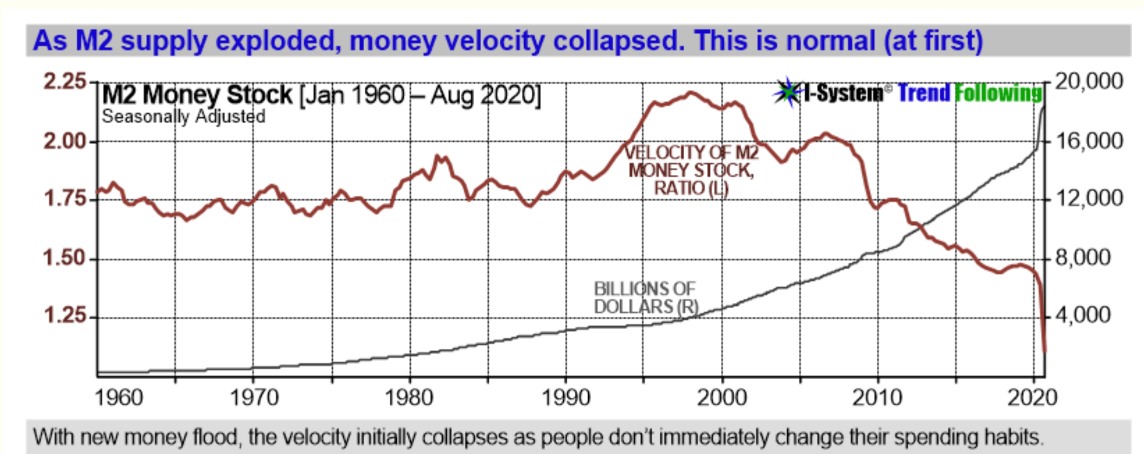
I recently ran across an article[4] that did a terrific job explaining the relationship between currency creation and inflation. Frequently, in past issues of the "You May Not Know Report" and the weekly "Portfolio Watch" newsletter, I've discussed the time lag factor. The time lag factor is simply the amount of time that passes between currency creation and the emergence of inflation.

The current inflation that we are experiencing is a result of the currency that was created about 18 months ago in my estimation. Here is a bit from the article (for reference M2 is a measure of the money supply):

M2 money supply is perhaps the most important early indicator of price inflation. In 2020, the Fed added almost $3.5 trillion to the aggregate. The transition is more striking still, in percentage terms:



The relationship between money supply and price inflation is not linear; price inflation tends to move with some inertia. The 1970s inflation was preceded by the "Great Prosperity" of the 1960s: monetary expansion began in October '62 and continued through 1969. While money supply increased by 38% during that time, prices rose only 11% from April '62 to September '69. This inertia of price inflation convinced the era's "New Economists" that inflation was a thing of the past. But inflation did emerge, only with a delay.



As new money enters circulation, there is a corresponding drop in money velocity since households don't change their spending habits right away. They tend to use it to pay down debts and increase their savings so initially there is little upward pressure on prices of goods and services. However, prices ultimately do catch up and when they begin to rise, velocity reverses course. From that point on price inflation begins to accelerate.

Gestation and the eruption of 1970s inflation

After seven years of growth fueled by deficit spending and credit expansion, U.S. economy began to overheat in 1969 and price inflation reached almost 5%. Nixon administration responded by instituting a tight money regime and extreme budget cutting. This led to a sharp recession.

A wave of mass layoffs and business bankruptcies spooked the government to abruptly reverse itself once more once more and increased deficit spending in the summer of 1970. Federal Reserve ramped up monetary inflation rate to 6.5% and the outlook quickly brightened again: interest rates plunged, stock markets soared and the nation was back on the high road to "prosperity." But by now inflation began to accelerate and in 1974, it reached 11% and stayed high for the rest of the decade.

This pattern has repeated itself throughout history time and time again. Currency creation seems to lead to prosperity initially, but that prosperity is illusionary.

