DIAPASON COMMODITIES MANAGEMENT

Tangible Ideas

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Lord Timon's Purse

A Diapason Research Report by Sean Corrigan

Lord Timon's Purse

"In historical reality, there can be found no more of a counterpart for [Keynes'] oversaving theory than for underinvestment theory… it emerges whenever, in the eyes of impatient observers, cyclical depressions appear to be of infinite duration. In retrospect it appears that Keynesian deflation jitters are weakly founded, indeed. In terms of doctrinal history, there is a certain irony in the fact that around the year 1936 there began a period of seemingly secular inflation… rarely has somebody been so subject to faulty vision as was Keynes [then]"

Albert Hahn, 'The end of the era of Keynes?', Kyklos Vol XX, 1967

Despite the US seeing its fortieth banking failure of the calendar year – the greatest number in sixteen years - financial markets are managing their usual feat of deluding themselves that a Goldilocks outcome is in prospect.

News articles abound in sighting of what, in the tiresome horticultural parlance, are invariably referred to as 'green shoots'; a back up in bond yields is rationalized away as a 're-normalization' from crazily-depressed levels (a view with which we actually have some sympathy); rising commodity prices are not to be feared, being merely the expression of an understandable eagerness to indulge in 'recovery' plays; slack labour markets and the widespread under-utilization of capacity is seen to allow central banks to maintain their current accommodative stance for many months to come and – mindful of the 'mistakes' made in 1937 – when the unwinding process finally arrives, it will be well-signalled and gentle.

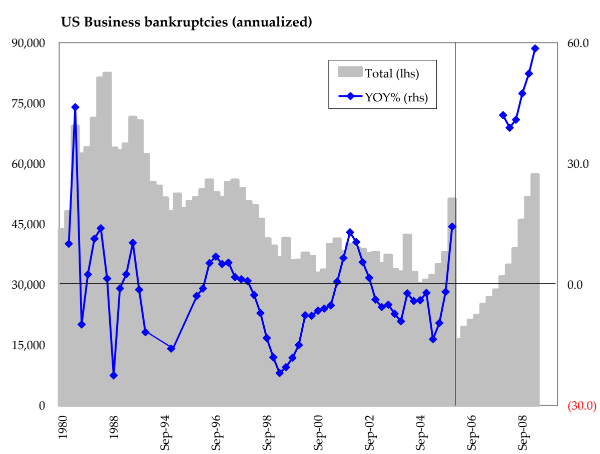

Figure 1: US Business bankruptcy filings

So, 'Out of the eater came forth meat; out of the strong came forth sweetness' and out of banking weakness comes forth equity delight – or so the Street desperately hopes.

Away from the sales pitches and book-talking, opinion is still, as ever, divided over the outlook for prices. The old war of words is being rehashed between those who see a long, gloomy stretch of near-deflation as the outcome and those beginning to fret over a resurgence of inflation almost as soon as the real economy regains some traction.

Inevitably, this polemic has degenerated into yet another battle pitting Gold Bugs against New Dealers and Dollar Permabears vs. card-carrying Keynesians – a Prosperian dialogue light on intellectual substance and generally lacking in insight.

Certainly, the death-by-freezing doomsters can marshal what looks like an impressive array of facts behind them as we unwind possibly the single greatest credit bubble in history, for this has triggered seismic changes in the productive landscape and has stressed balance sheets to near breaking point. As a result, we do not have to look too hard for signs of a decelerating provision in - and even an outright contraction of - the amount of credit being extended to the private sector.

In the Eurozone, for example, the three Boom years starting in June 2005 saw bank loans to households and non-financial corporates grow at an underlying rate of close to 10% per annum before the Snowball Earth episode brought on by the collapse of Lehman and AIG slammed shut the gates to a road intricately paved with Good Intentions, to the echo of a resounding Clang!

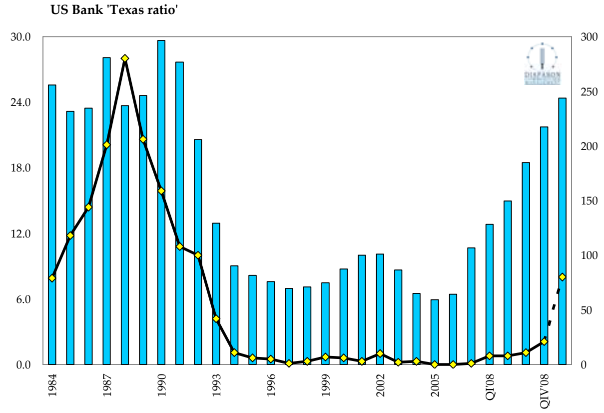

Figure 2: US Doubtful Loans-Reserves/Tangible EQTY

By marked contrast, the past five months have witnessed that rarest of modern day events, a *reduction* in loans outstanding, albeit a slight one. The tightening of supply conditions by once-overeasy banks now fearful for their own survival has obviously played a significant role in this, but not to be overlooked either is the drastic shift in loan *demand* as investment schedules have been crimped, housing speculation has evaporated, M&A activity has stuttered to a halt, and inventories have been run down – something for which we can get a sense by considering the chart taken from the ECB's quarterly lending survey, reproduced here.

