Newport Global Summit

Nathan Lewis

August 25, 2022

Nathan Lewis

Five books about monetary and economic topics, including the “gold standard trilogy.”

Gold: The Once and Future Money (2007)
Gold: The Monetary Polaris (2013)
Gold: The Final Standard (2017)

The Magic Formula (2019)

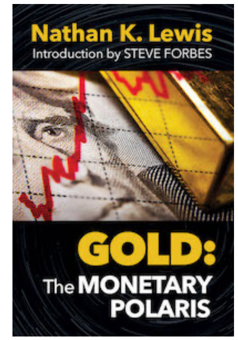
Inflation (2022), with Steve Forbes and Elizabeth Ames

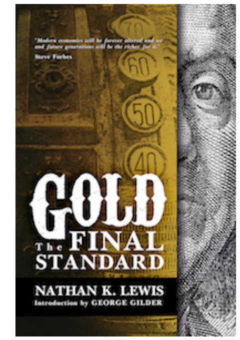
Discovery Institute Fellow

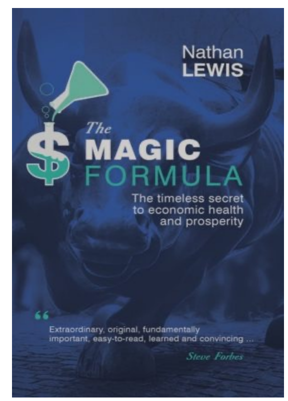
15+ years of institutional research and asset management experience.

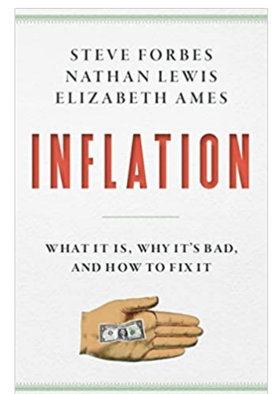
Newworldeconomics.com

The Polaris Letter (polarisletter.substack.com)



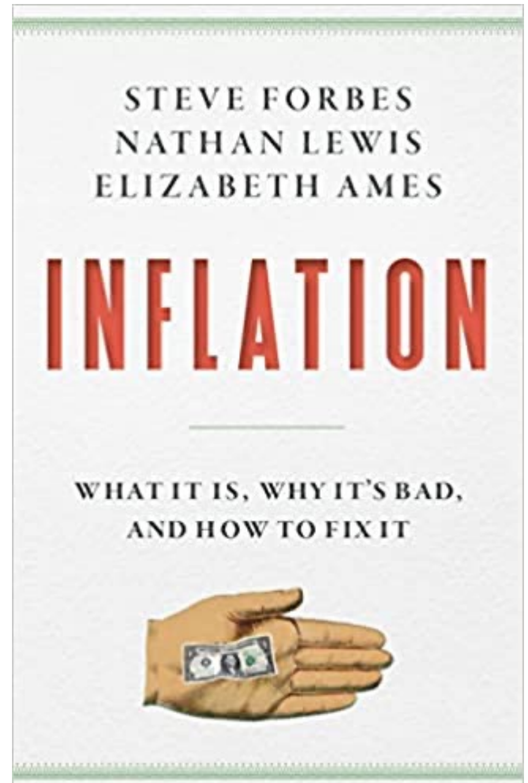






What is “Inflation”?

Discussions about “inflation” soon degenerate into word salad.



We knew this was going to happen.

Word cloud of a speech, “The outlook for inflation and monetary policy,” Federal Reserve Governor Michelle Bowman, June 23, 2022

Monetary and Non-Monetary Processes (Keynes vs. Friedman)

Postwar Keynesianism:

Keynesian economics are the various macroeconomic theories and models of how aggregate demand (total spending in the economy) strongly influences economic output and inflation. (Wikipedia)

=Supply and Demand of Goods and Services

Monetarism:

"Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output." (Milton Friedman)

=Quantity of Currency

Both of these guys were half right … sort of.

Supply/Demand for Goods and Services:

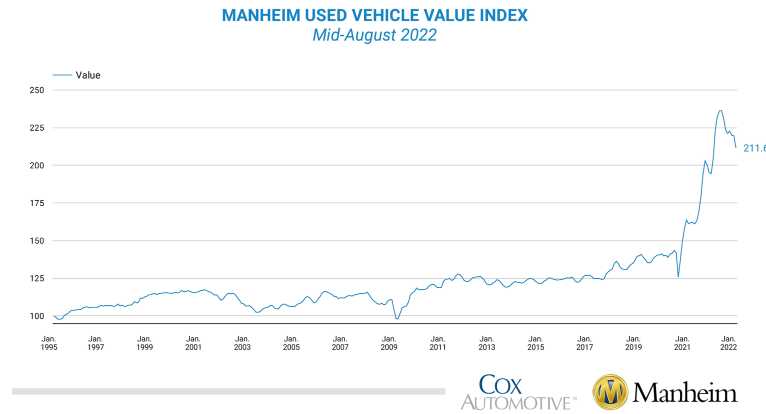
Rising energy prices (natural gas in Europe!)

