

Predictions for 2012: The Year of Inflation

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The Mayans were right!



Except they didn't say 2012 would be the end of the world, they said it would be the end of the euro.

Big Themes for 2012

- Credit Crisis II - centered in Europe
 - Escalating EU sovereign interest rates
 - Lowered EU sovereign credit ratings
 - Bank failures and nationalizations (Dexia, 37 banks in EU and U.S. downgraded on 11/29)
 - Eurozone will have to be restructured.
- Global Recession (may not be admitted in U.S.)
- Both will be handled by Money Printing and this will be the tipping point for a huge inflationary spiral (real interest rates have been negative for many years).

Current Conditions Overseas

- Downgrade of sovereign debt in Portugal and Hungary to junk, Belgium to AA. Australia upgraded to AAA.
- EFSF (bailout fund) accused of buying its own bonds at auction on Nov 7th – “other EU entities” cited as purchasers.
- Failed 10-year bond auction in Germany on 11/23. Little more than ½ of bonds sold.
- Italian 10-year auction rates 7.56% on 11/29 (above 6% dangerous). Shorter maturity, higher yields.

Current Conditions Overseas

- Greek 1-Year bond yields over 300%, 10-year yields over 30%.
- Greece and Italy now run by technocrats in transitional governments.
- Cost of borrowing \$ in euros around 2008 levels (Fed starting 2nd new dollar swap facility on 12/5).
- Officials admit EU in mild recession.
- UK engaging in QE2.
- Inflation rate 5.0% in UK, EU rate 3.0%.
- EU Unemployment rate 10.3%.

Greek One-Year Bond Yields



Red arrow when last rescue plan announced.

Greek 10-Year Bond Yields



Red arrows are when rescue plans were announced.

Portuguese 10-Year Bond Yields



Red arrow when ECB started buying Portuguese bonds.

Italian 10-Year Bond Yields



Red arrow when ECB started buying Italian bonds.

Spanish 10-Year Bond Yields



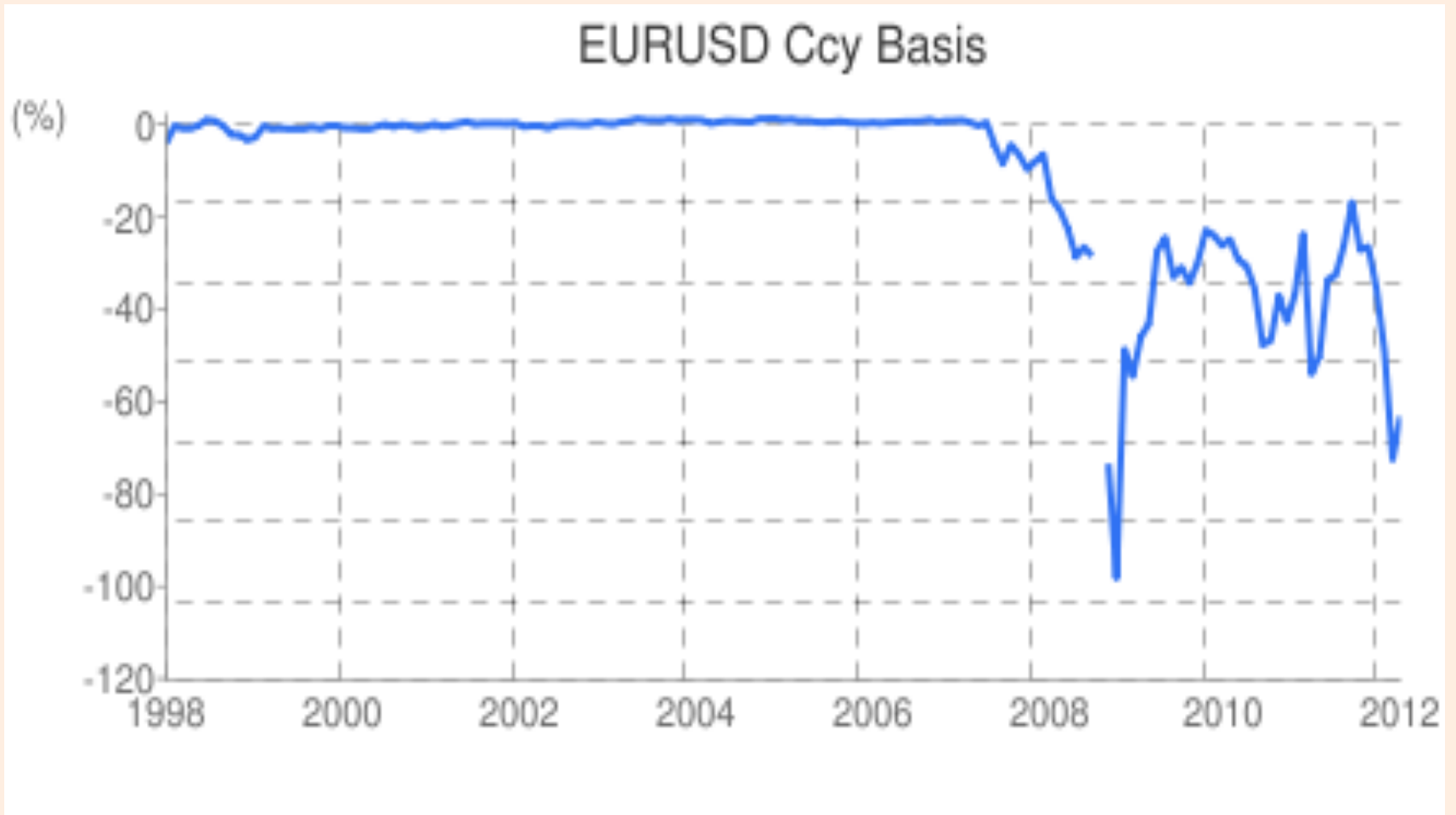
Red arrow when ECB started buying Spanish bonds.

