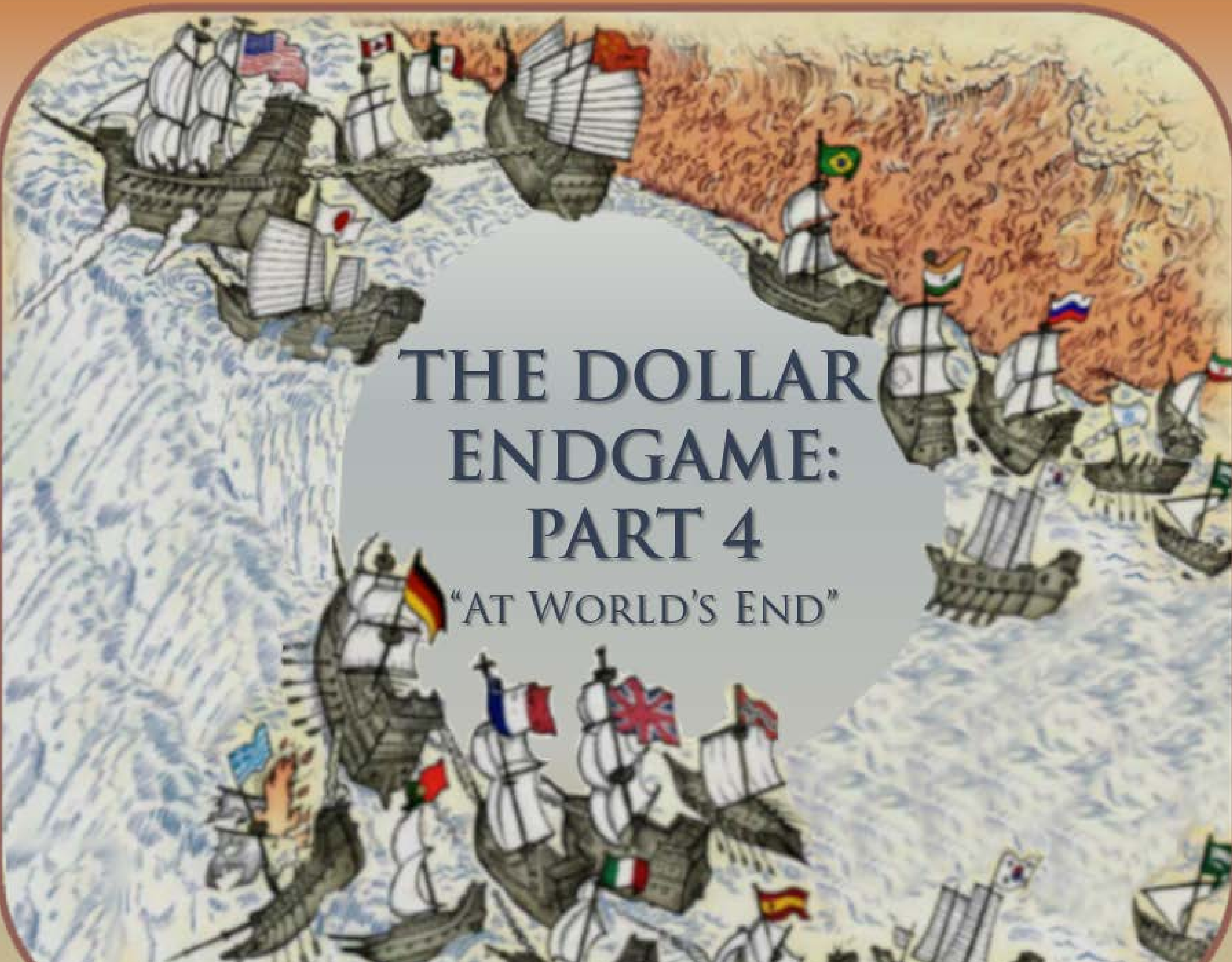
HYPERINFLATION IS COMING



THE DOLLAR ENDGAME: PART 4

"At World's End"

u/Peruvian_Bull

Hyperinflation is Coming- The Dollar Endgame: PART 4.0, “At World’s End”

DD

I am getting increasingly worried about the amount of warning signals that are flashing red for hyperinflation- I believe the process has already begun, as I will lay out in this paper. The first stages of hyperinflation begin slowly, and as this is an exponential process, most people will not grasp the true extent of it until it is too late. I know I’m going to gloss over a lot of stuff going over this, sorry about this but I need to fit it all into four posts without giving everyone a 400 page treatise on macro-economics to read. Counter-DDs and opinions welcome. This is going to be a lot longer than a normal DD, but I promise the pay-off is worth it, knowing the history is key to understanding where we are today.

SERIES (Parts 1-4) TL/DR: We are at the end of a MASSIVE debt supercycle. This 80-100 year pattern *always* ends in one of two scenarios- default/restructuring (deflation a la Great Depression) or inflation (hyperinflation in severe cases (a la Weimar Republic). The United States has been abusing it’s privilege as the World Reserve Currency holder to enforce its political and economic hegemony onto the Third World, specifically by creating massive artificial demand for treasuries/US Dollars, allowing the US to borrow extraordinary amounts of money at extremely low rates for decades, creating a Sword of Damocles that hangs over the global financial system.

The massive debt loads have been transferred worldwide, and sovereigns are starting to call our bluff. Governments papered over the 2008 financial crisis with debt, but never fixed the underlying issues, ensuring that the crisis would return, but with greater ferocity next time. Systemic risk (from derivatives) within the US financial system has built up to the point that collapse is all but inevitable, and the Federal Reserve has demonstrated it will do whatever it takes to defend legacy finance (banks, broker/dealers, etc) and government solvency, even at the expense of everything else (The US Dollar).

I’ll break this down into four parts. ALL of this is interconnected, so please read these in order:

Part One: The Global Monetary System- “A New Rome” <

Part Two: Derivatives, Systemic Risk, & Nitroglycerin- “The Ouroboros” <

Part Three: Banks, Debt Cycles & Avalanches- “The Money Machine” <

Part Four: Financial Gravity & the Fed’s Dilemma- “At World’s End” < (YOU

ARE HERE)

If you haven't already, PLEASE go back and read Parts 1-3. We'll be referring heavily to concepts like Triffin's Dilemma, Derivative Feedback loops, and Debt Supercycles throughout Part 4. I want to make sure everyone is on the same page as we delve into Part 4, the largest and most comprehensive section yet.

Preface:

Some Terms you need to know:

Hyperinflation: This is a term to describe rapid, excessive, and out-of-control general price increases in an economy. While inflation is a measure of the pace of rising prices for goods and services, hyperinflation is rapidly rising inflation, typically measuring more than 50% per month.

Money Velocity: The velocity of money is a measurement of the rate at which money is exchanged in an economy. It is the number of times that money moves from one entity to another. It also refers to how much a unit of currency is used in a given period of time. Simply put, it's the rate at which consumers and businesses in an economy collectively spend money.

The velocity of money is usually measured as a ratio of gross domestic product (GDP) to a country's M1 or M2 money supply.

Monetary Base: The monetary base (or M0) is the total amount of a currency that is either in general circulation in the hands of the public or in the form of commercial bank deposits held in the central bank's reserves. This measure of the money supply is not often cited since it excludes other forms of non-currency money that are prevalent in a modern economy.

Seigniorage: Seigniorage is the difference between the value of currency/money and the cost of producing it. It is essentially the "profit" earned by the government by printing currency. The greater the seigniorage, the more money the government is incentivized to print. Since this money hits government coffers before it circulates in the general economy, it represents "stolen wealth" that is used to fund expenditures. This "profit" has to come from somewhere, so thus it is drawn from the real wages and incomes of the working class people of a country, since their wages/incomes stay constant, but inflation caused by money printing increases the real costs of living.

Currency Pair: A currency pair is the quotation of two different currencies, with the value of one currency being quoted against the other. The first listed currency of a currency pair is called the base currency, and the second currency is called the quote currency. A pair such as EUR/USD which trades at 1.25, for example, means that 1 Euro can buy 1.25 Dollars.

Gresham's Law: Gresham's law is a monetary principle stating that "bad money drives out good." At the core of Gresham's law is the concept of good money (money which is undervalued or money that is more stable in value) versus bad money (money which is overvalued or loses value rapidly). The law holds that bad money replaces good money in circulation, since people prefer to dispose of a currency that is falling in value rather than one that retains it; thus in a currency system with two competing currencies, such as Zimbabwe during it's hyperinflation, the populace prefers to use hyperinflated dollars over US dollars since the Zimbabwean dollars will lose most of their value in just a matter of weeks.

*(Disclaimer: I have been reported for spreading FUD and hit with dozens of PMs stating that I am doing this to fear-monger- please know this is NOT my intention. History shows us that hyperinflations, although very difficult times, do NOT MEAN a complete societal collapse. Life gets harder for many people, but humans adapt to the challenges and continue to try to lead a normal life- crime rates DO increase (mainly theft) but **people DO NOT start randomly hunting each other like The Purge.**)*

Part Four: Financial Gravity & the Fed's Dilemma- At World's End

(Part Four is so large, it had to be split into multiple sections; 4.0, 4.1, 4.2, and so on. It will likely be 6 or 7 sections in total)

Prologue:

The Ships of Trade

"Imagine the world economy as an armada of ships passing through a narrow and dangerous strait leading to the sea of prosperity. Navigating the channel is treacherous- err too far to one side and your ship plunges off the waterfall of deflation; but too close to the other and it burns in the hellfire of inflation. The global fleet is tethered by chains of trade and investment so if one ship veers perilously off course it pulls the others with it.

Our only salvation is to hoist our economic sails and harness the winds of innovation and productivity. It is said that de-leveraging is a perilous journey and beneath these dark waters are many a sunken economy of lore. **Print too little**

money and we cascade off the waterfall like the Great Depression of the 1930s... print too much and we burn like the Weimar Republic Germany in the 1920s... fail to harness the trade winds and we sink like Japan in the 1990s.

On cold nights when the moon is full you can watch these ghost ships making their journey back to hell... they appear to warn us that our resolution to avoid one fate may damn us to the other."

- **Artemis Capital Research Paper**

The Weimar Republic Hyperinflation

On June 28th, 1914, Austrian Archduke Franz Ferdinand and his wife Sophie were assassinated by a Bosnian Serb nationalist named Gavrilo Princep. The assassination set off a rapid chain of events, as Austria-Hungary immediately blamed the Serbian government for the attack, and a complex web of alliances and treaties dragged country after country into the carnage.

As large and powerful Russia supported Serbia, Austria asked for assurances that Germany would step in on its side against Russia and its allies, including France and possibly Great Britain. On July 28, Austria-Hungary declared war on Serbia, and the fragile peace between Europe's great powers collapsed, beginning the devastating conflict now known as the First World War.

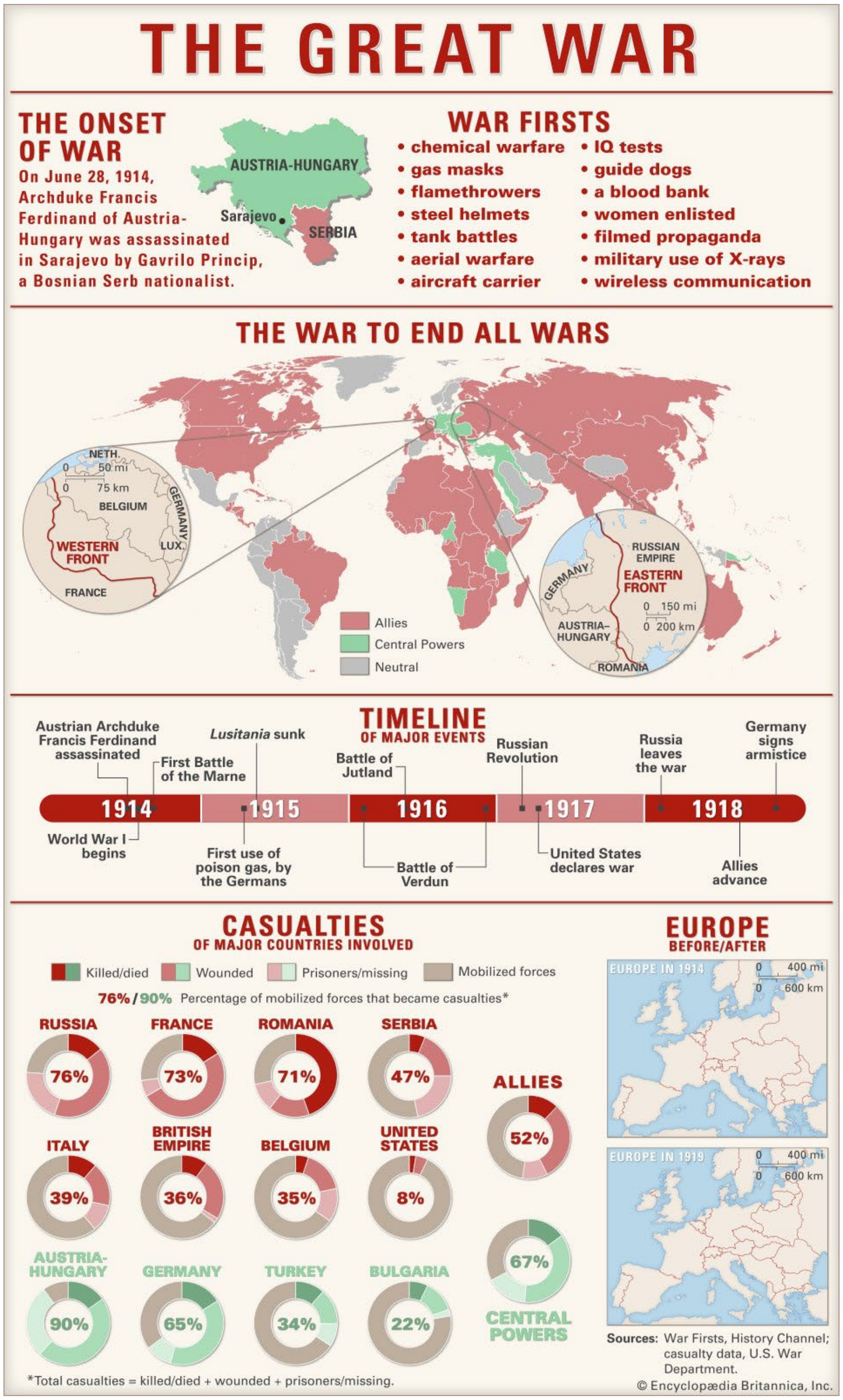
The first month of combat consisted of bold attacks and rapid troop movements on both fronts. In the west, Germany attacked first Belgium and then France. In the east, Russia attacked both Germany and Austria-Hungary. In the south, Austria-Hungary attacked Serbia. Following the Battle Of The Marne (September, 1914), the western front became entrenched in central France and remained that way for the rest of the war. The fronts in the east also gradually locked into place.

In terms of sheer numbers of lives lost or disrupted, the Great War was the most destructive war in history until it was overshadowed by its offspring, the Second World War. By the end, the combatants would estimate 10 million military deaths from all causes, plus 20 million more crippled or severely wounded. Estimates of civilian casualties were harder to make; they died from shells, bombs, disease, hunger, and accidents such as explosions in munitions factories; in some cases, they were executed as spies.

Although both sides launched renewed offensives in 1918 in an all-or-nothing effort to win the war, all efforts failed. The fighting between exhausted, demoralized troops continued to plod along until the Germans lost a number of individual battles and very gradually began to fall back. A deadly outbreak of Influenza, meanwhile, took heavy tolls on soldiers of both sides. Eventually, the governments of both Germany and Austria-Hungary began to lose control as both countries experienced multiple mutinies from within their military structures.

The war ended in the late fall of 1918, after the member countries of the Central Powers signed Armistice Agreements one by one. Germany was the last, signing its armistice on November 11, 1918. As a result of these agreements, Austria-Hungary was broken up into several smaller countries. Germany, under the Treaty Of Versailles, was severely punished with hefty economic reparations, territorial losses, and strict limits on its rights to develop militarily.

World War I was one of the great watersheds of 20th century geopolitical history. It led to the fall of four great imperial dynasties (Germany, Russia, Austria-Hungary, and Turkey), resulted in the Bolshevik Revolution in Russia, and, in its destabilization of European society, laid the groundwork for World War II and the Weimar Hyperinflation.



Great War Infographic

This destabilization was especially visible in Germany, as soon after the war ended, it was thrown into economic and social disorder. After a series of mutinies by German sailors and soldiers, Kaiser Wilhelm II lost the support of his military and the German people, and he was forced to abdicate on November 9, 1918.

The following day, a provisional government was announced made up of members of the Social Democratic Party (SDP) and the Independent Social Democratic Party of Germany (USDP), shifting power from the military. In December 1918, elections were held for a National Assembly tasked with creating a new parliamentary constitution. On February 6, 1919, the National Assembly met in the town of Weimar and formed the Weimar Coalition. They also elected SDP leader Friedrich Ebert as President of the new Weimar Republic.

As in the case of other wars, governments suspended the gold standard during World War I to increase the money supply and pay for the war. Therefore, as in the case of all post-war eras, many countries faced much higher inflation rates at the end of World War I than they had experienced beforehand.

> Thus were the Government's plans drawn up, wilfully and simply, for financing the war - not by taxation, but by borrowing; and with the printing press as the well to supply both the needs of the Government and the growing credit demand of private business. Taxation was to play not the smallest part in meeting the costs of war before 1916. The Allied blockade of the Central Powers threw Germany, which over half a century had grown to be a foremost trading nation, fully back on her own resources for fighting the most devastating war in history. It was inevitable that those resources would be shot away to nothing: the question was when the bill would be presented, and who would pay it.