Chip shortage → Rising car prices

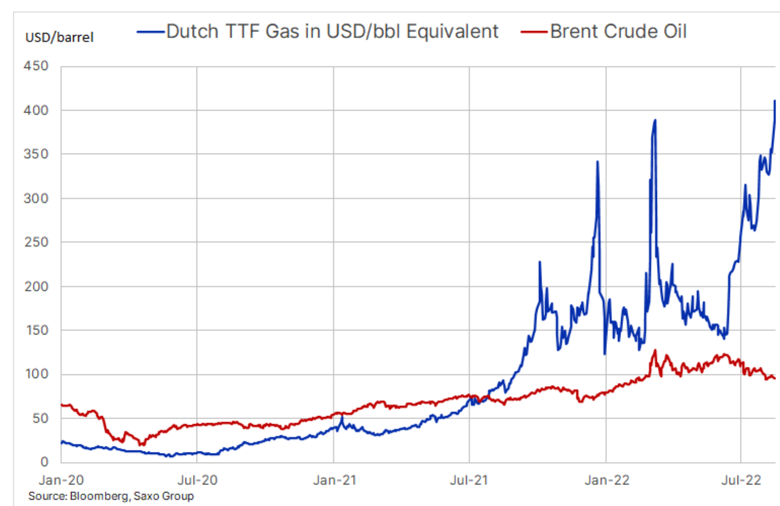
Tight labor market →Higher wages

Lack of housing development in popular cities, plus Red State migration →Higher house prices, rents

Economic recovery powered by 15%-of-GDP Federal Deficit in 2020-21 (more spending!)



Was this caused by the Federal Reserve?



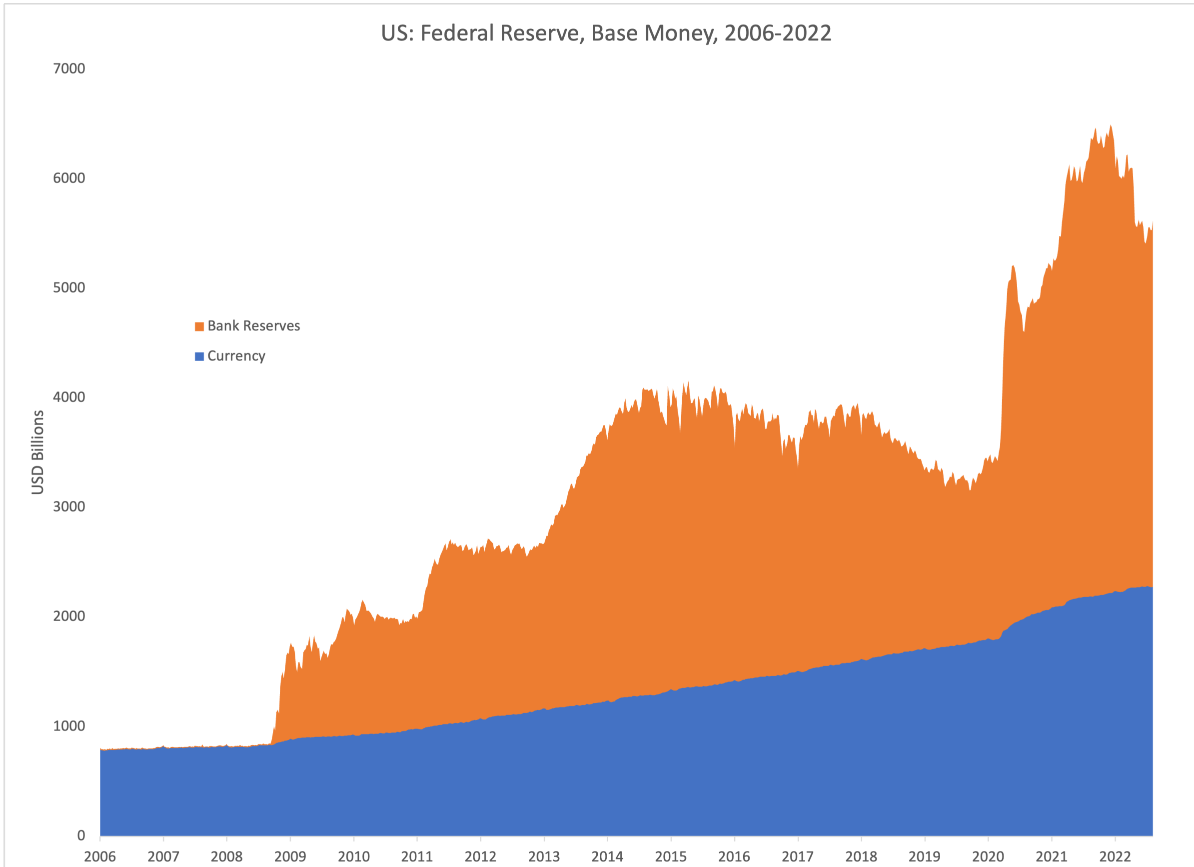
Did the ECB do this?

Central Banks were wildly expansionary.

Money Supply:

The Federal Reserve increased the Monetary Base (currency in circulation + bank reserves) by about $3.0 trillion, or 86%. But, it later removed about $1.0 trillion of this.

Other major central banks acted similarly.



Focus on the Value of the Currency, not the Quantity

- Coins have been debased (gold and silver content reduced, thus reducing their market value) since the 7th century BC.
- Henry VIII of England reduced the silver content of the English penny by 83% in 1542-1547.
- Today, it's all virtual: We have floating fiat currencies whose values go up and down.
- Sometimes they go down -- a lot!

- When a currency's value declines, markets adjust and it eventually takes more money to buy things.

One of Henry VIII's debased pennies.

