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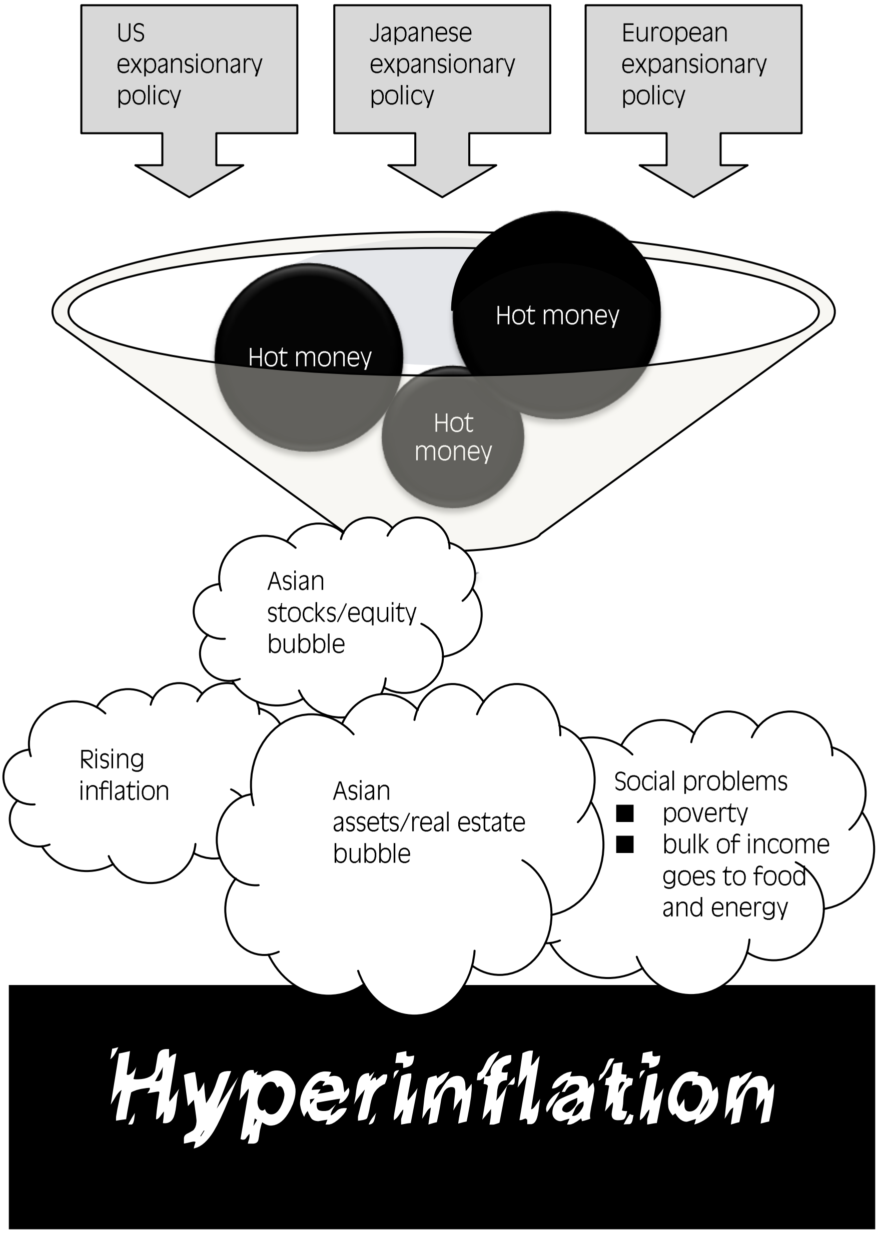
Impact of Money Printing

Proverbs 23:5

Wilt thou set thine eyes upon that which is not?
for riches certainly make themselves wings;
they fly away as an eagle toward heaven.

Implications for the world

The inordinate printing of money has grave implications for the rest of the world.



The impact of money printing is inflation, the loss of purchasing power. First, hot money from excessive printing of currency flows into emerging markets like Asia, creating market bubbles. Like the tide, this hot money comes and goes. Devastating when it sweeps in, it is equally destructive when it flows out, causing a vacuum, even collapse, in the markets it leaves in its wake.[1] For an example of how this "hot money" originates, take the case of US. On 25 March 2009, the Federal Reserve injected liquidity into the market through Quantitative Easing (QE). QE1 amounted to US$1.3 trillion and QE2 was US$700 billion. Likewise, Europe and Japan have their own forms of QEs. This flooding of the market with money causes inflation and eventually hyperinflation.

