

Despite multiple QEs, why the US is yet to be hit by hyperinflation?

[Economics / HyperInflation](#) Sep 11, 2011 - 06:55 AM GMT

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[partial quote follows]

.....As everyone knows, due to the QE1 and QE2, about \$1.7 trillion have been printed and pumped into the economy. The question is why hasn't the US experience hyperinflation?

The problem is, the media only tells you how much have been printed but they didn't tell you, how much have actually gone to the real economy through the banks. The total US money supply is estimated to be \$10.2 trillion. Out of the \$1.7 trillion, the M2 only increased by \$168 billion in 2009 and \$141 billion in 2010. In other words, the US money supply barely moved !! With the total of \$309 billion injected into the economy, over 2 years which is equivalent to 3% of the total money supply, it is considered negligible and could hardly make a dent on the money supply.

So, the question is where have the balance of \$1.4 trillion gone? The banks park it at the Fed as excess reserves and earning about 0.25% in interest, instead of lending it out to the public and businesses to generate genuine economic growth. If the \$1.4 trillion were to go into the economy, it could turn to at least \$7 trillion through the multiplier effect of the economy.

Another factor that need to take into consideration, is the velocity of money. The faster the velocity, the bigger the multiplier effect it has on the economy. But in this case, most of the money is park at the Fed, so basically there is zero velocity. Hence, we can conclude that the Fed's previous Quantitative Easing will not lead to much inflation because most of the money found its way back into the Fed's accounts.

In actual fact, the US is already into QE 2.5, meaning the FED already started printing money even before QE2 ends in June. It is estimated that the various stealth measures through the bonds market, the FED already pump more than \$500 billion into the economy. Again, we have yet to feel any effect of hyperinflationary from the Fed's latest round of Quantitative Easing.

Secondly, the US has exported most of its inflation to foreign countries. Since the 1980s, US corporations have been setting up manufacturing plants all over the world. It is estimated that more than 10 million jobs has been transferred overseas. This resulted in the transformation of the US economy from being a manufacturing to a consumer economy. In the end this has led to a destruction of the lower and middle class in the United States. As we know the vibrancy of any economy and hence economic growth of any country is directly co-related to the size of its middle class.

The destruction of the middle class no doubt will lead to a prolong miniscule economic growth. The Federal Reserve has no choice because it happened to be between a rock and a hard place. The Fed choose to bail out the banking industry because the financial industry is the most important pillar of strength in any economy. Just look at how the Al-Qaeda organization collapses, without funding after the US froze all the assets and funds related to Al-Qaeda..

Thirdly is the dollar to oil link, made hyperinflationary effect even more remote in the US. Since most commodities and precious metals are priced in US dollars, you can't purchase any of these without the dollar. This too made the dollar the world's reserve currency and also the currency of trade. It is also true that due to the dollar's link to commodities and precious metal, it will also be affected by high levels of inflation but certainly not what hyperinflation as defined.

From experience, high levels of inflation during the 1970s and 1980s, can still be managed by prudent micro and macroeconomic monetary policies by the Fed.

Fourthly, the US dollar link to oil, coupled with the US military might also helped to stabilize the dollar. Should the supply of oil from the Middle East is threatened, the US in no time ,will immediately send its carrier battle group to its vicinity. Should the dollar to oil link be threatened, the US will not hesitate to take drastic military actions.

As seen during Saddam Hussein's rule in Iraq. In 2000, Saddam Hussein tried to decouple the oil from dollar by insisting payments in Euros for Iraq's oil. And you know what happened to him. Same as Hugo Chavez of Venezuela, his policies are contradicting and challenging the hegemony of the US in South America. He encouraged Chinese and Russian oil companies to explore and drill oil in his country and at the same time sidelining American oil companies. He knows that his days are numbered and America is going to do a Saddam on him, and that is why he is recalling his gold from the Bank Of England. It is more of a political decision than economics to recall his gold, after seeing how the international bankers froze Libya's Ghadaffi and Egypt's Hosni Mubarak assets and bank accounts worldwide.

Lastly, the US is able to escape hyperinflation is due to the fact that most US imports are from China. China is able to provide the US with cheap goods for the past two decades and hence help to bring down the inflationary pressure due to the increase in the money supply. Consumer goods like electrical goods, clothing, food items, car parts and etc can be bought at a much lower cost than those of American made. So consumers are still able to enjoy a high level standard of living despite the dollar losing its value. Moreover, the Chinese yuan is pegged to the dollar, so this makes it more difficult for the dollar to collapse. Any further debasement of the dollar to yuan doesn't do any good to the Chinese because this will make the Chinese exports more expensive and at the same time makes it cheaper for the Americans to pay their debts.

Finally, I can safely say that, you will not see any hyperinflation in the US, at least in the next 3 years but maybe a higher level of inflation. Definitely, not hyperinflation as defined by Philip Cagan's model of at least 50% increase in monthly inflation.

No doubt, the US will be able to pull through this round of crisis, but what will it be of the US? Will it still be a developed or is it going to be a developing country? To be able to maintain its status, that of a developed nation is out of the question, but it might just fall in between a developing and a developed economy.

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