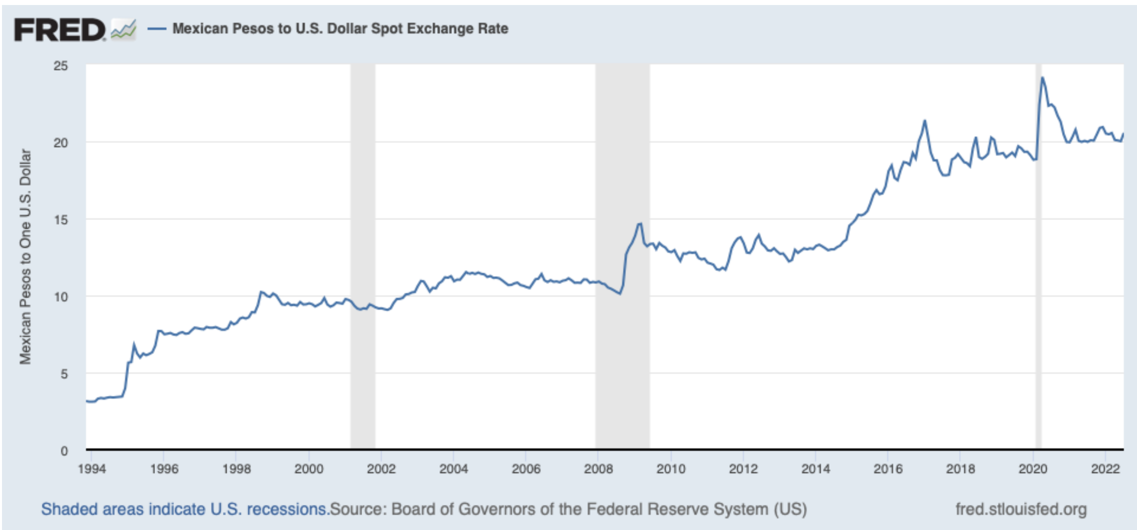
Bitcoin's quantity is fixed, but the value is wildly variable.

Bitcoin doesn't work well as a basis for money.

Figure 13.1: U.S.: Value of 100 Continental Dollars Vs. Bullion Coin, 1777-1781[1]

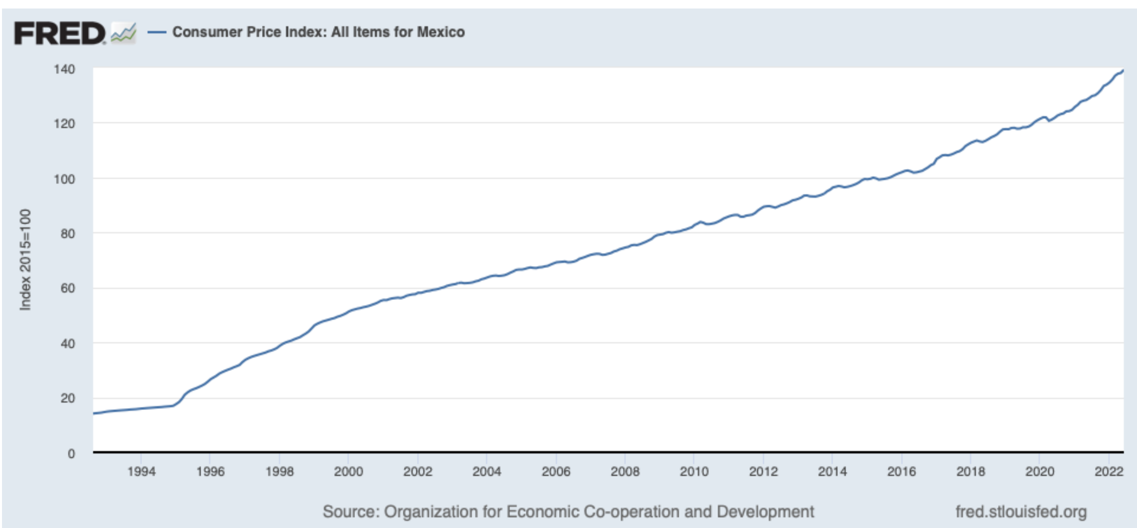
In the 1780s, Congress issued a "continental dollar" that was hyperinflated into oblivion.

It’s obvious when it happens to *someone else*.



It takes more Mexican pesos to buy a dollar.

It takes more pesos to buy everything else too.