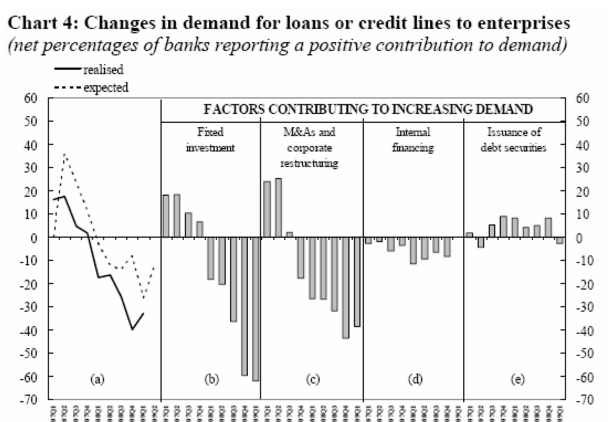

Figure 3: ECB Lending Survey

As we will argue below, such an alteration in demand is the inevitable outcome of the changes being wrought within the productive structure of the real economy and is thus as much an effect as a cause of the present difficulties. Taken in isolation, 'deflation' it is not.

In the US also, once we abstract banks' purchases of government securities, the acquisition or conversion of holdings from the non-bank sector, and disregard the extraordinary build-up of surplus reserves held with the Fed, we can see that their residual assets - effectively the credit extended to private institutions - have been dwindling at a pace unprecedented since at least the early Seventies.

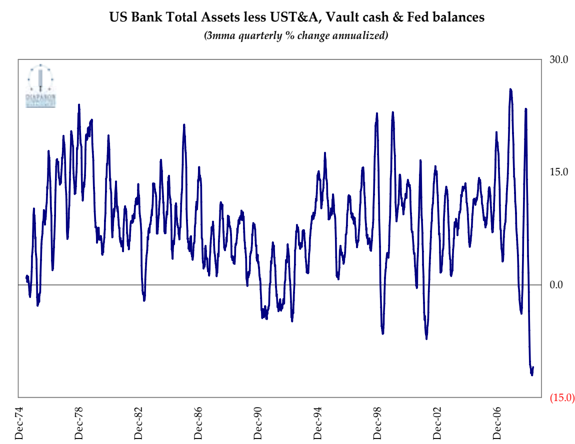

Figure 4: US Commercial Bank Assets

In Britain, meanwhile, the latest BoE report reveals that there has been essentially NO new lending to non-financial corporates for the first time in nine years, reinforcing the slump in credit extended to households in evidence ever since the local housing bubble burst.

It is true that if bank *lending* has been dismal, the last few months have witnessed something of a renaissance in bond issuance to the extent that QI's tally jumped 157% from QIV's ten-year low. However, any joy elicited by this development should be tempered by the knowledge that an excessively high proportion of it has been due to zombie-banks exercising their new-found right to a government-guarantee in order to secure roll-overs of liabilities there are anyway unable to repay. Overall, state-backed loans amounted to no less than five-eighths of the total – a development we regard as rather worrisome (of which more below).

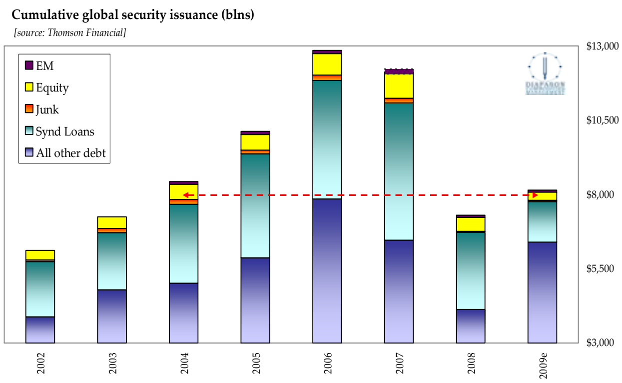

Figure 5: Global security issuance

On such observations as these rests the case of those Deflationists who do at least possess sufficient sophistication not to regard a mere drop in the CPI index (and one highly influenced by the fall in over-elevated energy prices, at that) as the Alpha and Omega of the argument. However, these sages then usually make at least one of two further mistakes in their analysis; viz., that they confound Money with Credit and that they then entirely neglect what is fast becoming the primary mechanism by which new money is being introduced to the economy.

In order to dispel the confusion, we must here digress to reprise a few basics.

'Money'- for now disregarding the question of its particular composition - is above all the medium of exchange whose other commonly-cited attributes as a unit of account and a store of value are decidedly derivative, emergent functions, the first of which is not strictly commensurate with current money itself – e.g., SDRs - and the second of which is sadly more often an aspiration rather than a statement of fact.

In order to function as the medium of exchange, money must be widely and unequivocally accepted - indeed, it must be THE most widely accepted - substitute for the specific consumable goods we seek in a typical trade when we surrender a different batch of consumables to our counterparty but have no use for the goods which he, in turn, is offering for sale. The upshot of this is that money is itself a *present* good, that is, one instantly utilisable in the here and now.

Again, to emphasise the crucial point, money must be thought of as THE present good par excellence (not, incidentally, just a mere representation of such goods) the one for which there is always a ready market: to say otherwise is an existential denial that it is money at all. While this may have been easier to grasp when money actually took the form of a tangible good - whether cowrie shells, cattle, or silver crowns - it is no less the case today when it has largely been robbed of physical expression.

Money, then, is the medium in which we can make *final* settlement of any transaction, as is recognised by those *étatiste* legal tender laws which Leviathan wields to force free individuals to use the bastard versions to whose creation it reserves to itself the exclusive right of sanction and from whose creation it thereby intends mischievously to profit.

By contrast, 'Credit' is an assignation of the right of command over present goods to another, whether for a fixed or an indeterminate period. Entailed in this alienation is a sacrifice for which we seek recompense by charging a fee - namely, interest.

[NB: *contra* the mainstream misconception, interest is not the price of *money* (that can only mean its reciprocal value expressed in the other goods for which it exchanges), but the price of the *time* which passes while we forego enjoyment of our property]

When I lend you my bicycle – in the expectation that I will therefore be able to call upon a proportionate favour in my turn at some future date – I extend you credit. I also intrinsically deny to myself the possibility of using the bike while it is in your possession. I therefore sacrifice present enjoyment (broadly speaking, 'income') for the sake of earning a deferred return of greater magnitude some time hereafter.

