

NATIONAL INFLATION ASSOCIATION 2010

U.S. Inflation Report

www.inflation.us

June 2010

Inflation, simply explained, is the printing of money. As the Federal Reserve prints money by expanding the money supply, the U.S. dollar loses its purchasing power. Since the creation of the Federal Reserve in 1913, the U.S. dollar has lost over 95% of its purchasing power. Considering that the purpose of the Federal Reserve was to end the business cycle and preserve the purchasing power of the U.S. dollar, the Federal Reserve has been the greatest failure in American history.

The U.S. constitution stated that only gold and silver shall be used as legal tender for payments. The U.S. dollar was backed by gold until the U.S. government defaulted on its gold obligations when President Nixon ended the gold standard in 1971. A shocking number of Americans still believe the U.S. dollar is backed by gold today, but today it is backed only by faith and confidence that it will always be accepted as money. The U.S. dollar is now a “fiat currency”, as is all major currencies in circulation around the world.

The very existence of the Federal Reserve and the printing of fiat U.S. dollars is unconstitutional, yet there is still no widespread outrage about it. Americans have come to accept inflation as being normal. Most Americans either remember or hear stories from family members about how 60 years ago it cost only 5 cents for a glass bottle of Coca-Cola, 5 cents for a Hershey chocolate bar, and 15 cents for a burger at McDonald’s, but inflation is still the last concern on their minds because these tremendous price increases occurred over a very long period of time. NIA believes it is possible for the price inflation Americans have experienced over the past 60 years, to occur all over again on a percentage basis within the next 6 years.

America’s financial problems today all arise from the government having too much debt. The official U.S. national debt has just surpassed \$13 trillion. This does not include the debts of Fannie Mae and Freddie Mac, which are now backed by the Federal Government. Once you include Fannie/Freddie’s debts of \$6.3 trillion, our real national debt is now \$19.3 trillion. The U.S. also has \$60 trillion in unfunded liabilities for Social Security, Medicare and Medicaid, which bring our total obligations to \$79.3 trillion or about 5 1/2 times our gross domestic product (GDP) of \$14.6 trillion. With consumer spending now making up 71% of our GDP (compared to the long-term average of 65%), it is impossible for the U.S. to ever pay its national debt and unfunded liabilities through taxation.

Total U.S. tax receipts in 2009 were only \$2.105 trillion, less than the \$2.112 trillion Americans received from the government last year in the form of transfer payments for

Social Security, unemployment compensation, welfare, and other entitlement programs. The U.S. government had a budget deficit in fiscal year 2009 of \$1.4 trillion, which is projected to reach \$1.6 trillion in fiscal year 2010. Congress recently raised our national debt ceiling to \$14.3 trillion, which we will easily hit in less than one year.

When a U.S. corporation is publicly traded on the stock exchange, it is expected to follow Generally Accepted Accounting Principles (GAAP). GAAP forces companies to not only report cash earnings losses, but also non-cash losses from the increase in liabilities on its balance sheet. The U.S. government does not follow GAAP when reporting its budget deficit. The official U.S. budget deficit recognizes only our government’s cash losses. Once you account for increases in our unfunded liabilities for Social Security, Medicare and Medicaid, our actual 2009 budget deficit was \$4.3 trillion, more than triple the reported cash deficit of \$1.4 trillion.

It took 25 years for our official national debt to double from \$257 billion in 1950 to \$533 billion in 1975. On September 30th, 2003, the U.S. ended fiscal year 2003 with a national debt of \$6.78 trillion. This means that a few months from now, the latest doubling of our national debt will have occurred in just 7 years! Our official national debt is now growing more than 3 1/2 times faster than decades ago.

It is the Federal Reserve’s manipulation of interest rates that create the booms and busts our economy has experienced over recent decades. In 2001, the U.S. was faced with a collapsing dot-com bubble, which was going to send the U.S. economy into a depression. During the years 1998-2000, companies like eToys.com had market caps of many billions of dollars despite having very little in revenue and large net losses. eToys.com had a market cap (\$10.3 billion) at its peak that was 2 1/2 times larger than Toys R Us (eToys.com lost \$29 million that year while Toys R Us reported a \$372 million profit).