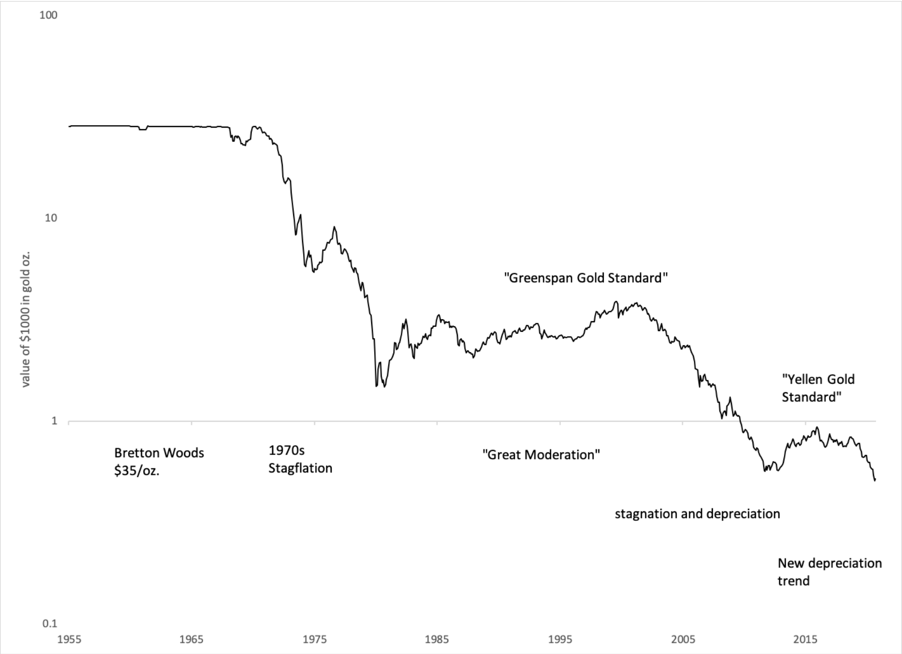


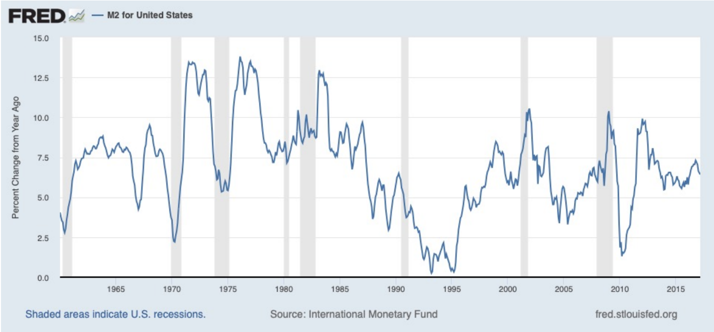
Was there a “more rapid increase in the quantity of money than in output”?

Maybe … maybe not … who cares.

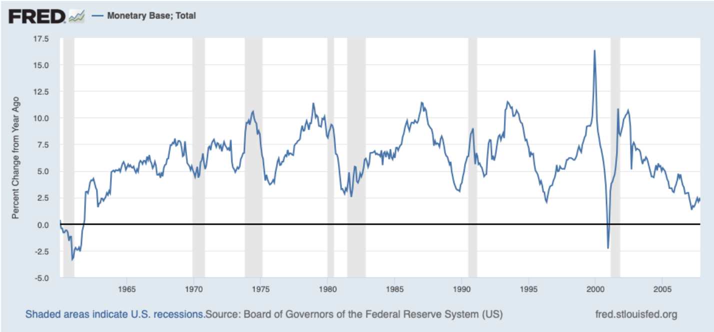
The 1970s: Value, not Quantity (Classical not Monetarist)

- The inflation of the 1970s is easy to understand as a decline in currency value of about 10:1. ($35/oz. of gold to $350/oz.)
- Monetary quantity statistics (M2, base money) don't show much. You can't understand conditions, or make policy, based on them alone.





Annualized growth rate of M2:
1960s: 7.1%
1970s: 9.7%

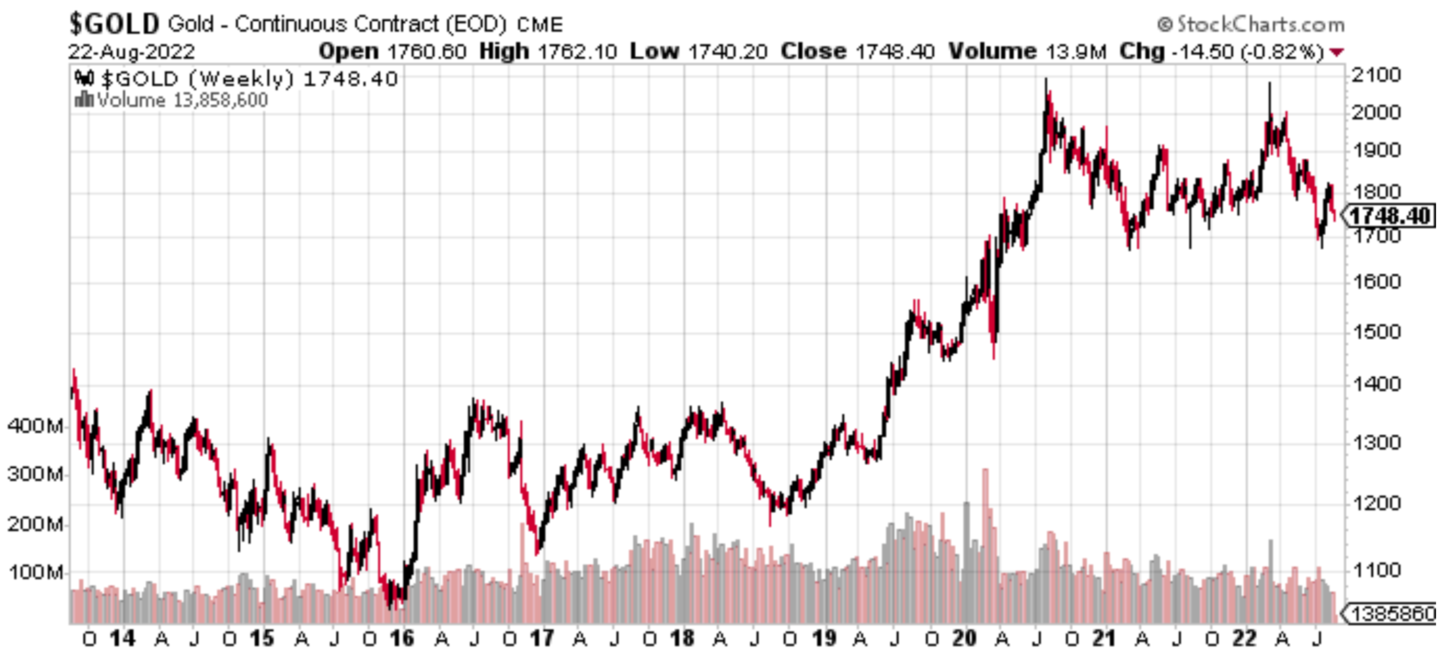


The Monetary Base is the only quantity the Federal Reserve actually controls.