This is a precursor of the famine to come. Men and women and children will cry when their stomachs are hungry. And as the saying goes, a hungry man is an angry man. This anger then vents itself in social unrest. One such violent expression was the uprising among the hungry and jobless youths in the Middle East who, from January to March 2011, took to the streets to vent their frustrations.

Hyperinflation

Excessive money printing leads to inflation, the devaluing of purchasing power. Simply put, the same amount of paper money buys less of the goods than it used to.

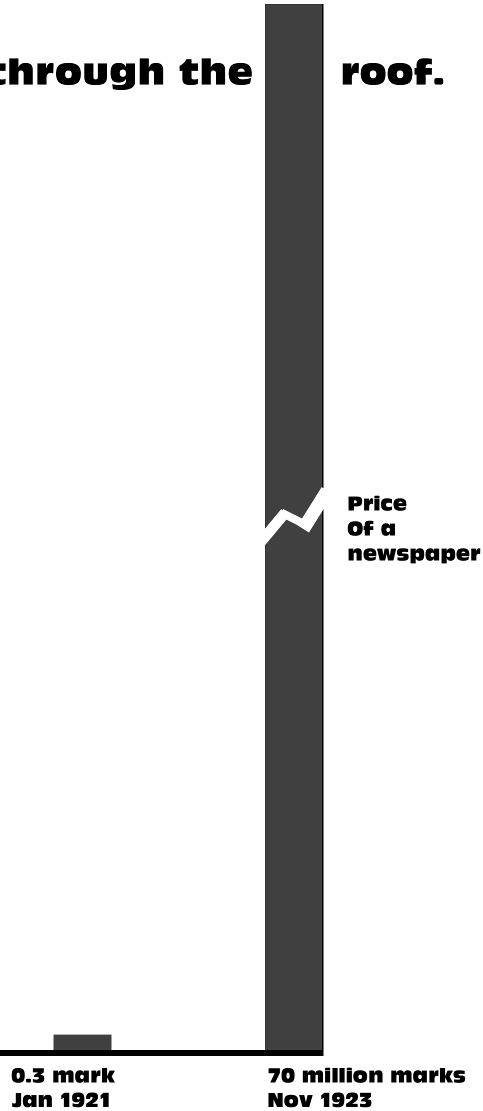
History is a good teacher. Let us trace the history of hyperinflation to help us see the similar perils we are in today. Before World War I, Germany printed money at an exponential rate.

[1] In the Straits Times Report dated 29 March 2011 "No let-up in funds outflow from Asia" it is reported how US$26 billion has flowed out of Asia so far this year, creating volatility in the equity/assets markets.

What was the impact
of such money
printing in Germany?

For a start, prices shot through the roof.

This graph shows the cost of a newspaper in Germany. In January 1921, the price was 0.3 mark. Thirty-five months later in November 1923, it cost 70,000,000 marks.[2] This graph could *not* be drawn to scale because of the huge disparity in y-axis values.



[2] Mankiw, Principles of Macroeconomics, 3rd ed., 2004, instructor ancillaries

It took just three years of runaway inflation for the German mark to be totally without value. As smaller denomination notes became worthless, the government resorted to printing notes in larger and larger denominations. By 1923, the highest denomination was 100 trillion marks.

The descent of the mark into oblivion is painfully documented by Adam Fergusson in his book, When Money Dies.[3] As described on its back cover, "When Money Dies is the classic history of what happens when a nation's currency depreciates beyond recovery. In 1923, with its currency effectively worthless (the exchange rate in December of that year was one dollar to 4,200,000,000,000 marks), the German republic was all but reduced to a barter economy. Expensive cigars, artworks, and jewels were routinely exchanged for staples such as bread; a cinema ticket could be bought for a lump of coal; and a bottle of paraffin for a silk shirt. People watched helplessly as their life savings disappeared and their loved ones starved. Germany's finances descended into chaos, with severe social unrest in its wake."