Now it may well be that, in times of general confidence, credit instruments can find a circumstantial acceptance as a form of payment in place of money. But, then, so can a whole range of other goods and claims thereto. Your author remembers that, during his schooldays, debts would be both contracted and paid in terms of pats of butter, portions of chips (*frites*), and helpings of ice cream, all of which were made artificially scarce to the degree necessary to enhance their exchange value by his not-so Alma Mater's dire culinary practices.

To argue, however, that these could effect more than a temporary and conditional replacement of money services would clearly be foolish, a statement which is not, however, to deny that similar phenomena do not exert a variable and episodic influence upon the value of money proper.

However, one must resist the temptation to over-generalize from this. There is no need to ask, as Hayek did (in one of his many tergiversations on the issue, executed over the course of a long career):-

> *"…can we even to-day draw a sharp line between what is money and what is not? Are there not already all sorts of 'near-moneys' like saving deposits, overdraft facilities, bills of exchange, etc., which satisfy at any rate the demand for liquid reserves nearly as well as money?"*

The answer, we would humbly suggest, is that while we can never *categorically* predict the extent to which people will accept things other than money in payment – and so multiply the efficacy of the quantity already in existence – we firmly believe the most important instance of this acquiescence is a child of the bull market. What adds the thickest patina of 'moneyness' to other tradable entities – what the market loosely calls 'liquidity' - is an artefact of people's eagerness to plough their theoretical entitlement to a sum of real money straight back into the market by 'plunging' on yet another CDS transaction, punting on yet another private equity fund subscription, or taking out yet another buy-to-let mortgage.

Those who think Hyman Minsky offered genuinely original insights (rather than just correcting, while adhering to his overall framework, some of Keynes' more egregious misconceptions,) might see in this what he termed 'Ponzi finance'. In fact, the contention that, under conditions of speculative excess, all manner of things may *appear* to be 'liquid' - and hence the supply of money proper may seem a mere academic quibble – was analyzed in great detail in 1931 by Fritz Machlup in *" The Stock Market, Credit, and Capital Formation"* and taken up again in his 1932 paper *'The Liquidity of Short-term Capital'*

> *'The bottom of a great depression is, I feel, a particularly suitable time to investigate this question [can short-term capital remain liquid] and to criticize accepted doctrine. In times of prosperity, practical businessmen would scoff at the thesis, which I wish to put before you, that short-term capital is never really liquid; but in times of depression, the majority of savers and owners of capital – and also the majority of bankers – are inclined to admit that there may be "something in it."'*

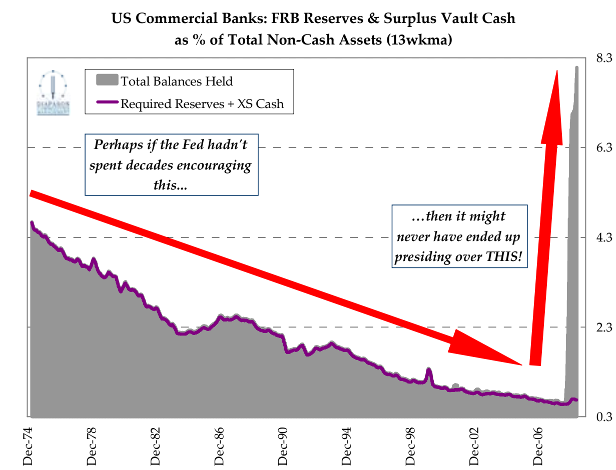

Figure 6: US Bank reserves/assets

As we can see, what Machlup is arguing us that what the individual may regard as 'liquidity' – whether financial claims in the casino economy or working capital in the real one - does not necessarily contribute to the liquidity of the system as a whole where a seller for cash ultimately requires someone, somewhere to surrender his claim to that same cash. It is upon the zero-sum nature of this jagged reef, hidden among the shifting praxeological sands of 'liquidity', that many of the great financial Booms tear out their bottoms and founder into the ensuing Bust.

Indeed, long before Machlup, the first great economist (and arguably one of the greatest speculators of all time), Richard Cantillon, had emphasized this exact point, writing in his masterful *"Essai sur la Nature du Commerce"*:-

> *"… excess banknotes, made and issued on these occasions, do not upset the circulation, because being used for the buying and selling of stock they do not serve for household expenses and are not changed into silver [i.e., money]. But if some panic or unforeseen crisis drove the holders to demand silver from the Bank, the bomb would burst and it would be seen that these are dangerous operations…. In 1720… purchases and sales of … pestilential stocks were carried on without difficulty through the quantity of notes of all kinds which were issued, while the same paper money was accepted in payment of interest. But as soon as the idea of great fortunes induced many individuals to increase their expenses, to buy carriages, foreign linen and silk, cash was needed… and this broke up all the systems."*

> *"This example shews that the paper and credit of public and private Banks may cause surprising results in everything which does not concern ordinary expenditure for drink and food, clothing, and other family requirements [i.e., final consumption outlays], but that in the regular course of the circulation the help of Banks and credit of this kind is much smaller and less solid than is generally supposed. Silver alone is the true sinews of circulation."*