Where's the "inflation" of the 1970s?

(Very little "money printing" took place during the 1970s.)

The USD recently took another step lower in value (vs. gold).



It takes about 50% more dollars to buy an ounce of gold. ($1200/oz. to $1800/oz.)

If gold is stable in value, this suggests that, over time, it will eventually take about 50% more dollars to buy everything else too ("all things being equal").

Since 1900 …

- The U.S. dollar’s value vs. gold declined by 90:1.
- The British pound’s value vs. gold declined by 324:1.
- The Italian lira’s value vs. gold declined by 28,000:1.
- Russia had hyperinflation in 1917-1921, and 1990-1995.
- China had hyperinflation in 1910-1912 and 1945-1950.
- Germany had hyperinflation in 1919-1923 and 1945-1949.
- Japan had hyperinflation in 1945-1949.
- All of Latin America had hyperinflation in the 1980s.
- All of Eastern Europe had hyperinflation in the 1920s and 1990s.
- It happens all the time.

1928

=

1x

U.S. $20 Saint-Gaudens coin from 1928, containing 0.97 troy oz. of gold.

1x

U.S. $20 Federal Reserve Note from 1928.

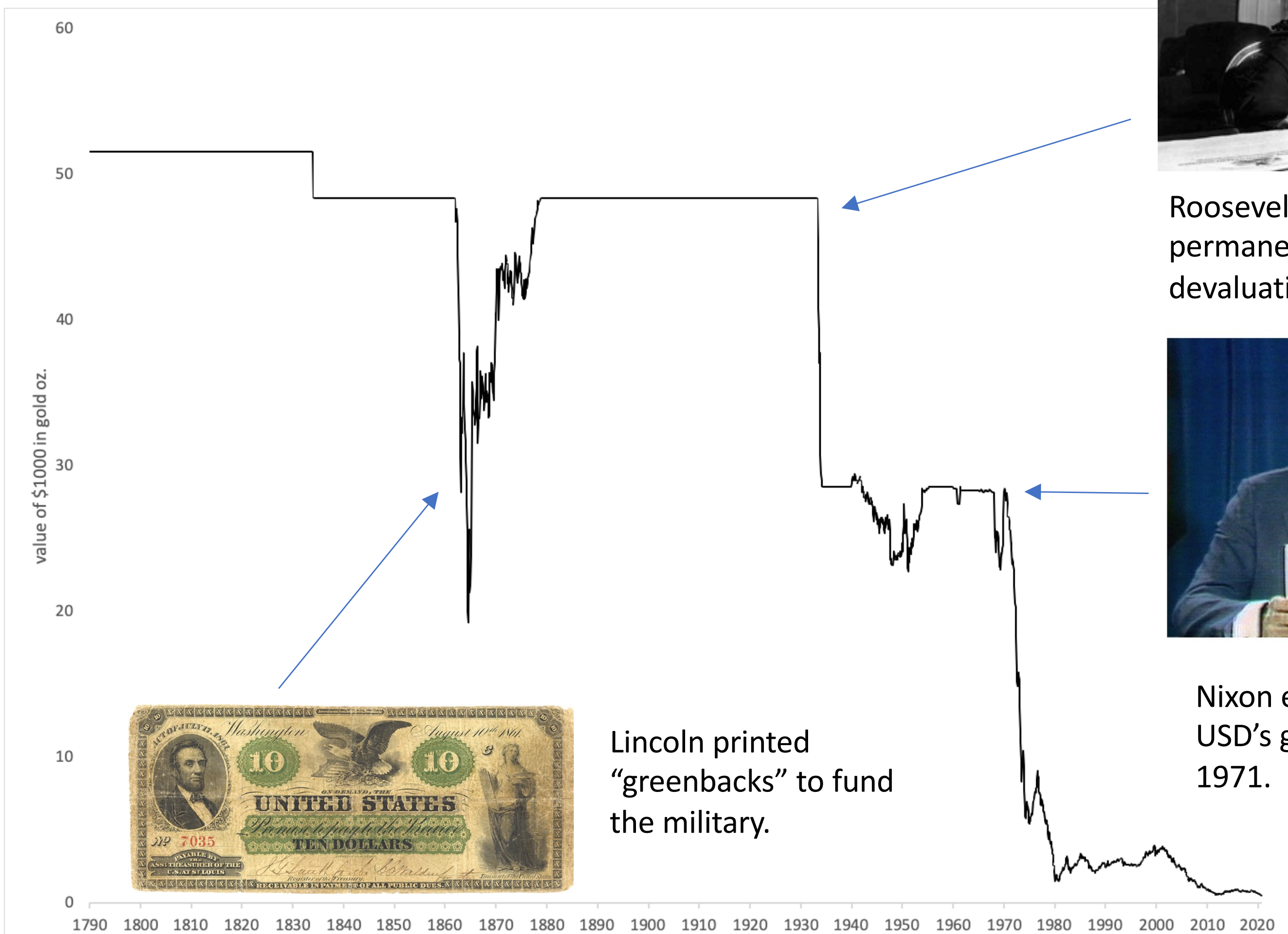
2022

=

1x

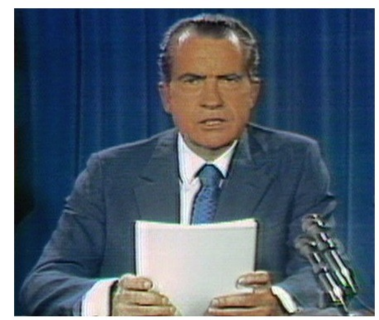
90x

These events defined the macro conditions of the time.



