
*[Real Investment Advice](#) welcomes Ben Masters to our growing list of contributors.•Benjamin Masters is the creator, designer, and writer for [Third Wave Finance](#), With over ten years of experience working as a lead Portfolio Analyst, Ben brings additional insights into the discussion of economics, markets and portfolio management.*

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**Part 1 Of The Series**

**Part 2 Of The Series**

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## Currency Devaluation

After addressing the dire condition of economics and monetary policy in Part 1, and highlighting some of their more-damaging effects in Part 2, it?s now time to address one of the fundamental pillars of current policy ? a hazard so deeply rooted yet one so easily accepted due to its illusory nature: namely, the process of currency devaluation and inflation targeting. Yet another adjustment/manipulation scheme used to temporarily boost growth, currency devaluation (via currency creation) is not a new policy ? it?s one that has been used throughout history by many countries and empires, including the Roman Empire.• And while the process of currency devaluation can evolve so slowly (potentially over a lifetime or more in a major economy/empire) that an unawareness develops and the instinct to question it subsides, its temporary benefits are often merely offset by a reduction in economic prosperity in the future; depending on the extent to which the policy is used, the economic strains may even lead to social disruption. **For an extreme example one need only look to the social disruptions and anger that developed in 1920s Weimar Germany; currency devaluations were so extreme that they yielded bizarre cases of zero stroke, and created an environment where it was cheaper to burn currency than use firewood.**•This example is not highlighted to imply that inflation *or* deflation should be the desired target, but merely to point out that economic policy can often be over-influenced by recent history ? the economic and social strain of hyperinflation in the 1920s led to a German tendency to fear inflation, while the U.S. Great Depression of the 1930s has led to an American tendency to fear deflation. The important point to make here is that deflationary and inflationary economic forces can often be occurring at the same time in different areas of the economy ? they may simply be indicating a transition (cost and/or popularity of one time falls as the cost and/or popularity of another item rises).• The more-dangerous situation is when extremes in deflation or inflation develop throughout the economy indicating an imbalance, or when that imbalance is specifically targeted.

## Inflation Targeting

As discussed, following the Great Depression, modern economic policies have reversed course so drastically that they have merely unbalanced the ship to the other side.• The fear of inflation has given rise to a tendency for central banks to ?lean on inflation? (i.e. actively target inflation) via a process of currency-creation/currency-devaluation. **However, actively targeting positive inflation to avoid its counterpoint, deflation, may simply result in a storing of deflationary energy to be released later, as a•misallocation of wealth builds.**•Here again the*wildfire suppression scenario* highlighted in Part 2 is at play: just as fires are restricted (the kindling builds, the ecosystem changes storing potential energy for larger fires), **so too does *inflation-targeting* work in the same way; it inhibits deflationary forces, allowing the potential energy of deflation to be stored and released later.**• A further visualization of this concept ? the storage-and-release of energy ? can be seen in introductory physics? A roller coaster that momentarily stops on the top of its very last large ramp has a high potential energy (energy that is not currently being used, as the coaster is motionless and high above•the ground), but a low kinetic energy (energy of movement). •Then•as the coaster begins to descend, the potential energy transitions to kinetic energy (motion).

> *?So inflation turns out to be merely one more example of our central lesson. •It may indeed bring benefits for a short time to favored groups, but only at the expense of others. •And in the long run it brings ruinous consequences to the whole community. •Even a relatively mild inflation distorts the structure of production. •It leads to the overexpansion of some industries at the expense of others. •This involves a misapplication and waste of capital. •When the inflation collapses, or is brought to a halt, the misdirected capital investment ? whether in the form of machines, factories or office buildings ? cannot yield an adequate return and loses the greater part of its value? ?Yet the ardor for inflation never dies. •It would almost seem as if no country is capable of profiting from the experience of another and no generation of learning from the sufferings of its forebears. •Each generation and country follows the same mirage. •Each grasps for the same Dead Sea fruit that turns to dust and ashes in its mouth. •For it is the nature of inflation to give birth to a thousand illusions.?•? Henry Hazlitt (H.H.)*

**The difficulty in ?leaning on inflation? (i.e. creating currency above the natural state) is that**

**creating more currency to distribute does not increase real purchasing power ? the country has more currency, *but that currency buys less items than it could before*** (a currency is only a tool used to exchange real wealth items, it is not fundamental wealth). **Yet, regardless, inflation continues to be targeted ?•arguably due to•ease, and its•illusory nature ? to ?paper over? the restrictive reality of deflation; and in that respect, inflation can be considered a clandestine redistribution of wealth ? one that is similar to an unpredictable, unbalanced, and spontaneous tax.** •The redistribution of wealth occurs as the created currency disproportionately benefits those who receive it first; they have the first bid (*vote*) on assets, goods, and services. •As the newly created currency reaches other individuals, the more desirable assets, goods, and services will have already been bid up (higher prices) by those that received the currency•first. •In effect, those that receive the currency last are punished at the expense of those that receive it first; and knowing who will be affected ? and to what extent ? will be difficult (What will the desirable assets be when the currency makes its way through the economy?). •By its very nature inflation indicates that some individuals benefited before others, yet it typically rests heavier on those least able to pay.

> *??inflation does not and cannot affect everyone evenly. •Some suffer more than others. •The poor are usually more heavily taxed by inflation, in percentage terms, than the rich, for they do not have the same means of protecting themselves by speculative purchases of real equities. •Inflation is a kind of tax that is out of control of the tax authorities. •It strikes wantonly in all directions.?•- H.H.*

**So although it?s possible that inflation targeting can be used to *temporarily* offset deflation, its risk is that it?s illusory and more easily abused. •In our current environment the tendency to question deflation is more commonplace than the inclination to challenge inflation (maybe merely•due to a lack of education and•awareness). •In deflation, the imbalance is visible; in inflation, the problems are for another day.** A more direct illustration, *case 1*:• If your income rises but inflation is greater than the change in your income, you?re actually poorer than you were before even though you have more money. •How can this be? •It?s because the total currency in circulation has increased,•thus•your currency ? simply a medium of exchange ? buys less real items; you?re poorer•even though you have more dollars because each dollar now buys fewer•real items. In a countering example, *case 2*:• If your income goes down but deflation is more significant than the change in your income, you?re actually wealthier than you were before even though you have less money ? each dollar can now buy more real items. **This is the illusory and deceptive nature of inflation: if the amount of currency has increased, your wealth is less ? and although it is openly targeted, inflation is infrequently questioned, because, in our current environment, there is less of an inclination to question the state of things when you have more currency (even though your real wealth has gone down). •The inclination to question the state of things ? even though it?s misplaced ? seems more natural in case 2 because you have less money.• The education and awareness are not present to raise the flag of warning.• For these reasons, inflation is politically favorable, leading us to the questionable state ? and abusive use ? of economics.**

> *?And this is precisely its political•function. •It is because inflation confuses everything that it is so consistently resorted to by our modern ?planned economy? governments.?•? H.H.*

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