Although a depression in 2001 would’ve been painful for many Americans in the short-term, it would’ve been very healthy for the U.S. economy over the long-term. The free-market would’ve cleaned up the excesses that were taking place and we would already have a very prosperous and fundamentally sound economy today.

Instead of allowing the free-market to operate, Federal Reserve Chairman Alan Greenspan was determined to do everything in his power to prevent a depression from taking place. Greenspan lowered the Federal Funds Rate from a high of 6.5% in 2000 to a low of 1% in 2003, but this did not prevent companies like eToys from going bankrupt (KB Toys acquired eToys’ assets in Chapter 11 bankruptcy for \$5

million). Americans became wise to the conflicts of interest on Wall Street and how analysts on CNBC pumped stocks on the air that their firms were secretly dumping at the same time. With America's trust in Wall Street at an all time low, the Federal Reserve's cheap money quickly found a new asset class for Americans to invest in: Real Estate.

The Real Estate bubble was created entirely by the Federal Reserve's monetary inflation. Although the average American's net worth reached an all time nominal high in 2007 of \$230,000 (at the height of the Real Estate bubble), adjusted for real inflation, the average American's net worth was still about 9% lower than it was at the height of the dot-com bubble in 2000. The truth is, despite the Real Estate bubble, the U.S. has been in a recession since mid-2000. Except for three quarters of miniscule GDP growth in 2004,

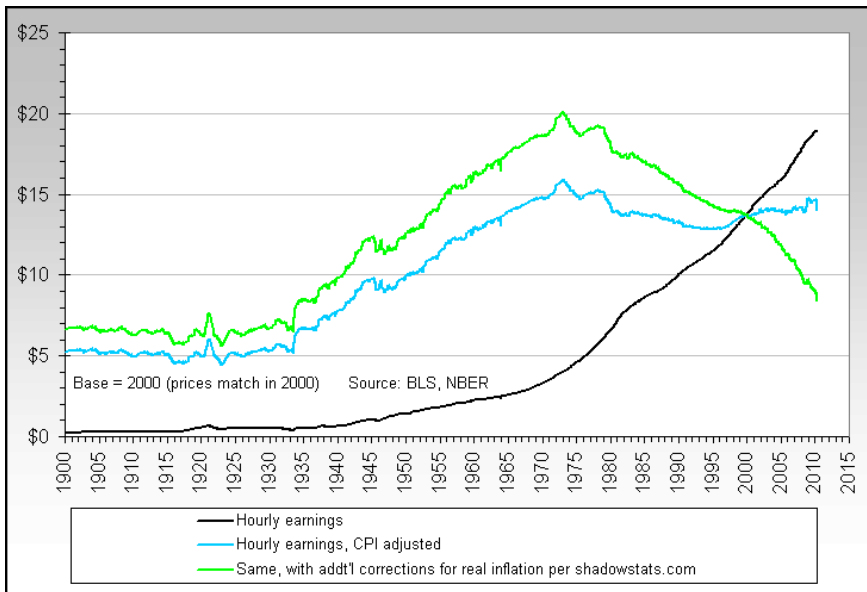
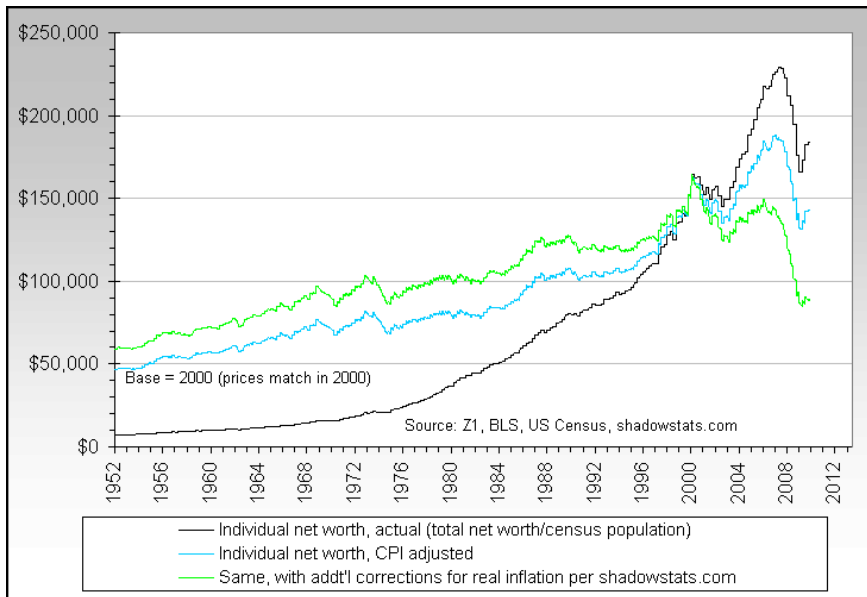
all government reported positive GDP growth from mid-2000 until now has been phony.