(When Money Dies, pg. 9)

The German inflation of 1914–1923 had an inconspicuous beginning, a creeping rate of one to two percent. On the first day of the war, the German Reichsbank, like the other central banks of the belligerent powers, suspended redeemability of its notes in order to prevent a run on its gold reserves. (Similar to what Nixon would do for the US several decades later on Aug. 15th, 1971, as discussed in Part 1).

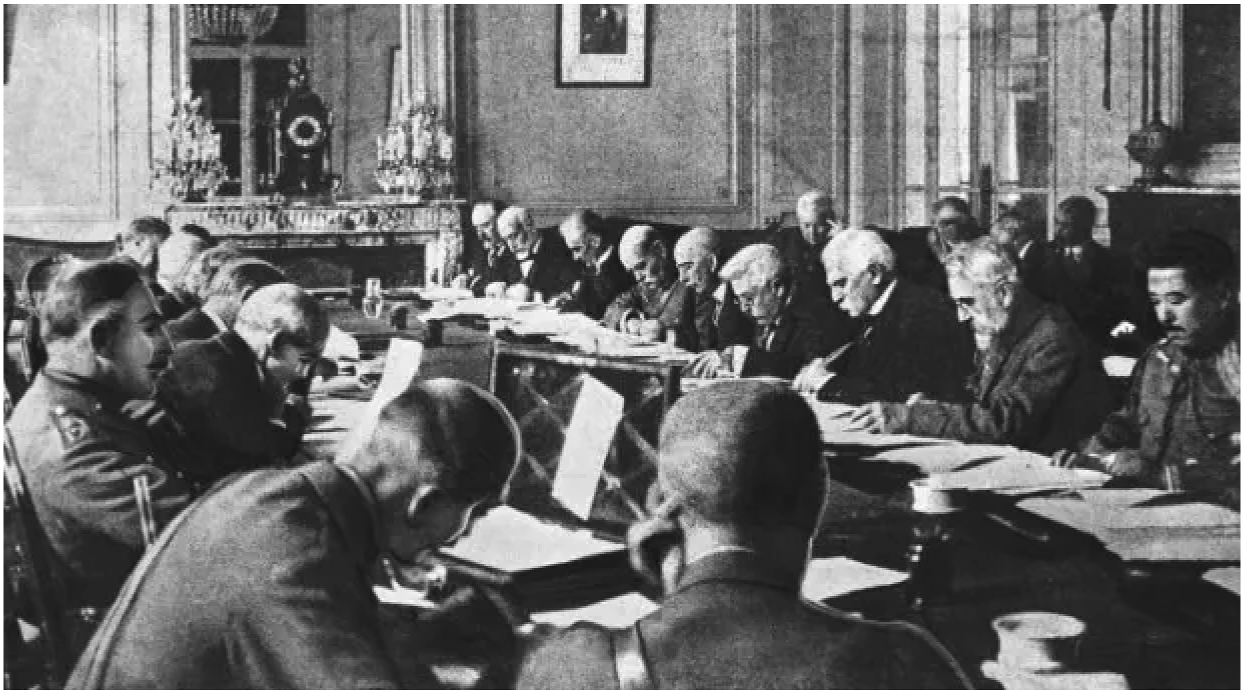
Furthermore, it offered assistance to the central government in financing the war effort. Since taxes are always unpopular, the German government preferred to borrow the needed amounts of money rather than raise its taxes substantially. To this end it was readily assisted by the Reichsbank, which discounted (read: purchased) most treasury obligations.

A growing percentage of government debt thus found its way into the vaults of the central bank and an equivalent amount of printing press money into people's cash holdings. **In short, the central bank was monetizing (directly printing) the growing government debt, which was being spent into the real economy.**

By the end of the war prices had risen some 140 percent, from their figures at the outbreak of war. The German mark had traded around a normal range of 20 marks to the Pound during the early stages of the war, and before that was as low as 5. It ended December 1918 at 43 marks to the Pound.

The U.S. returned to the gold standard in 1919, and other European countries and Japan reinstated the gold parity a couple years later. Considering the limited gold supply of the early 1920s, the European countries and Japan decided on a partial gold standard, where reserves consisted of partly gold and partly other countries' currencies. This standard is known as the *gold exchange standard.*

Germany, however, was in a much more difficult position. Devastated by the conflict, she saw her manpower collapse, her raw productive industries destroyed, and her old political establishment upended. Most destructive of all, however, was the Treaty of Versailles.



Signing of the Treaty

In January 1919, two months after the fighting in World War I ceased, a conference was convened at Versailles, the former country estate of the French monarchy outside Paris, to work out the terms of a peace treaty to officially end the conflict. Though representatives of nearly 30 nations attended- peace terms essentially were written by the leaders of the United Kingdom, France and the United States, who along with Italy, formed the “Big Four” that dominated the proceedings.

The defeated countries- Germany and her allies Austria-Hungary, the Ottoman Empire, (now Turkey) and Bulgaria, weren’t even invited to participate. In the end the Allies agreed that they would punish Germany in an attempt to weaken that nation so much that it wouldn’t pose a future threat. The counter-proposals submitted by the Central Powers on the 29th were all rejected. Germany refused to sign. On 17 June the Allies gave Germany five days to decide or have the war resume. Germany’s representatives had no real choice but to accept the terms, and thus assented to the “diktat”.

The terms were harsh, by any standard- The terms of the Treaty required the new German Government to surrender approximately 10 percent of its prewar territory in Europe and all of its overseas possessions. Germany was stripped of massive amounts of land, losing 68,000 km² of territory, including Alsace and Lorraine, which had been annexed in 1870, and 8 million inhabitants. Part of western Prussia was given to Poland, which gained access to the sea through the famous “Polish Corridor”. In addition, it lost most of its ore and agricultural production. Its colonies were confiscated, and its military strength was crippled.

Under the terms of Article 231 of the Treaty, the Germans accepted full responsibility for the war and the liability to pay reparations to the Allies, in an amount to be determined by a Reparations Commission. This last provision would prove to be the most catastrophic for Germany. The reparations figure was hotly contested by all parties- it began as a $5 billion payment in 1919, then $9 billion, and then as the war costs continued to be accounted for, ballooned to $33 billion in 1921 ((all figures in $ value of debt at that time, not adjusted for inflation)). **The victors elected to hoist every cost, that of healthcare of wounded French soldiers, of lost Belgian horses, of pensions for British railway workers, and more- onto the shoulders of the German State.**

Famous British economist John Maynard Keynes understood that a debt of this size was essentially unpayable, and further antagonized the German people against the Allies- **"I believe that the campaign for securing out of Germany the general costs of the war was one of the most serious acts of political unwisdom for which our statesmen have ever been responsible,"** he wrote in 1920.

Immediately after the war, the German government embarked upon heavy expenditures for health, education, and welfare. The demands on the Treasury were extremely heavy because of demobilization expenses; the debt of the Armistice, the repair of destroyed infrastructure, and the staggering deficits of the nationalized industries, all added up to massive fiscal deficits that only continued to increase.

> Thus within a few months of the Armistice the elements were present for the most devastating monetary collapse that any industrialised nation has ever known. Her industrial resources and manpower[2] heavily reduced, and hopelessly burdened with the insupportable weight of reparation payments stretching indefinitely into the future, Germany was required to regain her feet in those quicksands of her own making: the financial and fiscal arrangements of the Helfferich dispensation.
>
> The state of the mark, meanwhile, had become the barometer both of international confidence in Germany and of Germany's national despair. Before the war it had stood at 20 to the pound sterling. At the end of the war, in December 1918, it stood at 43. Before the terms of the Treaty of Versailles were accepted in June 1919, a pound would buy 60 marks. But when December came round again it would buy 185. Already the average annual war-time depreciation of about 20 per cent had come to resemble stability.

(When Money Dies, pg 15)

The wartime inflation of roughly 20% per year had largely been hidden from the public. Under the cloak of military secrecy, the government had been able to conceal the inflation figures, close the stock exchanges, and ban the publication of foreign exchange rates. The frequent shortages and price hikes were chalked up to wartime rationing, and thus many citizens thought that as the war ended and political agreement was finalized in Versailles, the high inflation rates would start to normalize and prices would come down. **What they did not understand was that the Treasury by this time was completely underwater in debt and war obligations- they had long since resolved to make up the massive deficits purely through the power of the printing press, electing to expand the money supply rather than default on payments.**

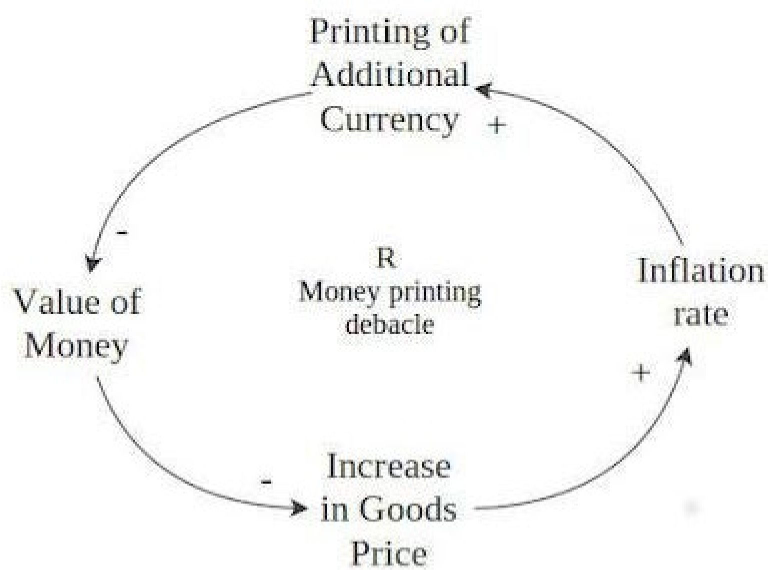
> The uncertainties to which these postponements gave rise in large measure accounted for the wild fluctuations of the mark during the year. At the outbreak of war the paper marks in circulation in Germany had a total face value of 2,700 million marks (less than half of the value of the coinage which the population were encouraged to trade in in return for paper). After the war's end, in November 1918, the figure had risen to 27,000 million; and by November 1920 to 77,000 million. But the pound sterling now stood at 240 marks, the dollar at 60. During 1920 when the Allies' Reparations Commission began its

(When Money Dies, pg 33)

The cost of living since the outbreak of the war had risen by nearly 12 times (compared with 3 times in the U.S., 4 times in Britain and 7 times in France). The food for a family of four which cost 60 marks a week in April 1919, cost 198 marks by September 1920, and 230 marks by November 1920. Certain items such as lard, ham, tea, and eggs rose to between thirty and forty times the pre-war price. (pg 30). Prices continued to rise across the board.

Throughout the period of the inflation the most popular explanation of the monetary depreciation laid the blame on an unfavorable balance of payments (also known as current account deficits, as covered, in-depth in [Part 1](#)) which in turn was blamed on the payment of reparations and other burdens imposed by the Treaty of Versailles. To most German writers and politicians, the government deficits and the paper inflation were not the causes but the consequences of the external depreciation of the mark. The wide popularity of this explanation, which charged the victorious Allies with full responsibility for the German disaster, bore ominous implications for the future- as it provided Hitler with scapegoats on which he could direct the German fury.

As the inflation continued to soar above 50% in late 1920, economists began to uncover a devastating feedback loop that drove consumer behavior. As consumer's inflation expectations rose, they went out and bought more goods, refusing to leave their cash sitting in bank accounts where it was losing half its value every year. This influx of buying served to increase prices, which confirmed the consumers' own suspicions of inflation, **revealing a hidden feedback loop** (The Ouroboros, covered in Part 2) that was nearly impossible to halt.



The Inflation Feedback Loop

The other problem that was quickly realized was the rapidly increasing money velocity. (The velocity of money is a measurement of the rate at which money is exchanged in an economy, measured in how many times the average bill is exchanged a year). Let's walk through this- If an economy has a total money supply of $1000, but those bills only pass between hands once a year, they can only bid for goods and services ONCE during the year. If those same dollars pass hands (ie transact) 365 times during the year, they can bid those same goods up 365 times during the year, thus increasing overall prices. Low money velocity means that people are saving their money, rather than spending it, and thus asset prices and consumer prices remain low- there is less money available to bid them up.

Money velocity is a second order derivative on top of inflation- it also represents another positive feedback loop. Velocity typically increases in times of inflation and decreases in times of deflation, thus exacerbating moves in either direction (making inflation more severe or deflation more severe).

Data for this time period is extremely scarce, so it was difficult to find good sources that could reliably estimate velocity- one decent source from an Economics PhD I found showed that money velocity started at 8 in 1920, **but rapidly increased to 10 in 1921, then 100, then soared above 10,000 in the final stages of the collapse in 1923. A rate this high implies the average single paper mark was changing hands 27 times a day!** (The way the Fed calculates money velocity today is EXTREMELY flawed, as we will cover in the coming sections).

Most Germans were oblivious of the ruin that lay in front of them. Frau Esenmenger, a widow in Austria who documented the hyperinflation in detail, went out and used her life savings to buy 20,000 kronen worth of government bonds at the end of the war. When she returned a year later, it already had lost 75% of its value. Several years later, it wouldn't even buy a loaf of bread. She stormed into the banking hall, asking her banker about her investment from a year prior- she documented this in her diary:

In the large banking hall a great deal of business was being done… All around me animated discussions were in progress concerning the stamping of currency, the issue of new notes, the purchase of foreign money, and so on. I went to see the bank official who advised me. “Well, wasn’t I right?, he said. “If you had purchased Swiss francs a year ago when I suggested, you would not now have lost three fourths of your fortune”. “Lost!” I exclaimed in horror. “Why, you don’t think the currency will recover again?” **“Recover!” he laughed. “Just test the promise made on this note and try to get 20 silver kronen in exchange”. “Yes, but mine are government securities”, I replied- “Surely there can’t be anything safer than that?” “My dear lady- where is the State which guaranteed these securities to you? It is dead.”**

BUY, HODL, BUCKLE UP.

>>>>>>>TO BE CONTINUED >>>>>>> PART 4.1>>> COMING LATER THIS WEEK

(Adding this to clear up FUD- My argument is for hyperinflation to begin in a few years- this is a years- long PROCESS, and will take a long time to play out. It won't happen tomorrow, but we are in the same situation as Germany after WW1. Hyperinflation is GOOD FOR GME--- DEBT VALUE COLLAPSES, MONEY CHASES ASSETS (EQUITIES) pushing the price UP, so shorts will have to cover) BUY AND HOLD.

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*If you would like to learn more, check out a Google doc of my recommended reading list here. This is a dummy google account, so feel free to share with friends- none of my personal information is attached. You can also check out a Google docs version of my Endgame Series here.

If you want a PDF version, u/zedinstead made copies of Parts 1,2, and 3 in his Superstonk DD library here.

Hyperinflation is Coming- The Dollar Endgame PART 4.1, "At World's End"

DD

Series Intro: (I am getting increasingly worried about the amount of warning signals that are flashing red for hyperinflation- I believe the process has already begun, as I will lay out in this paper. The first stages of hyperinflation begin slowly, and as this is an exponential process, most people will not grasp the true extent of it until it is too late. I know I'm going to gloss over a lot of stuff going over this, sorry about this but I need to fit it all into four posts without giving everyone a 400 page treatise on macro-economics to read. Counter-DDs and opinions welcome. This is going to be a lot longer than a normal DD, but I promise the pay-off is worth it, knowing the history is key to understanding where we are today.)

This is a continuation of Part 4.0- If you haven't already, PLEASE go back and read the prior sections before continuing.

I want to caveat the below by stating that I do not think a potential hyperinflation in the U.S. would look the exact same as Weimar Germany. We have had 100 years of technological and social advancement, and thus it would manifest very differently today. The 1920's German hyperinflation is a worst-case scenario, but it is vital to understand the history to analyze the similar situation which our nation faces.

Hyperinflation Begins

As 1921 dragged on, the fiscal situation continued to worsen. **The German Government faced an impossible situation: they could either choose to hike taxes to over double their current rates (which were already high due to tax hikes authorized during wartime), which would most certainly cause a political revolution in Germany and potential default; or they could continue to print their deficits, and hope that the Allies wouldn't seize German assets or that the rising cost of living would cause food shortages and riots. They continued down the path of money printing, unaware that they were steering their country ever more rapidly into the abyss.**

In March 1921, France occupied German ports, due to increasing frustration on the side of the Allies of the Germans' inability to pay. The Rhine ports of Duisburg, Ruhrort, and Dusseldorf were seized, which further reduced the ability of exporting businesses to sell their products, driving their shares down on the exchanges. The next month, another devastating blow was dealt as the Commission finalized the determination of Germany's War reparations. Adam Ferguson continues:

> On April 27, 1921, the Reparations Commission fixed Germany's total liability at 132,000 million gold marks, equivalent to £6,600 million. The problem before the London conference was how, and over what period, that enormous sum should be paid. It was decided that Germany was to be asked to pay 2,000 million gold marks - £100 million - a year and, in addition, a sum equal to 26 per cent of her exports; and these terms were conveyed to Berlin accompanied by the threat of further sanctions - namely the occupation of the Ruhr which the French were pressing for - if compliance did not come within the week. This 'London Ultimatum', which drove the mark to 268 to the pound, caused the Fehrenbach government to fall. It was supplanted by that

(pg 36)

With the political situation becoming more volatile, large banks and wealthy Germans began to sell their marks on the foreign exchange. At the beginning of the negotiations, this had begun as a slight trickle, as most educated Germans believed that the Treasury officials would right the ship, balance the government budget, and be able to pull Germany out of the quagmire.