Lincoln printed "greenbacks" to fund the military.

Roosevelt caused the first permanent dollar devaluation in 1933.



Nixon ended the USD's gold link in 1971.

Value of $1000 in gold oz, 1790-2020

How do you fix “inflation”?

Keynesians:

We need less “aggregate demand” so:
Higher taxes, higher interest rates;
Less government spending, lower wages.

= ”fiscal austerity” = recession

Monetarists:

Contraction of “money supply” by central bank until aggregate spending (=nominal GDP) hits target.

= “monetary austerity” = recession

Classicals:

Stabilize the value of the currency. At least, don’t let it drop any further. (Maybe, allow it to rise somewhat.)
Lower taxes, reduce impediments to business and production (housing, supply chain, etc.)

= stable money + good policy = economic boom

”Reaganomics”:

Lowered top income tax rate from 70% to 28%.

Volcker and Greenspan stabilized USD vs. gold and commodities.

Everyone said it wouldn’t work.

It worked!

Stabilizing currency value fixes “monetary inflation.”

You can stabilize currency value in a crude, ad-hoc fashion as Volcker and Greenspan did (and as Powell has done since mid-2020).

Or, you can formalize and institutionalize the process by explicitly linking your currency to some external benchmark.

In the past, this was gold.

Today, over 100 countries link their currencies to the USD, EUR or something else. (The IMF bans gold standard currencies today.)

Even hyperinflations have been fixed instantly when currencies are stabilized:
- 1923: German mark stabilized vs. gold.
- 1949: Japanese yen stabilized vs. gold and USD.
- 1991: Argentine peso stabilized vs. USD
- 1997: Bulgarian lev stabilized vs. German mark/euro.

Emperor Constantine ended hyperinflation in Eastern Rome by establishing the gold solidus coin in 312. It was unchanged for seven centuries.

Napoleon ended hyperinflation in France in 1801 by linking the franc to gold. It was unchanged until 1914.

Mao Tse-tung ended hyperinflation in China in 1949 by linking the yuan to gold.

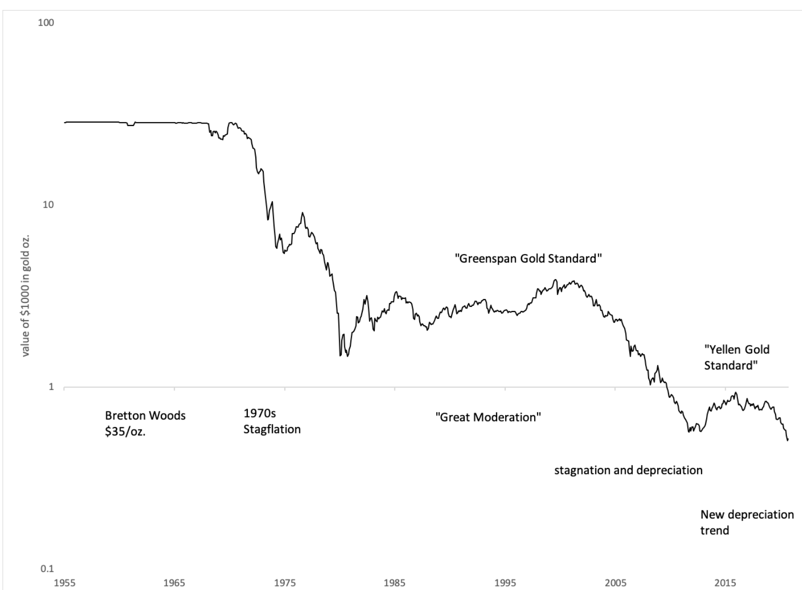
Elizabeth I replaced Henry VIII’s junk coinage in 1560. The British pound was unchanged until 1931.

The "PhD Standard" → chronic long-term currency decline.

Do Something About The Economy!

Do Something About Inflation!