Today, the average American's net worth (adjusted for real inflation) is down to year 1970 levels. In terms of income, average hourly earnings in the U.S. is now at a record nominal high of \$18.99; but adjusted for real inflation, hourly earnings is now about half of what it was in the early 1970s. Americans have experienced a dramatic decline in their standard of living since 1970. During the 1970s, it was possible for American college students to pay their own tuition by working part time, without student loans or any help from their parents. (Besides paying their own tuition, many students in the 1970s could also afford their own car and apartment.) Today, college students need to get deeply into debt and have their parents help pay their tuition; students can barely afford to pay for food and beer on their own.

The mainstream media today always makes the mistake of using changes in the Consumer Price Index (CPI) to determine whether or not the U.S. is experiencing inflation. The CPI gets reported on a monthly basis by the U.S. Bureau of Labor Statistics (BLS). NIA conservatively believes that the methodologies used today to calculate the CPI, understate the real rate of price inflation by at least 3% to 4%.

If the CPI is to be believed, Americans today have about the same standard of living that they had 40 years ago. However, all Americans can feel their standard of living decline. The CPI today no longer accounts for the cost to maintain the same standard of living, it more or less accounts for only the cost to stay alive. Adjusted for the real rate of inflation, Americans should be receiving Social Security payments that are approximately double what they receive today.

One of the ways the BLS understates the CPI is through geometric weighting, which provides a higher weighting to goods that are falling in price and a lower weighting to goods that are rising in price. If steak was rising in price but hamburgers were falling, the BLS will heavily weigh the CPI towards



hamburgers. Maybe they are right that some Americans would substitute steak with hamburgers in order to save money, but that would mean a decline in their standard of living.

The BLS also uses hedonics to understate inflation, which account for the increased pleasure of goods. Many IMAX theaters across the country are currently charging \$20 for tickets to see the new movie “Shrek Forever After”. This is an astronomical price increase for a movie ticket, but with hedonics, it’s possible the CPI won’t show any price inflation for this movie because it uses 3D technology.

In 2008 with the bursting Real Estate bubble, the U.S. economy was once again headed towards a depression like it should’ve experienced in 2001. Only this time, the magnitude of this depression would’ve likely rivaled the Great Depression of the 1930s. Federal Reserve Chairman Ben Bernanke, having not learned from Greenspan that you can’t reflate a bubble through the manipulation of interest

rates, lowered the Federal Funds Rate not just to 1%, but to a new all time low in December of 2008 of 0-0.25% where it has been held for an unprecedented 17 months.