But, as the situation deteriorated through 1920 and 1921, bankers, speculators, merchantmen, and wealthy industrialists all began dumping marks on the exchanges, further driving down the value of the mark and thus increasing the import prices of foreign goods for Germans. **By July 1921, the German merchant banks began ordering foreign exchange traders to sell all holdings of paper marks- at any price that was bid.**

Soon, the general public joined in. Anyone with any excess wealth held in marks took them to the exchanges to sell and convert to more stable currencies, further adding to the dumping of marks on the exchange and crushing its value in foreign exchange markets. Capital had begun fleeing the country en masse.

Meanwhile, inflation continued to soar. As the Treasury continued to spend, it found that the prices it was paying for goods and services (worker pay, food, oil, coal, steel, etc) kept rising, which in turn increased the amount of money the Treasury itself needed to spend just to keep the government running.

This increased demand for new currency fell on the Reichsbank, who readily printed it into existence and handed it to the Treasury- thus representing ANOTHER devastating feedback loop that would lead to an exponentially increasing money supply.

On September 20, 1921, Mr Joseph Addison,[11] Councillor at the British Embassy in Berlin, reported to the Foreign Office:

> The daily creation of fresh paper money which the government requires in order to meet its obligations both at home and abroad (services and goods which it is 'obliged both to render and deliver') inevitably decreases the purchasing value of the mark and leads to fresh demands, which in turn bring about a further decline, and so on *ad infinitum*.

Even progressive increases in taxation could not completely meet the situation, since new impositions meant an increased cost of living, which automatically reduced the purchasing value of the mark, and in turn brought about more inflation and budget instability.

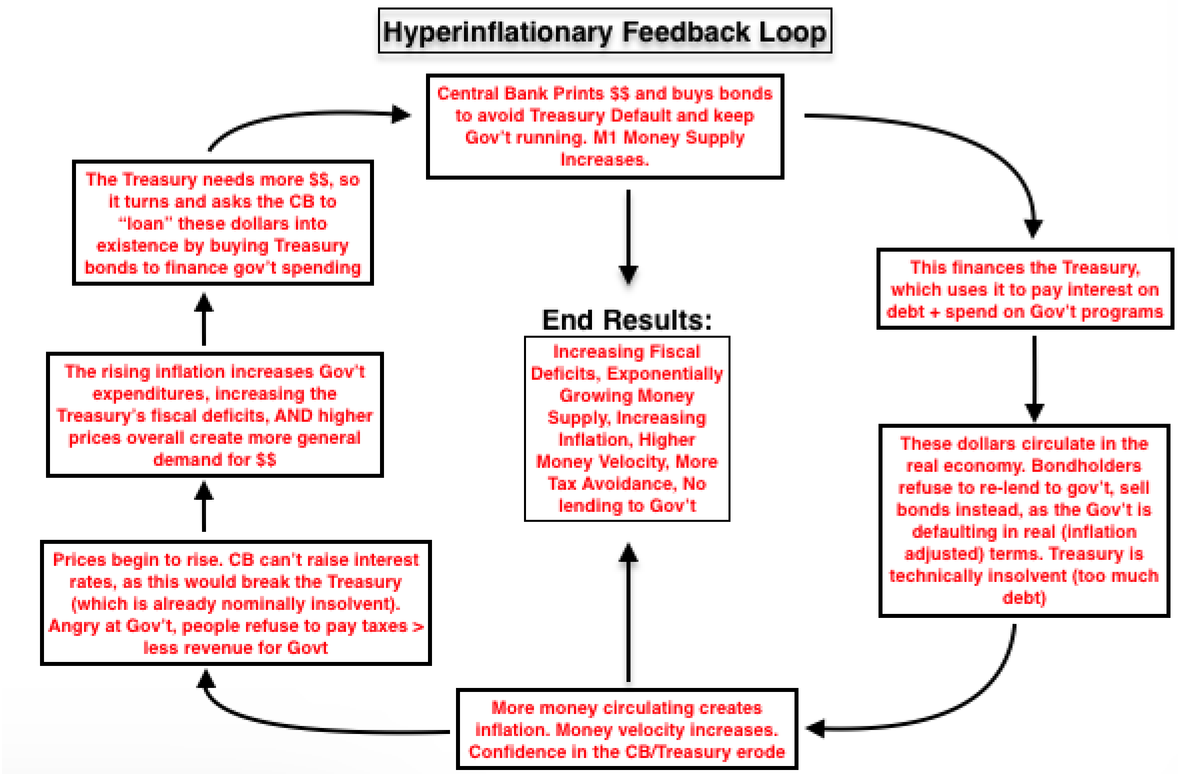
(pg 46)

Furthermore, as seen above, the Tax system could not keep up. The bankers and the wealthy industrialists had already moved the bulk of their wealth overseas or into foreign currencies, and the middle class, squeezed by the ravages of inflation, had no patience for any increase in taxation.

Like most industrialized nations, the government collected most taxes on a yearly basis, but with inflation growing past 100% by the winter of 1921, the annual taxes were basically a moot point. If the government charged an individual with a 100 mark tax liability, and he paid it a year later, it would only be worth approximately 16 marks or so- and the longer he deferred it, the less he would have to pay (in real terms).

Other sources of government revenue, such as railway fares, patent fees, coal taxes, and import duties, were fixed at low pre-war levels. The large and complex German bureaucracy made changing these fees extremely difficult, and even when they could adjust these fees, they could never raise them fast enough or often enough to keep up with inflation.

When the government needed taxes the most, the population began a mass program of tax evasion, due to both anger at the current incompetence of the Weimar government and the rapidly rising inflation. **Thus, the government had no response but to continue to increase their request for printed notes from the Reichsbank, as all other sources of financing (taxation and borrowing) were slowly being cut off.**



(Hyperinflationary Positive Feedback Loop)

European bankers soberly concluded that it was impossible for Germany to continue to pay her payments to the Entente, and sooner or later she would have to declare herself bankrupt. The state of the mark on the foreign exchanges continued to deteriorate. It had somewhat stabilized in mid-August at 310 to the pound, but had sped downwards to over 400 by mid-September, and was still going down. (pg 45).

By October 1921, the state of the budget was sombre. In terms of paper marks, the sum of the governments' ordinary expenditure plus the reparation payments to the Allies was more than 191 Billion Marks. The revenue from the previous budget and new taxation proposals of July would only amount to 152 Billion Marks. (pg 49, paraphrased).

In November, a buying frenzy had begun. Seeing the steady decline of the mark, throngs of people rushed to stores to buy out their stocks. Cash accounts were emptied at the banks, and safety deposit boxes were stripped of all contents except gold and silver as prices began to skyrocket in terms of paper marks. Store shelves were stripped bare, and black markets of food and manufactured goods quickly developed. British Embassy Councillor Addison observed the scene:

> Many shops declare themselves to be sold out. Others close from one to four in the afternoon, and most of them refuse to sell more than one article of the same kind to each customer. The rush to buy is now practically over as prices on the whole have been raised to meet the new level of exchange. In almost every camera shop, however, the sight of a Japanese eagerly purchasing is still a common feature. But on the whole, as far as Berlin is concerned, it is the Germans themselves who are doing most of the retail buying and laying in stores for fear of a further rise in prices or a total depletion of stocks.

Addison then had an interview with the Chancellor who said despondently that the continual, fast rise in prices was at last giving immediate concern for the maintenance of public order. Dr Wirth said that all reasonable demands

(pg 57).

That same month, mass strikes began across the country. In Berlin for instance, Addison reported that he had to work in his office in semi-darkness due to a strike of municipal electrical workers.

This strike was only broken by a promise of wage increases all around, involving an extra expenditure of $400 million marks, pushing the State budget even further underwater. He commented “the impossibility of the working classes to obtain even obvious necessities except at exorbitant prices, coupled with severe winter setting in, might lead to serious trouble.” (pg 58).

The mark, already in serious trouble, dropped to over 1,300 to the pound in late November. Food riots began taking place in Berlin.

(Lines of Shoppers outside Grocer, 1922)

With essential goods shortages becoming more and more frequent, people began lining up in queues hours before stores opened. Those who had the means hoarded dozens of pounds of food, saving much of it for their families and selling any extra on the black markets for exorbitant profits, as black market prices were often 30% higher than in-store.

To the anger of the beleaguered Germans, foreigners of all stripes began to pour in and purchase everything off the shelves. French citizens poured in by the thousands, as even the common working man could now afford items in the high-end boutique stores, due to the favorable exchange rates.

Europeans from all around wined and dined in the most exclusive restaurants, buying out all the finest entrees and cakes. Workers could only helplessly watch from the windows as the citizens of the victorious nations now rushed in to engorge themselves on cheap German goods.

The first few months of 1922 offered no reprieve. Food prices continued to soar, and theft in stores became commonplace. By the end of March, the prices had soared another 50% compared to the previous December.

Gambling on the stock exchanges became rampant. As capital continued to lose value daily, the opening of the stock exchanges became a national pastime, with hundreds of thousands of Germans, from bellboys to cab drivers, dumping any extra funds into the exchanges in some hope of keeping up with the rapid inflation.

The favorites were firms of heavy industry, of steel, coal, or iron, as well as agricultural production or clothing manufacturers- really anything that dealt in real goods. The clearing houses were days behind in settling trades as the volumes were soaring to levels never seen before.

By July 1922, Mr. Seeds, the Consul-General in Munich, wrote to say that his chauffeurs' weekly expenditure on food alone was now more than 550% more than than a year ago. Rarer items, like butter and marmalade, could not be had for less than 8 times their price the previous year, and could only be found on the black markets, which were outlawed by the Congress.

The foreigners who had bought up entire stores full of goods now set their sights on German real estate. Prices for land were soaring in terms of marks, but even they could not keep up with the rapidly rising exchange rate- this meant that in terms of foreign currency, the price of homes was actually falling. Wealthy French, Italian, British, and Japanese businessmen began buying up swaths of real estate for literal pennies on the dollar.

The wealthy took advantage of the rapid collapse by taking out massive loans to buy assets, as the real value of the debt collapsed due to the rampant inflation. Hugo Stinnes, an industrialist and multi-millionaire, became infamous nationwide, as he built a manufacturing empire which held one-sixth of the country's total industrial production.

He saw his debt payments for his factories inflated away as the Reichsbank's printing presses continued to churn out marks in ever increasing quantities during 1922. He justified inflation as a means of guaranteeing full employment- It was, he maintained, the only way whereby "the life of the people could be sustained" (pg 74).

Lord D'Abernon, British Councillor to the Ambassador in Berlin, wrote in his entry for July 10, 1922:

"The whole sky is overcast and gloomy. The fall of the mark continues- today it is at 2,430, or about half the price of a month ago. Prices are rising, and will soon be double the level of June 1, wages and salaries must be adjusted. Adjusted to what?" (pg 81).

In the four weeks of July the index of wholesale prices had risen from 9,000 to 14,000, another monthly rise of over 50%. The Frankfurter Zeitung recorded that wholesale price of goods had gone up by 139 times since before the war; of leather and textiles by 219 times. An egg which had once cost 4 pfennigs now cost 7.20 marks, a 180-fold increase. A bank clerk's annual salary, would therefore only keep his family alive for about a month.

At what might otherwise have been the height of the immediate crisis at the end of July 1922, the Reparations Commission decided to take its summer holidays, effectively postponing any settlement of the exchange turmoil until mid-August; and M. Poincaré, bent as ever (it was believed) on Germany's destruction, sent a Note to Berlin accusing the government of wilful default on its debts, and threatening 'retortion'. The effect on the financial situation was calamitous. The rise in prices intensified the demand for currency, both by the State and by other employers. Private banks could not meet the demand at all, and had to ration the cashing of cheques, so that uncashed cheques remained frozen while their purchasing power drained away. It became impossible to persuade anyone to accept any description of cheque for that reason, and much business quickly came to a standstill. The panic spread to the working classes when they realised that their wages were simply not available.

(pg 85).

The excessive rise in the cost of living put more and more pressure on employers. **Government officials were granted a 38% salary increase on August 1, and workers an additional 12 marks an hour- a further burden of 125 Billion marks on the State budget.** There were no plans to meet this besides a 50% increase in railway fares and another increase in postal rates, which only provided a fraction of the needed revenue.

To say that the inflation was ravaging the middle classes was an understatement. The German Ministry of Education came out in early 1922 stating that they found the average school child two years behind in development, both physically and intellectually, due to the lack of available bread and milk, as well as the children being pulled out of school to work to provide for their families.

In wealthy neighborhoods, lower- class mothers were seen searching the garbage bins for discarded food, in hopes of finding their children something to eat. The fate of the elderly, was far worse however. Their fixed pensions and savings held in government bonds had been inflated away, so much so that some could not even afford a single apple. With no salary, they had no way of keeping up with the skyrocketing costs of living. Many began to starve and beg in the streets. (pg 87)

Meanwhile, the politicians continued to deny that the printing press was the cause of their woes. Dr. Rathenau, the Minister of Reconstruction, began to claim that a *rise* in the value of the mark should immediately worry the populace, as any strengthening of the mark against other currencies likely would cause increased bankruptcies across all major industries as debts become comparatively more expensive to pay. The Chancellor echoed this note:

The Chancellor would accept no connection between printing money and its depreciation. Indeed, it remained largely unrecognised in Cabinet, bank, parliament or press. The *Vossische Zeitung* of August 16 declared that

> the opinion that the flood of paper is the real origin of the depreciation is not only wrong but dangerously wrong … Both private and public statistics have long shown that for the last two years the interior depreciation of the mark is due to the depreciation of the rate of exchange … It should be remembered today that our paper circulation, although it shows on paper a terrifying array of milliards, is really not excessively high … We have no 'dangerous flood of paper' but, on the contrary, our total circulation is at least three or four times as small as in peace time.

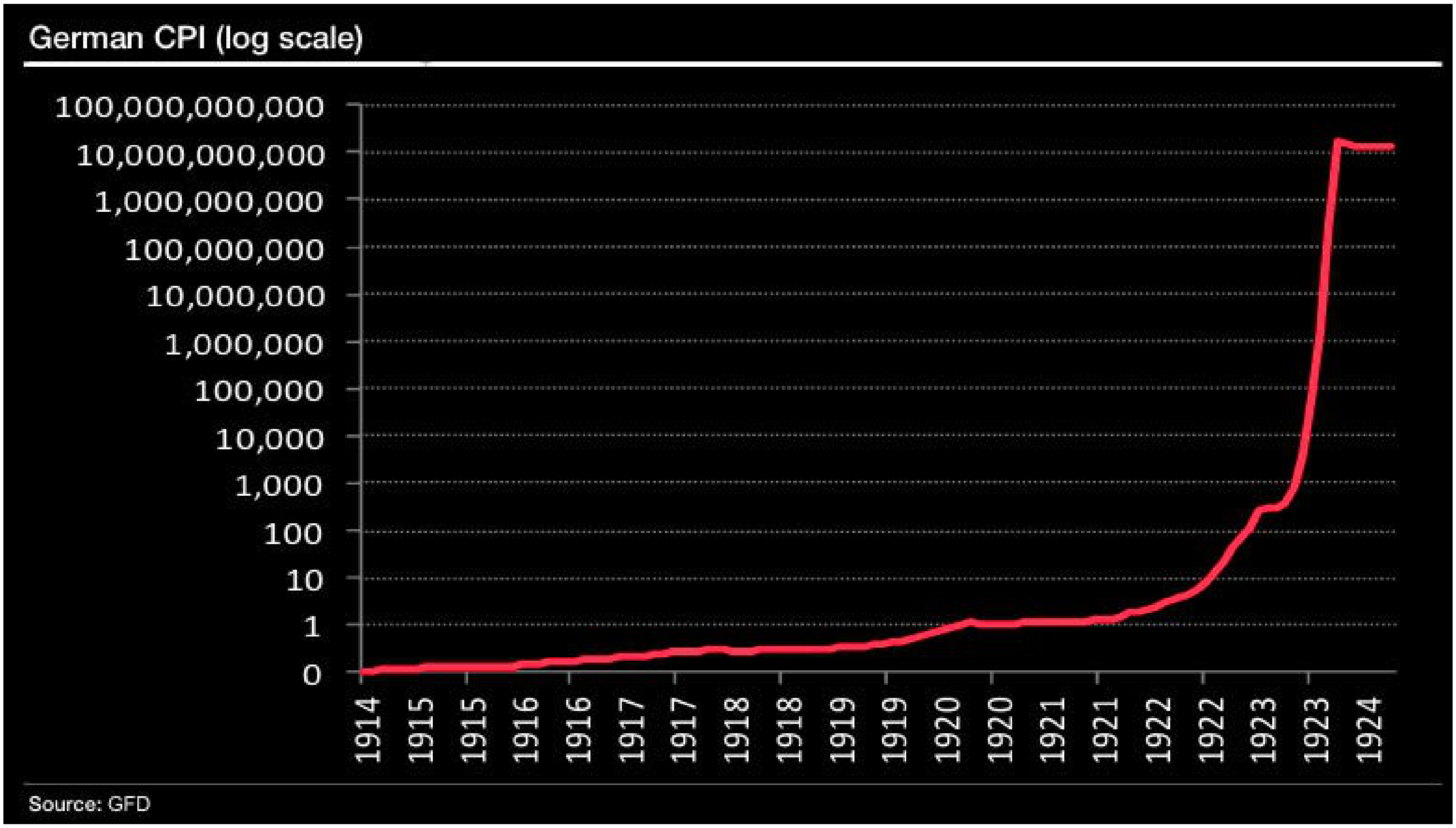
(pg 89- milliards means billions)

It was no surprise that with real wages plummeting, bribery and corruption became rampant. Workers at the patent offices would demand large cash bribes, sometimes of 1,000 marks or more, to file patents, and government officials of all types began adding exorbitant fees which they personally collected instead of sending to the State coffers.