Eventually, after a gestation period as described in the article above, the currency creation leads to inflation. Seems that is where we now find ourselves in the cycle.

Are Other Central Banks Doing What the Fed Should be Doing?

Wolf Richter reported[5] that many world central banks are increasing interest rates to attempt to tame inflation. Meanwhile, the US central bank, the Federal Reserve, is holding rates near zero while they talk taper. This from Richter's report:

> **The Czech National Bank** *dished out another surprise today, raising its main policy interest rate by 100 basis points to 3.75%, the highest since February 2008, and the fifth rate hike this year. A hefty rate hike had been expected, but not this hefty: None of 11 analysts polled by Reuters predicted a 100-point hike.*
>
> *At its prior meeting on November 4, the CNB had jacked up its policy rate by 125 basis points, the biggest shock-and-awe rate hike in 24 years. Since June, when it began its rate-hike tango, the CNB jacked up its policy rate by 350 basis points, from 0.25% to 3.75%.*
>
> *This sense of urgency – sorely lacking from the Fed – was motivated by red-hot inflation which hit 6.0% for November, the highest since 2008, amid supply chain bottlenecks, labor shortages, and spiking energy prices.*
>
> *Ironically, the Fed, which is confronted with an even higher inflation rate – 6.8% in November – hasn't yet raised the target range for its policy rate, which is still stuck near 0%.*
>
> **The Central Bank of Russia,** *on December 17, raised its policy rate by another 100 basis points to 8.5%, its seventh rate hike this year, totaling 425 basis points, from 4.25% to 8.5%, pressured by surging inflation, particularly food price inflation. Overall inflation in Russia hit 8.4%, food inflation hit 10.8%.*
>
> *This makes the Central Bank of Russia the only central bank whose rate hikes have actually caught up with inflation. Interest rates that are*

below the rate of inflation are still stimulative and inflationary; Russia has reached some level of neutral.

Since July, the Bank of Russia has been using the term "persistent" in its statements to describe this inflation, while the Fed's Powell was still clinging ludicrously to "transitory" and "temporary."

The Bank of the Republic (Colombia), *also on December 17, hiked its policy rate by 50 basis points to 3.0%, the third rate hike in a row, totaling 125 basis points since liftoff at 1.75% in September. Inflation hit 5.3% in November.*

The Bank of England, *on December 16, raised its policy rate by 15 basis points for liftoff, to 0.25%, dishing out a surprise to markets, after having walked back expectations of a rate hike at this meeting. Inflation in the UK surged to 5.1% in November, the worst in 10 years.*

The BoE could start Quantitative Tightening as soon as February next year. In a strategy paper last summer, the BoE said that it would stop reinvesting the maturing bonds on its balance sheet, and would therefore allow its balance sheet to shrink, once its policy rate reaches 0.5%. A 25-basis-point rate hike to 0.5% could happen at its next meeting in February, which would open the door to QT.

Norges Bank, *the central bank of Norway, also on December 16, hiked its policy rate by 25 basis points to 0.5%, its second rate hike, after its September liftoff from 0%. Inflation in Norway jumped massively from 3.5% in October to 5.1% in November, the worst since 2008.*

The ECB, *also on December 16, announced a sharp reduction of QE, from an average of €92 billion a month currently, to about €40 billion by March, and to €30 billion in Q3, and to €20 billion in Q4.*

This reduction is a two-step process: First, the end of its €72 billion a month Pandemic Emergency Purchase Programme (PEPP) by March. To ease the blow of the €72 billion cut, the ECB will raise its classic QE program from €20 billion a month now to €40 billion in March, cutting on net its total QE by €52 billion a month by March.