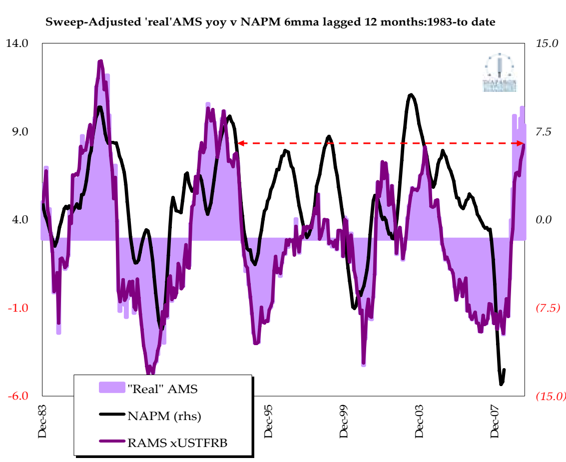

Figure 7: US Real Money v NAPM

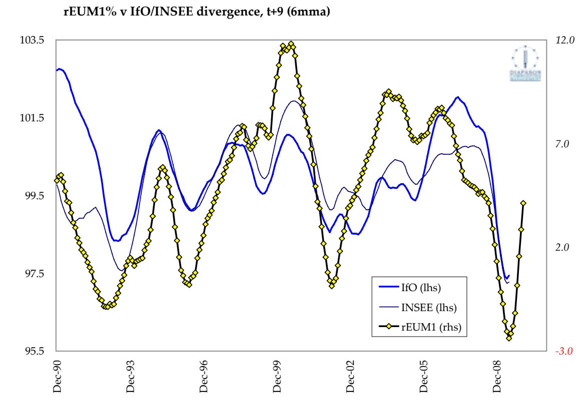

Figure 8: EZ Real Money v Ifo/INSEE

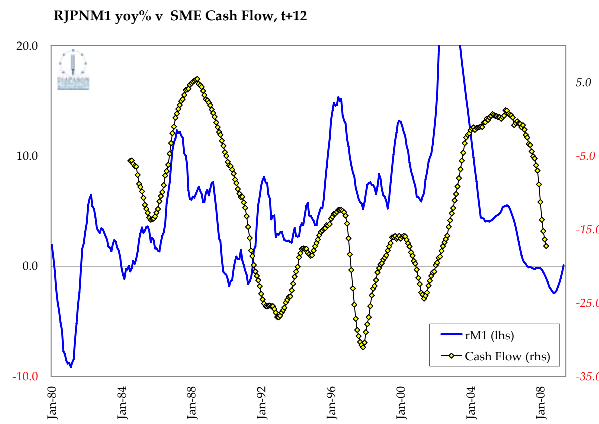

Figure 9: JPN Real Money v Small Business Sales

Though much of the emphasis here is on the effects of the profusion of so-called 'fiduciary' - or unbacked – paper money then being issued in place of an increase in real specie both by John Law and, across the Channel, by the infant Bank of England, rather than on credit, *per se*, the analogy is fairly exact between the two instances.

As has not exactly been uncommon since, the much-vaunted 'financial innovations' of Cantillon's day actually did little more than to economise on the use of real money and so helped erect unsteady pyramids of contingency to teeter on the narrow foundation of too little cash

The next crucial point to establish is that, ever since the early 19th Century, 'money' has been consonant with notes and coin in circulation outside the banks and the demand (usually chequeable) deposits recorded in their books, the latter becoming greatly more significant as time has gone by. Though no longer redeemable into a specified quantity of gold or silver, as they (theoretically) were then, the same definition holds true today.

Note also that the first of these quantities are *liabilities* of the central bank and/or national treasury under a centralized fiat money system and that the second are *liabilities* of the commercial banks. Loans are, of course, *asset*s of the banks and so those focusing on developments here are looking at the wrong side of the balance sheet when they talk about deflation even if the behaviour of loans and other credit instruments may be instructive in other ways.

To some extent, the confusion is understandable, arising from the fact that commercial banks *normally* create the bulk of money deposits through the process of granting loans to the private sector (this capability, in fact, being one of their great evils) while only in utterly dysfunctional states like latter-day Zimbabwe does the direct production of bank notes have any significant role to play. Ergo, the Deflationists presume, no lending means no deposits – and, by an extension which is rarely made explicit - no deposits, no spending. Thus, they contend, we are all, today, staring into the abyss.

However, this misses the point that what may be true in what we might call the lower energy states of our chronic inflationary system – when we tend to cook quietly and imperceptibly in the heat of its ambient radiation – such a dynamic in no way exhausts the possible means of money creation to which a determined central authority has access during periods of greater excitation.

Once it does begin to act out such a resolve, we can often fully reverse the causality and say that it is *spending*, as undertaken by that largest and least constrained of all economic actors – the State - which, when unmatched by the taxes it sequesters from its subjects, itself gives rise to the deposits registered by those banks who either buy its debt directly or who extend repo finance to those non-banks who have done so instead.

Then, of course, we have the efforts of the Bank (i.e., the central bank) itself – efforts which are essentially limitless, absent an external constraint such as a gold or a foreign exchange standard. This is all the more so if we assume that, should the Bank incur any capital losses during the course of its 'unorthodox' operations, we can expect to go through the pass-the-parcel farce of having the public authorities 'finance' the necessary indemnity by means of the unfunded sale of yet more bonds back to it, or to any other monetary institution whose own inherent insolvency it is one of the primary functions of the Bank to disguise.