The only people living with any comfort were those living off the country- farmers, ranchers, and the like had the readiest access to real values, and their products, primarily food, continued to rise in price, increasing their profits. Any land debts they owed were evaporating before their eyes- a mortgage of 7 years' standing had been 399/400ths paid off by inflation alone. **The end of August 1922 marked another grisly milestone, as the mark plunged past 9,000 to the pound- more than 3 times its level just two months prior (108).**

Those who owned land, houses, manufactured goods, precious metals, and raw materials were the only ones whose wealth remained intact. For all others, the mark's plunge by this time had destroyed virtually all of their wealth.

On September 9 1922 the financial authorities announced that in the previous ten days 23 billion marks had been printed and distributed, representing 10% of the total circulation of paper in the country. The newspapers recorded, "**The daily production of the Federal printing press has now risen to 2.6 Billion paper marks. In the course of this month it will be increased to 4 billion paper marks per day, at which figure it is hoped the shortage of money will definitely be overcome**" (pg 111).



German CPI

In October 1922, the situation continued to worsen. The mark seemed to enter a state of free fall, falling from 9,000 to 13,000 in a matter of weeks. September's 26-mark litre of milk became October's 50 mark litre. Butter at 50 marks a pound in April could only be had now for 480. The price of a single egg had also doubled, to 14 marks. At the end of October, the mark had slid again, to over 18,000 to the Pound.

The disparity between the rise of the cost of living and the rise in wages had now become very marked. Whereas the former had gone up by about 1,500 times, the wages of the miner- the best paid worker in Germany- had gone up by barely 200 times. With the mark in Mid-November at 27,000 to the pound, and prices following course, even the highest paid workers were unable to purchase the barest necessities of life. The others- especially those on fixed incomes, suffered accordingly (113-114).

The gold value of the money in circulation, equivalent to nearly £300 million before the war, and to £83 million in July 1922, had by November fallen to £20 million. The more notes were printed, the lower the value fell - illustrating the Copernican thesis expounded by King Sigismund of Poland in 1526 that 'money loses its value when it has become too much multiplied'. How the business of the country could be carried on with so small an amount of real currency mystified many observers, and accounted for the ever-mounting pressures on the bank to go on printing. That trade continued notwithstanding was usually explained by reference to the accelerating velocity with which money circulated. Notes were held for as short a time as possible. Private-account cheques were hardly accepted. Anyone receiving money for goods quickly converted it back into other goods, and the money never stopped moving, doing the work of ten times the amount moving a tenth as fast.

(117)- Money Velocity Increasing

Social and political unrest continued. Hatred of all foreigners, but especially Jews, became widespread, as the popular explanation was that the Allies and the Jews were collaborating together to manipulate the exchanges and drive the mark ever downwards. The newspapers, goaded on by government officials anxious to drive the public anger away from themselves, propagated and supported these theories.

In the third week of November, there were serious collisions between police and crowds of angry workers across Germany after they demanded a 100% wage increase and threatened to strike. In Dresden there was a fierce outbreak against the cost of living, with provision shops looted and damage estimated at 100 million marks. This was followed by a noisy display of xenophobia in front of the hotels which housed the foreigners- whose presence in the country was commonly supposed to be the cause of the rise in prices. Food riots followed in Braunschweig and in Berlin.

Mr. Seeds' chauffeur still instinctively regarded the mark as being as good as gold, failing to realize how desperately sick it had become. His records in December reported that milk which had cost him 78 marks a litre in the first week of November cost him 202 marks a month later. Butter had risen from 800 to 2,000 marks a lb, sugar from 90 a lb to 220, eggs from 22 each to 30. Meat of any kind was practically unavailable, as sausage skyrocketed to 1,400 marks per lb.

1923- The Year of the Wheelbarrow

Even more monetary chaos was yet to come. The French, Belgian, and Italian members of the Reparation Commission, with Britain dissenting, decided on January 9th, 1923, that Germany had been in voluntary default on her coal and timber deliveries under the peace treaty.

There was then no legal way from preventing Poincare (French Commissioner) from carrying out his threats of invasion. On January 11th, French and Belgium forces crossed the border and seized the Ruhr “for the purposes of securing deliveries”, beginning a formal occupation of the valley. The French Prime Minister warned that sanctions and “coercive measures” would be used if necessary.

(French soldiers entering The Ruhr)

The Ruhr Valley represented the beating industrial heart of Germany, and accounted for the vast majority of her manufacturing power. The populace there, many of which were war veterans with undying patriotism for the fatherland, began a mass campaign of passive resistance, called “Ruhrkampf”. Hardly anyone worked; hardly anything ran. Coal mining was halted. The population there - 2 million workers, 6 million souls- had to be supported by the rest of the country.

The German economy was now called upon to subsidize an open-ended strike, and denied the most important domestic products and raw materials- coal, iron, and steel- and was also robbed of its substantial earnings from the Rhine-Ruhr exports. The Exchequer (Treasury) was itself deprived of all the normal tax revenue from a huge portion of the nations’ industry, as well as the coal tax and railway fares. All railway lines within and out of the Ruhr were shut down, as workers refused to operate them, and in some cases, blew the tracks up (122).

> in to claim their missing telegraph poles on January 11. The Ruhr basin in 1923 provided nearly 85 per cent of Germany's remaining coal resources, and 80 per cent of her steel and pig-iron production; accounted for 70 per cent of her traffic in goods and minerals; and contained 10 per cent of her population. The loss of the Ruhr's production, and all it implied, was therefore a bale of last straws. At 35,000 to the pound at Christmas 1922, the mark fell to 48,000 on the day after the invasion, and at the end of January 1923 touched 227,500, well over 50,000 to the dollar.
>
> That was the moment when the Reichsbank circulated its first 100,000-mark note. Its purchasing power equalled a little more than two dollars, or ten shillings sterling: perhaps a tenth or a fifteenth of what its face-value must have been when it was on the drawing-board. It did not matter: a million-mark note was on the stocks and would be issued within another three weeks.

(127).

The significance of the loss of the Ruhr cannot be understated. With her industries no longer producing, and millions out of work, refugees from the Ruhr flooded into the rest of Germany. Goods shortages became even more severe as thousands of farms and factories in the Ruhr were left unattended. Fewer goods being produced meant that prices had to rise even more to account for the shortages.

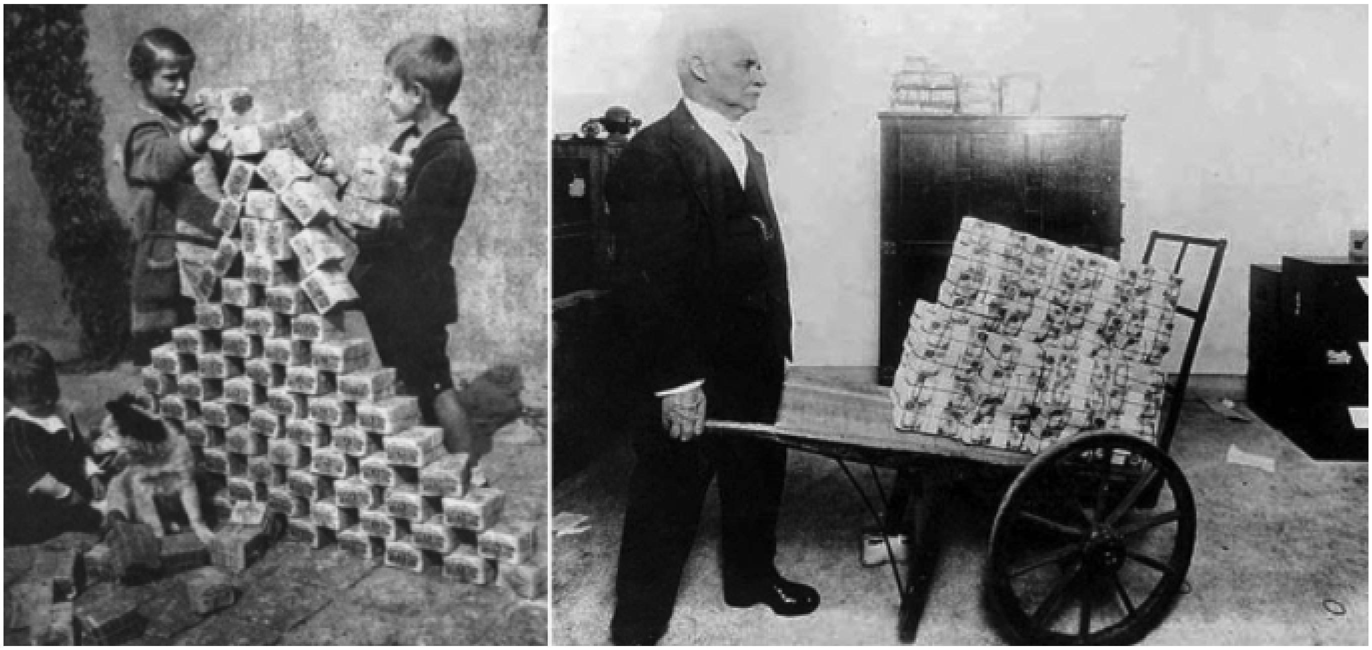
Hemingway, visiting from France, recorded in March 1923 for the Toronto Daily Star that champagne cost 38,000 marks a bottle, and lunch 3,500 marks.

In March, April, and May of 1923 the government's income was less than a third of its expenditure. The state of the budget continued to worsen. The Reichsbank, printing out trillions of marks a day, began to run out of ink.

The officials resolved, therefore, to only print the markings on one side of the bill to save ink. They then ordered periodicals and newspapers to cut down issuance so that their ink and paper could be appropriated for use by the printing presses. Between May 1st and may 31st the mark fell from 220,000 to 320,000 to the pound. The 1st of June was celebrated with the issuance of the first five-million mark note (pg 137).

Petty crime, the crime of desperation, was flourishing. Pilfering had of course been rife since the war, but now it began to occur on a larger, commercial scale. Metal plaques on national monuments were removed. The lead was beginning to disappear overnight from roofs. Petrol was siphoned from tanks of motor cars.

Barter was already a usual form of exchange, but now commodities such as brass and fuel were becoming the currency of ordinary purchase and payment. A cinema seat cost a lump of coal. Shirts were priced in potatoes. “The Middle Ages have come back,” a German remarked. (139).



Wheelbarrows of Cash

There were stories of shoppers who found that thieves had stolen the baskets and suitcases in which they carried their money- leaving the money itself lying on the ground. Workers who had collected paychecks monthly just a few years before, now demanded daily payment- and they brought wheelbarrows with which to pick up their cash.

object of bringing the dollar below 100,000’. The government’s hopes again turned out to be illusions. In mid-June, the note circulation stood at 8,564 milliard marks. By June 21 the daily increase in the circulation was 157 milliards. By June 28 the mark was at 170,000 to the dollar, the total circulation had risen to 11,000 milliards, and no notes of less than 100,000 marks (2s 10d) were being printed.

In a letter to the Foreign Office on June 29 Addison recorded a circulation increase between June 25 and 26 of 959,156,010,000 marks and between June 26 and 27 of 1,523,534,460,000: in one day, an *increase in the increase* of more than 500,000,000,000 marks. ‘We are far from the modest daily increase of 160 milliards of a week ago,’ he wrote, and added Mephistopheles’s comment from *Faust*:

(pg 142- A Milliard here means a Billion)

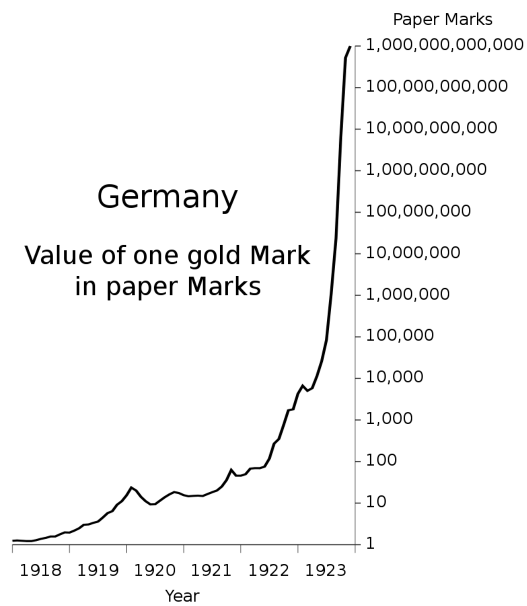
Prices for everything exploded exponentially higher. The announcement of the exchange rates via the radio became commonplace in shops, as shopkeepers wanted to be updated every minute. Shoppers who walked in to buy cheese, for instance, found that the cost had risen from 6,000 marks to 8,000 marks per pound by the time they left the store.

Tradesmen could not know how to establish prices, and often simply shut up shop. Cafes began requiring down payments on coffee as the price would double in an hour, and the owners wanted to be sure the customers could pay.

The sickening truth that was beginning to set in was that as prices rose, the demand for money itself rose. With nearly all food prices upwards of 10,000 marks per pound, the country needed billions of marks per day of new notes to satisfy these prices. They were stuck in a vicious cycle that seemed to drive them ever further into the depths of monetary destruction.

During the last days of June 1923, the mark sank from 600,000 to 800,000 to the pound, as the Reichsbank, desperate for foreign currency, was printing marks wholesale and selling them in order to purchase other currencies on the exchange. A month later, the mark would trade at 5,000,000 to the pound.

Companies began to pay workers in shoes, or leather, or anything else they could get their hands on. Many businesses began to refuse accepting marks altogether- unless they had ready means of getting rid of them immediately. The Reichsbank, running out of paper, requested all forms of paper be turned in for use by the presses.



Ratio of Paper Marks to Gold Marks

Pay raises became daily occurrences. Those firms and cities that did not comply faced mass rioting and looting of their businesses. The demand for money continued to exponentially increase, with one company in Coblenz reporting that it needed $300 Billion marks in cash on Monday in order to stave off riots from the union workers.

The Reichsbank in early August promised to print locally a trillion marks per day- 2,500 times that which had been printed daily 8 months before. Again the government ordered price increases of 400% for railway fares, and 140,000% increases for income and corporation taxes. A few days later it was proposed to be 600,000% increase. Even if the taxes worked, it would not have reduced the budget imbalance by half (pg 165).

On August 17, Dr. Havenstein, President of the Reichsbank, stated with pride “Today we issue 20 Trillion marks of new money daily… In the next week, the bank will have increased this to 46 Trillion daily. The total money supply at present amounts to $63 Trillion- thus we will be able to issue, in a few days, 66% of the total prior circulation. Before he spoke the mark was trading at 12.5 million to the pound, within 48 hours it collapsed to 22 million to the pound.

The state of the people was desperate. **Farmers, seeing the monetary chaos unleashed by the Reichsbank, withheld their produce and meat from the cities. Bakers hoarded their bread, as each passing day they waited to sell, the prices climbed even more.**

This created the perverse scenario where farms were filled with food, and barns bursting with produce- but nothing at all to eat in the cities, where mass starvation began. Looting of grocery markets became commonplace, so they shut down. Tens of thousands began dying of starvation. A general state of famine was unfolding across Germany- as recorded by a British businessman:

> I was sickened by the sights I saw. I happened to pass through the Arcade between the Friedrichstrasse and Unter den Linden, and in that small space I saw three almost moribund women. They were either in the last stages of decline or starvation, and I have no doubt it was the latter. They were beyond asking for alms, and when I gave them a bunch of worthless German notes, it shocked me to see the eager way in which they seized upon them - like a ravenous dog at a bone. I am no pro-German, but that we should tolerate such a state of things five years after the Armistice is to my mind appalling. I cannot help doubting whether persons who have not seen these miserable things really realise what they are … Of course one sees motors and crowds of well-to-do people in profusion in Berlin, but do we know what is going on in the poorer quarters? The waiting queues tell their own tale.

(pg 199)

The Nazi party, unknown to most before 1922, exploded in popularity. On September 2, 1923, 100,000 demonstrators gathered for a rally at Nuremburg, where Hitler stood and launched a virulent attack upon the government, which was about to surrender Germany's honour to France. Within a week, sometimes speaking 5 or 6 times a day, Hitler was calling for the installation of a national dictatorship.

The government, hungry for anything that still held value, ordered soldiers to raid cafes in Berlin, forcing customers at gunpoint to hand over all foreign currencies. The soldiers only collected a few thousand dollars worth of money, but the exercise demonstrated not only the futility of the policy, but the desperation of an advanced industrial nation which was unable to find bidders in a foreign market for their marks.

British Councillor to the Ambassador, Addison, recorded on September 9th, 1923 that the mark had collapsed from 300 million to the pound to 500 million just in the last 24 hours. In an act of desperation, everyone, Ministers and the Chancellor included, were hoarding all the food they could, and refused to pay taxes. The only impediment to the distribution of food was the lack of negotiable currency to pay for it.

By late September, the Reichsbank was printing 3.2 Quadrillion marks per week, an astounding amount which only purchased a measly 5.2 million Pounds. Calculating prices became near impossible, as the dizzying numbers were hard to contemplate.

(The cash needed to buy a single loaf of bread, Oct 1923)

The Government’s control of the political, let alone financial situation, was near the breaking point. On September 26th, Stresemann, the Minister of Foreign Affairs, suspended the Weimar Constitution, declared a State of Emergency, and gave executive powers to Herr Gessler, the Defense Minister. The transfer was a formality- Effectively, from then on, for five months, General von Seeckt, Commander in Chief of the Reichswehr (Weimar Army), was the supreme executive power in the land. There were whispers of a military coup in the streets.

