

Hello Everyone,

*Guns N' Roses* singer, Axl Rose, and Treasury Secretary, Steve Mnuchin, are having a Twitter spat over patriotism, pandemics, and Liberian flags.

Yes. That is a real sentence ----that somehow makes sense in 2020 America.

Oh, and in case you were wondering; Liberia is nestled between Cote d'Ivoire and Sierra Leone on the western African coast. :>)

Today's missive has nothing to do with any of that.

We're on part two of our "understanding inflation" theme. It is not nearly as exciting as debating Axl Rose.

Signed, Your Was-Always-Too-Square-For-GNR-Music Financial Advisor,

Greg

## **KKOB 05.08.2020 Inflation Part 2 Acceleration**

**Bob:** So, Greg, on Monday we basically left it at this:

Historically, there are phases to inflation cycles.

In Phase One:

- Governments start the ball rolling, by promising too much----and then printing too much currency.
- As the currency debases, businesses first compensate by lowering quality and shrinking package sizes. They only raise prices when they have to.
- Meanwhile, government plays games with the inflation statistics to make it look less than what it really is.

So, my two questions are this:

- Why doesn't the government just tell the truth? And
- How long can Phase One go on?

**Greg:** Good summation. And to answer your questions:

- Many of government's largest expenses are "indexed" to inflation. Think cost-of-living adjustments (COLA) for social security, employee pay, military retirements, etc. If government expenses rose based on real inflation numbers, the budget (which is already a mess) would be blown to smithereens.
- Oh, and Phase One can go on for years....even decades. And this is the danger of Phase One. We citizens get used to low-to-moderate inflation. We say, "*Well, this is just the way it is...prices gently rise.*" So, we work harder ---we adjust our behavior ---to compensate. We think things will never change.

But, if history is any guide, eventually you will get to Phase Two.

**Bob:** And, this is what you said on Monday. You thought we were going to the next phase. And, I think I know why you said it. Covid19---and the trillions we have printed since---have pushed us there.

**Greg:** Exactly.

So, what happens in Phase Two? Well, the wealthy-and-connected see the ***acceleration of inflation*** first.

For example, ***before*** Germany's great hyperinflation of the 1920's a German Industrialist named Hugo Stinnes knew the Reich Mark was going to be debased. He hurriedly used his paper money to buy coal mines, shipping lines, steel mills, newspapers, railroads...anything of value.

As inflation accelerated, the people who had sold to Mr. Stinnes --in exchange for paper money---saw their supposed "wealth"

evaporating. Yet, rather than being mad at him, they thought him clever and smart.

Today, you are starting to see the same types of things. The Russians have already sold their US Treasury holdings. They bought tons of gold.

The Chinese are disgorging billions in US debt every month. And, it's no secret they've been buying farmland in South America, mining interests in Africa, and seaports across Asia. You get the idea.

**Bob:** All that makes sense. I mean if the US can create \$4 to \$6 trillion in a few weeks, it makes sense the dollar will lose value.

Still, with that said...

Why do I still hear people say deflation is coming?

**Greg:** Great question. And there are some really smart deflationists out there. And here is the confusing part of Phase Two. During this phase, ***money is being both created and destroyed***. Thus, you get inflation and deflation side-by-side. Let me explain.

Because of Covid19, millions have lost their jobs. Those people still have bills to pay. What money they had is disappearing from their bank accounts.

The same thing is happening with both small and large businesses. As the customers evaporate, so does the money. Therefore, it's as if their money is being destroyed.

Bob, that's what happened in the 1930's during America's Great Depression.

**Bob:** So, this is why the government is compensating by sending everyone checks. Big businesses are getting billions, the medium size guys millions, and the little guys thousands. But it all adds up to trillions.

**Greg:** I see what you did there...nice.

Yes, and this is why Phase Two is so tricky. Inflation and deflation together. Food prices may rise---- while real estate prices fall.

Think of it this way....if currency is destroyed faster than it's created, deflation reigns and cash is king. If, however, currency is created faster than it is destroyed, then the outcome is certain...inflation. And, cash is trash.

But there is one more element to this; and that element is confidence in the currency itself. And that's Phase Three which we can tackle on Monday.

**Bob:** OK. But quick question. What if everyone around the globe prints money? Then what? Let's talk about that, too. Until then, how do people reach you?

**Greg:** Deal. My number is 250-3754. Or, go to my website at [zanettifinancial.com](http://zanettifinancial.com)

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