



Inflation Zugzwang

August 10, 2022

Zugzwang; what a great word! A chess term meaning: it is your move, but there is no good move you can make. When faced with zugzwang, all you can do is play for time. We are in inflation zugzwang.

There is much talk of inflation, most of it disingenuous. The July CPI print dropped this morning, and it continues to show that consumer inflation is running white hot, albeit a bit less than last month as gas prices are in retreat (for now). No surprise: the markets are rallying as the report was "better than expected," and it seems to believe the Fed is winning the battle. That's like celebrating the Fed turning a garden hose onto the 4-alarm fire that they created! If the Fed was serious about killing inflation, it should go to the source: money supply growth. We blew up the money supply by nearly 45% over an 18-month period. That is to say that 45% of all of the money ever created in the two hundred- and forty-six-year history of the USA was dumped into the economy in the preceding year and one half. This de facto debased the value of the currency which manifests as inflation. Want to stop inflation in its tracks? Massively shrink the monetary base once again. Unfortunately, this could not be achieved without an historic deflationary depression! And, it is still easier said than done. The only way to shrink the monetary base is to retire the debt which caused the expansion. How does this happen? Repayment, taxation, loan forgiveness, or default; all zugzwang. Repayment - not an option. Ramp up taxation to very high levels, and you crater the economy. Loan forgiveness will trash the US\$. Default will lead to a deflationary spiral. The problem once again is the source of the debt. When banks were the intermediaries of money supply via loans, those loans could be repaid, and the banks could lower their required reserves. But when the government is propping things up via treasury issuance (and we're still running a \$2TR deficit!), and these proceeds fund consumption and not investment, leaving no recourse for repayment, the money supply expansion is permanent. Even on a small scale, i.e. the Fed's planned quantitative tightening (QT) or selling off their bonds into the market, you cannot shrink the monetary base as someone will still have to buy/hold those instruments. What this will do is put pressure on market rates higher. And again, should



this lead to an increase in defaults, that is one way to extinguish money, and it is deflationary.

So, the Fed raising the benchmark rates does nothing except drive home a demand destruction recession. This is clearly indicated via the record inversions across yield curves. It is coming, and there will be no "soft landing". QT does nothing aside from also pressuring rates, and this initiative will not last very long due to fiscal necessity (and they've only done about \$50BN to date; 1/2 of 1%). The overwhelming majority of price inflation experienced to date and yet to come will be permanent. The demand/supply imbalances arising from excess demand from stimmy checks vs. supply constraints from Covid lockdowns is only the tip of the iceberg. Nonetheless, the rate of change associated with this dynamic will slow further as the economy hits the bricks. The Fed will call this victory, and again, markets may rally further as expectations of further rate increases subside. Regardless, we will still be the poorer for the base effect. And remember, inflation may be a problem for the people, but it is the solution (and plan) for the government to get out from under their untenable debt burdens. As I've stated, our debt-based economic system is at an inflection point. There will be more zugzwang twists and turns in the road ahead (renewed rate cuts and QE infinity to buy more time), and central bank digital currency will be at the rainbow's end.

PS – On a related note, the recently passed "Inflation Reduction Act" is nothing of the kind. It will only further stoke inflation and hamper growth, i.e., stagflation.

Inflation Zugzwang was written by a wise third party investor.



From BLS: CONSUMER PRICE INDEX - JULY 2022

The Consumer Price Index for All Urban Consumers (CPI-U) was **unchanged in July** on a seasonally adjusted basis after rising 1.3 percent in June, the U.S. Bureau of Labor Statistics reported today. **Over the last 12 months, the all items index increased 8.5** percent before seasonal adjustment.

The gasoline index fell 7.7 percent in July and offset increases in the food and shelter indexes, resulting in the all items index being unchanged over the month. The energy index fell 4.6 percent over the month as the indexes for gasoline and natural gas declined, but the index for electricity

increased. The food index continued to rise, increasing 1.1 percent over the month as the food at home index rose 1.3 percent.

The index for all items less food and energy rose 0.3 percent in July, a smaller increase than in April, May, or June. The indexes for shelter, medical care, motor vehicle insurance, household furnishings and operations, new vehicles, and recreation were among those that increased over the month. There were some indexes that declined in July, including those for airline fares, used cars and trucks, communication, and apparel.

The all items index increased 8.5 percent for the 12 months ending July, a smaller figure than the 9.1-percent increase for the period ending June. The all items less food and energy index rose 5.9 percent over the last 12 months. The energy index increased 32.9 percent for the 12 months ending July, a smaller increase than the 41.6-percent increase for the period ending June. The food index increased 10.9 percent over the last year, the largest 12-month increase since the period ending May 1979.

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