On October 15, the marks' rate against the pound passed 18 billion. Six days later, it was at 80 billion. At the end of the month, the total M1 money supply (bills in circulation) amounted to 2,496,822,909,038,000,000- or 2.49 Quintillion marks. The mark traded Oct 31st at 310 Billion to the pound.

As November started, a new man, Dr. Schacht was appointed as Commissioner of the Currency. The state of the National Budget was appalling. In the previous 10 days, Federal spending had exceeded revenue by 1,000 times. The financial statements of the State included on every page a reminder that all figures were in Quadrillions.

The cost of living index, taking 1914 as 1, had risen from September's average of 15 million, to 3.6 billion in October, and reached 218 Billion on November 12, 1923.

Dr. Schacht ordered the immediate halt of the printing press on November 15. Havenstein, the President of the Reichsbank, was furious. Schacht recorded that all the unissued paper marks then in the hands of the Reichsbank, would have filled 300 ten-ton railway wagons.

The mark, already in freefall, had too much downward momentum, and thus continued it's parabolic decline. 12 Trillion to the Pound on November 15- then 18 Trillion to the Pound just 5 days later.

Schacht announced the creation of a new currency- the Rentenmark, which was to be backed by land.

> There were problems, many of which had already been thrashed out at the end of the summer. The gold and gold-equivalent reserves had been so frittered away during the *Ruhrkampf* that they were inadequate to back the new currency. The Rentenbank's notes were therefore guaranteed in equal amounts by mortgages on landed property and by bonds on German industry - trade, commerce, banking and transport - to a combined amount of 3,200 million gold marks, about £160 million. The maximum note issue in Rentenmarks was to be 2,400 million. The Rentenbank was independent (as the Reichsbank had been) of government interference. In return for special credits of 1,200 million to the Reich -

(pg 206)

By November 30, 500 million Rentenmarks went into circulation. This finally did the trick- as there was a fixed issuance of notes, and they had been backed by a scarce commodity like land, the people, exhausted from the chaos of the months before, readily switched to the Rentenmark. Prices stabilized, exchange rates normalized, and food started flowing back into the city markets. The new money was accepted, despite the fact that it was an inconvertible paper currency. It was held and not spent as rapidly.

The exchange rate from the paper mark to the old gold marks was 1,000,000,000,000 to 1- one Trillion old marks for each gold mark. The previous exchange rate before the war had been 4:1. The total old paper mark note circulation (M1 Money Supply) had ended November at 400 Quintillion.

By December, the food shortages had completely resolved, and the political situation stabilized somewhat. The Weimar Republic would exist for another decade, until 1933, when the Nazi Party, led by Hitler, took over the government and permanently suspended the constitution.

Smooth Brain Summary:

Germany entered WW1 due to a complex web of alliances that dragged it into conflict via Austria Hungary declaring war on Serbia in 1914.

Millions of men died, and enormous amounts of infrastructure were destroyed. The German state loaded itself up with debts to pay for the war, and spending continued to increase after the War, setting the nation up for a monetary disaster.

As no financing options were available, the State decided to allow the Reichsbank to print the State deficits, so that they could come up with the money needed to pay reparations payments and keep government services functioning.

Inflation began soaring in 1921, and devastating feedback loops came into effect. German banks began dumping marks on the exchange, and capital began fleeing the country. Social confidence in the mark deteriorated, and money velocity started to accelerate. Inflation reached into the thousands of percent.

Furious that they were being paid in ever more worthless paper marks, the French occupied the German Ruhr river valley in early 1923. This was the last straw, as the Ruhr was the industrial heartland. Goods became even more scarce, and prices raced upwards.

In mid-1923, the mark, already in a hyperinflation, began to go parabolic. Food shortages became common, and riots and political turmoil followed. Radical elements, like Hitler, grew in popularity.

Things were finally stabilized in late November 1923 with a monetary reset- a new currency was introduced, one that was backed by land, and monetary velocity + inflation finally began to fall, prices stabilized. The seeds were sown for the Nazis' ascent to power a decade later.

Epilogue:

We've covered in depth the rapid collapse of the mark and Germany's descent into the abyss of hyperinflation. The next sections will focus on the United States in the present day, and the dilemma the Fed faces- how to deal with the insurmountable debt levels now permeating the entire American economy and Federal Gov't- and their ultimate dilemma; whether to destroy the Treasury (by raising rates) or destroy the Dollar (by printing it to oblivion).

As we continue through this series, I want you to reflect on the factors present in Weimar Germany in 1919 before the collapse, compared to the modern U.S. Of course Weimar is not a perfect analogue to the US, we are 100 years more advanced technologically, more socially progressive, and not under threat of military invasion. That being said, there are important similarities.

Factors:

- **Massive, unpayable government debt**
- **Rapidly increasing Federal deficit spending**
- Tax evasion, especially by the wealthy
- Recently lost a costly war
- **Exponentially growing money supply**
- Inflationary Feedback Loops
- **Rising Inflation**
- Increasing political polarization
- **Social and moral decay of the upper classes; decline of institutions**
- **Increasing wealth inequality; Mass amounts of homeless veterans**
- Increasing xenophobia
- End of debt cycle + mass bankruptcies of companies
- **Political turmoil, riots against the establishment**
- Profiteering by wealthy industrialists to buy up huge swaths of real estate
- Banks using backchannels to move capital out of the country
- **Massive loss of industrial manufacturing** (In Germany, due to War/Occupation- in the US, due to China)
- **Shortages of goods**
- **Evaporation of the Middle Classes**
- **Rapidly rising home + asset prices**
- Gambling on the stock exchanges (WSB in general, except GME)
- Rampant corruption and greed in government offices
- Central banks buying massive amounts of government debt
- Politicians' continual denial of the worsening inflation

BUY, HODL, BUCKLE UP.

>>>>>>>TO BE CONTINUED >>>>>>> PART 4.2 “AT WORLD’S END”

(Adding this to clear up FUD- My argument is for hyperinflation to begin in a few years- this is a years- long

PROCESS, and will take a long time to play out. It won't happen tomorrow, but we are in the same situation as Germany after WW1. BUY AND HOLD.

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Hyperinflation is Coming- The Dollar Endgame PART 4.2 "At World's End"

DD

I am getting increasingly worried about the amount of warning signals that are flashing red for hyperinflation- I believe the process has already begun, as I will lay out in this paper. The first stages of hyperinflation begin slowly, and as this is an exponential process, most people will not grasp the true extent of it until it is too late. I know I’m going to gloss over a lot of stuff going over this, sorry about this but I need to fit it all into four posts without giving everyone a 400 page treatise on macro-economics to read. Counter-DDs and opinions welcome. This is going to be a lot longer than a normal DD, but I promise the pay-off is worth it, knowing the history is key to understanding where we are today.

SERIES (Parts 1-4) TL/DR: We are at the end of a MASSIVE debt supercycle. This 80-100 year pattern *always* ends in one of two scenarios- default/restructuring (deflation a la Great Depression) or [inflation](#) (hyperinflation in severe cases (a la Weimar Republic). The United States has been abusing it’s privilege as the World Reserve Currency holder to enforce its political and economic hegemony onto the Third World, specifically by creating massive artificial demand for treasuries/US Dollars, allowing the US to borrow extraordinary amounts of money at extremely low rates for decades, creating a Sword of Damocles that hangs over the global financial system.

The massive debt loads have been transferred worldwide, and sovereigns are starting to call our bluff. Governments papered over the 2008 financial crisis with debt, but never fixed the underlying issues, ensuring that the crisis would return, but with greater ferocity next time. Systemic risk (from derivatives) within the US financial system has built up to the point that collapse is all but inevitable, and the Federal Reserve has demonstrated it will do whatever it takes to defend legacy finance (banks, broker/dealers, etc) and government solvency, even at the expense of everything else (The US Dollar).

I’ll break this down into four parts. ALL of this is interconnected, so please read these in order:

[Part One: The Global Monetary System- “A New Rome” <](#)

[Part Two: Derivatives, Systemic Risk, & Nitroglycerin- “The Ouroboros” <](#)

[Part Three: Banks, Debt Cycles & Avalanches- “The Money Machine” <](#)

Part Four: Financial Gravity & the Fed’s Dilemma- “At World’s End” < (YOU ARE HERE)

If you haven’t already, PLEASE go back and read Parts 1-3. We’ll be referring heavily to concepts like Triffin’s Dilemma, Derivative Feedback loops, and Debt Supercycles throughout Part 4. I want to make sure everyone is on the same page as we delve into Part 4, the largest and most comprehensive section yet.

Also Please Check out Part 4.0 and Part 4.1 before continuing.

PART 4.2 “Financial Gravity”

The Panic of 1907 and the Creature from Jekyll Island

As the industrial economy expanded following the Civil War, the weaknesses of the nation’s fractional reserve banking system became more serious. Bank panics or “runs” occurred regularly. Many banks did not keep enough cash on hand to meet customer needs during these periods of heavy demand, and were forced to shut down.

News of one bank running out of cash would often cause a panic at other banks, as worried customers rushed to withdraw money before their bank failed. If a large number of banks were unable to meet the sudden demand for cash, it would sometimes trigger a massive series of bank failures. **In 1907, a particularly severe panic ended only when a private individual, the financier J.P. Morgan, used his personal wealth to arrange emergency loans for banks.**

The Bank Panic of 1907 occurred during a six-week stretch, starting in October 1907. In the years leading up to the Panic, the U.S. Treasury, led by Secretary Leslie Shaw, engaged in large-scale purchases of government bonds and eliminated requirements that banks hold reserves against their government deposits. This fueled the expansion of the supply of money and credit throughout the country and an increase in stock market speculation, which would eventually precipitate the Panic of 1907. (Credit Bubble as discussed in Part 3).

The role of New York City trust companies played a critical factor in the Panic of 1907. Trust companies were state-chartered intermediaries that competed with other financial institutions. That said, trusts were not a main part of the settlement system and also had a low volume of check-clearing relative to banks.

Consequently, trusts at the time had a low cash-to-deposit ratio relative to national banks—the average trust would have a 5% cash-to-deposit ratio versus 25% for national banks. **Since trust-company deposit accounts were demandable in cash, trusts were at risk for runs on deposits just like other financial institutions.**

The specific trigger was the bankruptcy of two minor brokerage firms. A failed attempt by speculators Fritz Augustus Heinze and Charles W. Morse to buy up shares of a copper mining firm (using huge margin loans to buy the shares) resulted in a run on investment banks that were associated with them and had financed their speculative attempt to corner the copper market.

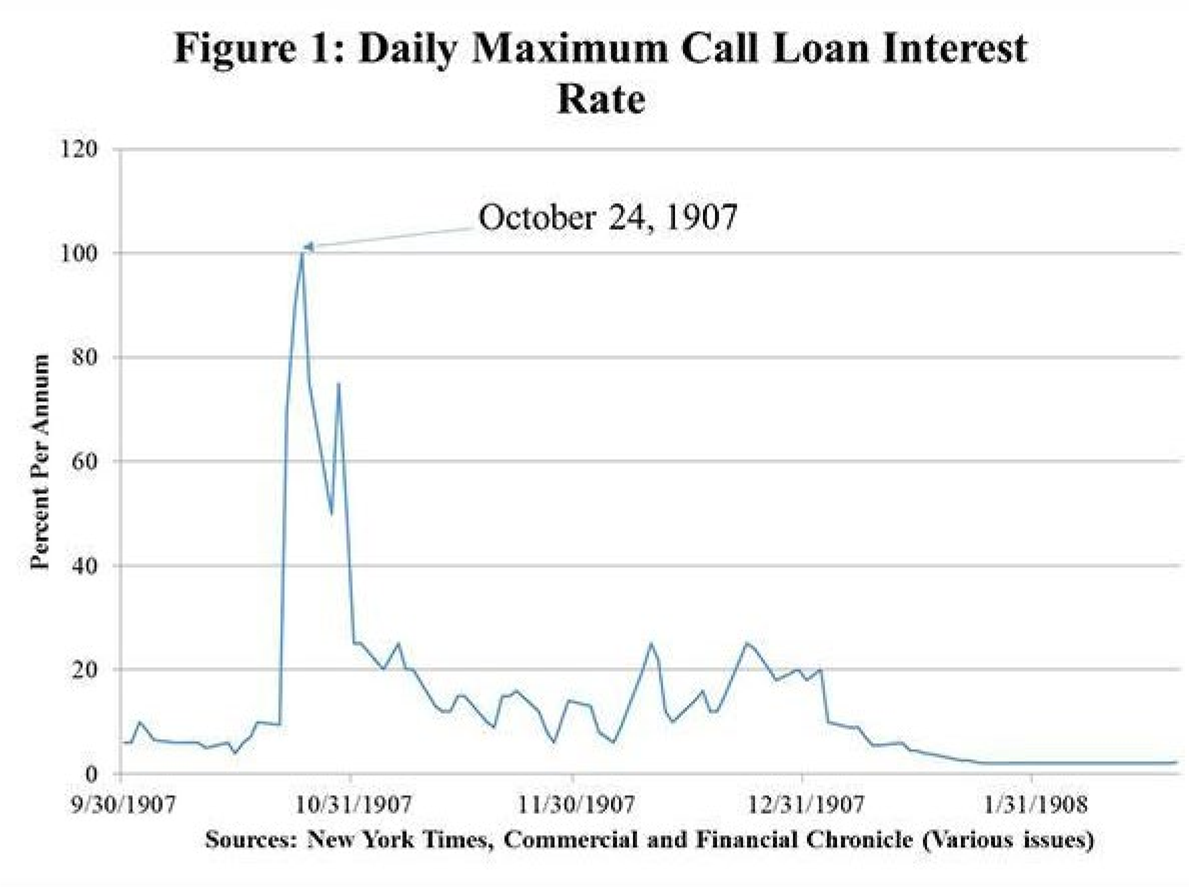
This loss of confidence triggered a run on the trust companies that continued to worsen even as banks stabilized. The most prominent trust company to fall was Knickerbocker Trust, which had previously dealt with Heinze. Knickerbocker, New York City's third-largest trust, was refused a loan by banking magnate J..P Morgan and was unable to withstand the run of redemptions and failed in late October.

This undermined the public's confidence in the financial industry in general and accelerated the ongoing bank runs. Initially, the panic was centered in New York City but it eventually spread to other economic centers across America. **In many ways, this crisis forebodes the 2008 financial crisis which began with similar circumstances (overleveraged institutions, financial speculation, shadow banks) and had similar results (collapse of financial institutions, emergency programs to save the system).**

In an attempt to head off the ensuing series of bank failures, Morgan, along with John D. Rockefeller and Treasury Secretary George Cortelyou, provided liquidity in the form of tens of millions of loans and bank deposits to several New York banks and trusts.

In the following days, JP Morgan would strongarm the New York Banks to provide loans to stock brokerages to maintain stock market liquidity and prevent the closure of the New York Stock Exchange (NYSE). He later also organized the Tennessee Coal, Iron, and Railroad Company (TC&I) buyout by Morgan-owned U.S. Steel to bail out one of the largest brokerages, which had borrowed heavily using TC&I stock collateral.

A spike in the interest rate on overnight collateral loans, provided by the NYSE, was one of the first signals that trouble was brewing. Specifically, annualized rates spiked from 9.5% to a whopping 70% on the very same day that the Knickerbocker shut down. Two days later, it was at 100%.

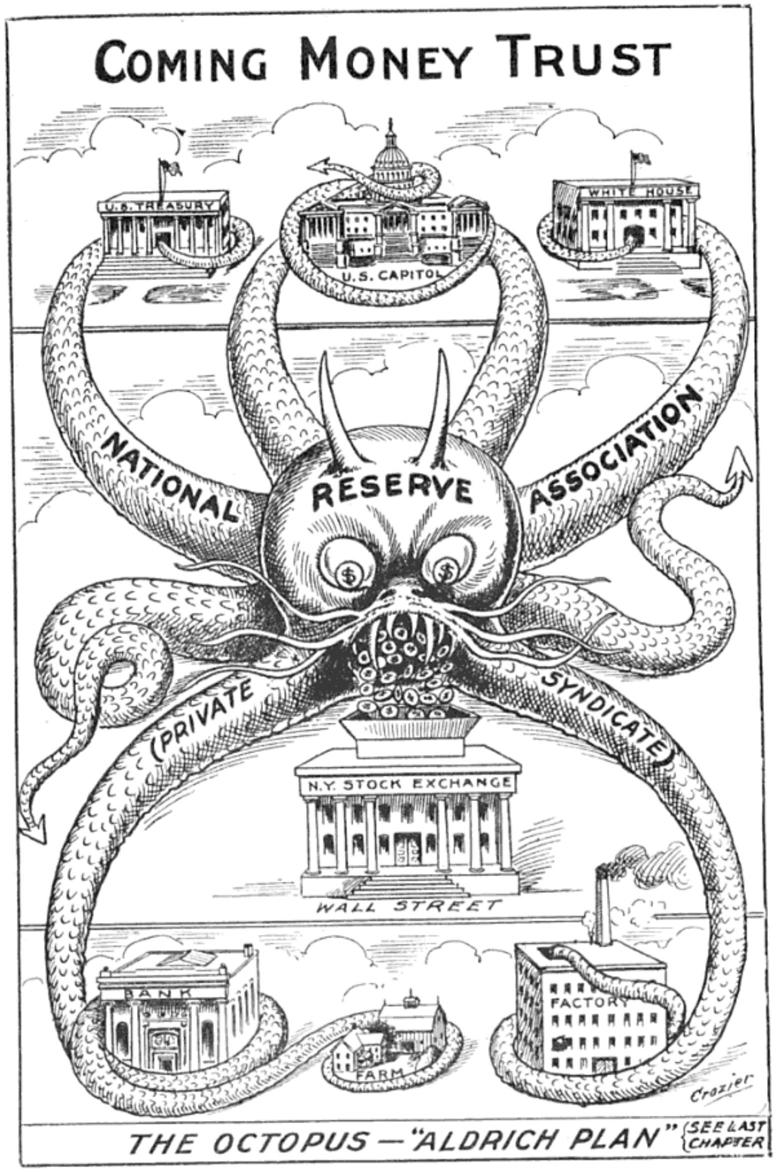


The NYSE managed to stay open mainly because of J.P. Morgan, who obtained cash from established financial institutions and industrial behemoths. Morgan then provided it directly to brokers who were willing to take on loans.