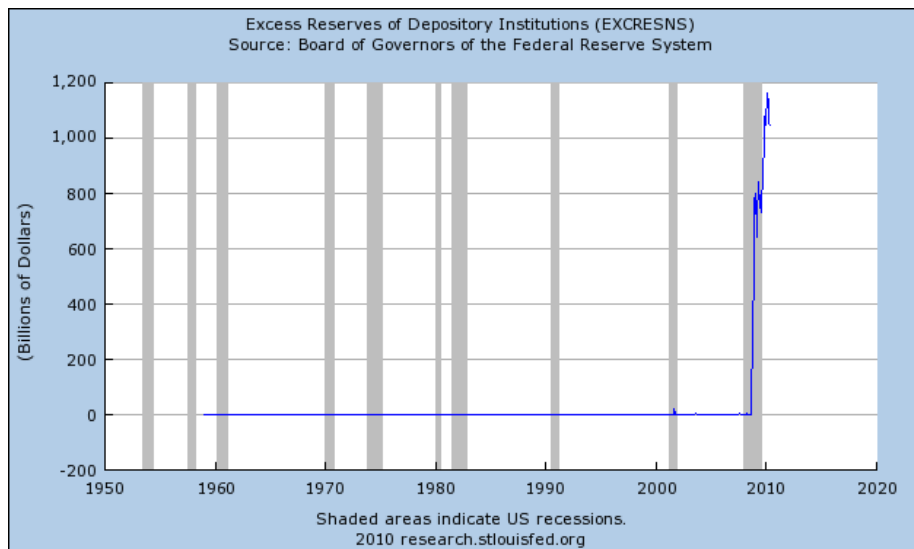
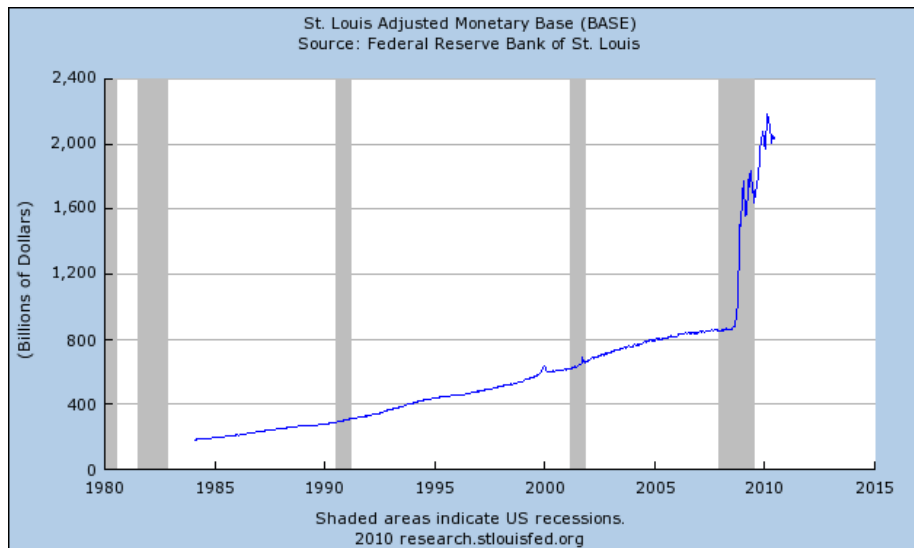
Meanwhile, the Federal Reserve has expanded its monetary base from \$873.8 billion in September of 2008 to its current level of \$2.036 trillion. U.S. financial institutions now have over \$1.045 trillion in excess reserves, compared to only \$59.5 billion in excess in September of 2008. Banks currently have their excess reserves parked at the Fed where they are earning interest.

Based on the BLS’s latest CPI report, the current year-over-year U.S. price inflation rate is 2.02%. Taking into account how the CPI understates inflation, we believe the real rate of U.S. price inflation is currently 5.02% to 6.02%. We doubt that banks will want to keep their \$1.045 trillion in excess reserves parked at the Fed for much longer earning 0.25% interest, when based on the real rate of inflation, those dollars are losing about 5% of their purchasing power

on an annualized basis by sitting there. Eventually, these banks will be forced to seek a higher return than what the Fed is paying them. As these dollars get lent out and enter the money supply, they will multiply through our fractional reserve banking system, creating a huge surge of price inflation.

As price inflation begins to run out of control in the U.S., the Federal Reserve will be forced to raise the Federal Funds Rate. Most likely, when the Federal Reserve begins to raise rates, they will raise them only 1/4 or 1/2 percentage point at a time. Slow increases in interest rates will do little to stop price inflation. Interest rates will remain very inflationary until they reach a level that is higher than the real rate of price inflation. The Federal Reserve needs to raise interest rates immediately up to 5.02% to 6.02%, but by the time they actually do so, we could already have a real price inflation rate of 10% or more.

Back in 1981, Federal Reserve Chairman Paul Volcker was able to put a stop to price inflation by rais-



ing the Federal Funds Rate up to 20%. Back then, we were the world's largest creditor nation with a national debt of only \$909 billion or 33% of GDP. Today, we are the world's largest debtor nation with a national debt that is 14 times larger and 89% of GDP (not including our Fannie/Freddie debts and unfunded liabilities).

Today, it will be more difficult to stop price inflation by raising interest rates, because our country will have to deal with rising interest payments on our national debt that will ultimately have to be monetized. In April of 2010, the U.S. paid \$22.48 billion in interest payments on our national debt for an interest rate on our marketable debt of only 2.498%. Just three years earlier in April of 2007, our total marketable debt interest rate was 4.963% (almost double). We will inevitably see our marketable debt interest rate rise back up to 5%, which will cause our annual interest payments on our national debt to rise above \$500 billion or 23% of projected 2010 tax receipts of \$2.165 trillion.