$0.02 dollar

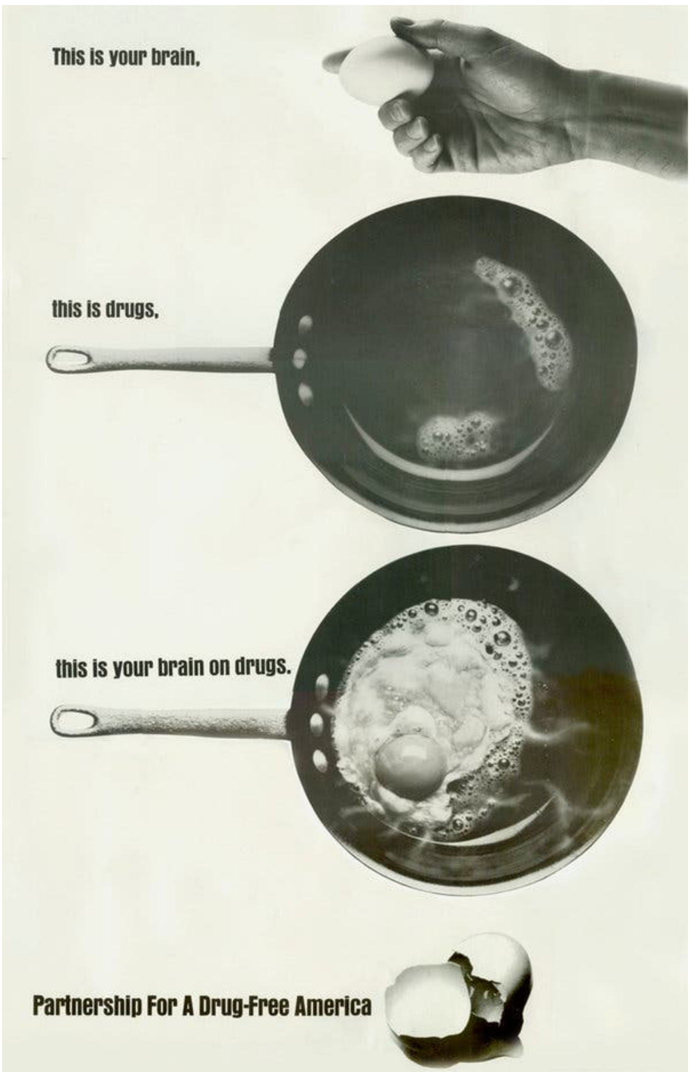


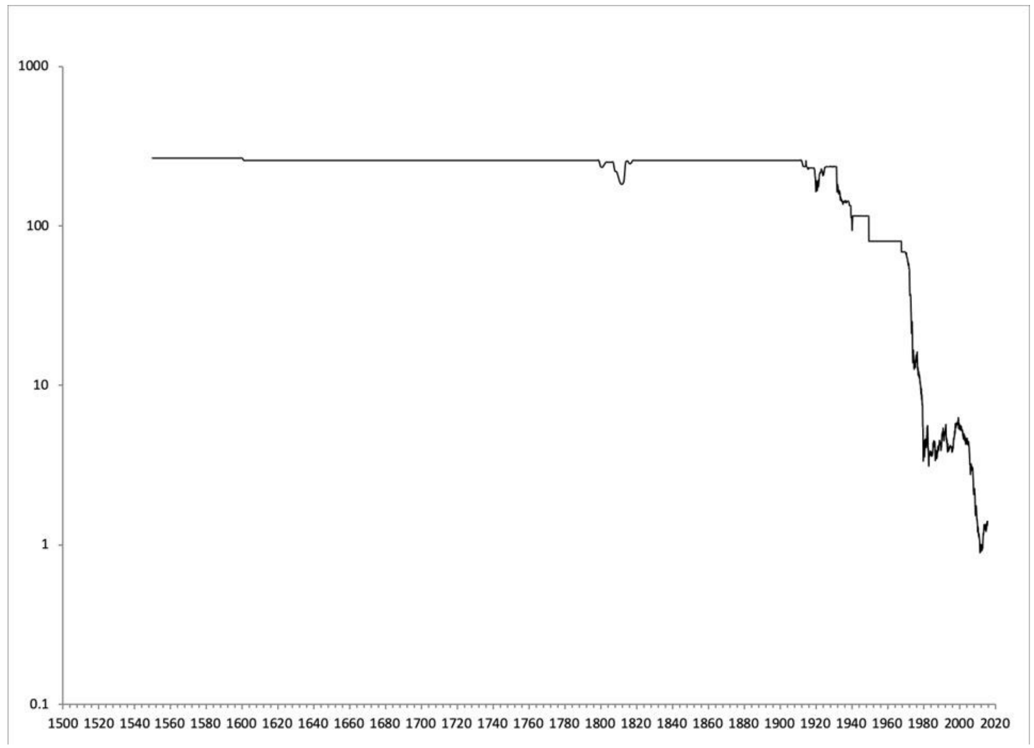
The USD today is worth about 1/50th of its value in the 1960s vs. gold. ($1800/oz. vs. $35/oz.)

During these five decades, every central banker was against "inflation" and currency depreciation.

It just happens anyway.

Ideas have consequences.





This is your currency on
Keynesian/Monetarist manipulation.
(="PhD Standard")

Value of 1000 British pounds in gold oz., 1560-2016. Log scale.

Government printing-press finance → hyperinflation

Issue bonds to fund the government

Central bank buys the bonds
with newly-created money

Confetti currency

Yugoslavia, 1993

Israel, 1983

China, 1949

Russia, 1995

Venezuela, 2021

Iran, 2018

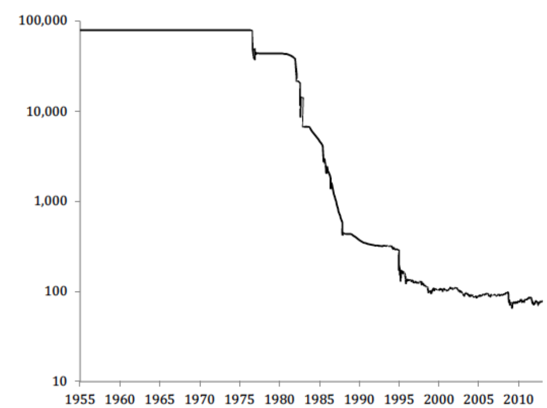


Figure 16.2: Mexico: Value of 1000 Pesos (1 Million pre-1993 Pesos) in U.S. Dollars, 1955-2012
logarithmic scale

Mexico in the 1980s

The US and other governments are drifting into a hyperinflationary situation (="Sovereign Debt Crisis")

In 2009, the US ran a $1.4 trillion deficit (9.8% of GDP).