After a hold-up of several days, the New York Clearing House Committee got together and developed a panel to promote the insurance of clearinghouse loan certificates. They provided a short-term boost in liquidity and also represented an early version of the window loans provided by the Federal Reserve.

The 1907 financial panic fueled a reform movement. Many Americans had become convinced that the nation needed a central bank to oversee the nation's money supply and provide an "elastic" currency that could expand and contract in response to fluctuations in the economy's demand for money and credit. Others did not agree and saw this as a back-door attempt to continually save corrupted banks.

It was clear that a shrewd financier like JP Morgan would not be around forever- bankers grew extremely worried about the next financial crisis. They began to lobby Congress to create a “permanent” solution to bank runs. After several years of negotiation and discussion, Congress established the Federal Reserve System on December 23rd, 1913.

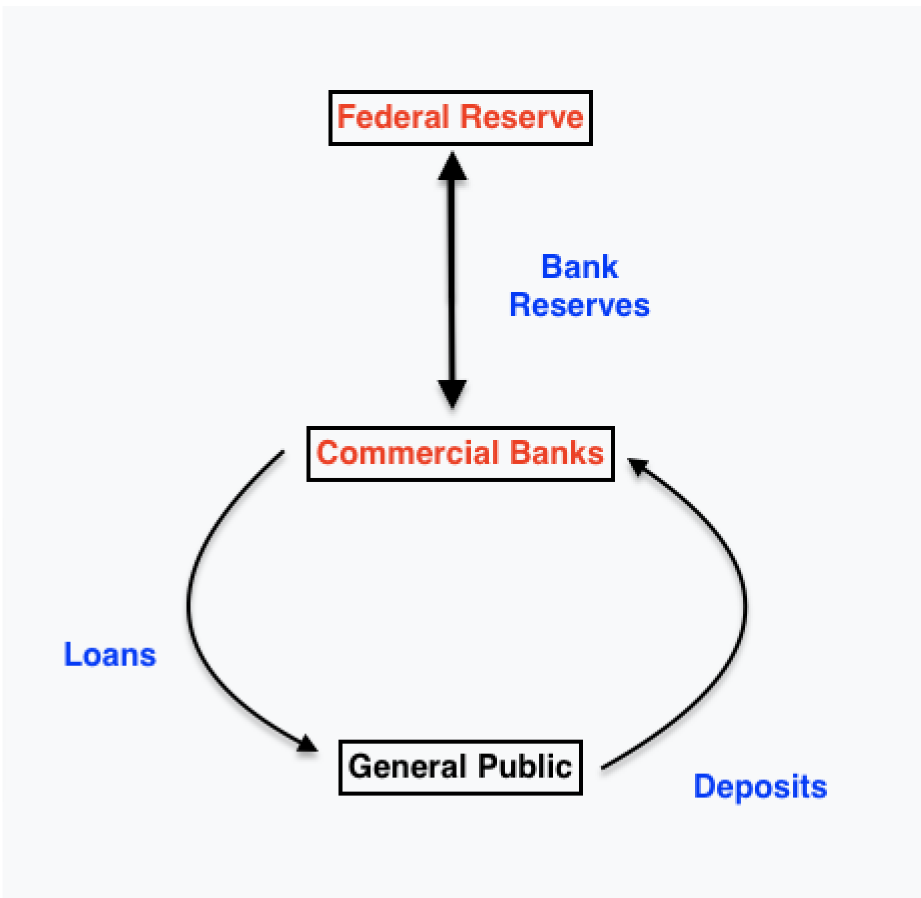


Under a fractional reserve banking system, no bank has enough cash on hand to give out during redemptions. Money deposited in a bank account is very quickly lent out again, with only a fraction (say 10%) being kept on hand to handle withdrawals.

As a run on one bank would ensue, the web of financial obligations that tied the banks together would start pulling other banks down with it. Any loans owed by the bank in crisis would immediately start to be downgraded, and the creditor banks, even if healthy, would see the value of their assets fall as the market started pricing in the default of the collapsing bank.

What was seen in the crisis of 1907 was not only a credit collapse, but a collapse of confidence- the entire banking system was thrown into question, as depositors did not know which bank is solvent and which was not. Similar to the Prisoners Dilemma, individual depositors, knowing even though leaving the money in the banks would make the system as a whole much safer, took the conservative route and pulled as much money out as they could.

What the banks needed at this time were cash loans- but at the very moment they most desperately needed it, the loans were not available as other banks faced runs as well. Thus, the Fed was created as a “Lender of Last Resort”- it could create bank reserves out of thin air and lend them to banks in order to ensure their solvency.



Many were infuriated by the creation of the Federal Reserve, which they viewed as a perpetual savior to Wall Street and a breeding ground for “Moral Hazard”, an Economics term used to describe a situation that occurs when an entity has an incentive to increase its exposure to risk because it does not bear the full costs of that risk. For example, when a corporation is insured, it may take on higher risk knowing that its insurance will pay the associated costs.

With time, their predictions would prove to be correct. With every financial crisis, the Fed’s power has grown, so much so that the institution would not be recognizable today to those who first founded it in the Winter of 1913.

The Fed’s role was inalterably changed during the 1930’s when the U.S. faced its worst banking crisis in history. Coming at the cusp of a major credit downturn combined with a speculative bubble (that it had helped create), the Great

Depression saw the collapse of over 10,000 bank and non-bank entities, including shadow banks such as trusts. The Fed did not respond adequately to this crisis; many monetary economists, including Milton Friedman, blame the Fed for not lowering interest rates or lending to failing banks.

Remember from our discussion in Part 3, in our current fractional reserve banking system, most money in the system (~95%) is actually credit. So, when companies/banks/individuals default, the loans are written down, and money is actually destroyed- it is deleted from the ledgers of banks. This is the nasty dual sword of credit- it gives (creates money) in good times, leading to increased revenues, asset values increasing, business growth, employment, etc- BUT, every dollar lent out has to be repaid. These dollars need to be paid back as the economy starts to roll over, and when they aren't, the money they constituted is eliminated from the system. M3 Money Supply fell an estimated 30% during the Great Depression. (The Fed mysteriously stopped tracking M3 Money Supply in the early days of the Great Financial Crisis).

Thus, the widespread collapse in prices (deflation) that began in 1929 on Black Monday was not just due to overleveraged speculators on the stock market- if that were the case, it would have just been a equity bear market and perhaps a mild recession (like the 2000 Tech Bubble, where DotCom stocks fell 80%, but the general economy pulled back only slightly).

The continued spiraling drop in prices of everything, from homes, to bread, to oil- was a result of the actual destruction of money that was occurring in the banking system. As credit was destroyed, money was as well- and with fewer dollars chasing the same goods, the dollars became more valuable, and thus it required fewer of them to purchase real goods.

Add onto that the hoarding of cash, which reduced money velocity, and prices fell even further. Businesses that were overleveraged were the first to default, but as prices continued to fall and revenues collapsed, even good businesses with sturdy credit could not find willing lenders. No one was willing to lend for fear of default.

Thus, in 1933, the Federal Deposit Insurance Corporation (FDIC) was created, which insured all deposits of U.S. Commercial Banks up to a limit (now $250k, and now has expanded to include far more than bank deposits). Further, the Fed's powers were expanded substantially. It had seen small trials of the Open Market Operations in 1907 and again in 1923, and in 1933 took this strategy under its wings, although it did not use it to its full effect as it would in 2008.

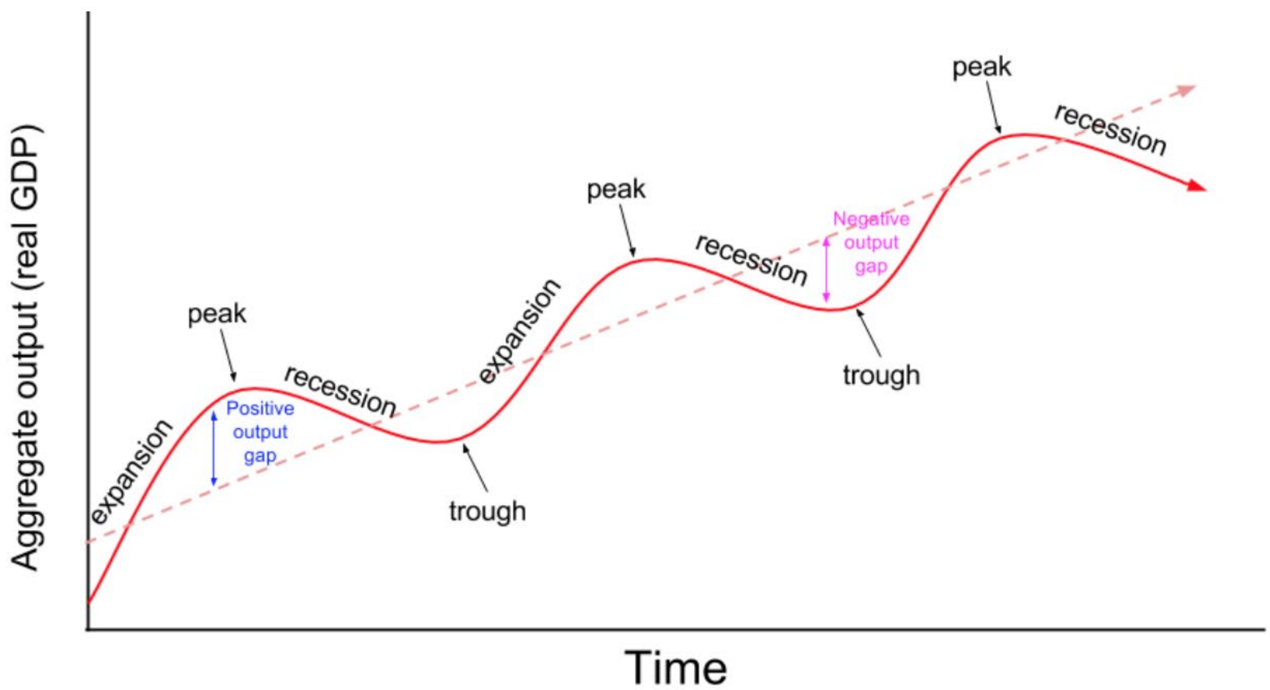
Open market operations (OMO) refers to the practice of buying and selling U.S. Treasury securities, along with other securities, on the open market in order to regulate the supply of money that is on reserve in U.S. banks. This supply is what's available to loan out to businesses and consumers. The Fed purchases Treasury securities to increase the supply of money and sells them to reduce the supply of money.

The Fed can thus influence the Price (interest rates) and Quantity ([M2 Money Supply](#)) of Money itself- and by doing so, indirectly affect the prices of everything else in an economy.

Again, this practice was originally limited to only U.S. Treasuries, but it would be expanded in future crises to include Mortgage Backed Securities (MBS, 2008), and Corporate Bond ETFs (2020).

During the latter part of the 1930's, as part of their bid to widen the powers of the Fed, Federal Reserve Governors adopted the "mandate" of ensuring full employment (or as close to it as they can muster), in a bid to shift the overall strategy from solely bank lending to a more holistic monetary policy view. During the inflationary 1970's, Congress added new stipulations to the Federal Reserve Act of 1913, so that now the Fed aims to follow their Dual Mandate of Price Stability and Full Employment.

In the aftermath of the Great Depression, many monetary scholars envisioned a re-imagined Federal Reserve. The Fed, they argued, should work to eliminate the business cycles all together. Economic cycles have existed for millennia- the Kondratieff Cycle, for example, is an 80 year economic supercycle borne out of technological innovation. Credit cycles have been observed for hundreds of years, and consistently caused spurs in economic growth followed by subsequent recession.



The business cycle is an upwards trending sine wave, where credit creation fuels economic expansion for a time, and then the economy begins to roll over, and all these debts become due, and thus a recession/depression occurs. The cycle has been seen in countries as different as Japan, Afghanistan, the U.S., China, and Brazil- and has even been observed in biblical times (debt Jubilees, Leviticus 25) as well as ancient Egypt, Rome, and Mesopotamia.

Financial Gravity and the Event Horizon

Economics is a social science- it is a blend of both humanities (sociology, psychology) and hard sciences (science, math, statistics). That being said, there are fundamental laws that govern economic systems wherever they prop up. In my personal life, my father has a PhD in Atmospheric Science- he was fascinated by how ice crystals and condensation are formed in clouds, and traveled the world (Chile, Antarctica, Canada) studying cloud physics. As a boy and basically an only child, he instilled a love of science in me- and I still view many things through that prism.

When I explain economic concepts to him, I like to use physics metaphors to get the point across, because this is the world he understands. To me, Debt is a form of financial mass.

One of the emergent properties of mass is gravity, as described by Newton's equation. The mathematical formula for gravitational force is

$$F_{\text{gravity}} = G\frac{m_1 m_2}{r^2}$$

The more mass an object has, the greater its gravitational pull, (multiplied by the gravitational constant, G). The distance between two objects in space is represented by r. The gravitational force gets weaker by the square of the distance between two masses.

Debt is very much the same. At first, when debt is added onto an economy, it stimulates growth, as it creates new credit for businesses to access to build factories, train workers, construct buildings, etc. But, as the debt continues to grow, so do the interest payments- at some point, the debt load is too heavy, and the mass of the economy causes it to fall into itself in a credit contraction- leading to defaults and deflation.

Let's say you own a company making net income of $100M a year. With a debt load of $1B and an interest rate of 7%, you have to pay $70M a year in interest alone just to keep the creditors off your back. If for some reason the company's income falls to $50M, or interest rates rise, say to 11%- **then you can't pay your debt. The math doesn't add up.**

The reason why debt cycles exist is as fundamental as the laws of physics; when an entity can't pay its debts, or even cover the interest on the debt- what happens? It defaults. This isn't a machination of political pundits, or econ professors, or conspiracy theorists- it is simply a law of math.

When this happens across an entire sector, that's when you get deflation, credit contraction, and a downturn in the business cycle.

If an entity can't pay back their loans, they default- who would want to lend money to an entity that can never pay them back, a la Evergrande? No one.

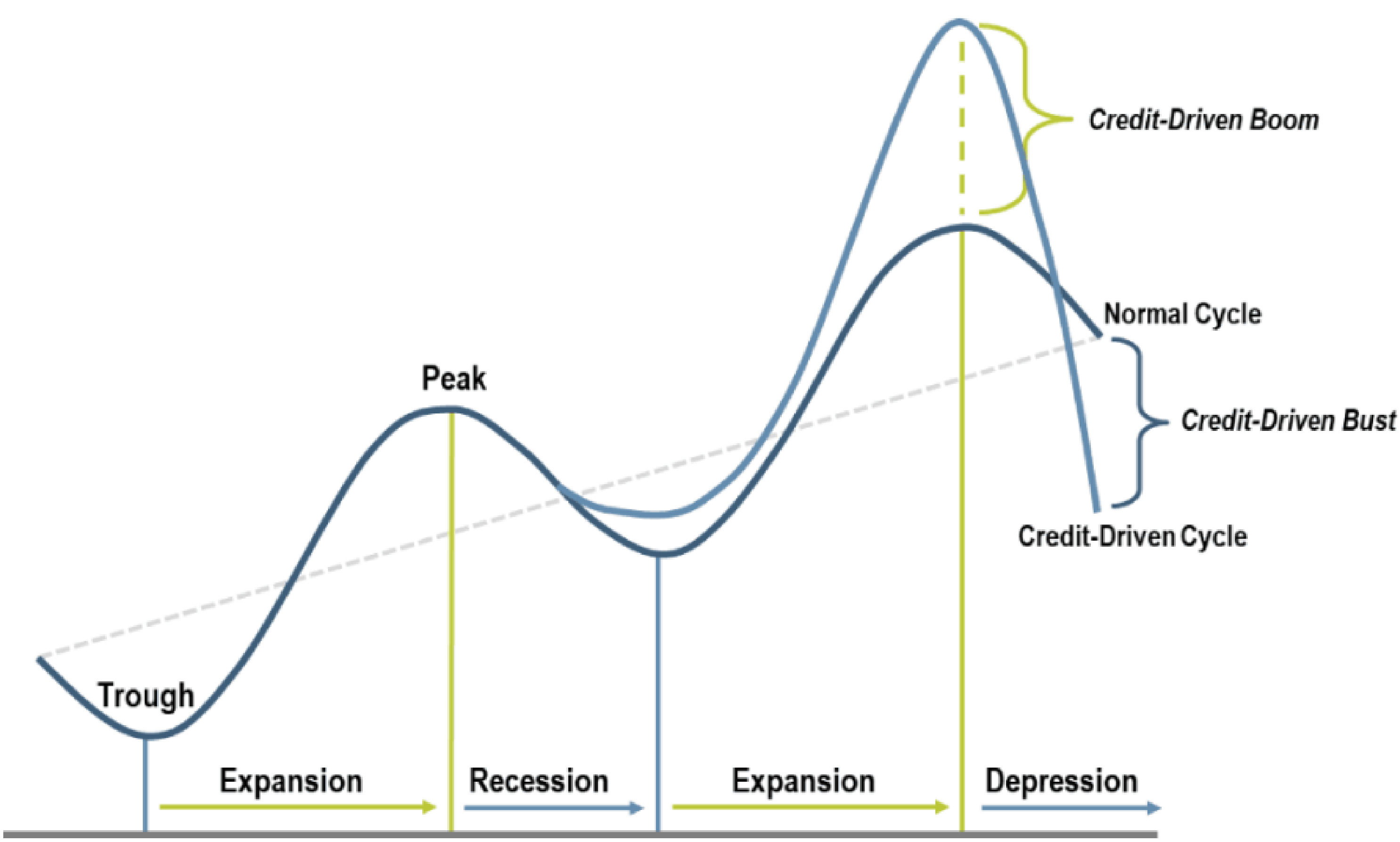
This is why I compare some economic laws (such as debt) to those of physics- both systems are ruled by math, the fundamental law of the universe. (NOT ALL Economic laws- MANY economic laws are more complex/nuanced or based on human behavior, which doesn't follow perfect logical rules like math does).