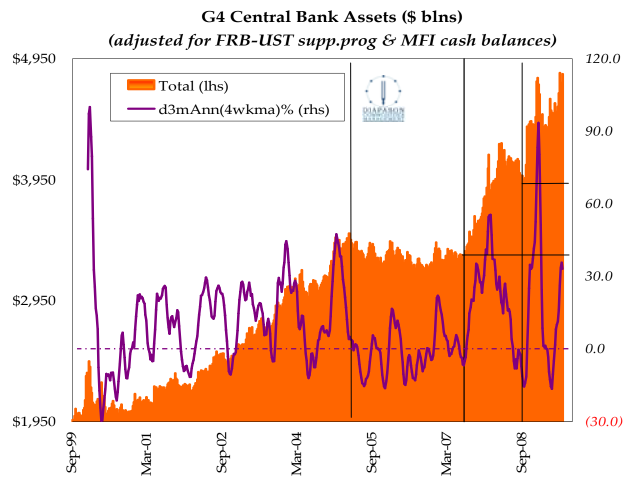

Figure 10: G4CB net balance sheets

At root, the Bank has two specific pathways by which it can increase deposits: either it, too, can take up debt directly from the government (or, *in extremis*, from any other issuer of claims) or it can later purchase it from those private sector actors who – for the sake of a spurious respectability – do its initial buying for it. Risibly, to acquire such debt direct from the fisc is deemed a taboo of the highest order, while to bid for it in the secondary market (often to the needless enrichment of one of its chosen cabal of middlemen) is the very essence of respectable monetary management!

Alternatively, the Bank may mimic its commercial bank wards and provide repo-type finance for any of its counterparties who offer it such securities as it decides, largely at whim, are acceptable to it (typically now governments, in defiance of the 19th and early 20th century precepts of only discounting 'real' commercial bills in order to grease the wheels of trade). Again, though such repos tend to become almost self-perpetuating – whether or not, as is current practice, their original tenor is itself extended from days to weeks to months – and therefore become functionally indistinct from outright purchases, this is all seen as thoroughly unexceptionable.

Such 'quantitative easing' – to use the current jargon - was, in fact, a much more important factor in igniting the fabled Weimar inflation than was the later crude running of the printing presses since most of the initial monetary overhang resulted from Wilhelmine efforts to finance the Great War when – in a mirror of the current, controversial US 'Public-Private Investment Program' – the people were encouraged to buy copious amounts of war-bonds with the inducement that they would be instantly eligible for cheap Reichsbank finance up to a sizeable fraction of the purchase price.

So, there we have it. Money is *not* credit and the genesis of that money needs neither paper and ink nor for the banks to find people 'willing to borrow' from them. As long as people do not refuse to accept the money which comes into their hands, the state can spend money into existence independent of their appetite for debt and as long as the credibility of the entire system is not challenged, the central bank can issue monetary claims upon itself against any identifiable title – whether financial or tangible – to property it wishes.

As for the present lack of private sector lending – and, *ipso facto*, of private sector borrowing – what this is telling us is that people have been forcibly confronted with the folly they were inveigled into committing during the Boom and so are having to rehabilitate their individual balance sheets. Their reluctance will also have an element of fear that the State's raft of frenetic and often arbitrary interventions will jeopardize their ability to earn the future income with which they must service any new debt which they might incur. The dearth of new lending is, in fact, showing that an over-extended productive structure is being rapidly dismantled and that a new, less fulsome architecture is being agonisingly constructed in its place, but it does not, *of necessity*, condemn us to a destructive feedback of output declines and further monetary shrinkage, even if that has been a frequent complication of such catharses, principally through their effect on a money made far too unstable by the very business of fractional reserve banking.

'Elasticity' of the money supply may appear as a boon during a Boom in which we are overstretching our means in the scramble for an accelerated prosperity, but it rapidly becomes a curse when the tension becomes irresistible and matters snap violently back into place.

If, in this circumstance, new money is pumped willy-nilly into the system, it may lead to a series of highly undesirable consequences, especially if the main agency for that injection is the government. Employment may be given, failing enterprises put on life-support, and banks spared the further pain of default and delinquency, but from this will also arise a complex interaction of malign and sometimes intractable side-effects.

Firstly, the intervention may itself retard the required adjustment process. Ultimately, an under-utilization of resources, whether material or personal, can only come up about because of that systemic disco-ordination of their prices which emerges arise through a combination of monetary delirium and political diktat. It is not, as the Keynesians falsely charge, an expression of Calvinistic cant to say that the effects of such disruptive economic disharmony must be fully worked off before the conditions for a lasting recovery can be established.

To attempt to short-circuit the convalescence through the patent hokum of reducing 'sticky' real wages – and hence of pricing people back into work - through lowering the value of the money in which they are paid, or by lessening their cost to foreign customers via currency depreciation, offers no panacea. On the one hand it requires labour to be unnaturally passive in the face of such trickery – in fact, it ludicrously assumes that while their boss will spot his renewed advantage, members of his staff will not. On the other hand, it presumes other countries will not take counter-measures of their own. Yet, the more aggressively these preconditions are violated, the more they will reinforce one another: the more heavily involved the state becomes in matters economic, the more likely this becomes the case and the more the call will go out for further, harmful intervention to address the failure of the first.

A yet more powerful refutation comes from the fact that by denying to private entrepreneurs the resources being taken up by the zombies, the more the healthy face being culled in order to preserve the more enfeebled – a policy of corporate catagenics, or reverse Darwinism. Further, as more and more spending becomes state-directed or state-supported, *non*-monetary kinds of disco-ordination arise and any fleeting simulacrum of prosperity becomes ever more analogous to the unnatural flourishing of a mediaeval Avignon and thus similarly dependent upon the Pope (or Anti-Pope) continuing to hold his court there. This last is the real lesson of the fabled relapse of 1937 – one which is subtly but materially different to the usual reading of the event.

