Four Reasons Why Hyperinflation Hasn't Hit the U.S. Economy….Yet
by Keith Fitz-Gerald

Everything we know about classic economic theory suggests the U.S. economy should be experiencing Zimbabwe-like hyperinflation right now, thanks to the nearly $2.2 trillion the U.S. Federal Reserve has pumped into the system. But, we're not…yet.

Classic economic theory says that money supply can be used to stimulate the economy and our central bankers seem to agree. That's why they've pumped more than $1 trillion dollars into the economy, engineered countless bailout bonanzas for zombie institutions, put Detroit on life support and delivered a bunch of financial Band-Aids to the trauma ward – all in a desperate bid to make Americans feel better about the global financial crisis.

To their way of thinking, the trillions of dollars have been a success. That's why any meeting of the Group of Eight (G8) nations looks more like a mutual affection society with central bankers anxious to claim credit and backslap each other in congratulations for having avoided the "Great Depression II."

But by taking the Federal balance sheet to more than $2 trillion from $928 billion in 2008, they've created a situation that should have resulted in an epic inflationary spike to accompany the 137% increase in liabilities. Yet that hasn't quite happened.

Core inflation – which denotes consumer prices without food and energy costs – has actually decreased from 2.5% in 2008 to 1.5% presently. And that has many investors who have heard the siren call of the doom, gloom and boom crowd wondering if they're worried about nothing. So what gives? Well, there are four reasons we haven't yet seen hyperinflation:

Banks are Hoarding Cash
Despite having received trillions of dollars in taxpayer funded bailouts and lived through a litany of shotgun weddings designed to reinvigorate the shattered lending markets, most banks are actually hoarding cash. So instead of lending money to consumers and businesses like they're supposed to, banks have used taxpayer dollars to boost their reserves by nearly 20-fold according to the Federal Reserve. The money the bailout was supposed to make available to the system is actually not passing. "Go," but rather getting stopped by the very institutions that are supposed to be lending it out. Three-year average annualized loan growth rates were 9.6% before the crisis; now they are shrinking by 1.8%, according to *Money Magazine.*

The United States Exports Inflation to China…
…which remains only too happy to continue to absorb it. What this means is that low priced products from China help keep prices down here. And this is critical to something that many in the "China-is-manipulating-their currency" crowd fail to grasp. If China were to un-peg the yuan and let it rise by the 60% or more it's supposedly undervalued by, we'd see a jump in prices here in everything from jeans to tennis shoes, toys, medical

equipment, medicines and anything else we import in bulk from China. Chances are, the shift would not be dollar-for-dollar or even dollar-for-yuan, but there's no doubt it would be significant. Many economists I've talked to privately think 25% to 35% is probable. So the next time you hear a "Buy American" extremist, you might want to share this little convenient truth.

Now, before I get a bunch of hate mail about this, let me just say I want to "Buy American" too. I'm all for supporting our native industry and our own domestic job markets. But in today's world, "made anywhere" is really hard to do and even harder to support. The interconnected nature of businesses and global manufacturing chains, not to mention the payment system, makes that nearly impossible. Granted, perhaps that's part of the problem, but that's a subject for another time. The lessons we learned in the 19320s are clear, and they must be acknowledged – protectionism only makes matters worse, no matter how we feel about it personally.

Consumers Are Still Cutting Back

Therefore, the spending that normally helps pull demand through the system is simply not there. I don't know how things are in your neighborhood, but where I live, people are still cutting back. Indeed, data from the U.S. Department of Commerce and the Federal Reserve Board shows that consumer spending growth averaged 1.4% a year prior to the crisis and is not shrinking at a rate of 0.7%. What this means is that people have figured out that it's more important to save money than it is to spend it. And, given that consumer spending makes up 70% or more of the U.S. economy, this is a monumental change in behavior that all but banishes the last vestiges of the "greed is good" philosophy espoused by Michael Douglas as Wall Street pirate Gordon Gekko in 1987.

Businesses Continue to Cut Back Rather Than Hire New Workers

Therefore, wages and wage inflation figures are lower than they would be if the economy was truly healthy and the stimulus was working. This is especially tough to stomach because it means people are still being marginalized, laid off and "part-timed" instead of being hired. And that means that most of the earnings growth we've seen this season has come from expense reductions rather than top line sales growth – and those are two very different things. But, while this is tough, it's also helped keep inflation lower than it would otherwise be. Prior to the financial meltdown, job growth averaged about 1% a year over the last three years whereas now it's falling by 4.2%.

The upshot? Any one of these factors could change at any time. And that means investors who are relying on the Fed's version that everything is okay and that the government is managing inflation may be in for a rude awakening. The only thing the Fed is doing is managing to manipulate is the data, and even then, not very well.
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