Finance at it's heart is about numbers, math- and the math doesn't lie. When the numbers don't add up, and you have more liabilities than you can ever pay back, you default (Lehman Brothers and Bear Stearns, AIG, etc).

"But wait!" You say. "Governments issue debt in their own currency, which they print. Thus they can never default!

Problem solved!” **Potato, potahto. If they print money to stave off the default, they only devalue their currency- thus, they don’t default in nominal terms (they DO pay back your $1,000 Treasury Bond) but in real terms (that $1,000 buys less stuff due to inflation).**

Back to the business cycle- wherever the cycle peaks above the grey dotted line, this is called a positive output gap, and when it is below the line, it is a negative output gap. Post Great Depression, the Fed began to take responsibility for trying to control the business cycle, as they had just seen how destructive a credit bust could be.

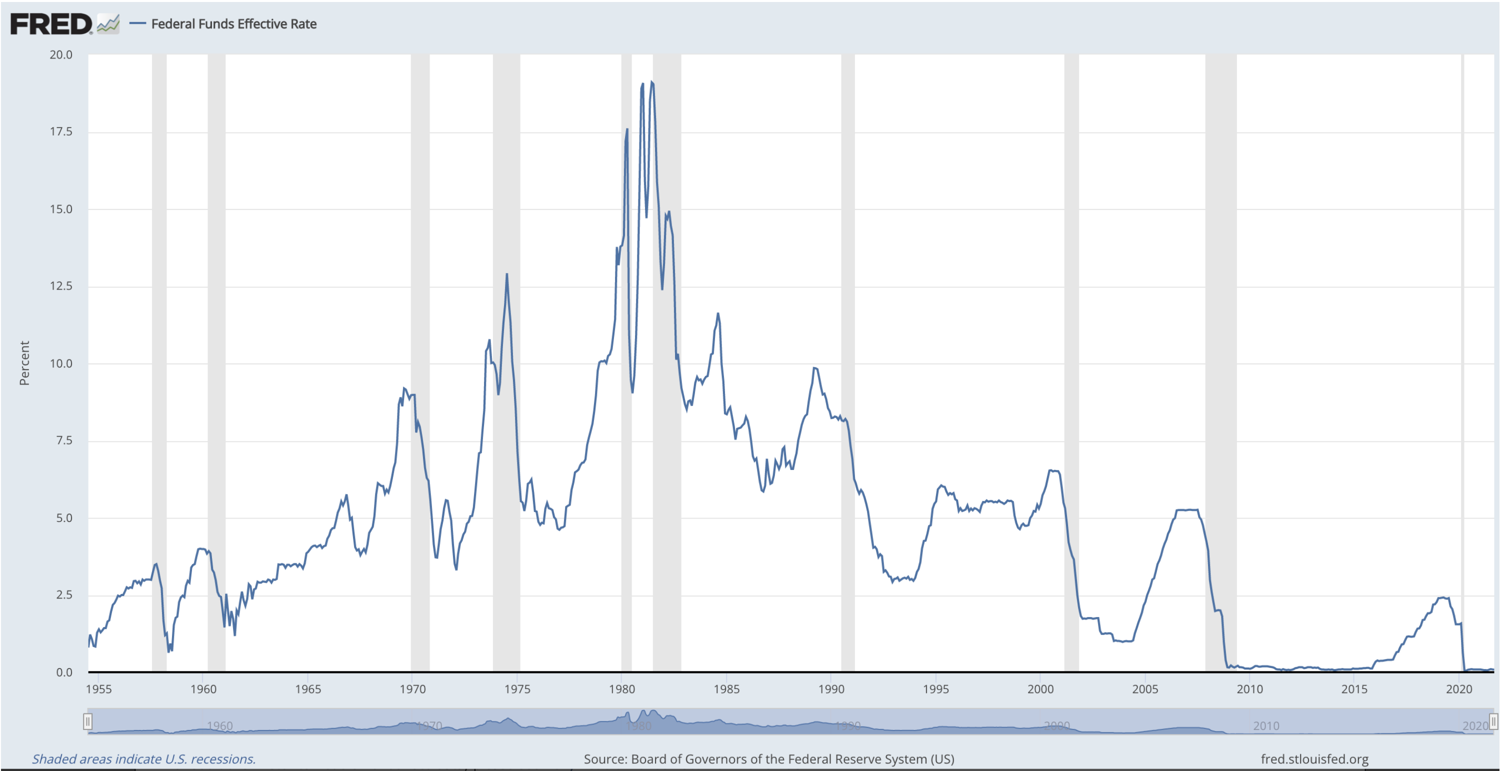


Thus, the Fed decided to take on a role of “regulating” the cycle. **It would do this by lowering interest rates and easing monetary conditions during a recession, spurring borrowing and lessening the rates of default, to make sure companies can continue to hire and train workers as needed.**

During economic booms, they would tighten monetary policy, to prevent the economy from “overheating” by increasing interest rates, thereby tightening monetary conditions and preventing excessive speculation and overleveraging.

They also do this to get interest rates high enough so that they can drop them once again during a crisis, as interest rate policy is one of their most critical tools. (An overheating economy sees excessive credit growth, which often creates inflation- this is why inflation tends to peak before a recession. Just as many have pointed out in this sub, the last time inflation was above 5% was right before the Great Financial Crisis of ‘08)

Don’t believe me? Look at their own tracking of the [Federal Funds Rate], the interest rate at which depository institutions trade federal funds (balances held at Federal Reserve Banks) with each other overnight. (the shaded areas indicate a recession)



After every recession begins, they drop interest rates down to mitigate the hit of the downturn. As the economy improves, they are able to raise them back up again. It's a near perfect lagging indicator of a recession.

How long do they keep interest rates down once they are in a recession? No one really knows. **The Fed is perpetually caught in a catch-22; if they raise interest rates too soon during a recession, they worsen it or cause a depression.**

But, if they keep interest rates low to spur an upturn in the credit cycle (bubble in this case), then they are sowing the seeds for the next crash, as the debt created on the way up must be paid back on the way back down.

When the economy is booming, if they raise interest rates too fast), then they cause debt payments to spike, which means defaults occur, and the economy starts to roll over.

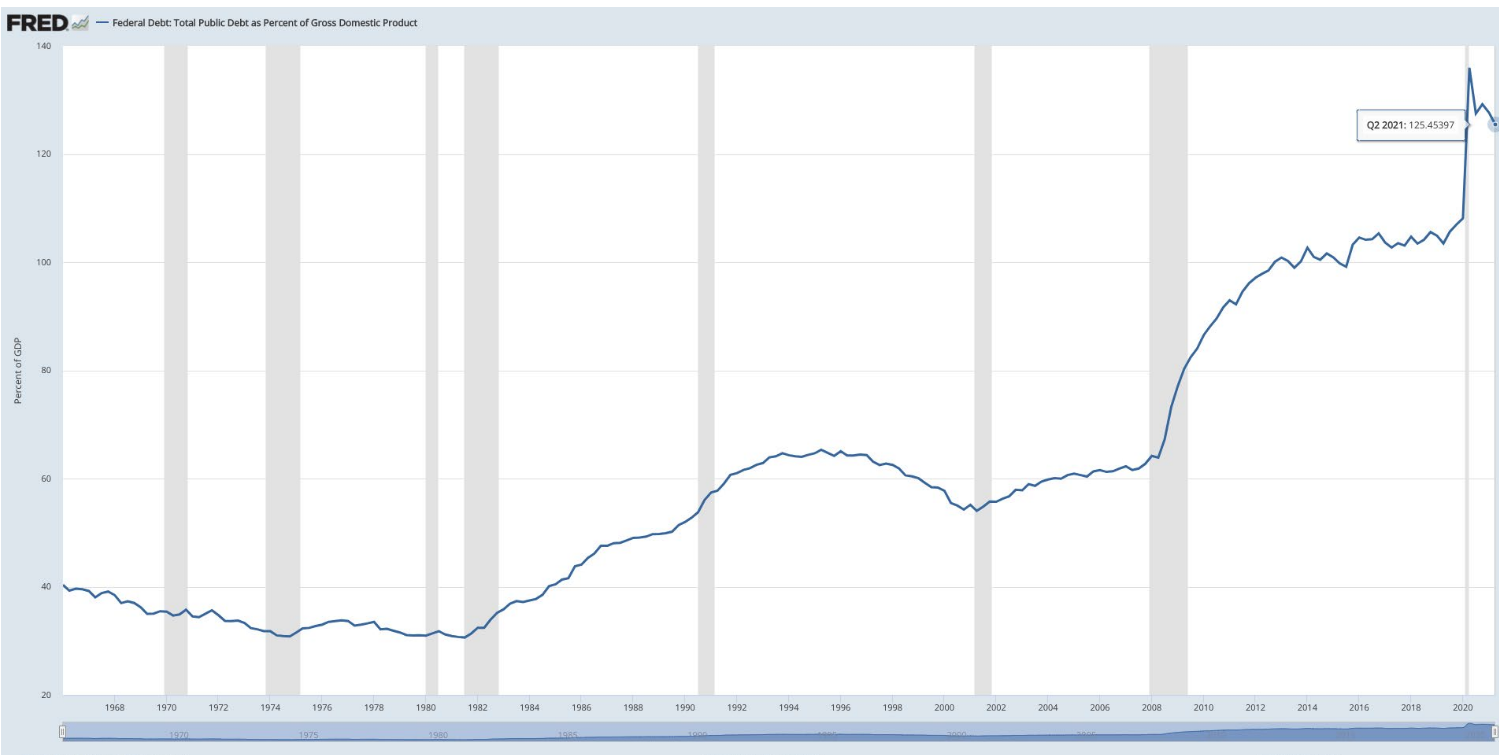
There is no real escape from this conundrum. **As you can see, the Fed has been fighting it for the better part of a century to no avail- it keeps reacting to crises in hindsight, never understanding that many times, it is also the one that caused it-** Just like a firefighter coming to put out a fire he set an hour before.

Each bubble bursting must be met with the Fed creating a bigger bubble. 1990 sees a mild recession? Time to lower interest rates and ("accidentally") spur the Tech Bubble. That bursts in 2000? Time to lower interest rates and start a housing bubble. That collapses? Start an Everything Bubble in 2009. Rinse and repeat. (Again, cycle every 8-10 years- March 2020 anyone?) (I'm oversimplifying, there are many other factors that contributed to these bubbles, but low interest rates just adds fuel to the fire).

This process continually creates more debt, more inflated assets, and more risk in the system. Look at the chart above- you'll notice that the troughs (low interest) get larger and deeper, and the peaks get shorter- with each crisis, they are able to raise the rate to a lower level than before, and have to drop it to a deeper level than before, to get themselves out of it.

Pre 1990, the Fed Funds Rate was at 9.5%. In 2000 it hit a cycle high of 6.5%. Pre 2008 it barely got above 5%, then it was pinned to near zero post Great Financial Crisis until Yellen finally decided to start hiking in late 2015, but even then it took four years to get to a measly 2.4%, and even that could be held for only a couple months.

Why do they keep lowering interest rates, and keeping them lower than before? Simple, just look at a chart of Public Debt to GDP for the United States. As the Fed has continued with this game, debt as a percent of GDP has continually increased, from a starting point of 30% in 1981 to 127% where we sit today. Ever increasing levels of debt means the Federal Government will go bankrupt if interest rates stay at historic norms (6-8%), so the Fed has worked to suppress interest rates to keep the Treasury solvent.



The Fed, with this trend of lower and lower interest rates in their vain attempt to kill the credit cycle, have created a financial black hole- the more they lower rates to get out and stave off default, the more debt is created, piling on more and more mass. This pushes interest rates even lower, which creates more loan demand, and thus more debt, in a devastating feedback loop.

This game will continue until the whole thing collapses under the weight of it's own gravity. That, or they burn their way out with inflation. (Guess which path they're currently choosing).

There has been much discussion of a taper, that the Fed will stop printing money to buy securities, and will raise interest rates to "fight inflation". To me, anyone who believes they will accomplish this is being foolish.

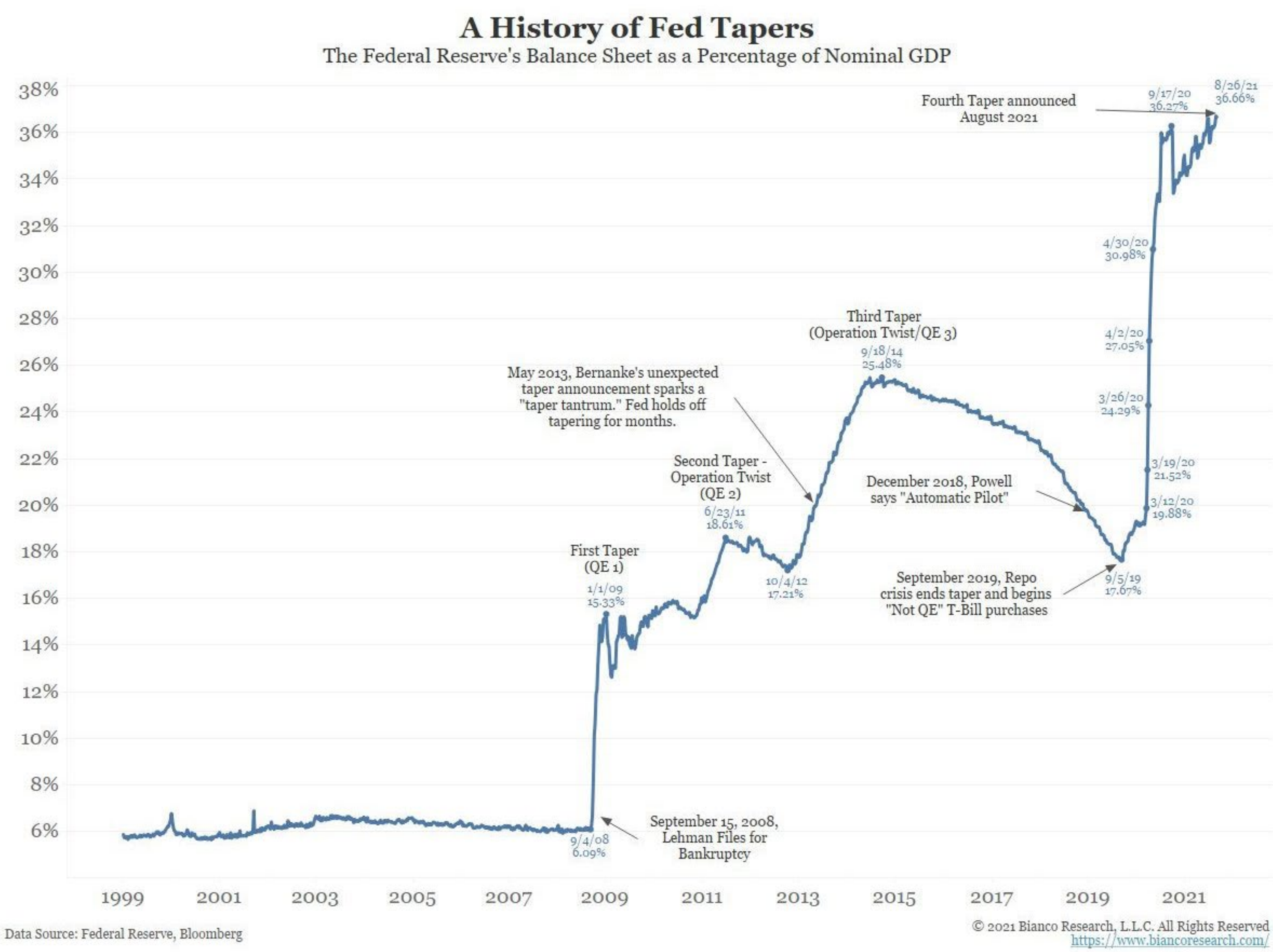
The Fed could barely get interest rates above 2.4% in late 2018/early 2019 before the stock market began to fall into bear market territory and the repo market blew up in September 2019. What makes them think they could get interest rates high enough to matter to fight inflation (above 7%) with Debt to GDP 30% higher than it was in 2019?

See below for a brief overview of all the Fed "Tapers".

Each time they begin this program, the markets react violently. Addicted to the heroin of easy money and low interest rates, the prisoners of this system (the banks and the US Treasury itself) are up to their eyeballs in debt, and any attempt to offload that debt is vehemently opposed. ([See this article]() for a timeline of the 2013 Taper Tantrum).