If the U.S. reaches a point where nearly 1/4 of projected tax receipts go towards just paying the interest on our national debt, it will be a danger zone that it must do everything possible to reverse from. The White House budget is projecting an interest rate on its marketable debt in 2014 of only 4%, but history tells us that artificially high interest rates will eventually be needed to counteract the damage being done today with artificially low rates. By 2014, an outbreak of inflation could cause interest rates on our debt to reach 10%, which based on our likely marketable debt at the time of about \$15 trillion, would equal interest payments of \$1.5 trillion or 43% of projected 2014 tax receipts of \$3.455 trillion.

With the babyboomers beginning to retire, we believe the White House is being overly optimistic by projecting tax receipts to grow from \$2.165 trillion in 2010 to \$3.455 trillion in 2014, a compound annual growth rate of 12.4%. The White House expects to achieve this projected increase in tax receipts through 5.61% annual growth in our GDP along with an increase in taxes from 14.8% of GDP in 2010 to 19% of GDP in 2014.

Americans are already taxed to the hilt. Any additional taxes runs the risk of driving further business out of this country and generating less tax revenues. But let's assume tax receipts do reach 19% of GDP in 2014, how on earth will our GDP grow to \$18.193 trillion?

With our manufacturing base continuing to rapidly deteriorate, any increases to our GDP will likely have to come from an increase in consumer spending (consumer spending would have to rise to 75% of GDP, from its current level of 71%). Considering that the average American peaks in

spending at 46 years old and the last babyboomer will turn 46 in 2010, the U.S. economy is currently positioned to experience a significant decline in consumer spending. The only way it will be possible to increase consumer spending is through massive monetary inflation with further stimulus bills and quantitative easing from the Federal Reserve. (Quantitative easing is the Federal Reserve's term for increasing the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.)

So basically our GDP growth since 2000 has been fueled by inflation, inflation will lead to much higher interest rates and substantially higher interest payments on our national debt, and this will occur while the government raises taxes and Americans contract consumer spending, which will lead to the government trying to create more phony GDP growth through more inflation. This is an endless cycle of doom.

The White House is not projecting the U.S. to ever achieve a balanced budget ever again. Best case scenario, if the White House's projections are correct and we see 5.61% annual GDP growth for the next four years and taxes receipts reach 19% of GDP in 2014 with interest payments on our marketable debt that year of only 4%, we will still have a cash budget deficit in 2014 of \$706 billion.

Meanwhile, Americans are more dependent on the government than ever and will continue to rely more heavily on government entitlements. There are now 40.2 million Americans on food stamps up 21% from one year ago. That is more than 1/8 of the U.S. population. Food stamp usage has increased for 16 consecutive months and 43% of Americans on food stamps have a job. The White House estimates that food stamp usage will increase in fiscal year 2011 to an average of 43.3 million people.

Americans are now only receiving 41.9% of their income from private wages, down from 44.6% in December of 2006 and 47.6% in the first quarter of 2000. Americans are receiving 17.9% of their income from government programs, up from 14.2% in December of 2007 and 12.1% in the first quarter of 2000.

Inflation does not create jobs. Although the official U.S. unemployment rate is now 9.7%, including short-term discouraged workers who gave up looking for a job, the real unemployment rate is 16.9%. If you also include long-term discouraged workers who haven't looked for a job in over one year, 21.7% of Americans are now unemployed.

President Obama recently signed an executive order creating the National Commission on Fiscal Responsibility and Reform with a mission to propose recommendations to balance the budget EXCLUDING interest payments, by

2015. The significance of this executive order is, Obama is effectively admitting that it will be impossible to achieve a real balanced budget again. He is trying to redefine a balanced budget as to not include interest payments, when interest payments will soon rise from a miniscule percentage of the budget outlays to the largest part of it.

If this new commission does its job, it will have to recommend to Obama that the U.S. government cut its mandatory entitlement spending for Social Security, Medicare, and Medicaid, as the U.S. had a cash budget deficit in 2009 from entitlement programs alone. Beginning in 2010, between 1.5 million and 2 million Americans are expected to sign up for Social Security annually, compared to only 500,000 per year last decade. Baby boomers getting ready to retire need to assume now that Social Security won't be there and even if they receive Social Security, the dollars they receive won't have the purchasing power they expect.

