Stagflation is Here, and It is a Weapon of Mass Destruction

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U.S. wholesale prices in July 2008 grew at the fastest rate since 1981. The cost of materials has risen 9.8 percent in the last twelve months, according to government data. While gasoline prices fell the week of August 18 to $3.74 a gallon, they remain far higher than the $2.40 a gallon of mid-2005. Meanwhile, the price of food at the grocery store continues to climb, while consumer purchasing power remains stagnant.

According to analyst Michael Hodges, average family income adjusted for inflation declined six percent from 1999 to 2005, and the drop has continued since then. With families no longer able to borrow on their shrinking home equity for purchasing power due to the collapse of the housing bubble, they have had to tap into their savings. According to Hodges, "As of summer 2007, savings were a negative 1.3 percent, an all-time low." (Grandfather Economic Report, August 2008)

The government claimed that GDP grew during the 2nd quarter of 2008—hence no recession—admitting at the same time that the chief driver of growth was the economic stimulus rebates sent by the IRS to taxpayers. The rebates, however, were paid for by more government debt, with a $490 billion federal budget deficit projected for fiscal year 2009 that begins next month.

Whether even the paltry 2nd quarter growth at an annual rate of 1.9 percent was "real" is subject to debate. Since the U.S. began to lose its manufacturing economy, a long-term slide that began after the Vietnam War, all economic growth has been in the services and financial sectors.

The government counts any financial transaction that can be taxed as part of the GDP whether or not it results in the creation of goods and services of tangible value. Bizarrely, a transaction can add to GDP even if it is based on money that has been borrowed and must be repaid with interest in the future.

So this type of debt-based GDP growth can actually be destructive in the long-run. This has happened in the U.S. , where total household, student, business, and government debt will soon be pushing $70 trillion against an annual GDP in 2007 of $13.8 trillion.

The best measure of economic health for working men and women in the producing economy is not GDP but rather M1. This is money available as immediate purchasing power from cash-on-hand, checking accounts, and NOW accounts.

M1 measures what can be bought today without a consumer being required to incur new debt. The amount of money available as M1 has fluctuated in the $1.3-$1.4 trillion range since December 2003. Growth in M1 has essentially been flat.

This means that even moderate inflation can result in erosion of consumer purchasing power. By this measure, the producing economy has been in a mild recession for four-and-a-half years. But according to the M1 Money Stock Forecast of the independent Financial Forecast Center , M1 was projected to fall from June to August of 2008 from 1.3883 trillion to 1.386 trillion.

Thus with inflation now running at close to ten percent, we have entered a period of stagflation potentially worse than the 1970s. And stagflation is nothing less than a weapon of mass destruction aimed at the livelihoods not only of the elderly and those on fixed incomes, but also on students, the unemployed, families, and almost everyone who has a job in the producing economy.

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