Fergusson set the opening scene for the mark in pre-First World War 1913 when it held par with the British shilling.[4] This meant that the exchange rate was about 20 marks to a pound sterling. During the war years, the government resorted to printing money to finance the war. After the war, harsh war reparations, empty state coffers and monetary ineptitude more than ensured that the practice of money printing continued. As a result of this blizzard of marks, the currency shrank to such an extent that the exchange rate became a numerical curiosity. By 20 November 1923, you would have needed 18,000 milliard marks or 18,000,000,000,000 marks to buy a pound.

[3] Adam Fergusson, When Money Dies, PublicAffairs, 2010
[4] Ibid., 1

Pound vs mark
How many marks for 1 pound sterling

1913	**20**
1 Sep 1923	**50 million**[5]
11 Sep 1923	**315 million**[6]
2 Oct 1923	**1,500 million**[7]
15 Oct 1923	**18 milliard**[8] or **18,000 million**
30 Oct 1923	**310 milliard**[9] or **310,000 million**
15 Nov 1923	**12,000 milliard**[10] or **12,000,000 million**
20 Nov 1923	**18,000 milliard**[11] or **18,000,000 million**

Such tremendous loss of purchasing power wreaked havoc on the populace. "In the cities, in the towns, in the villages, (German central bank president) Havenstein's voluminous inadequate banknotes, far too many yet far too few, multiplied the already manifold difficulties of existence and drove people further to despair … The sight of shoppers with baskets full of banknotes was now common in every town. 'You could see (people) in the streets … pushing baby carriages before them, loaded with paper money that would be devalued the next day,' said Erna von Pustau,[12] (a German lady who lived through those difficult times)."

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5 Ibid., 175
6 Ibid., 188
7 Ibid., 188
8 Ibid., 196
9 Ibid., 198
10 Ibid., 206
11 Ibid., 206
12 Ibid., 173

As larger and larger denominations were minted, “sums of less than one million marks were no longer dealt with, and indeed, as (British ambassador to Berlin) Lord D’Abernon reported, ‘a beggar would hardly accept any smaller note’.”[13]

Money to burn

It was cheaper to burn marks to keep warm in winter than to use them to buy firewood.[14]

Fiscal reform finally ended the inflation. At the end of 1923, the number of government employees was cut by a third. A new central bank was set

[13] Ibid., 188

[14] The European Union Times, http://www.eutimes.net/2009/12/zimbabwe-releases-the-100-trillion-dollars-bank-note/

up with a commitment to create honest money.[15] No more lawless printing.

Hyperinflation was not peculiar to Germany alone. Many other countries suffered the same evil.

Brazil: Hyperinflation from 1986 to 1994[16]

- In 1994, inflation reached 2,075.8%.
  1 (1967) cruziero < one trillionth of a US cent.
- In 1994, the real was adopted.
  1 new real = 2,750,000,000,000,000,000 old (1942) reals.
- In 1986, President Jose Sarney … froze prices, controlled wages, and lopped three zeroes off the Brazilian currency.
- Higher prices were quickly replaced by other problems.
- Severe shortages of daily necessities such as eggs, meat and milk developed.
- Black markets quickly filled the vacuum, resulting in higher prices.

Angola: Hyperinflation from 1991 to 1995[17]

- Underwent two currency reforms.
- Overall impact to date:
  1 kwanza = 1,000,000,000 old kwanza.

Zimbabwe: Hyperinflation from early 2000s[18]

- "Mr Robert Mugabe's government has printed trillions of new Zimbabwean dollars to keep ministries functioning and to shield the salaries of key supporters … " (NYT, May 2006)

