

## FED SPINNING GOLD

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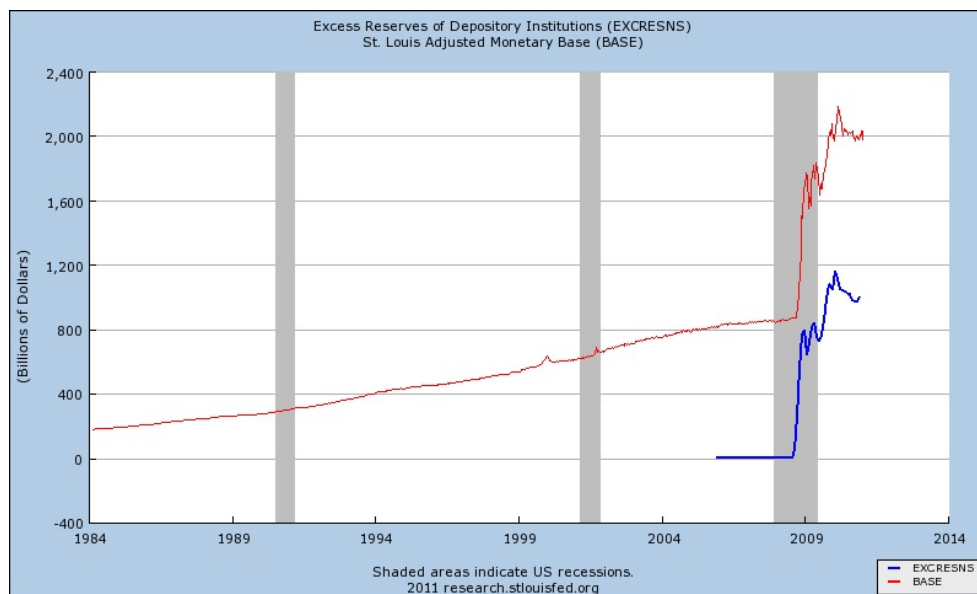
The Fed is spinning gold. Deep in his subconscious, Ben Bernanke secretly yearns to return the country to the gold standard, but he knows that if this were to happen, he'd be out of job. And so would thousands on the government payroll who have perfected the art of printing money out of thin air. So, every day Chairman Bernanke issues the money printing quota to the cohorts, who print away, day after day, to the monotonous beat of the "deflation" drum.

There can be no other reason that the Chairman has stuck to the easy money policies of the last several years, despite the fact that his persistent intervention in the markets and his efforts to stimulate the US economy utterly have failed.

But Bernanke is not the first Fed chief to do the wrong things in the face of economic challenge. In the 1930's, the Fed contracted the monetary base by 30%, totally misreading crisis conditions of the time. According to Friedman and Schwartz (1963), Fed malfeasance in the early 1930's was the major cause of the Great Depression.

All economies have boom and bust business cycles. History shows the longest downturns are the result of government intervention. The most egregious government intervention has come in the name of salvation. "Raising interest rates will restore economic growth and prosperity" (1930) "By taking these steps, we will stimulate the economy and create millions of jobs." (Bernanke, 2009) "Quantitative easing will stimulate the economy and bring down long term interest rates." (Bernanke, 2010)

When the housing bubble burst, the Fed and the Treasury conflated the crisis at a few Wall Street banks with a "systemic crisis in the global banking system." Failing banks and insurance companies were deemed "Too big to fail." This lie spread quickly in mainstream media. Bernanke's first misguided step was his unprecedented expansion of the monetary base by \$1.4 Trillion (top curve in the chart below). The idea was to inject liquidity into the banking system, allowing consumers to borrow and spend and producers to borrow and expand to meet increased demand. But the Chairman did not expect the banks to hoard the new credits and stop lending. Bank Excess Reserves skyrocketed (lower curve below); banks essentially quit lending, leaving consumers and small businesses in a lurch. More recently, the Fed began its Quantitative Easing 2 program to add another \$600 Billion in "stimulus" funding, further adding to Excess Reserves.



The Fed's action was intended to 1) thaw the credit freeze and 2) fend off deflation. But two years later, the banks continue to restrict consumer and business loans. Deflation in the housing sector continues today, but prices in the broader sectors, such as commodities have continued to rise since the meltdown lows of 2009. Inflation always follows over-expansion of the money supply compared to GDP growth. Irving Fisher's equation holds:

$$MV=PT$$

Where M is the money,  
V is the velocity of money (economic activity),  
P represents price, and  
T is transaction for goods or service

The important conclusion from this equation is that an increase in MV must increase PT. In other words, when the Fed expands the money supply, prices and/ or transactions rise. Friedman maintains that the proper balance is achieved when money growth equals modest GDP growth. Excessive printing of money by the Fed creates devastating inflation and devalues the Dollar.

We have seen a rapid and continuing rise in commodity prices since Fed intervention of 2009. Higher commodity prices are feeding through to increases in producer prices (PPI) and consumer prices (CPI). Actually, reported CPI numbers do not reflect prices most Americans experience (e.g the so-called Core CPI excludes food and fuel). GDP growth remains sluggish, which may portend a return to the stagflation of the 1970's.

But what if the amount of money were fixed, as in the gold standard? Returning to the Fisher equation, if we fix M as a constant, any increase in T must coincide with a decrease in P or an increase in V to maintain the equation. When more transactions occur in an economy with a fixed currency, prices must fall or the velocity must increase or both. As the economy grows, prices can actually decline. Because money is constant it gains value in exchange for more goods and services or commodities. Fixing money does not change the economy; the economy changes the value of money without changing the amount in circulation.

Bernanke's nightmare may be our salvation. History has shown that in uncertain times, investors at every level turn to gold. Owning gold is hedge against paper currencies vulnerable to inflation, corrupt governments, war and revolutions. Those who chose to own gold have prospered, while those with assets linked to fiat currencies have seen the value of their assets wither away.

The question for you to consider is how are you going to protect yourself from the vagaries of the financial world and the secession of economic bubbles and crashes which characterize our age? We publish *The Gold Speculator* to help people make better decisions about their money. Our Model Conservative Portfolio gained 66.7% in 2010. Subscribe by visiting our web site, [www.thegoldspeculatorllc.com](http://www.thegoldspeculatorllc.com) and pressing the PayPal button (\$300/yr) or by sending your check for \$290 (\$10 cash discount) The Gold Speculator, 614 Nashua St. #142 Milford, NH 03055

Thank you for your interest.

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