Irish 10-Year Bond Yields



Red arrow when ECB started buying Spanish bonds.

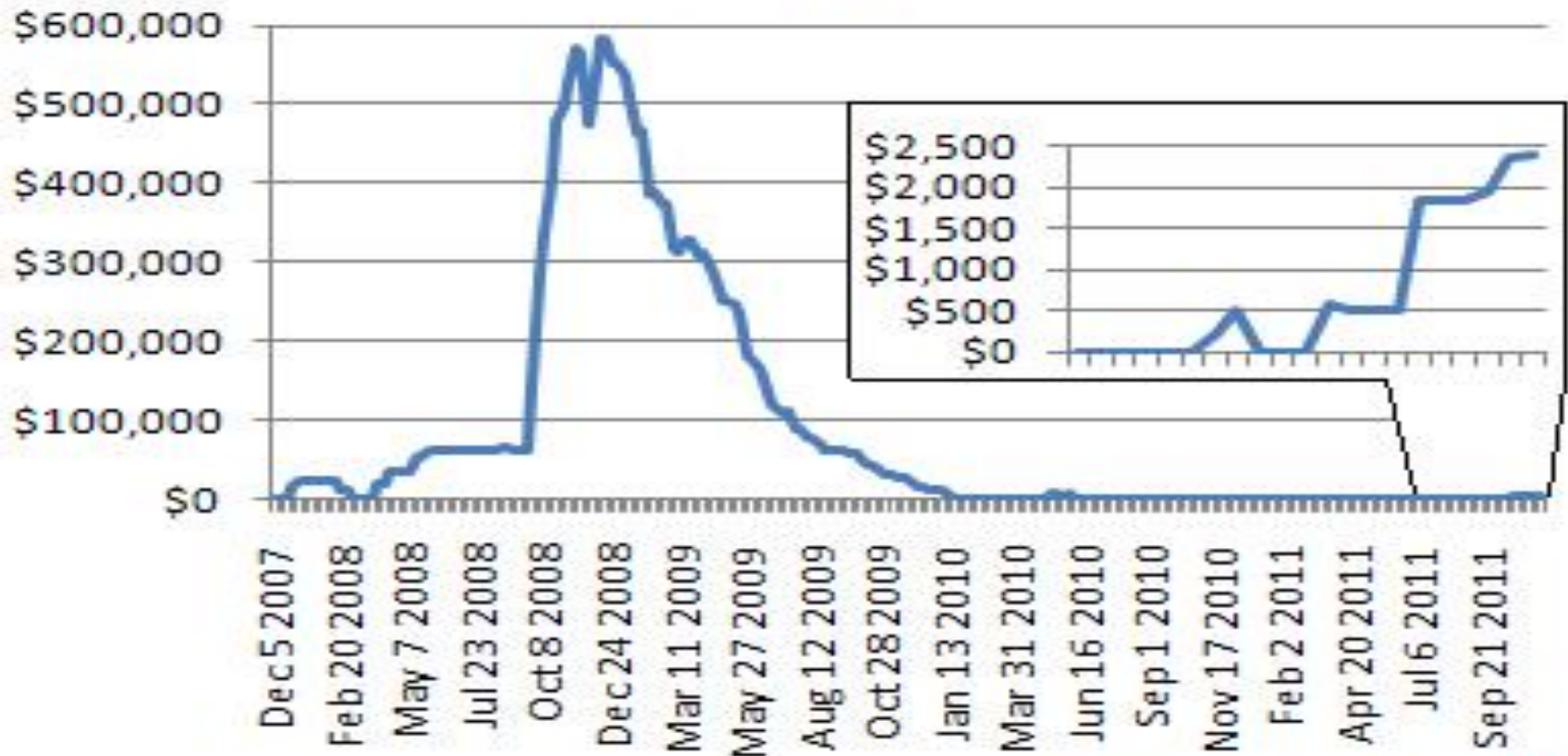
EURUSD Currency Basis



Cost of borrowing dollars in exchange for Euros.

Fed Dollar Swap Facility

Central Bank Liquidity Swaps, in millions



Source: Federal Reserve

Current Conditions – U.S. Fiscal State

- National Debt: \$15.1 trillion
State and Local Debt \$3.0 trillion
Unfunded liabilities \$117 trillion.