Social Security's peg to the CPI will eventually have to be severed. Even though the CPI understates inflation, the CPI will eventually start rising rapidly and a Social Security peg to the CPI will cause a downward death spiral in the U.S. dollar. NIA believes that retirement for most Americans will soon become a thing of the past, as the Social Security ponzi scheme comes to an end.

In NIA's top ten predictions for 2010, we predicted the

U.S. dollar would have a short-term bounce in early 2010 because more people had become bearish on the U.S. dollar than ever before. Since then, the U.S. dollar index has rallied from 75 to 88 and is approaching its high from March of 2009 of 89.

The U.S. dollar index only compares the value of the U.S. dollar to other fiat currencies and is heavily weighted against the euro. The best way to determine the purchasing power of the U.S. dollar is the price of gold. Despite the huge rally this year in the U.S. dollar index, the price of gold rose to a new all time nominal high on June 8th of \$1,252.10 per ounce.

The U.S. dollar index has rallied in 2010 only due to the declining euro, which has been fueled by the debt crisis in Greece. Greece had a budget deficit in fiscal year 2009 that reached 13.6% of its GDP. As a member of the eurozone, Greece's budget deficit wasn't supposed to exceed 3% of GDP.

The European Union and IMF recently put together a 110 billion euro (\$132 billion) rescue package for Greece. As part of the bailout, Greece has agreed to slash government spending and reduce their budget deficit to 8.1% of their GDP in 2010 and to below the 3% ceiling by 2014. Greece is now having to implement austerity cuts of almost 14% of its GDP. Greece has slashed wages and pensions across the



board for civil servants, which is causing rioting and civil unrest across the country.

Other eurozone countries also have major financial problems. Fitch Ratings just downgraded Spain's debt from AAA to AA+. Spain has a budget deficit of 11.2% of GDP and the country has pledged to cut 2011 spending by 7.7%. Even Italy, which is in much better shape than Greece and Spain, just announced 24.9 billion euros worth of budget cuts to take place over the next two years.

All of the problems in Europe have only served as a distraction from the real debt crisis in the U.S. If you do a search on Google for "Greece Debt Crisis", there are now 17.3 million web results and 711 news results. If you do a search on Google for "U.S. Debt Crisis", there are only 616,000 web results and 9 news results. The U.S. has a GDP that is 41 times larger than Greece and should be the focus of attention.

The U.S. economy has stayed afloat until now due to the U.S. dollar's status as the world's reserve currency. Because the world trades oil and other valuable commodities in U.S. dollars, foreign countries have a need of holding large amounts of U.S. dollar reserves. This has allowed the U.S. to print money instead of producing goods. Up until now, the U.S. has been successful at convincing the Chinese to roll over their maturing U.S. treasuries plus interest into larger amounts of new ones. The U.S. has effectively exported its inflation to China in return for the goods that they produce.

The U.S. dollar became the world's reserve currency because it was backed by gold and the U.S. had the world's largest manufacturing base. Today, there is no reason for the U.S. dollar to remain the world's reserve currency and the U.S. is abusing the dollar's reserve status. China is slowly taking steps to move away from the U.S. dollar and we could soon see China begin trading oil with Saudi states using a new basket of currencies.

China's currency is currently pegged to the U.S. dollar so that the Chinese can maintain the status quo of exporting their goods to the U.S. Although this is good for export companies in China, it is bad for Chinese citizens who are seeing their standard of living artificially suppressed. U.S. politicians are now calling China "currency manipulators" and demanding that the Chinese allow their currency to strengthen. U.S. politicians believe it is China's currency peg that is causing the U.S. to have such a huge trade deficit and if the Chinese allow the yuan to rise, the U.S. would be able to increase its exports.

The truth is, if China allows their currency to rise, the U.S. trade deficit would shrink not because the U.S. would

export more goods, but because the U.S. won't be able to afford as many imports from China. The Chinese will use their savings and more valuable currency to purchase their own goods that they produce. The Chinese will see an increase in their standard of living, while America's standard of living falls off a cliff.

