

BALANCING ACT

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Ben Bernanke is on the tight rope, trying to balance between unemployment and inflation. This is a difficult balancing act; no one before him has successfully reached the twin mandated goals of price stability and full employment using monetary policy alone. But monetary policy is the only tool in the Fed's tool bag. The Chairman is persistent, but he is on a fool's mission. His easy money strategy has not created price stability nor reduced unemployment. To the contrary, Fed monetary policy has contributed to precisely the opposite result--growing inflation and high unemployment. And there are unintended consequences of the Fed's prolonged accommodation, namely, the death of the Dollar and rise of the commodities bubble.

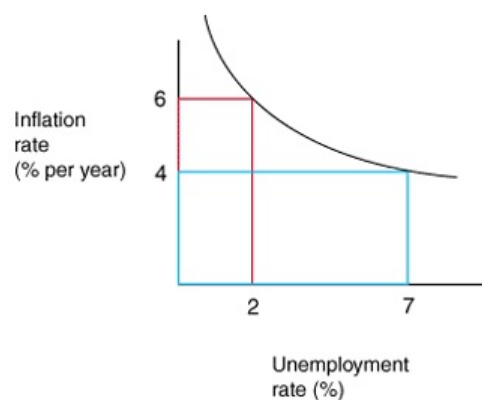
For gold bugs, the Fed's single-minded easy money policy has been a godsend. Since the Fed began its ultra-low interest rate and Quantitative Easing policies in 2008, the Fed balance sheet increased by \$2.1 Trillion and gold has doubled in price. Silver has quadrupled over the same period.

Many consider the price of gold to be the barometer for risk facing the economy. During good times, gold prices tend to lag stocks, bonds, real estate and other investment assets. Gold tends to outperform when there is uncertainty in global economies and dollar-denominated assets are in decline. The Fed's easy money policies contributed to the real estate bubble, which ended in the financial crisis of 2008 and the drop in the Dollar. Gold led commodities out of the abyss of the financial meltdown.

Over the last two years, massive and continued Quantitative Easing (QE2) combined with economic weakness in the EU and political uncertainty in Africa and the Middle East has weakened the Dollar and pushed gold to record highs. But the weakening Dollar has also fueled inflation in every asset class except real estate, and the US unemployment rate remains above 8%. Clearly the Fed's monetary actions have failed to achieve mandated goals.

I say it should not be the Fed's mission to solve the unemployment problem in the United States. As we have seen, near-zero interest rate policy does not create jobs, and Quantitative Easing does not create jobs. Further, the premise that there is a balance between inflation and unemployment, as represented by the Phillips Curve is fundamentally flawed.

The Fed mandate emanates from the Keynesian notion that there is a trade-off relationship between inflation and unemployment, and that economic prosperity can be achieved by the proper balancing of the two variables. But the stagflation of the 1970's defeats the Phillips Curve. The current economic situation is proving the theory to be false once again.



Today, the Fed recognizes inflation to be 2.1%, but in fact inflation is closer to 10%. According to the US Labor Department, US unemployment is 8.8%, but actual unemployment (U-6 rate) is 16%. Latest GDP growth has slowed to 1.8%, down from 3.1% in 4Q10. These numbers represent stagflation, the condition of simultaneous high inflation and high unemployment. The Federal Reserve cannot set the magic interest rate that achieves a balance of tolerable inflation and unemployment.

As readers have seen on the pages before, the road to US prosperity is not through government intervention in the markets. On the contrary, it is the private sector that is the engine of growth. Government should help create the environment for private sector growth. US private sector expansion has created more permanent jobs than any government stimulus program, including the 1930's WPA programs.

The environment that is most conducive of economic growth is one of smaller, less intrusive government. Pro-growth economic policy is one of low corporate and individual tax rates, responsible fiscal policy (much lower government spending), lower government regulation and sound money.

History has shown that tax cuts, not tax increases have stimulated job growth and prosperity in the United States. The "soak the rich" approach to tax policy is a myth. Government revenues actually increase when taxes are reduced. In the 1920s, tax rates were slashed from over 70 percent to less than 25 percent. Revenues rose from \$719 million in 1921 to \$1164 million in 1928, an increase of more than 61 percent.

In the 1930s Hoover and Roosevelt pushed marginal tax rates to more than 90 percent. In the early 1960's Kennedy cut tax rates to 70 percent which increased revenues to \$94 billion in 1961 and \$153 billion in 1968, an increase of 62 percent. When Reagan cut tax rates in the 1980's, tax revenues climbed by 99.4 percent.

In 2003 Bush cut the dividend and capital gains tax to 15 percent each. The U.S. economy added 8 million new jobs from 2003-2007. From 2004 to 2007, federal tax revenues increased by \$785 billion, the largest four-year increase in American history.

But tax cuts are not part of the current Washington plan forward. Instead, tax hikes are planned to help fund continued deficit spending. This will continue to pressure the Dollar and impede GDP growth. Industry will continue to bump along like Vonnegut's Harrison Bergeron, weighted down with excessive regulation and class-leveling "fair" taxes, set by the Handicapper General.

There are better choices for investors seeking to maintain their wealth. Investors can choose to protect their wealth by owning gold and silver. Today's pullback provides a good entry point. The bull market in gold and silver has a long way to run.

Investors from around the world benefit from timely market analysis on gold and silver and portfolio recommendations contained in *The Gold Speculator* investment newsletter, which is based on the principles of free markets, private property, sound money and Austrian School economics.

The question for you to consider is how are you going to protect yourself from the vagaries of the higher prices and economic uncertainty? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010, and 55% for 1Q2011. Subscribe at our web site www.thegoldspeculatorllc.com with credit card or PayPal (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055