- Debt to GDP ratio **100.1%** (actually much higher).
- Debt doesn't include Federal Reserve or Fannie Mae, Freddie Mac and FHA obligations.
- Debt Ceiling at \$16.4 trillion (up to election).
- Federal budget deficit for 2012 estimated at \$1.1 trillion. State/Local deficit \$654 billion.
- 2011 Trade Deficit estimated at \$538 billion (dependent on price of oil).

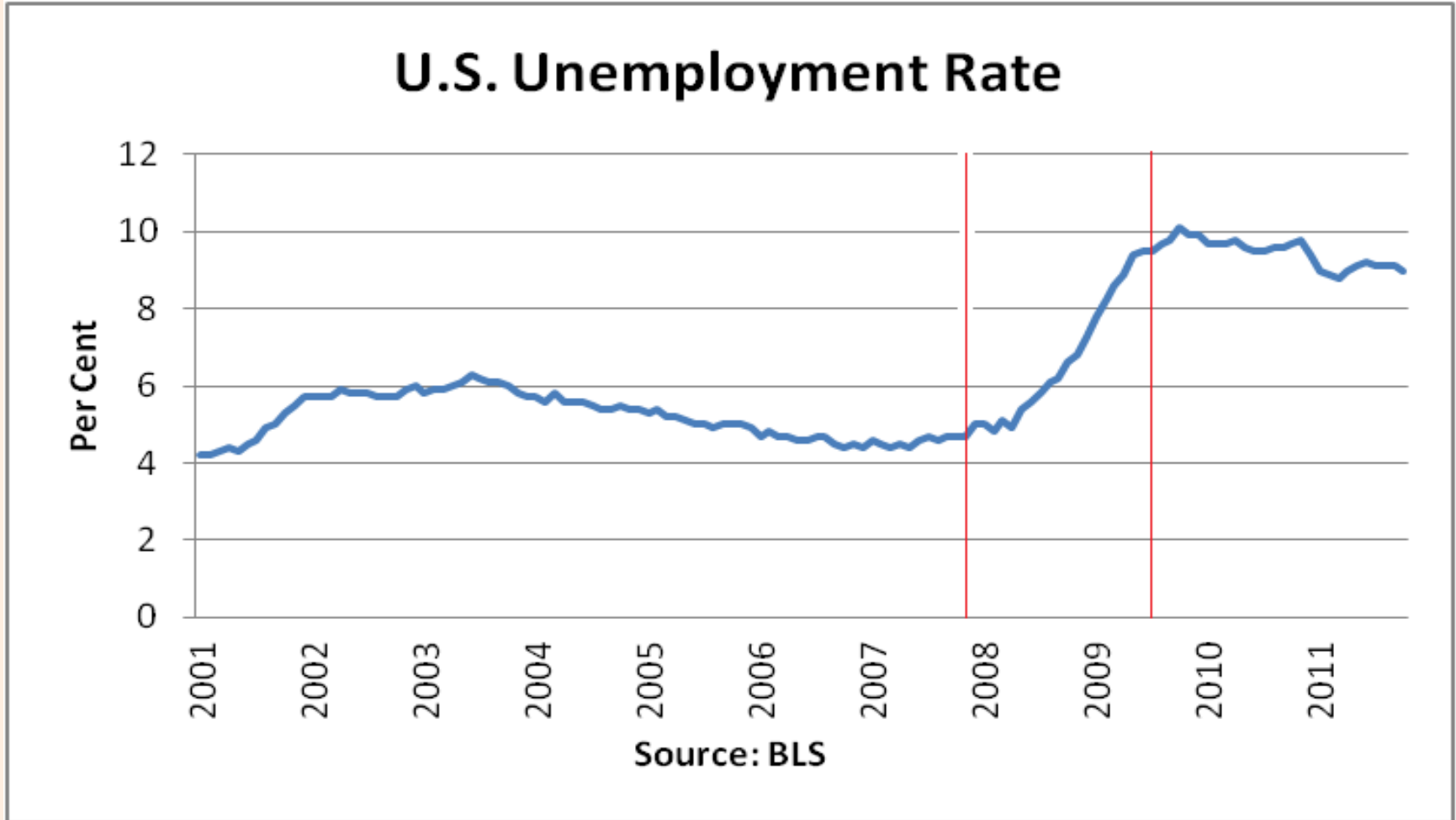
Current Conditions in U.S.