The Bank of Mexico, *also on December 16, surprised markets by raising its benchmark rate by 50 basis points to 5.5%, the fifth rate hike in a row, totaling 150 basis points. Inflation in Mexico has jumped to 7.4% in November, the worst since January 2001.*

The Central Bank of Chile, *on December 14, dished out a 125-basis-point rate hike, to 4.0%, in line with expectations, following the shock-and-awe surprise 125-basis-point rate hike at its October meeting, and the fourth rate hike since the cycle started in July, totaling 350 basis points.*

Inflation surged to 6.7% in November, the worst since 2008, but ironically below inflation in the US, where the Fed had steadfastly refused to even acknowledge inflation as a serious issue until the U-turn in recent weeks.

The National Bank of Hungary, *also on December 14, hiked its policy rate by 30 basis points to 2.4%, the seventh rate hike in a row, from liftoff in June at 0.6%. Inflation has spiked to 7.4% in November, the worst since 2007, up from 6.5% in October, and from 5.5% in September. So this is moving fast, much faster than the rate hikes, but at least it's doing something, unlike the Fed.*

The State Bank of Pakistan, *also on December 14, jacked up its policy rate by 100 basis points, to 9.75%, after the shock-and-*

awe 150-basis-point hike in October, and a 25-basis-point liftoff hike in September from 7.0%. The three rate hikes totaled 275 basis points. Inflation in Pakistan spiked to 11.5% in November.

The Central Bank of Armenia, *also on December 14, hiked its policy rate by 50 basis points to 7.75%, seventh rate hike in this cycle, from liftoff at 4.25%. Inflation jumped to 9.6% in November.*

The Central Reserve Bank of Peru, *on December 11, hiked its policy rate by 50 basis points to 2.5%, the fifth rate hike in a row, since liftoff at 0.25%. Inflation was at 5.7% in November.*

The National Bank of Poland, *on December 8, hiked its policy rate by 50 basis points to 1.75%, third rate hike in a row, totaling 165 basis points, from liftoff at 0.1%. Inflation spiked to 7.8% in November, from 6.8% in October and 5.9% in September – now moving very fast, and the central bank is falling way behind, but not as far behind as the Fed.*

The Bank of Brazil, *also on December 8, hiked its policy rate by another 150 basis points, to 9.25%. Since March, when the rate hikes started, it has jacked up its policy rate by 725 basis points, from 2.0% to 9.25%, as inflation shot straight up starting last year, to 10.7% in November, the worst since 2003, driven by all the usual suspects, from fuel to housing costs.*

The Bank of Korea, *on November 25, during its final meeting in 2021, raised its policy rate by 25 basis points to 1.0%, following its 25-basis-point hike in August. Inflation has jumped to 3.7%, the worst since 2012.*

The Reserve Bank of New Zealand, *on November 24 during its final meeting in 2021, hiked its policy rate by 25 basis points to 0.75%, the second rate hike in a row, after having ended QE cold-turkey in July, and after having created the worst housing bubble in the world.*

The South Africa Reserve Bank, *on November 18, during its final meeting in 2021, hiked its policy rate by 25 basis points to 3.75%, marking liftoff. Inflation hit 5.5%.*

The Central Bank of Iceland, *on November 17, hiked its policy rate by 50 basis points to 2.0%, fourth rate hike since liftoff in May from 0.75%. Inflation has surged to 5.1%, the highest since 2012.*

The Bank of Japan, *like the Fed and the ECB, has not hiked rates yet. And unlike the Fed and the ECB, it is not yet under red-hot pressure from inflation and housing bubbles. But ahead of the Fed and the ECB, the BoJ has ended its super-massive QE in May, after beginning the taper in the fall last year, when Abenomics came to an end with the exit of Prime Minister Shinzo Abe. And so one of the biggest money printers in the world has stopped printing money, which is a start.*

In an attempt to get inflation under control the central banks of Czechoslovakia, Russia, England, Norway, the European Central Bank, Mexico, Chile, Hungary, Pakistan, Armenia, Peru, Poland, Brazil, Korea, New Zealand, South Africa, Iceland and Japan have all increased interest rates.