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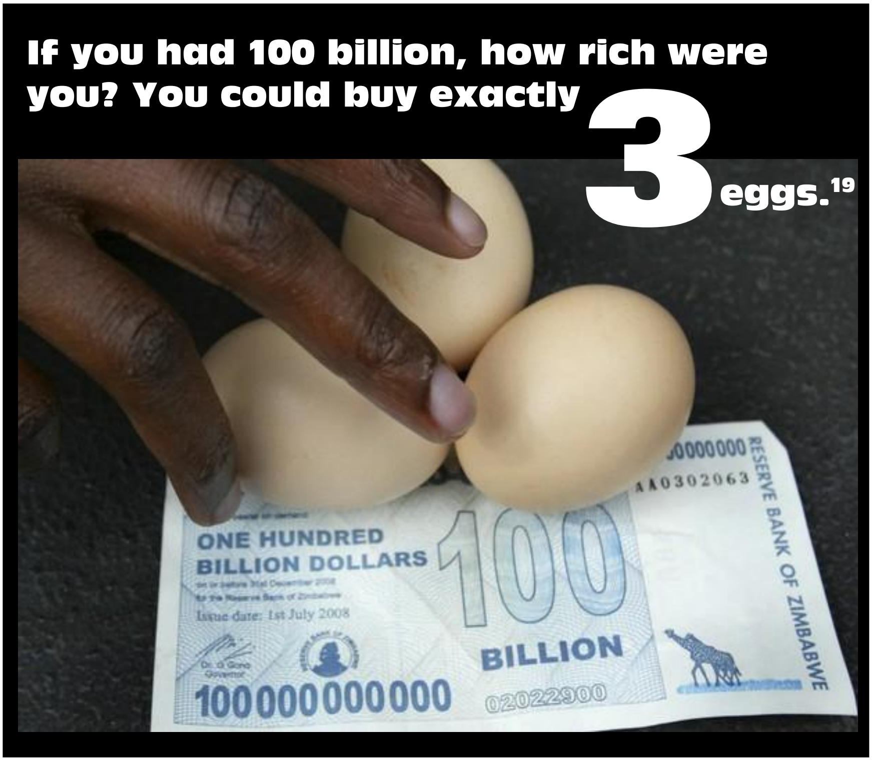
15 Mankiw, Principles of Macroeconomics, 3rd ed., 2004, instructor ancillaries www.docstoc.com/docs/67869702/MisesCircle_Furman_2010_Terrell

16 Ibid

17 Ibid

18 Ibid

- In December 2008, Zimbabwe's annual inflation rate was said to be 6.5 quindecillion novemdecillion %, (that's 65 followed by 107 zeros).
- Prices doubled every 24.7 hours.



- As billionaires became paupers, trillionaires were minted.

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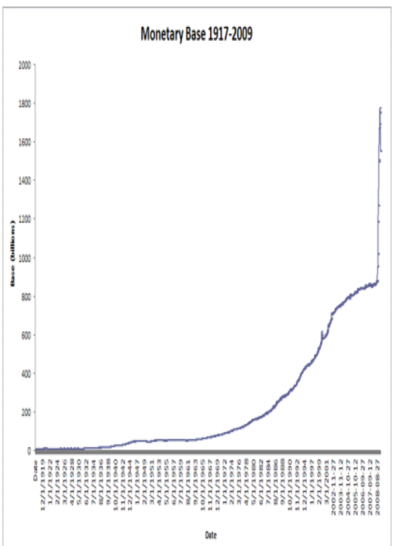
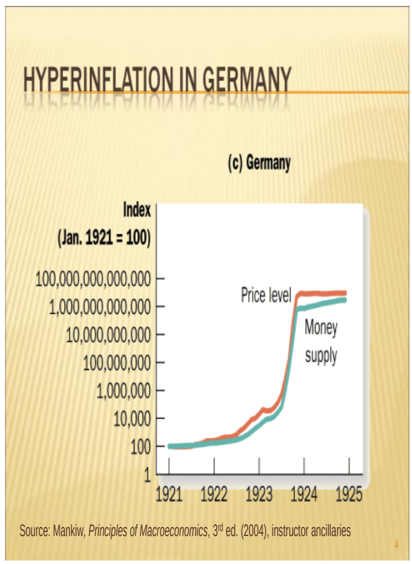
[19] http://www.eutimes.net/2009/12/zimbabwe-releases-the-100-trillion-dollars-bank-note/

Other hyperinflations[20]

- Bolivia (1984 – 1986), inflation rate of 20,000% at the peak.
- Chile (1971 – 1973), 1,200% at peak.
- Greece (1942 – 1944), 8.5 billion% per month.
- Russia (1992 – 1994), 2,520% in 1992.
- Ukraine (1993 – 1995), 1,400% a month.

If we study the money supply chart of the US, we realise that the US is very close to possibly triggering hyperinflation. The chart on the left shows a tremendous surge in the US monetary base reminiscent of the scenario in Germany before hyperinflation set in.





If the unthinkable should happen to the US, then the repercussions on the world will be deadly. Since it involves the US dollar, the reserve currency of the world, the implications on the currencies now pegged to the US dollar will be catastrophic. A time of poverty is coming as the world system heads towards a reset.

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20 Ibid