- Deficit super committee fails to agree to cuts. Automatic cuts will be undermined.
- U.S. Q3 GDP now 2.0% instead of 2.5% (expect revisions lower in the future).
- Harrisburg, PA and Jefferson County, AL declare bankruptcy.
- Consumer Confidence at 56.0, up from 40.9 (jobs are plentiful up to 5.8 from 3.6, conditions: present 38.3, future 67.8). Average during Great Recession 53.9. Good is over 90.

Current Conditions in U.S.

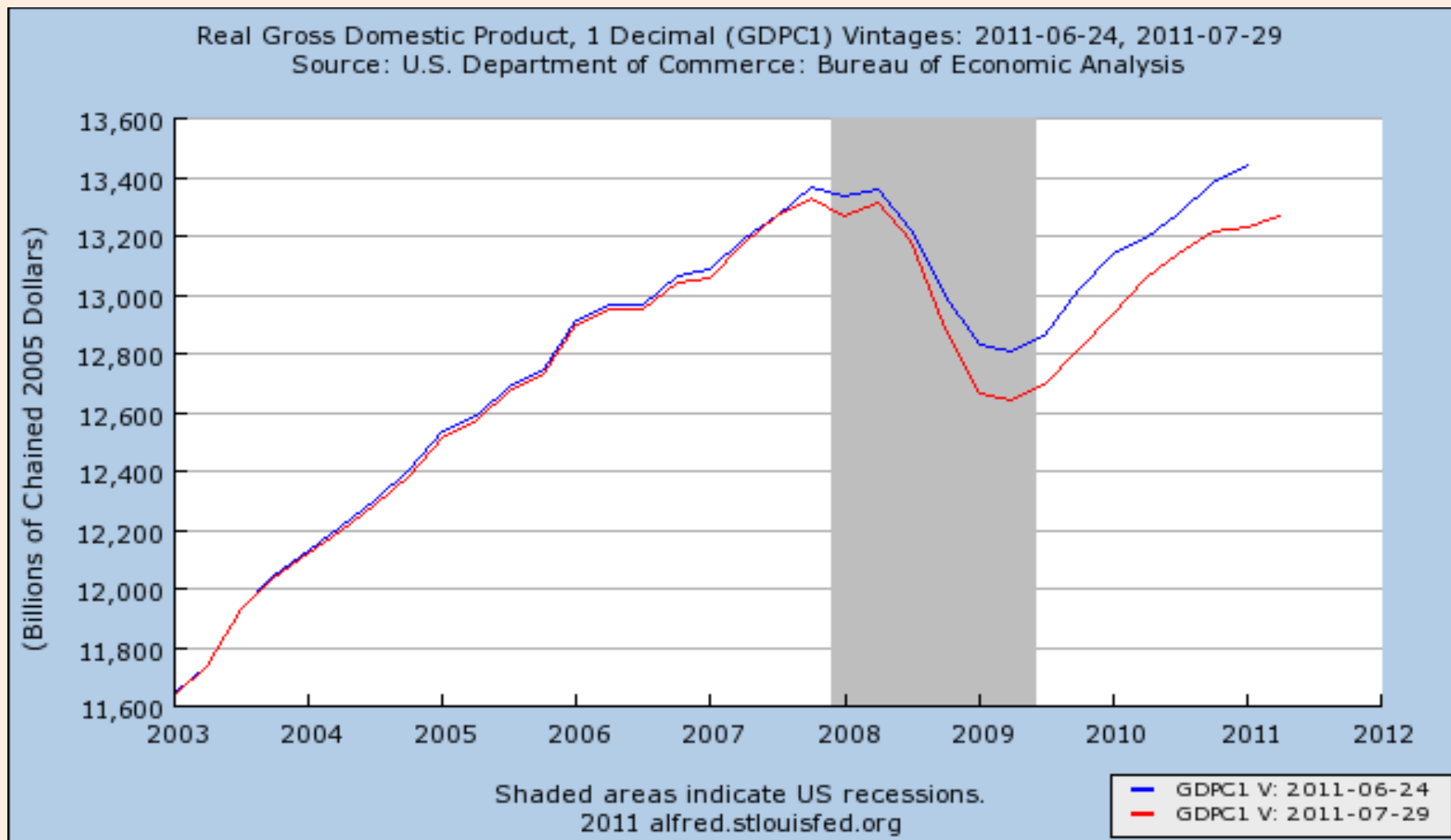
- U.S. Unemployment rate 9.0%.
- Manufacturing PMI 50.8%.
- Official CPI inflation 3.9% yr over yr (Shadow Stats around 11%).
- Retail sales up 7.2% yr over yr, unadjusted for inflation (gas up 15.6%).
- Fed pumping money into banking/financial system at rapid. Funds rate at 0% since Dec 2008 (real interest rates -9% to -11%).