In order to have a real, fundamentally sound economy, you need to have a strong manufacturing base. In the early 1900s, clothing trade was the largest industry in New York, with triple the output of its second largest industry, sugar refining. 70% of U.S. women's clothing and 40% of U.S. men's clothing was produced in New York. Today, the textile industry in New York is nonexistent and 34.5% of the clothes purchased in the U.S. was made in China. Decades ago, the U.S. also had television manufacturers like RCA and Zenith, but today there are no television manufacturers left.

India just reported 8.6% GDP growth for the first quarter of 2010, due to manufacturing activity in the country rising to its highest level in 27 months. Meanwhile, the U.S. manufacturing sector saw 448 mass layoffs of 50 or more employees during the month of April, accounting for 24% of total mass layoffs for the month.

In order for the U.S. to rebuild its manufacturing base, Americans need to increase their rate of savings. After the financial crisis of late-2008/early-2009, the first instinct of Americans was to start saving and the U.S. savings rate tripled to a high in May of 2009 of 6.2%. After the U.S. government interfered in the free market with bailouts and artificial stimulus bills, the savings rate plummeted in half to 3.1% in March of 2010. 43% of Americans now have less than \$10,000 saved for retirement.

If the free market was allowed to function, it would persuade Americans into having a savings rate of 10% or higher. The Federal Reserve's manipulation of interest rates to artificially low levels is preventing Americans from increasing their rate of savings to a healthy level. 20 years ago, senior citizens were able to purchase Certificates of Deposit (CDs) and live off of the interest they collected. With just \$200,000 in a CD, seniors would earn \$17,000 per year in interest income. Combined with social security, they had plenty of money to live comfortably.

Today, \$200,000 in a CD would only earn \$600 per year in interest income and \$600 today only has the purchasing power of \$150 compared to 1990. This means seniors are now earning 99% less interest income on their savings compared to 20 years ago. It's easy to see how the Dow Jones rallied by 74% from its low in March of 2009. Americans are being forced to speculate with their money.

The very day the Dow Jones reached its 12 1/2 year low in March of 2009 of below 6,500, NIA released an article entitled, "The World is Awashed with Dollars". Everybody called us crazy and asked us what planet we were on and what market we were looking at. The mainstream media, which has proven time and time again that it only has the ability to look in a rear-view mirror, was warning about a major threat of "deflation". NIA understood that the real threat was inflation and Americans weren't going to sit there on the sidelines with worthless pieces of paper paying practically no interest.

So we saw the Dow Jones rally to a high one year later in April of 2010 of 11,257.93. The mainstream media, still as ignorant as ever, began declaring that the U.S. is in the midst of an economic recovery. There were no jobs being created, with the unemployment rate remaining steady at a multi decade high, but the media declared that rising stock prices are a leading indicator for job growth in the future.

The media also declared that there was no inflation. Despite the Federal Reserve expanding its monetary base by 133%, according to the media there was no inflation because the government's phony CPI only showed prices up 2.02% from a year ago (near the Federal Reserve's price inflation target of 2%). The media was simultaneously mystified by rising gold prices. CNBC and FOX News commentators openly questioned themselves on the air about why gold prices were soaring to new all time nominal highs, despite their belief that there was no inflation. They came up with wild explanations as to why gold prices are rising, such as Indians buying gold in preparation for India's wedding season.

