How Deflation Is Inflation

Let's squash the debate between deflationalists and hyper-inflationalists. Here follows the math that shows how we get the equivalent effect of price inflation (and skyrocketing gold price) when there is deflation on a debt money standard.

In short, **purchasing power is decreasing during deflation** on a debt money standard. That has a similar wealth destroying effect as price inflation. Purchasing power is decreasing because private sector (non-government) share of total debt is decreasing, as well for a more complex second reason. What deflationalists miss is that although totals are deflating, the composition of those totals are changing and there is a transfer (theft) of wealth from the private sector to those on the coattails of government and stimulus lost to waste, failure, and corruption.

Given a fiat money standard, where all money is debt, then as is the case now, there is deflation when the total (private+public) levels of debt and real production (GDP) are declining. Simultaneously, the private sector's portion of total debt and GDP is declining. While the public sector's portion of total debt is increasing and faster than its positive contribution to real GDP (i.e. negative marginal utility of debt, aka MUOD), because the government is always less efficient than the private sector at allocating spending. Thus by simple algebra, the private sector's portion of total debt is declining faster than the total debt is. And thus, the private sector's portion of total purchasing power (i.e. portion of total debt, since debt is money on fiat standard) is declining while the total production of goods and services is also declining faster than total debt is, both factors contributing to a reduction of purchasing power for the private sector. Note that a reduction in purchasing power is the same effect as holding a negative *real* interest rate asset during price inflation. Thus, we can conclude mathematically that **prices do not have to rise, to get the effect of price inflation on** the private sector. And thus we know the reason why **gold is a hedge against negative *real* interest rates** (click to see very compelling chart!), and not a hedge against inflation or deflation (which this article proves are ambiguous).

Given this deflation on a debt money standard, if the MUOD is negative, then prices rise because real GDP declines faster than total debt. Irregardless of whether MUOD is positive causing declining prices, or negative causing rising prices, the algebra of the preceding paragraph shows that the private sector's purchasing power is declining, and thus that deflation (on a debt money standard) is the equivalent effect of price inflation (while the private sector holds negative *real* interest rates paper).

The fact that the above is difficult for people to understand and the private sector is fooled by the total level of deflation, is what prevents the private sector from immediately jumping to gold to stop the destruction caused by the government run amok, i.e. climbing the "wall of worry" in the gold bull cycle. This is why the government and central banks are most concerned about "inflation expectations", i.e. how long the private sector can be fooled. Eventually, the private sector does move to gold, because the public sector's cannibalization of total purchasing power (total debt) eventually becomes unbearable.

The **above logic is only true on a debt (fiat) money standard**, where the government is determined to fight the private sector decline/defaults by increasing the public sector debt and spending. Whereas, on a gold+silver money standard, it is generally impossible for the government to expand the total debt once the private sector has decided to hoard its gold+silver and reduce debt. Thus, **on a gold+silver money standard, deflation actually results in an increase in purchasing power** for the private sector. For example, this was true in the non-depression from 1929 - 1933 as people were becoming more prosperous, until FDR confiscated gold and took the country off the gold standard domestically, enabling the depression to start in 1934 and loss of purchasing power which ended in severe shortages and rationing by WW2.

Thus until the government is willing to emulate the restraint of a gold+silver money standard and thus stop increasing the public sector's portion of the total debt (i.e to stop compensating for private sector defaults), then it is mathematically insured that the private sector's purchasing power will decline and negative *real* interest rates will persist. Positive *real* interest rates would be a means for the private sector to increase its purchasing power, thus can not exist until the government restrains itself. Gold increases in purchasing power during negative *real* interest rates, which thus logically brings us full circle to the fact that gold+silver money standards increase the purchasing power of the private sector during retrenchments of the business cycle. Proof of this is in the fact that holders of 10 year Tbonds during the 1800s gained roughly 33,900% more real appreciation than those in the 1900s. Interest rates were more than 5% in 1800s and less than 4% in 1900s, while prices declined by 51% from 1800 to 1896 versus an increase in prices by 6,667% from 1913 to 2009:

Appreciation **1800-1896**: 1.05 (x^y key) 96 = 108 ÷ 0.49 = 220 = 22,000%
Appreciation **1913-2009**: 1.04 (x^y key) 96 = 43 ÷ 66.67 = 0.65 = 65%
Appreciation **Ratio**: 220 ÷ 0.65 = 339 = 33,900%

If it seems hard to believe that we had **339 times more prosperity in the 1800s**, consider the delayed truth of delayed gratification and reversion to the mean. There has been a massive boom in technology in the 1900s, massive increase in the supply of cheap energy, and a massive transfer/parasite of natural resource wealth from the third world to the developed nations by the fiat system. Payback is going to be beaach. Currently the public debt is 141% and the private sector is 416% of GDP, but the public debt will climb another 283% if unfunded promises are funded, not to mention snowballing $trivillions for bailoops and stimulost, with the upper limit of $quadrillions in derivative promises in the private sector. The secular **top in gold will occur when *real* interest rates go positive**, then we will know the mess is done.

Gold is appreciating in all currencies, with a repeating staircase of breakouts. Pattern says we are at the start of a major breakout that projects to 25 ratio of gold to dollar index, or roughly $1600-$2200. A dip first back into the green rectangle is underway, as was the case in Dec. 2005, currently driven by the Fed's improbable promise to stop quantitative easing. If *real* interest rates rise enough to go persistently positive, then we will know the Fed is serious, however the Treasury has recently pledged unlimited funding for the F*Maes and the House has passed another $4 trivillion bailoop.

The reason we are in the mess is because of positive real interest rates and a bond bubble since 1980 (in synergy with real estate demand pulled forward by 30 years with 30 year mortgages compounded by orders-of-magnitude derivative distortions and a welfare state), which should have been impossible on a debt money system with no precious metal component, except the free market feedback loop of rising gold and silver prices, that regulates interest rates and debt levels, was delayed for decades by the unlimited selling of paper gold and silver on the future's and worse OTC derivative markets-- paper market abominations that did not exist before 1971. The upside leverage for physical gold and silver investors is thus violently scary. I suggest you give very careful thought to who knows how much you have and where it is stored. I have knowledge of those who think that physical gold and silver investors who will profit from the derivatives fraud should thus not have their property rights respected. These people may think they are for the rule of law, but if they succeed they will cause anarchy. I think there was one Treasury or Fed official who promised that those who hoard gold will have "their hands burned up their armpits". They want us to be impoverished relative to Chinese people's increasing accumulation of physical gold.

Disclaimer: consult your own investment advisor, some deflationalists even duplicate the performance (50±6%) of flipping a coin.