The Great Inflation of 2009

The late deflation of 2008 will turn into the great inflation of 2009

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The late deflation of 2008 will turn into the great inflation of 2009. In the last months of 2008, the US economy experienced deflation, falling prices. House prices had been falling for two years, and in the last months of 2008, the price of oil and gasoline fall sharply. The Federal Reserve deflated short-term interest rates, and the average price of goods in the US fell in October. There may well be wage deflation in early 2009, mostly in the form of employers not providing the usual cost-of-living increases, and in lower profits for the self-employed.

Falling demand results in lower prices, but only if the money supply is kept stable. Much of the $7 trillion spent or pledge to patch up the financial markets has been and will be money created by the Federal Reserve. Billions of the new dollars are already sitting in the banks as “excess reserves,” funds beyond the required minima. Bankers have feared to loan out that money as losses from past bad loans continue to mount.

But some time next year, 2009, the trillions of new dollars will start screaming, “loan me out, please.” Banks have to pay for their expenses, and for that, they need loan income, since competitive pressures limit how much they can raise from fees. Government programs to help homeowners with mortgage problems will reduce foreclosures, and house prices will level off. As the economies of Asia recover, rising demand will pull oil prices back up. As the US deflation comes to an end, the banks will be tempted to lend out the unemployed dollars. The federal government will also be pushing the banks to loan out the funds.

Every bank loan is a creation of money. The borrower now has money, and the depositors still have their money, so the new loan is a creation of money by the banking system. The hundreds of billions of dollars created out of nothing by the Federal Reserve will be multiplied into trillions of dollars created by the banks as they loan out money.

This vast expansion of money by the Federal Reserve and the banking system is a monetary inflation that then creates price inflation. Also contributing to price inflation is an increase in the turnover or velocity of the circulation of money.

The price inflation will first affect the commodity markets. Commodity prices, which had fallen substantially, will turn around and start climbing again. Copper, for example, fell from $4 to $1.50 per pound from July to December 2008. The momentum of development in the Asian economies will require huge amounts of copper again, and the price will escalate once more.

Gold, silver, copper, oil, and other commodities will rise as their prices are set at commodity exchanges that can respond quickly to changes in demand. Producer prices will then start to rise, followed by consumer prices. The surge in prices could be dramatic.

Many investors, consumers, commentators, and government chiefs will be surprised and shocked at how inflation will have escalated even before the economy recovers. Nominal interest rates — the real rate plus inflation — will hike up. The exchange value of the US dollar will plunge. Rather than seeking safety in US Treasury bonds, people worldwide will be seeking refuge in gold and silver.

The inflation will bring the fall in US real estate prices to a halt, as people seek to buy land as an inflation hedge. Land speculation will be back, as buyers take advantage of low-priced land. With rising inflation, renters will seek to become homeowners, and the government will surely be promoting loans with mortgage assistance. But the automobile companies will still not be happy, despite the huge bailouts from government, since slack demand and foreign competition will reduce their ability to raise prices, except for electric cars, which will be bestsellers if they work.

For the typical American, the coming inflation will reduce the value of their dollars of savings, and raise the prices of food, housing, and transportation. Wages will lag behind. Government chiefs will be tempted to impose price controls as well as limits and taxes on sending funds abroad. Price controls did not control inflation in the 1970s, and they would fail if tried again.

The US economy experienced stagflation during the 1970s, as unemployment remained high after the recession of 1973, while high inflation escalated the prices of tangibles such as gold and land. In December 2008, the main goal of the current and coming government chiefs is to stop the financial credit crunch, and to that goal they have thrown or pledged trillions of dollars, but those dollars will eventually come out of hiding, and so there is just no way to avoid the coming great inflation of 2009.

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FRED E. FOLDVARY, Ph.D., (May 11, 1946 — June 5, 2021) was an economist who wrote weekly editorials for Progress.org since 1997. Foldvary's commentaries are well respected for their currency, sound logic, wit, and consistent devotion to human freedom. He received his B.A. in economics from the University of California at Berkeley, and his M.A. and Ph.D. in economics from George Mason University. He taught economics at Virginia Tech, John F. Kennedy University, Santa Clara University, and San Jose State University.

Foldvary is the author of *The Soul of Liberty*, *Public Goods and Private Communities*, and *Dictionary of Free Market Economics*. He edited and contributed to *Beyond Neoclassical Economics* and, with Dan Klein, *The Half-Life of Policy Rationales*. Foldvary's areas of research included public finance, governance, ethical philosophy, and land economics.

Foldvary is notably known for going on record in the *American Journal of Economics and Sociology* in 1997 to predict the exact timing of the 2008 economic depression—eleven years before the event occurred. He was able to do so due to his extensive knowledge of the real-estate cycle.