U.S. Unemployment in the 2000s



Red lines indicate Great Recession

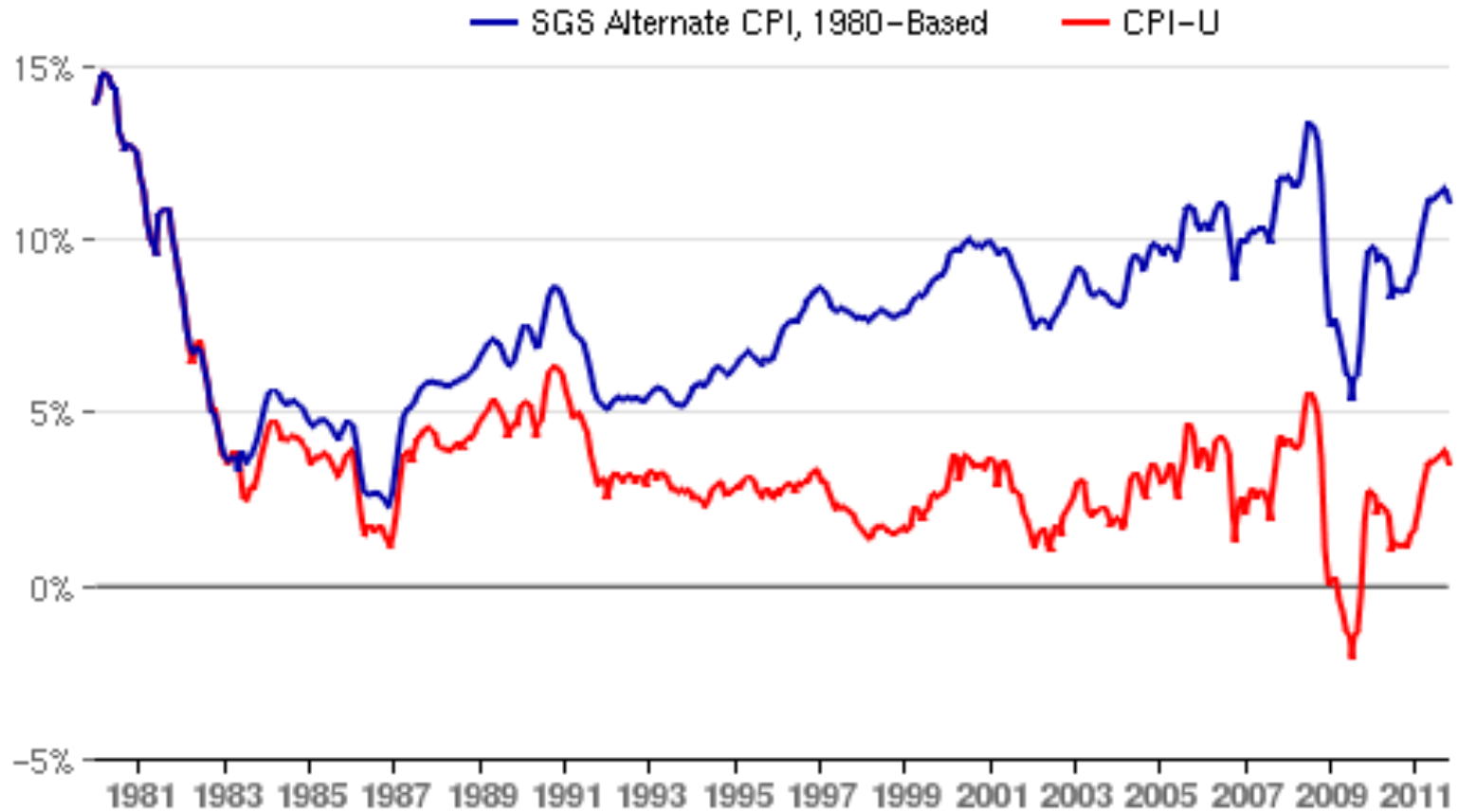
This Year's GDP Revisions Compared to Last Year



Blue line original numbers. Red line revised numbers.

