

## **Too Much Money**

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“One can never have too much money,” goes the Hollywood saying. But that old saw does not apply to Washington.

One of the primary stimulus measures implemented by the Federal Reserve over the last three years has been the injection of cash into the economy by giving money to the banks. The scale of the cash injection is unprecedented- the Fed has pumped nearly \$1.6 Trillion into the banks. But the US economy was in a deep recession, with the potential, it was thought, to slip into the Second Great Depression. The Fed and many demand-side economists believed that adding liquidity during a period of deflationary recession would have a stimulative effect on the economy. With more credit from the Fed, banks would lend more, making more money available to consumers to spend and businesses to expand to meet the increased demand. Recession would then give way to broad economic expansion and prosperity, with low unemployment, rising wages and higher GDP.

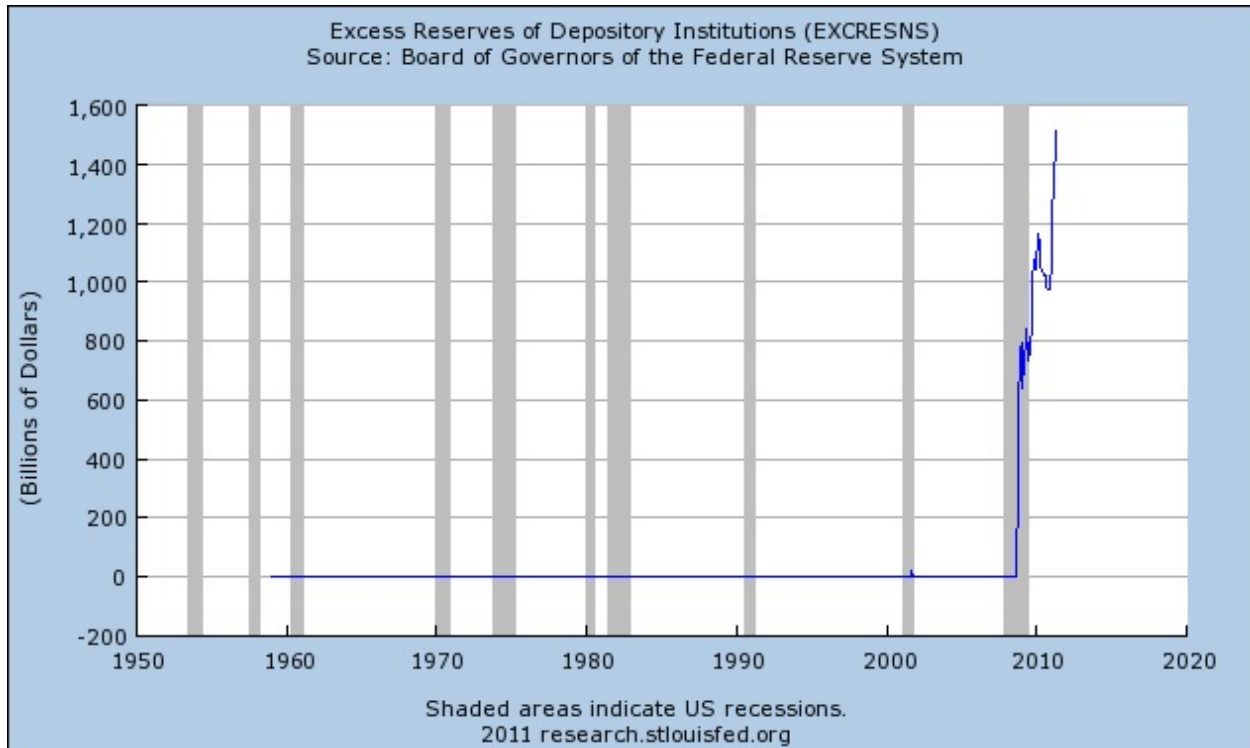
The notion that increasing the money stock increases aggregate demand has been around for decades. In 1936, John Maynard Keynes first presented the idea in *The General Theory of Employment, Interest and Money*. Keynes believed that government is more effective than the private sector at stabilizing the business cycle. In his model, control is applied by central bank monetary policy and government fiscal policy. Keynesian theory served as the economic model during the later part of the Great Depression, World War II, and the post-war economic expansion. Japan implemented Keynesian policies in the 1990's. Since the financial crisis of 2007, the US, the UK and much of the EU have relied on Keynesian stimulus programs as the basis of their recovery efforts.

But robust economic recovery in the United States has proved elusive. Although the recession is officially over, GDP growth has slowed, unemployment remains high and housing prices continue to decline. Prices for food, fuel and other necessities are climbing, but wages have stagnated. Today there are renewed fears that the US economy may be entering a double-dip recession. Why has the stimulus failed?

Keynesian economists such as Paul Krugman, Nouriel Roubini and others say the government stimulus was too small to do the job. Others, such as Ben Bernanke say that we must be patient, that there is a lag before monetary policy measures take full effect. There is little political interest in another round of Quantitative Easing (QE3). The wait and see approach is even more frustrating to people hungry for effective leadership.

Taking the Keynesian view, it's easy to point a finger at the banks. Despite the addition of massive Fed credit, the banks are not lending. Rather than extending the new Fed credit to consumers and businesses in the form of mortgages, car loans and business loans, the banks are hoarding \$1.5 Trillion in “excess reserves”. Certainly, the classic Keynesian expectation is that banks will lend more if given more credit to lend, but that has not been the behavior of the big

banks in this era of Fed credit expansion. The banks are treating money as a store of value, rather than capital for investment.



One reason the banks are not lending is they can make money on their excess reserves. The Federal Reserve began paying interest on reserves, for the first time in its history, in October 2008. So rather than make mortgage loans when housing prices are still falling, or make business loans when consumer demand continues to decline, the banks elect instead to pull in their horns. Imagine what \$1.5 Trillion in new working capital would do for households and businesses today.

The Austrian economist takes a different view of the current level of excess reserves in the system. First, if Ben Bernanke were an Austrian School economist, there would be no excess reserves in the system, because he would believe in restraint rather than intervention as the guiding monetary principle. Notwithstanding, given the current state of events, the Austrian economist would be happy to see \$1.5 Trillion excess reserves *not* loaned out by the banks. Imagine what the inflation rate would be with another \$1.5 Trillion created from thin air chasing scarce commodities today.

We have seen the effects of Fed monetary policy on the US Dollar. The Dollar buys 17% less today than it did in 2009 when the Fed increased its balance sheet with bonds paid for by printing money.



Prudent investors have learned to protect their wealth from the debasement of the currency by the Federal Reserve by buying and owning gold. Since the Fed began expanding the money supply in 2009, gold has nearly doubled in value. Gold has been recognized as a durable store of value for centuries and it is proving again today to be a reliable hedge against economic uncertainty.



In today's economic climate, one may have too much money, but never too much gold.

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