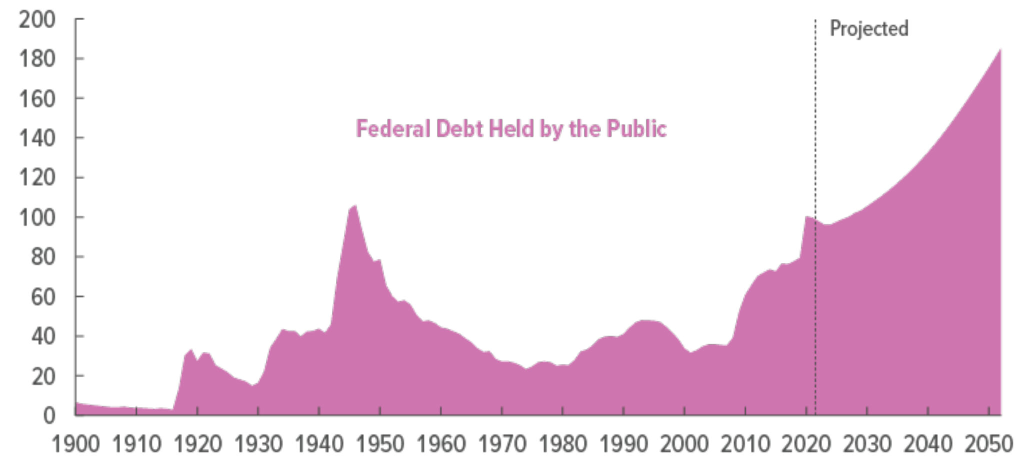
The Federal Reserve bought $1.2 trillion of bonds.

In 2020, the US ran a $3 trillion deficit (15% of GDP).

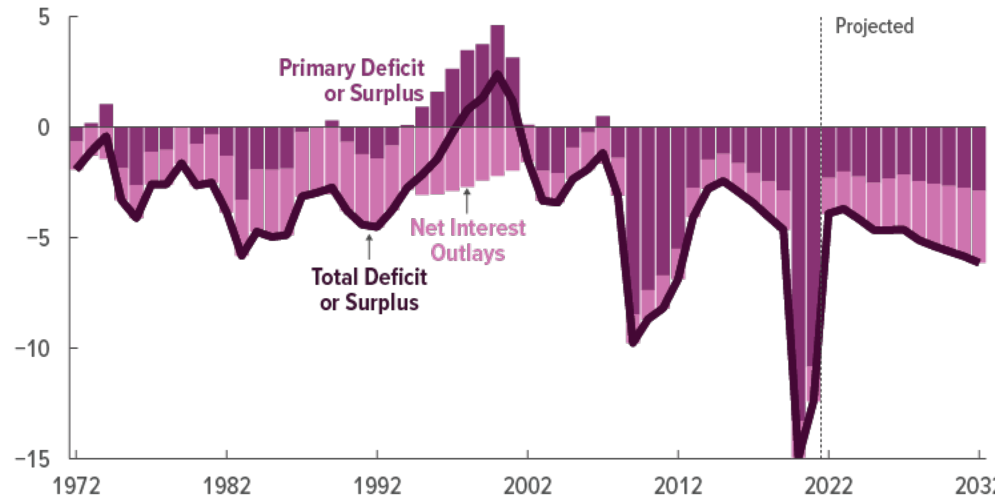
The Federal Reserve bought $3 trillion of bonds.

This is becoming a bad habit.

What happens in the next recession?



This is before any new spending programs.



Chronic deficits around 5% are expected. Note rising interest costs.

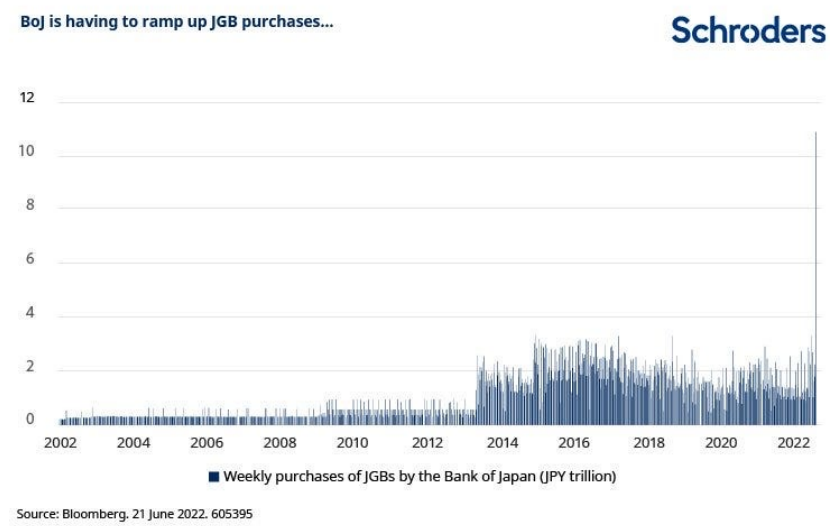
It’s worse in Europe and Japan.

The ECB says it's preparing a new anti-crisis tool as a surge in bond yields stirs memories of the eurozone meltdown

Harry Robertson Jun 15, 2022, 8:56 AM

In June 2022, the European Central Bank started to buy the government bonds of Italy to prevent a Sovereign Debt Crisis.

The euro isn’t doing so hot.



The Bank of Japan is buying government bonds to keep their yield from rising above 0.0%

The yen isn’t doing so hot.

Thank you

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