Shadowstats.com and Reported U.S. CPI

Annual Consumer Inflation - Official vs SGS (1980-Based) Alternate
Year to Year Change. Through Oct. 2011. (BLS, SGS)



Published: Nov. 29, 2011

shadowstats.com

Inflation Adjusted Retail Sales

Inflation-Adjusted Retail Sales (Monthly Level)

Through Aug. 2011. Seasonally Adjusted. (SGS, Census, BLS)

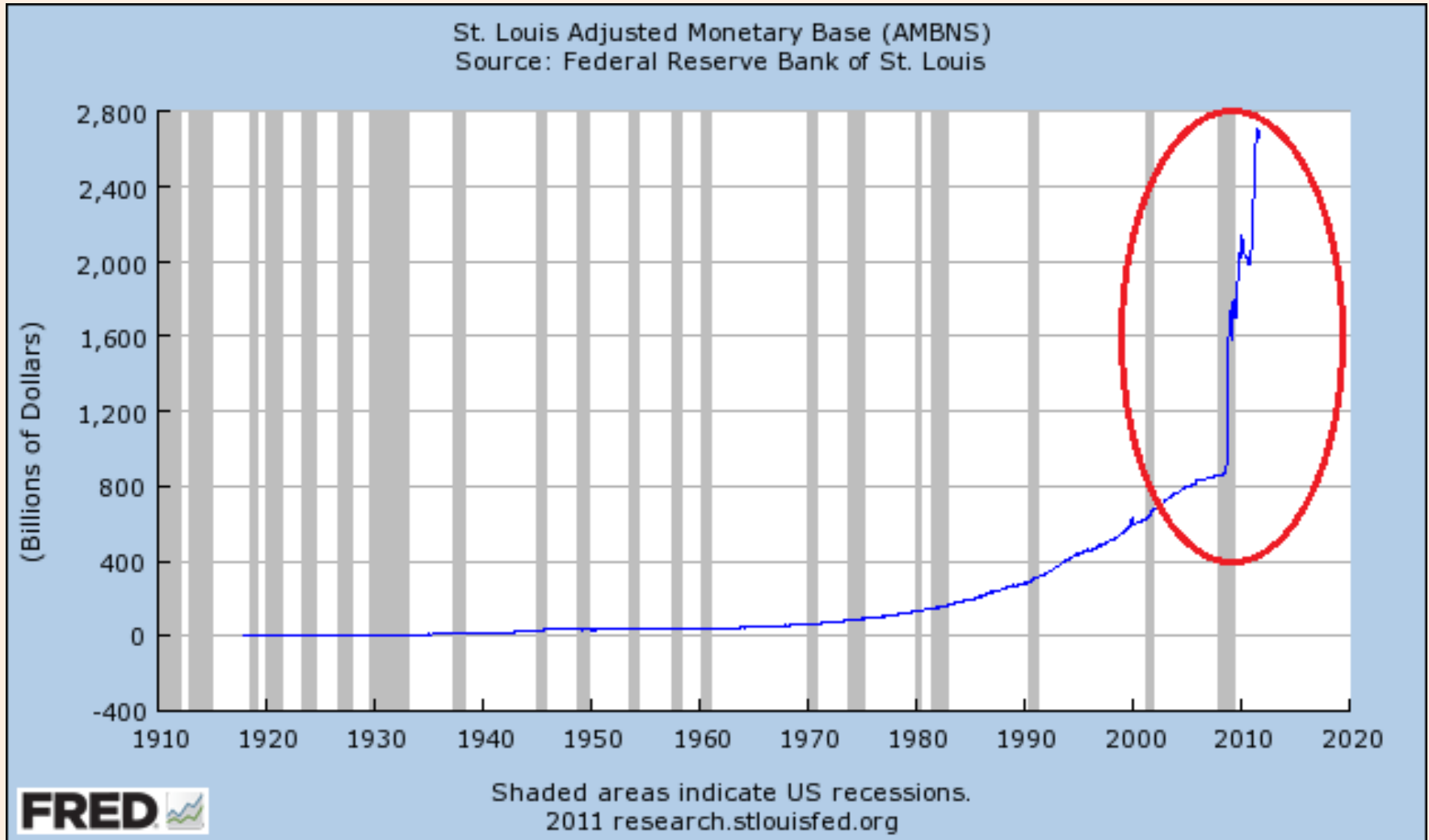
— Adjusted Retail Sales — 3-month Moving Average