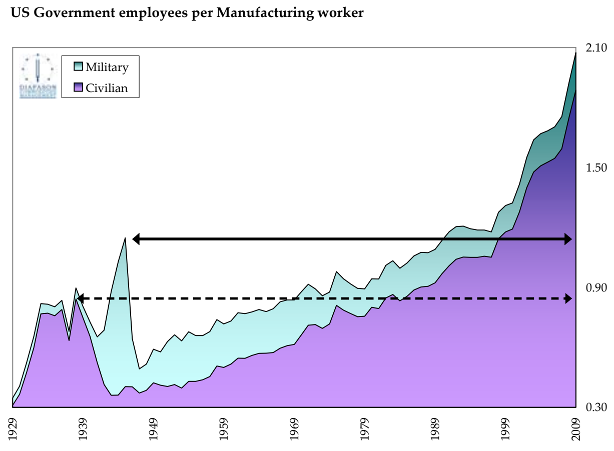

Figure 11: Ants v Grasshoppers – worse than the New Deal & WWII

Finally, the matter is subject to a further illusion, for if ever greater numbers of people find their employment in a government sector which is by its very nature adding less, no, or even *negative* economic value, all the costs associated thereto must indirectly be borne by those left striving to make a living under the harsh taskmaster of consumer preferences and subject to the unforgiving imperative of making a profit.

Thus, though the monetary debasement may make direct wage costs appear low (at least, in deflated terms), the entrepreneur has somehow to pay for an entire shadow workforce of rob-Peter-to-pay-Paul pocket-pickers in addition. The sad fact is that each US manufacturing worker, for example, already carries just over two government employees on his back – a 55% increase since the end of 2000 and appreciably more disfavourable a ratio than prevailed at the peak of FDR's 'peculating despotism' or even at the grand climacteric of WWII. Even assuming the army of apparatchiks to be doing nothing *actively* to hinder his effectiveness, our little ant - and more importantly still, his would-be employer - clearly has a lot more grasshopper food to gather before he himself gets to eat.

Thus, while the economy itself might be labouring under an 'output gap' (which is nothing but the tangible aftermath of the output derangement suffered during the Boom), more resources will be funnelled, using money created specially for the purpose, to those least able to use them well, to the demoralisation, if not the outright dissuasion of a more productive remnant who will already be under heavy assault from their spiteful socialistic critics, gleefully returned to power by the Crash.

To disaggregate this position somewhat, in Austrian terminology, we can talk about such government-led infusions as mainly constituting 'simple' inflation rather than engendering a classic, business-cycle credit expansion. Thus, there should be no encouragement of the sort of widespread entrepreneurial error made when market interest rates are unduly suppressed amid rising (nominal) profit expectations and hence no re-ignited private investment boom (no Keynesian 'multiplier' need therefore apply).

Instead, only the recipients of government payments and doles will benefit. These will, in all likelihood, shift the mix toward even more exhaustive, end consumption. In the parlance, we will see horizontal widening, not vertical extension of the productive structure, making it more present-oriented and less roundabout. This suggests it will also become less capitalistic and hence conducive to lower real standards of living, no matter how much prices themselves may rise under the influence of intervention.

As we recently tried to illustrate in a highly schematic form (see *'Resource Ruminations: Hayek's Overcoat', June 2009),* this may only serve to exacerbate the problems being faced by those suffering the worst effects of their prior misapprised investment, travails which are mainly attributable to an acute shortage of the suitably-priced complementary capital and labour needed to realise such investments and free up the means locked hopelessly within them. As with any such lack of real resources, it is one which can only be made good by a *lessening* of demand for immediate goods, not an intensification of it. Salvation is to be sought in *more* saving – at least of what we might call the active kind – not less.

Rather, what we are being served up is nothing less than a recipe for rising prices amidst supra-normal levels of unemployment and under-utilized capacity – conditions which have constituted the lot of the huddled masses in all too many poorly-governed countries around the world since the Great War of 1914-18 and the apotheosis it brought in its wake of the corporatist, paper money system and the militarized Provider State which relies completely upon that system's corrupted institutions to print out its endless stream of requisition orders.

In this light, it is perhaps just a little concerning to learn that, between them, the Fed and its foreign peers have bought US government debt to the tune of $408 billion these past six months, on top of which they have scooped up $510 billion in Agency paper and MBS. The total $918 billion exceeds even the contemporaneous runaway US Treasury issuance of marketable debt by no less than $144 billion, or 19%.

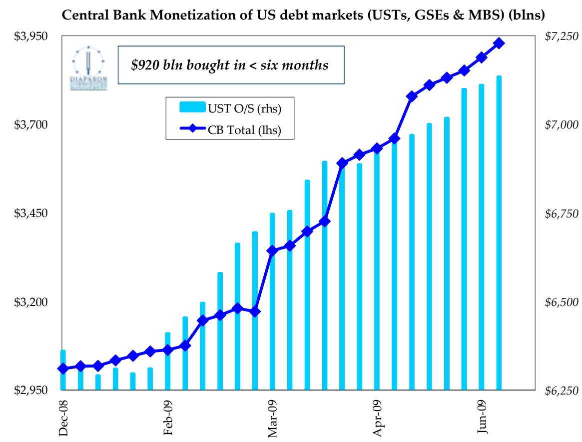

Figure 12: CB Monetization of US Debt

Nor has there been any notable reluctance to take such steps in the Eurozone where, even before this weeks' extraordinary €442 billion long-term repo, the banks had increased their holdings of government bonds by €219 billion and the ECB its stock by €64 billion in the six months to April (around $400 billion equivalent). For its part, since beginning its own QE programme in March, the BoE has added £96 billion ($157 bln) to the pool – outmatching even HMT's torrential net outpourings over the period.

