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Next on the horizon? It could be inflation

Real Money

By Rob Rikoon | For The New Mexican

3/5/2012

The world is awash in money. You and I may not be personally flush with cash, but global central banks -- with their newfangled financial instruments -- are more swollen than the Mississippi River after a Louisiana rainstorm.

What we are experiencing so far in 2012 is coordinated action on the part of the world's bureaucrats to stabilize topsy-turvy economies that threaten to spin some societies out of control.

The world's stock markets are happily celebrating the flood of liquidity that has raised most prices to levels that portend happy times ahead. That is good for people who own stocks: long-term investors who can stay the course through muddy waters. The almost inconceivable amount of financing that developed nations' bailouts have created, while allaying fears of widespread panic, has decimated the earning power of savers, retirees living on fixed pensions, insurance companies and bondholders.

Artificially low interest rates are one way that the financial powers that be are able to prop up unsound banks.

Another is the shell game, whereby problematic governments borrow from international institutions, which then deposit cheap funds into insolvent banks so that private bankers can turn around and buy more of their troubled government's bonds.

This is a ruse to paper over the intractable problem that Western nations and Japan spend way more than what we produce. Deficit spending is a powerful way of stimulating an economy, but it only works if interest payments on the debt can be made without creating a downward drag on a nation's productive capabilities.

Greece is obviously way past this point, bankrupt by all definitions but afraid to say the word. It will soon be under the boot heel of German dictates or else be reduced to waiting for the next olive harvest to trade for heating oil. Ireland, by virtue of its government capitulating to the European Central Bank and agreeing to pay for the excesses of its banking system, is losing its skilled working-age population through emigration to places such as Australia. It is too late for the Irish and Greeks to change course. How they got here is a matter of debate: overly generous social programs, bad management, corruption, tax evasion or some combination of the above. We have our own set of problems.

If the current political paralysis in Washington continues into the next administration and the financial floodgates of money creation remain open, then the "Reaganesque" hope that our domestic economy will somehow "grow" its way out of the hot water we are in will prove delusional. The most likely next economic event will be massive inflation. Inflation is historically the most common way governments get out of their self-generated addiction to chronic overspending. Other methods are war, default, devaluation or austerity. We are trying to debase our currency -- but so is everyone else, so that option is ineffective.

Austerity, like dieting, sounds feasible but nobody likes to do it for very long. War is not off the table, but it is unpopular. Defaulting is embarrassing and, since investors around the world seem anxious to lend money to us and Germany at close to a zero percent return, what's the point?

One place that money is not going is into new loans for entrepreneurial activity. European banks are afraid to lend to each other or anyone else for that matter. U.S. commercial banks are afraid of their regulators, who simultaneously want no (bad) risk taking but are under pressure to see taxpayer's money ignite some kind of economic rejuvenation. The political cowardly way out of our doldrums is to inflate without informing, and that is what we are experiencing now.

When you hear about deflation (prices going down), think of the value of what you own: your house, salary and interest earnings. Inflation (prices going up) is here in what we buy: movie tickets, medical care, education and travel. Government statistics are intentionally skewed so that cost-of-living adjustments lag far behind actual inflation. The price of gold and gasoline are better reflectors of reality than any news release.

Our job is to protect client lifestyles (purchasing power) through this morass of difficulty. As investment strategists, we used to be able to buy good-quality U.S. bonds for income and market indexes, mutual funds or large solid companies for growth, but now that doesn't cover the risks described above. Energy, income-producing real estate, precious metals and foreign bonds all take more work to research, track and report upon, but they seem essential in today's crazy world. Ben Bernanke, chairman of the Federal Reserve Bank and arguably the most powerful central banker in the world, knows that his actions are creating hardships on traditional investors. I suppose he figures there's no one else better able to bear the burden.

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