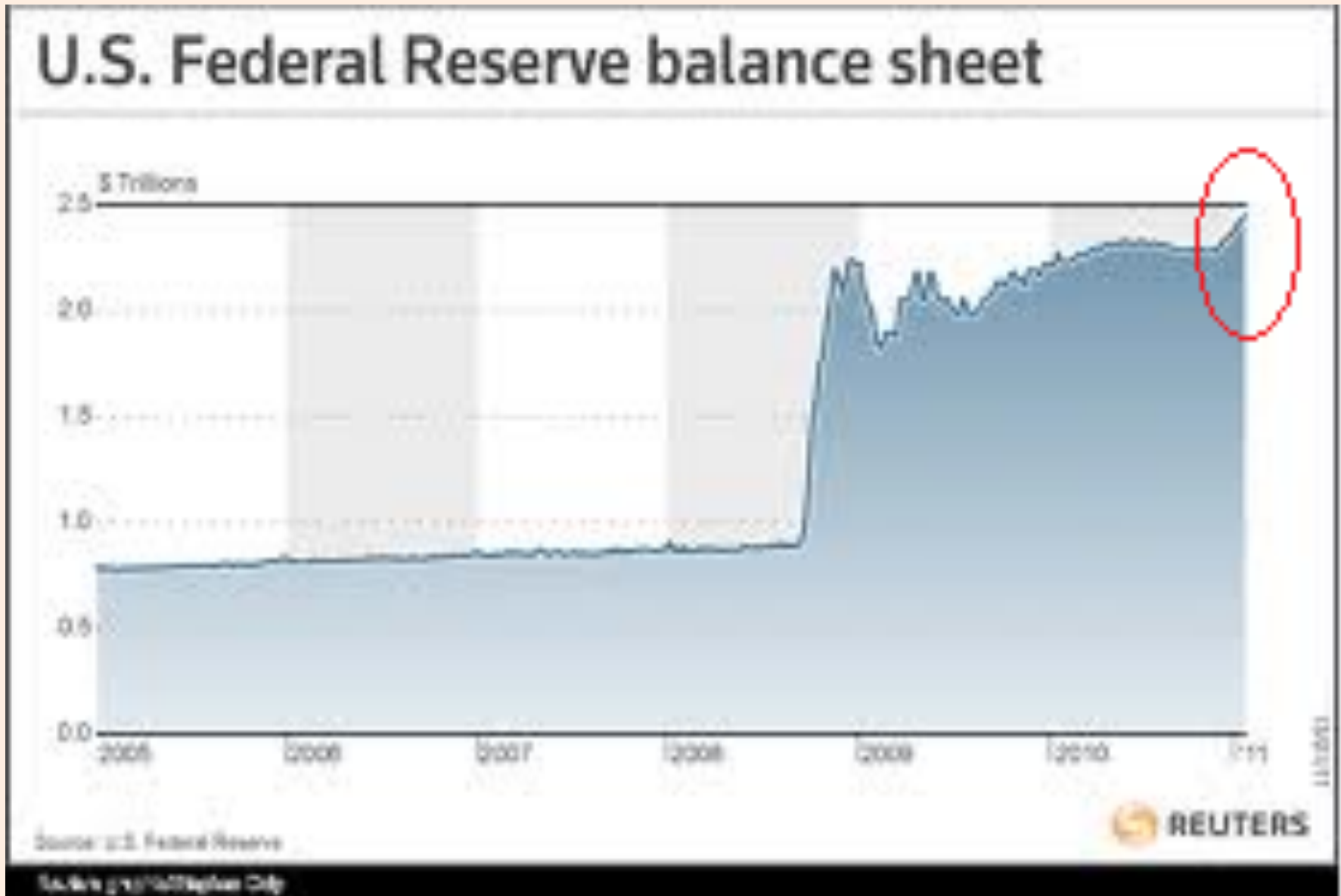
Published: Sep. 15, 2011

shadowstats.com

U.S. Monetary Base – Future Inflation

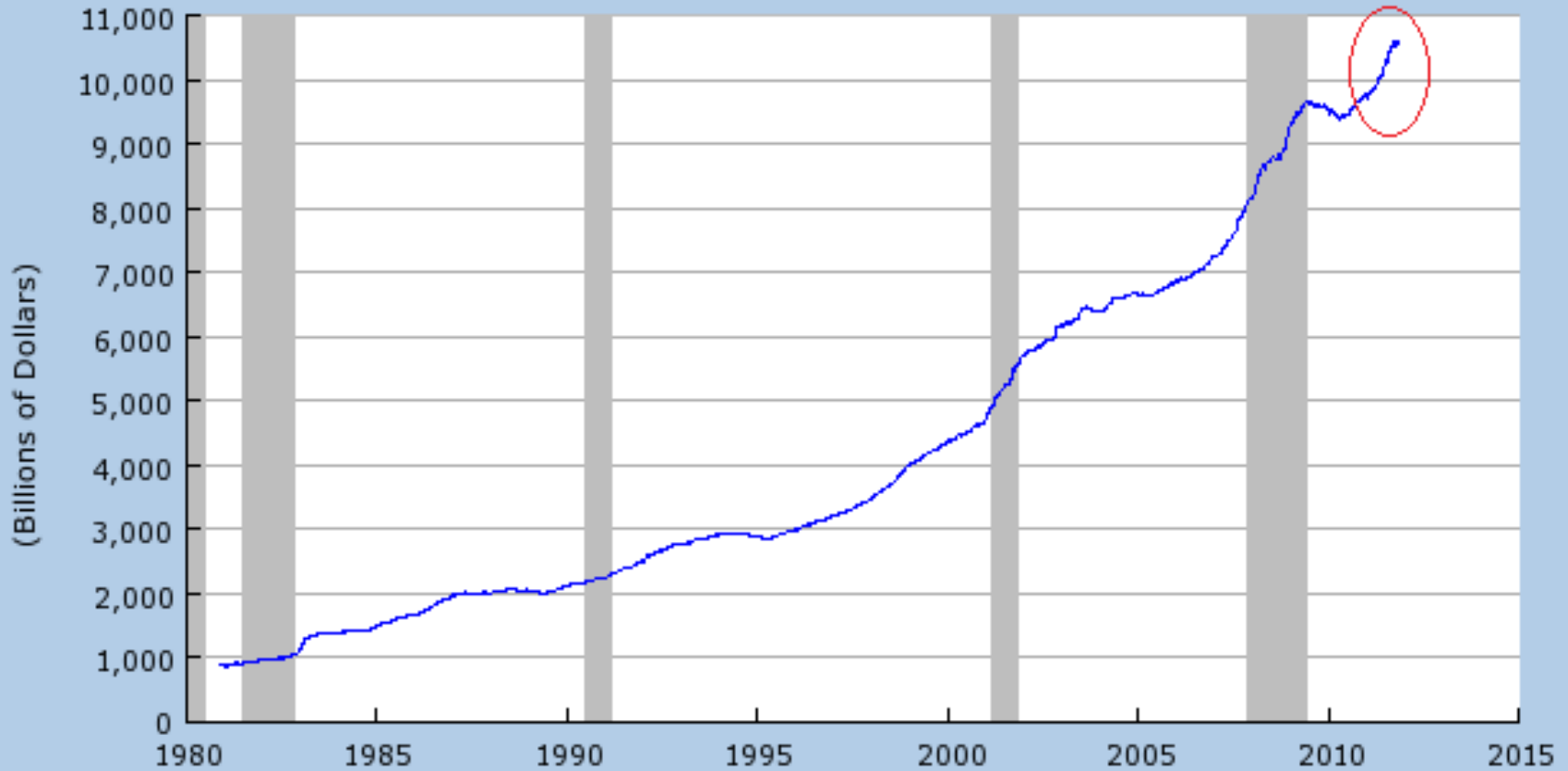


Fed Balance Sheet



MZM Money Supply

MZM Money Stock (MZM)
Source: Federal Reserve Bank of St. Louis



Shaded areas indicate US recessions.
2011 research.stlouisfed.org



Various forms of cash.

Predictions

- Greece will default either 100% or there will be a new rescue plan with a 75% cut for bondholders.
- Interest rates will continue to rise in PIIGS countries until massive bailout or restructuring.
- Euro currency union restructuring most likely.
- A number of bank failures in Europe will require nationalizations.
- Troubles will spread to U.S. banks and they will need bailouts of some sort.
- A secondary financial crisis will appear in Japan.
- Increased global social unrest.

Predictions

- Markets will hit an important bottom.
- New massive global money printing cycle will be needed to revive financial system.
- Fed will engage in QE3 (may not announce it).
- Markets will recover with inflationary assets doing the best.
- Inflation will rise noticeably in UK, U.S., EU, China, India and even in Japan.
- Rising inflation will lead to increased economic growth, which in turn will lead to higher inflation.