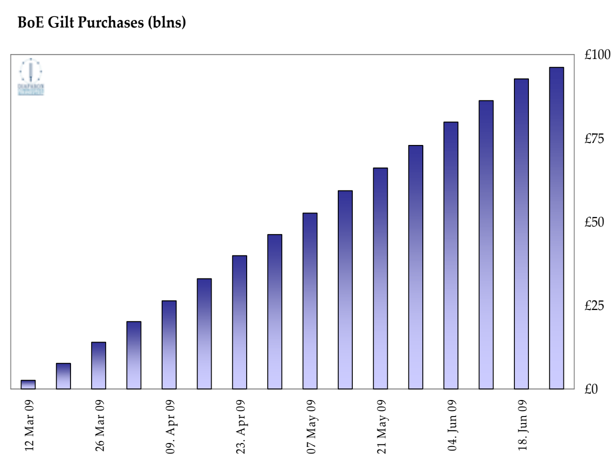

Figure 13: BOE debt purchases

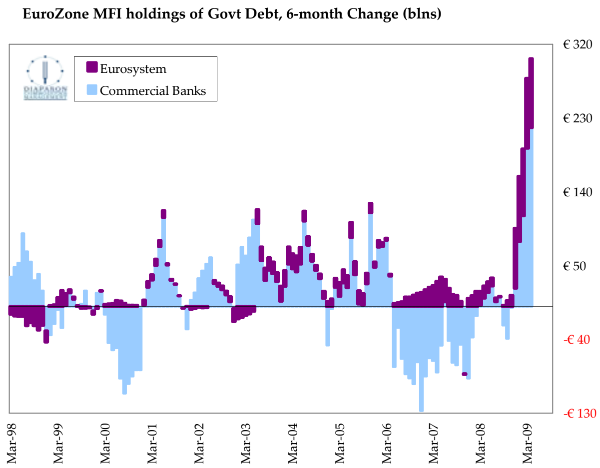

Figure 14: Eurozone monetization of Govt debt

Aside from the purely economic consequences of such developments, this further intertwining of fiscal and monetary policy risk empowering near-unaccountable executives yet further. To see where this leads, perhaps we could cite the words spoken by the Anti-federalist, Patrick Henry during the debate on the ratification of the American Constitution:

'Let him candidly tell us where and when did freedom exist, when the sword and purse were given up by the people? Unless a miracle in human affairs interposed, no nation ever retained its liberty after the loss of the sword and purse. If you give them up you are gone.'

Leaving such considerations aside, all this activity has not been without an effect on deposit holdings, which is to say, on the amount of money in existence. US private sector holdings of cash and deposits subject to cheque rose 19% in the year to March and while our slightly broader, 'Austrian' money supply measure - adjusted for changes in the CPI index – increased by a more modest 8.2%, this was still its fastest gain since 1993. In the Eurozone, real money holdings have risen at a 14% annualized pace since August, rivalling the burst of monetary creation which greeted the launch of the single currency itself, 10 years ago (an effusion which made no small contribution to the exacerbation of the growing Tech & Telecom bubble of that era).

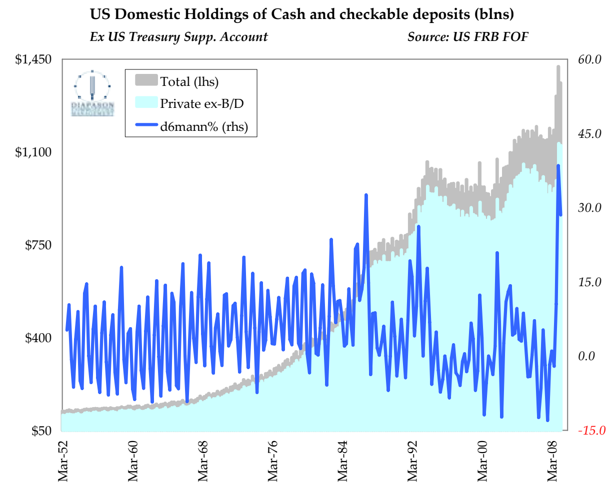

Figure 15: US private money holdings

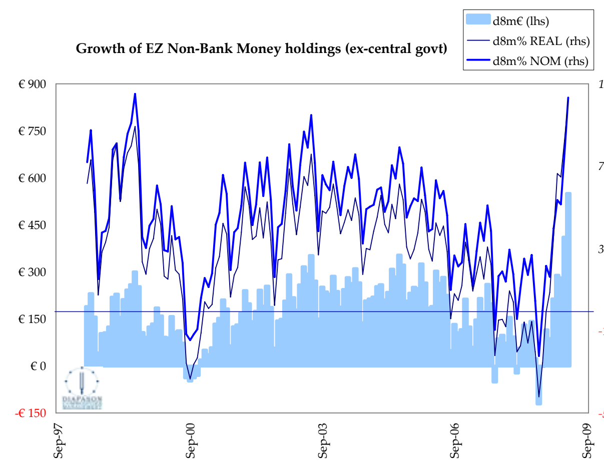

Figure 16: Eurozone private money holdings

It goes without saying that in China – where bank lending in a quasi-command economy has jumped by almost $1 trillion since November - real M1 has roared skywards at an annualized rate of approximately 33%. Even in Japan, real deposits (of all kinds) are up 8% and real M1 8.8% annualized in that same period.

In fact, taking real M1 as a rough proxy for effective money balances, a similar picture emerges across many parts of the world: e.g., Canada has seen a 6-month annualized ROC of 11%; South Korea, one of 23%; India, of 25%; Taiwan, 41%; Singapore, 45%, and Switzerland, no less than 57%.

So, given all this, have we come to the point where we must perforce espouse the Inflationist/Gold Bug case instead?

Certainly, the growing desire to transform these money balances into something less passive – and therefore into something potentially offering a higher return – can be held responsible for the rise in asset prices seen almost everywhere you looked this Spring.