Disconnecting the Fed's liquidity hose results in immediate withdrawal, and must be put back quickly if the Fed wants to avoid a full blown deleveraging event (deflationary spiral). The prisoners demand ever increasing liquidity, more and more QE, and tapers (pull backs in money printing) become ever shorter and fewer.

The inmates are running the asylum.



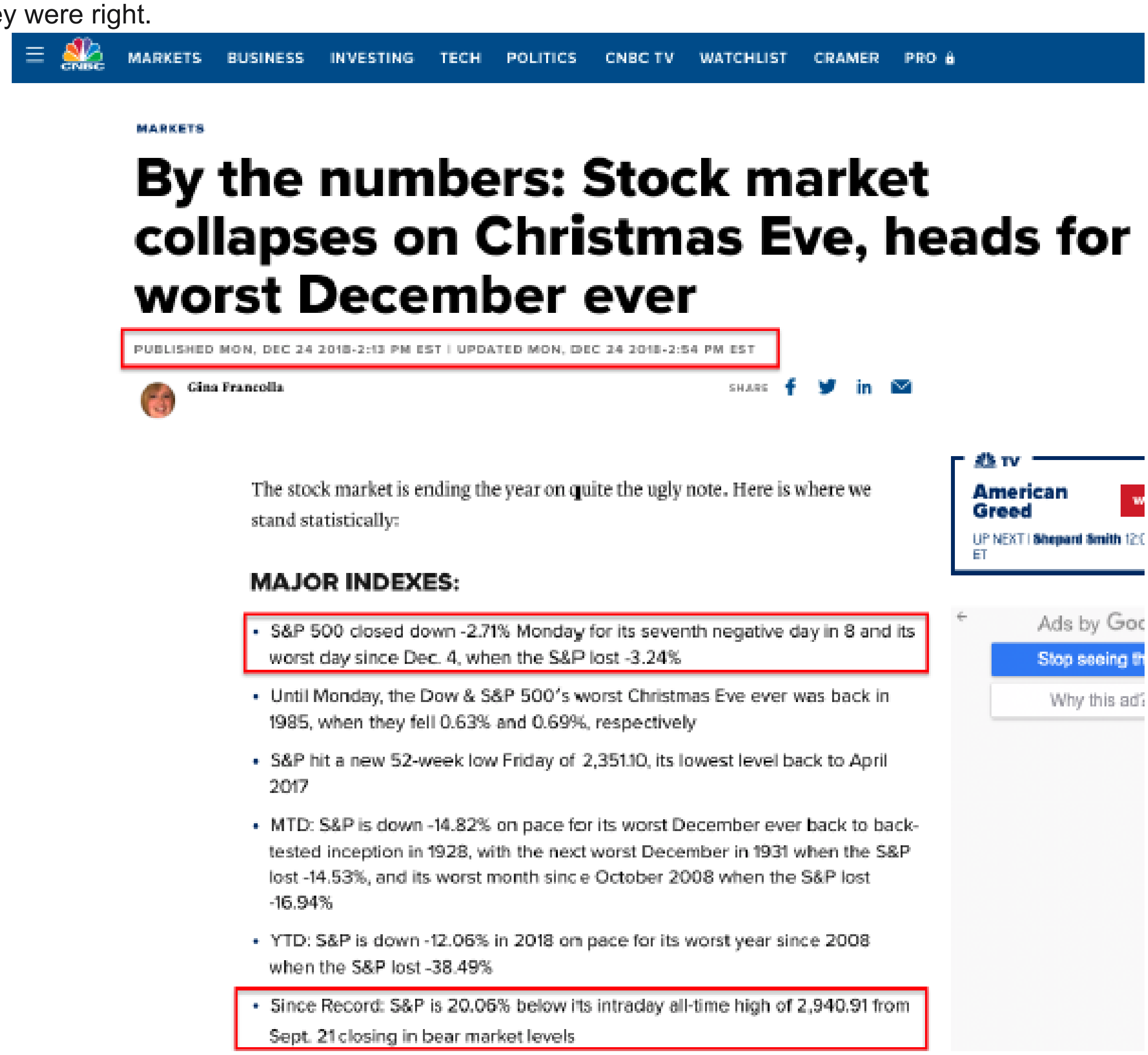
Bernanke assured everyone during the Financial Crisis that Quantitative Easing “would be temporary, and the tapers would be permanent”. **It appears the opposite is true- QE is permanent, and the tapers are temporary. They can only taper for a little while until something else blows up and they are forced to start printing again.**

Much like a black hole, in many ways we cannot directly observe the phenomenon, but we can see it’s effects on what surrounds it. The Financial Gravity the Fed has created by incentivizing ever more borrowing has caused more and more distortions in financial markets, pumping junk bonds to absurdly high levels and creating shortages in others (Treasuries, like the Reverse Repo Facility- [See my DD here])

The weight of the debt is pulling the economy and markets down, but with constant money printing the Fed hopes to stave off disaster. Much like a Black Hole however, the process is exponential, and the longer the Fed keeps interest rates at the zero bound, the harder it will be to escape and the more money they’ll have to print to get out.

For those of us who follow economics/monetary policy, this exact scenario played out in 2018- the Fed stopped QE, and started tightening/tapering, aka reducing it's balance sheet. (l[ook up Fed Balance sheet on FRED]). The markets, a month later, started nosediving. I was actually on Wall St at the time coincidentally (doing interviews, and touring the banks for job offers- never worked there).

I talked to a lot of analysts, they all said that this turbulence was bad, with no more Fed support (QE) the markets were due for a correction, etc. but they also confidently said that the Fed would change its mind and start QE again once things got bad enough. The taper, they said, would not last forever. The markets would make the Fed blink. Sure enough, they were right.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By the numbers: Stock market collapses on Christmas Eve, heads for worst December ever

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Gina Francolla

The stock market is ending the year on quite the ugly note. Here is where we stand statistically:

MAJOR INDEXES:

- S&P 500 closed down -2.71% Monday for its seventh negative day in 8 and its worst day since Dec. 4, when the S&P lost -3.24%
- Until Monday, the Dow & S&P 500’s worst Christmas Eve ever was back in 1985, when they fell 0.63% and 0.69%, respectively
- S&P hit a new 52-week low Friday of 2,351.10, its lowest level back to April 2017
- MTD: S&P is down -14.82% on pace for its worst December ever back to back-tested inception in 1928, with the next worst December in 1931 when the S&P lost -14.53%, and its worst month sinc e October 2008 when the S&P lost -16.94%
- YTD: S&P is down -12.06% in 2018 on pace for its worst year since 2008 when the S&P lost -38.49%
- Since Record: S&P is 20.06% below its intraday all-time high of 2,940.91 from Sept. 21 closing in bear market levels

From August to mid December, major equity indexes dropped 20%, putting them in a technical bear market. I was there in late October, and pretty much every day saw heavy selling. December got even worse, and as the selling continued, worry began to spread across financial markets.

Powell stuck to his guns and insisted the balance sheet reduction would continue barring another financial crisis. [Here's a quote from an article on December 19th, 2018.]

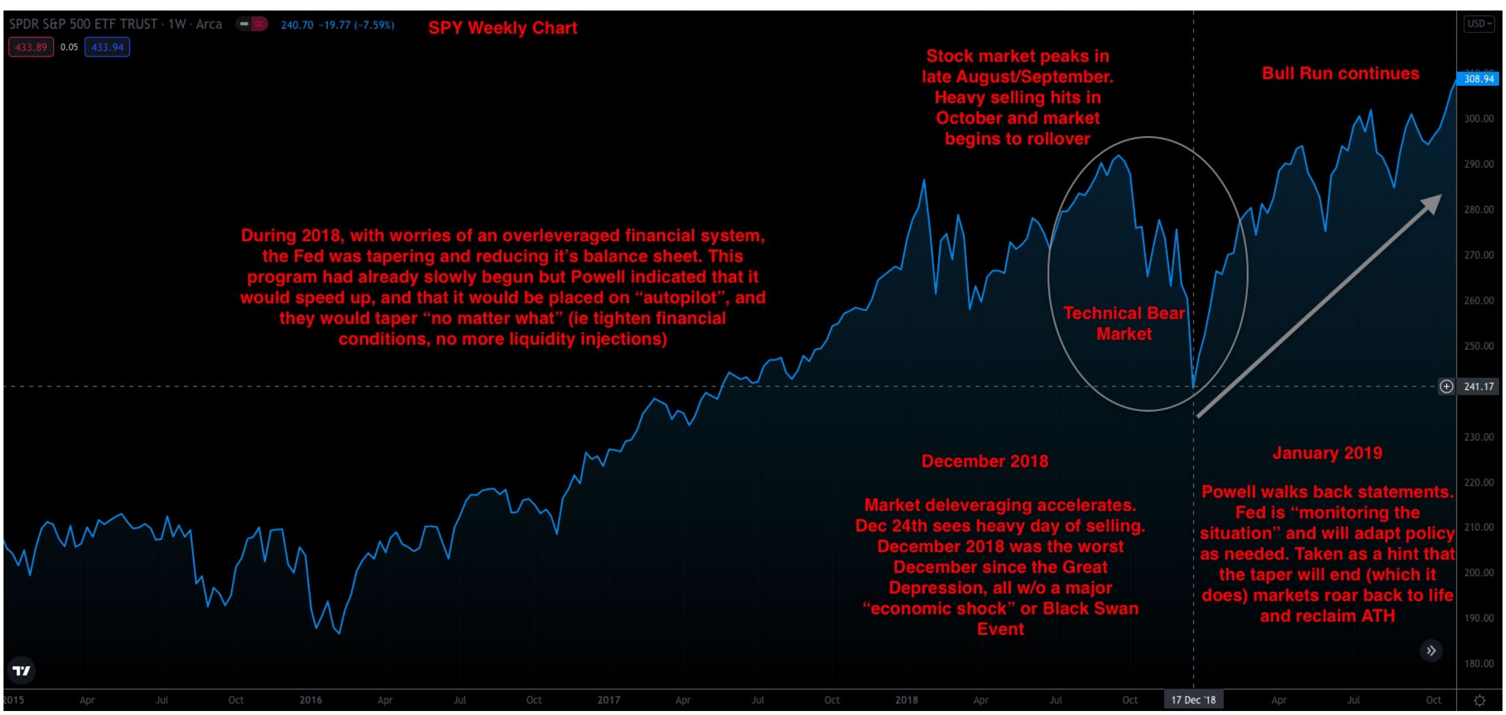
"Minutes into his press conference on December 19, Powell was asked if the Fed is looking into altering its strategy of undoing quantitative easing by allowing its massive holdings of Treasuries and mortgage-backed securities to mature off the balance sheet.

"I think that the runoff (reduction) of the balance sheet has been smooth and has served its purpose and I don't see us changing that," Powell said, adding that interest rates would continue to be the "active tool of monetary policy." When

Janet Yellen kicked off the unwind process at the end of 2017, the Fed outlined its intention to let the roll-off occur on "auto-pilot" with no promise of reverting back to quantitative easing — unless there were a "sufficient" negative shock to the economy."

Dec 24th, 2018 saw a big drop in the markets, a 400 point loss in the Dow, marking the third Friday in a row of red days in the markets. (See article below).

Again, this entire bear market occurred without an external economic shock or a default by a major US bank- it was purely driven by the fear that the Fed would not restart QE and the Taper would continue.



Not even two weeks later, everything changed. The Fed Chairman, Jerome Powell, came out and recanted his earlier statement of a tapering program "on autopilot". He said they'd stop tapering soon, and may even begin QE again after they'd "re examined the situation". Markets rebounded, and after QE began again, they started rallying hard. (CNBC Jan 14th, 2019)

Fed chief Powell gave the markets the message they wanted

Fed chief Powell gave the markets the message they wanted

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KEY POINTS

- Fed Chairman Jerome Powell used his appearance with his predecessors at an economic conference to walk back his previous comments on the Fed's balance sheet policy.
- Powell added context to the comment that its wind-down was on "autopilot" by saying that the balance sheet wind-down was supposed to operate in the background while the Fed actively used its interest rate policy to influence the economy.
- That added to rally in stocks and a surge in bond yields, as did comments that the Fed is listening to markets and can be patient on interest rate hikes.

(Yes, I know the Fed did not immediately restart QE in Jan 2019, but they signaled an end to the taper program and that they would be "open to restarting QE if the conditions warrant it". This was enough to soothe markets into rallying back to ATHs. They began QE again in September 2019)

Many market observers did not understand the implications of what just happened. What many others grasped, and what I was beginning to suspect, was that this series of events was a major signpost that something was seriously wrong in equity markets.

The markets were completely dependent on Fed liquidity, and the Fed had blown a bubble in literally every single asset class in the financial markets- this bubble was able to be maintained only through constant (and growing) QE, and any taper of these injections resulted in immediate collapse of the bubble.

December 2018 demonstrated that the removal of that liquidity injection (heroin) that the markets were addicted to resulted in rapid downward re-pricing of financial assets. The "wealth effect" the Fed had created was nothing more than an illusion.

Something had changed since 2008. Although the NBER (National Bureau of Economic Research) claimed that we had only experienced a recession, if we use their original terminology we actually had been through a depression. Depressions were originally defined as prolonged periods of economic underperformance, which by all indications we were experiencing. GDP nominally was rising, but much of that could be attributed to increased government spending (component of GDP) and inflation (raw GDP is not adjusted for inflation).

NBER estimates we underperformed GDP potential by around $8.2 Trillion in real growth since '08, which would have mostly gone to middle and working class workers in the form of wages. (see here and here).

Although there were no more bank failures after the fall of '08, unemployment spread throughout the economy, growth slowed to a standstill, and many left the workforce altogether. As we covered in Part 3, if we divide the performance of the S&P 500 by the Fed's Balance Sheet since the GFC, the LINE IS FLAT. This means that there has been basically NO REAL growth in stock prices since 2008- with the only rise in prices due to money printing.

The correlation coefficient between central bank quantitative easing and the price of stock indexes is nearly 1. The money printed by the Fed, because of the structure of the Open Market Operations, is plugged directly into the Treasury markets, and from there, flows into equities and derivatives. This has served to primarily enrich the

asset owners, financial institutions, and wealthy elites who own the majority of the stock market anyways.

The entire rally has been an illusion, financed by the Fed and maintained through QE. In the black expanse of space, many things are not what they seem.

Smoothbrain Overview

- **In 1907, a major banking crisis broke out across the United States when overleveraged investment trusts saw their clients default on margin loans. This spurred a general bank run.**
- **Hoping to prevent future panics, Congress created the Federal Reserve, the Lender of Last Resort to all US Commercial Banks (later they would lend to Hedge Funds like LTCM, Investment Banks, and even Insurance Companies)**
- **With each subsequent economic crisis, the role and power of the Fed has grown. Now it commands monetary policy for the World Reserve Currency (USD) and can thus indirectly influence every major global asset market.**
- **The Fed has resolved to reply to every recession with a drop in interest rates to spur credit growth. What this does unfortunately is build up massive amounts of debt over time.**
- **By doing so, they have created a Black Hole for themselves which they are desperately trying to escape (this is why they are set on tapering)**
- **Each dollar of debt that is created puts more strain on the system, as interest rates need to be ever lower to prevent widespread default. Thus the Fed has to move interest rates lower and lower, which incentivizes more debt.**
- **Tapering the balance sheet will quickly result in massive corrections in asset markets as we saw in the fall of 2018. If they chose this route, I expect they will have to reverse course in under a year.**
- **This feedback loop has resulted in interest rates pushing the zero-bound, and will soon be (if not already) in negative territory. To inflate away the debt, the Fed will have to push them even farther down (in real terms)**
- **This results in the ultimate dilemma- to save currencies or save bonds. Ultimately, the Fed will soon have to decide which choice to make.**

Conclusion

The Fed is now trapped in a Black Hole of it's own design. Continually crushed by the weight of the financial debt, the economy and markets themselves keep contracting inwards towards collapse. 2008 was a foreshadowing of what was to come- and in 2018, the system was beginning to unravel again. The Fed, desperate to prevent this, persists in heaping more and more liquidity and debt onto the system, desperately praying that there will be a way out.

Each crisis requires exponentially more stimulus to be used to fight it- $100 Billion for the Tech Bubble. $2.2 Trillion for 2008. $4.1 Trillion (and climbing) for March 2020. The Fed is running out of time.

They will almost undoubtedly try to Taper to escape. Even if they try this, it will fail in time, causing a rapid collapse in asset prices. When it does, they will have to turn back the liquidity hose even more than before, as they try to escape the event horizon, "the point of no return" where not even light itself can run fast enough to flee the massive gravitational pull of the black hole.

What they do not grasp yet is that they have already crossed the event horizon. Only hard choices lie ahead - the only thing on their mind will be avoiding another Great Depression, but to do this they will have to print trillions more.

This will only accelerate worsening inflation, and unleash devastating feedback loops that lurk under the surface of our economy. Many a State has wrecked itself on these shores, but sadly few heed the warnings. As stated in the prologue, *"On cold nights when the moon is full you can watch these ghost ships (economies) making their journey back to hell... they appear to warn us that our resolution to avoid one fate, may damn us to the other."*

BUY, HODL, BUCKLE UP.

>>>>>>>TO BE CONTINUED >>>>>>> PART FOUR “AT WORLD’S END”

(Adding this to clear up FUD- My argument is for hyperinflation to begin in a few years- this is a years- long PROCESS, and will take a long time to play out. It won't happen tomorrow, but we are in the same situation as Germany after WW1. BUY AND HOLD)

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