The Fed?

Interest rates are still at zero.

Hear that?

It's the sound of accelerating inflation.

Low Income Households Grapple with Inflation

It is no surprise that inflation hits low-income households hardest. In past issues of the "You May Not Know" Report, we've discussed how the wealth gap has continued to widen largely as a result of the Fed's easy money policies (in my view). Now it seems that low-income households are struggling even more as inflation saps their purchasing power and energy costs are rising. This[6] from CNBC:

> *It's gearing up to be an expensive winter, especially for those grappling with rising heating costs.*
>
> *In the last year, about 20% of Americans struggled to pay their energy bill in full at least once, according to a study by Help Advisor. At the same time, 18% kept their house at a temperature that was either unhealthy or unsafe.*
>
> *Even more people went without necessities to make sure they could afford their utilities. More than 28% skipped a basic expense such as food or medicine to pay an energy bill in the last 12 months, according to the study.*
>
> *"It's absolutely startling," said Christian Worstell, a senior writer at Help Advisor, adding that the most vulnerable households tend to be those with children under 18, people of color and folks who have the lowest incomes.*
>
> *"It does appear the problem has been accelerating slightly, but this is nothing new," he said.*
>
> *Nearly half of U.S. households that heat with natural gas are projected to spend 30% more than they did last winter on average, according to the Winter Fuels Outlook 2021 report from the U.S. Energy Information Administration. The 41% that heat with electricity are expected to spend 6% more.*
>
> *The smaller number that heat with propane or heating oil — 5% and 4% of households, respectively — could see even bigger leaps in cost. Propane users will spend 54% more this winter, while heating oil users could see bills go up 43%, according to the report.*
>
> *Inflation is the culprit. Energy prices are up 33.3% on the year, according to the November consumer price index from the Bureau of Labor Statistics. Fuel oil is nearly 60% more expensive than last year, electricity is up 6.5%, and natural gas rose by more than 25%.*

Time Deposit Rates

At the time of publication, these rates were valid:

1-Year	1.00%
2-Year	1.50%
5-Year	3.00%

Call the office for details at
1-866-921-3613.

The Changing Face of Long-Term Medical Care Insurance

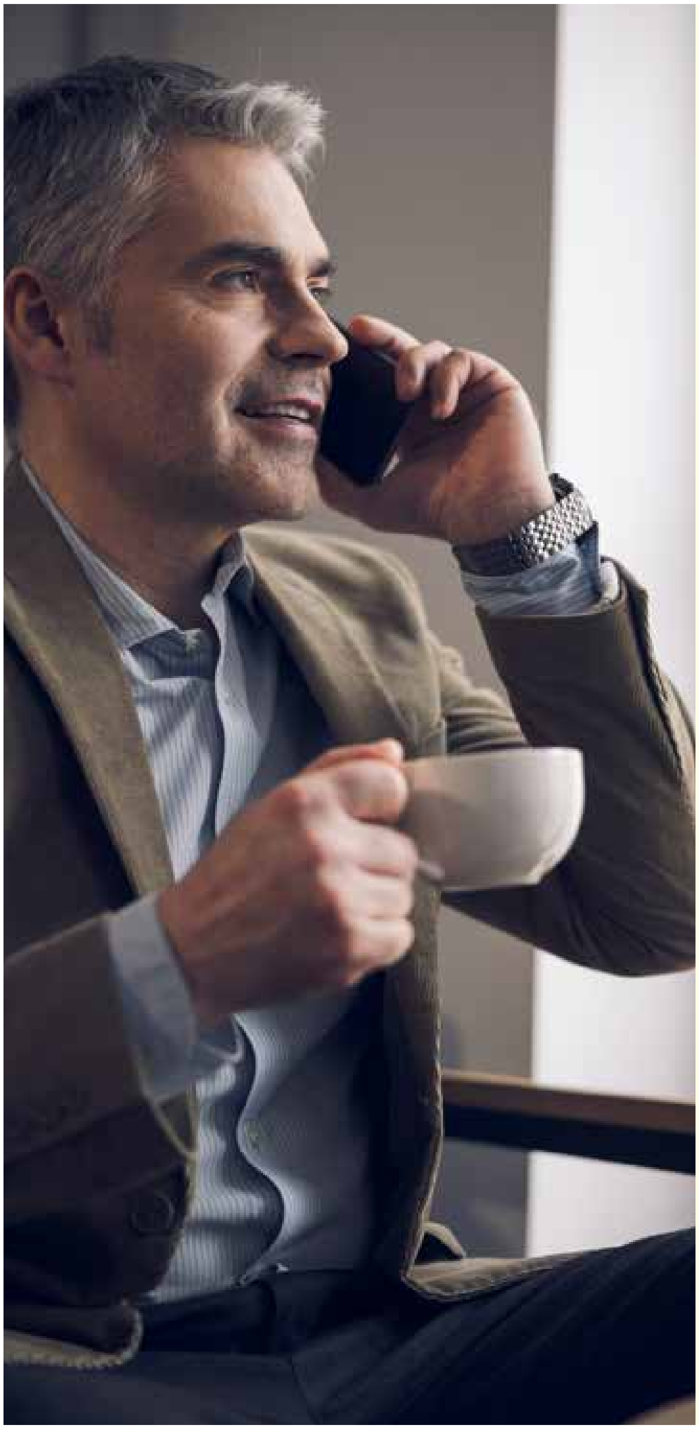
This month only, we are making available a free report titled, "The Changing Face of Long-Term Medical Care Insurance".