For instance, with nothing more to cling to than a limited degree of stabilization in a world economy where industrial production is back to levels first reached a decade ago, the MSCI World index managed to climb no less than 46% in the 13 weeks to the early June top – a move fully six sigmas beyond the norm established over the past 39-years of data. In turn, despite the fact that the minor recovery in world trade flows this spring already seems to have stalled out, forming a plateau at a 4-year low, the export-dependent MSCI EM index added no less than 69% over that same horizon, for a 4.8 sigma gain in terms of its particular 21-year statistical record.

In China itself, not only have we been witnessing yet another share price bubble; not only has real estate speculation re-emerged in spades; but the stockpiling of commodities in the hope of turning a profit (once matters improve as per fervently propagandized expectations) has been perhaps *the* main influence on a sector where genuine, end demand has had a decidedly peaky-looking complexion.

So, does all of this argue that in our attempts to avoid being sucked down in the Charybdis of deflation, we shall inevitably be devoured by the Scylla of inflation?

Well, not instantly. For the money which is being created *could* simply be held onto more avidly by its recipients. The 'inner objective exchange value' might rise, to cite Mises – 'velocity' might decline if the aggregatists insist upon that problematical phrase. After all, just because Damien Hirst pickles a whole herd of extra cows does not ineluctably mean they will go down in price – it just might be that there is an even greater demand from *nouveaux riches* resource oligarchs and private equity WAGs to maintain the bid price for such a calculated and venal assault upon aesthetic sensibility.

To take a more pertinent example, the 48% increase in new home construction in the US during 2001-5 was almost exactly matched by a 47% increase in median price as demand outstripped even that greatly expanded supply.

But, once disillusion sets in – once people tire of beef in aspic as art – the effect of the increased stock coming to market will depress prices further and further as the erstwhile connoisseurs scramble over one another in the rush for the exits.

So it can be with money where, notwithstanding the usual theoretical prescription, More (in terms of quantity) does not unavoidably mean Less (in terms of value).

But if there is one pharos of constancy rising out of the turbulent and unfathomable seas of economics, it is that the incendiary effects of money upon the fabric of one's trousers are unparalleled. Money, ultimately, is a good destined to be used and - once its perceived utility as a safe haven diminishes in the face of heightened optimism (or, conversely, by dint of even greater necessity), or is disabused by fear of its growing over-abundance - used it will be, once more.

If that shift in sentiment does not find a ready outlet in a greater range of goods to buy, then the prices of those which *are* on offer will rise. Once recognised, this evolution will only intensify the avidity of everyone who wishes to disembarrass himself of his now-depreciating money before his neighbours snap up all the bargains ahead of him.

Then – and only then – will we have an inflation and – given the scale of what we have set out above – perhaps an inflation the like of which have been fortunate enough not to have experienced for many a long year.

Of course, just as they injected money in profusion when it seemed the need was most urgent, the noble guardians of the people's cash can – and no doubt genuinely believe they *will* – take firm and timely steps to withdraw it in due measure, too.

In practice, however, this is likely to require a positively superhuman exercise of will, as well as truly Olympian degree of insight into the prevailing state of the economy – meaning that anyone deluding themselves that they will rise serenely and disinterestedly to this challenge is surely prey to yet another 'fatal conceit' of collectivist planning.

Moreover, this so-called 'exit strategy' presumes that the free-spending, Flash Gordons holding political office will be only too happy to shut down all the special bureaus, to disband all the task forces, and to terminate all the pet programmes set up in the interim and go back meekly to the tedious business of deliberating over the finer details of how their newly-modest budget allocations can be used to the voter's - and no longer to their own - best advantage.

In reality, the economy will, at this juncture, be in grave danger of having long since turned into a sickly runt which cannot easily be weaned from the teat of public largesse. As such, it is likely to squeal long and loud - and its health visibly deteriorate – the minute that succour is denied it.

On top of this, we are asked to imagine a successful outcome to the conflict to be waged between a government grown gross, bloated, and truculent in its profligacy – and with its Everest of unpaid bills threatening to slip and bury it at any instant – and a clutch of prim, professorial central bankers suddenly insistent upon a swift return to the Victorian hair-shirt of fiscal rectitude. Even were our pampered piglet able to subsist on the hard fare now being proffered to him in place of his foster-mother's milk, he would be unlikely to endure either the steep rise in bond yields or the swingeing tax increases such a battle royal would inevitably call forth.

It is a matter of record that populist democracies – especially those based around the principles of the welfare stare – do not face up to the kind of hard choices which will be the legacy of the last few decades' monetary insanity at all voluntarily. Such root-and-branch retrenchments as seem predestined are typically only undertaken under the pressure of an binding external restraint; amid an overthrow of the established order (whether from within or without); or following a complete collapse of the whole ramshackle of expedients erected in order to postpone the dreaded day of reckoning.

Though our masters may succeed in deferring that reckoning for some time yet, they cannot finally prevent it for, as Shakespeare put it in '*Timon of Athens'* III iv, the resources misused in the attempt must eventually run out:

> *Lucilius' Servant (LS): Welcome, good brother. What do you think the hour?*
> *Philotus: Labouring for nine.*
> *LS: So much?*
> *Philotus: Is not my lord seen yet?*
> *LS: Not yet.*
> *Philotus: I wonder on't; he was wont to shine at seven.*
> *LS: Ay, but the days are wax'd shorter with him. You must consider that a prodigal course is like the sun's; but not, like his, recoverable. I fear 'tis deepest winter in Lord Timon's purse; that is one may reach deep enough, and yet find little.*

So, is it to be deflation or inflation? If the first seems to us somewhat unlikely, nor is the second entirely pre-ordained. What is, however, ineluctable - for all the denials and prevarications we might meanwhile attempt - is that one day, no matter how steep his bill, the piper will finally have to be paid.

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