To request your complimentary copy this month only, return one of the postage-paid reply cards included with this month's newsletter. You'll notice that we've included three reply cards with this month's newsletter; we've done that so you can request a copy of this report for anyone you know that might find this information helpful.

In the report, you will discover:

- What current long-term nursing care costs really are
- The probability of requiring long-term nursing care in the future
- How long-term care costs are covered by insurance and other government programs
- The financial health of government programs that now pay for long-term nursing care expenses for many who require such care
- The possible new trend - laws being passed by states to require that individuals take more responsibility for the cost of this care should they need it
- Protection options and the pros and cons of each
- How to consider inserting long-term nursing care contingency planning into your retirement income plan

This report is being offered this month only.



Resources to Help You Stay Informed

All these resources are available at the Retirement Lifestyle Advocates website: **www.RetirementLifestyleAdvocates.com.**

The weekly "Portfolio Watch" newsletter. Each week, I give you an update as to where we are economically speaking and in the financial markets and where we are going based on my analysis.

The weekly "Headline Roundup" webinar. Replays are available on the website. "Headline Roundup" happens every Monday live at Noon Eastern Time. To get an invite to the live event, give the office a call at **1-866-921-3613**.

The weekly "RLA Radio" show and podcast.

We also have the RLA app available. All these resources are also available on the app.

You can download the YOURRLA app for free by visiting the app store (either Google or Apple) and searching under YOURRLA.

If you have questions when downloading the app or would like assistance, feel free to call the office. Our office phone is answered 8 to 5 Monday through Thursday and 8 to Noon on Friday.

Sources

1. https://goldswitzerland.com/fear-and-inflation-the-timeless-policy-tools-of-discredited-systems/
2. bls.gov
3. https://ca.finance.yahoo.com/news/summers-warns-markets-risk-spontaneous-213950091.html
4. https://www.zerohedge.com/news/2021-12-12/coming-inflation-tsunami-and-how-prepare
5. https://wolfstreet.com/2021/12/22/end-of-easy-money-global-tightening-in-full-swing-fed-promises-to-wake-up-in-time/
6. https://www.cnbc.com/2021/12/23/20percent-of-americans-couldnt-pay-their-energy-bill-in-the-last-year.html