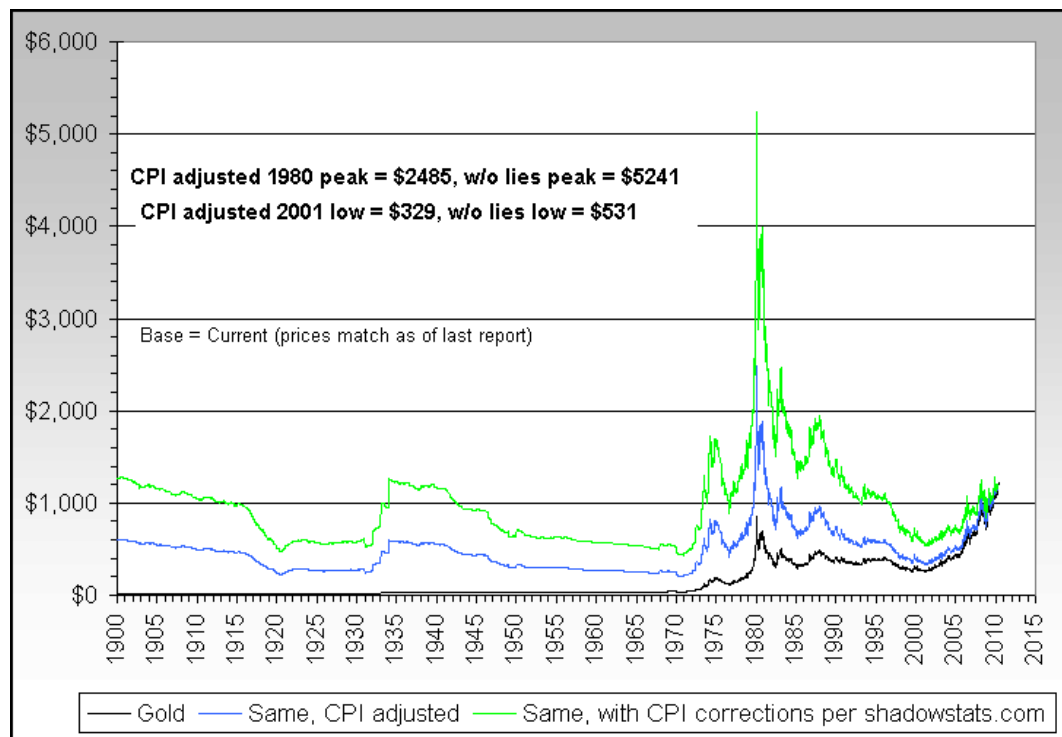
What if maybe, just maybe, the U.S. isn't in the midst of an economic recovery and stocks are rising only due to inflation? After all, gold is the best gauge of inflation, not the CPI index. This would certainly explain why there are no jobs being created (except for temporary census jobs that add no production to our

economy and will be paid for with more inflation).

CNN is now frequently airing stories saying that we have a "gold bubble". Just the fact alone that CNN says gold is a bubble, proves it's not a bubble. How many stories did CNN run in 2005 warning Americans about a Real Estate bubble that was about to collapse? In one CNN story from January of 2005, they said we would need to see an increase in the 30-year mortgage rate to 7.5% "before it starts to cut into home sales" but even then it would only "cut the pace of price increases for homes, rather than send housing values lower."

The closest thing we could find to CNN discussing the possibility of a Real Estate crash in 2005 was an article entitled, "How much is too much in real estate?" in which one of their analysts said, "I'm not predicting a real estate crash. But as more and more people like yourself begin chasing returns in real estate and bidding prices up, the harder it's going to be for real estate investors buying at those higher prices to earn the same sort of returns we've seen in recent years."

The bottom line is, the media has the worst track record in the world when it comes to predicting bubbles. The media sees gold at a new all time nominal high and they call it a bubble, without realizing that gold is still only trading for about 1/2 of its all time high adjusted to the CPI and 1/4 of its all time high adjusted for the real rate of inflation. Absolutely nobody in the media talks about how we actually have a government debt bubble and a dollar bubble.



Ironically, gold will only become a bubble if the government eliminates most of its departments, defaults on its Social Security obligations, and shrinks the military-industrial complex, along with the Federal Reserve dramatically raising interest rates. Only if these measures are taken, and taken very soon (before a very noticeable outbreak of price inflation where the world pulls the plug on the dollar), will it be possible to prevent a total collapse of our fiat currency system. Considering the rioting and civil unrest in Greece after the country announced plans to cut civil servants' entitlements by just 12%, one can only imagine the chaos that will ensue in the U.S. if our government announces much larger and more dramatic cuts to take place here.

In the unlikely event we are able to prevent a complete loss of confidence in the U.S. dollar, it will be possible that gold prices will overshoot to the upside at some point. If gold reaches \$10,000 per ounce and the U.S. makes the cuts necessary to balance its budget (including interest payments) and passes a Balanced Budget Amendment to the United States Constitution, which mandates that the U.S. always balance its budget, we could see gold make a sharp 50% decline back down to \$5,000 per ounce.

If we had to bet one way or the other, we would bet that U.S. politicians will never have the courage to make the tough decisions needed to save the U.S. dollar. Most likely, the Federal Reserve will become the U.S. treasury buyer of last resort and monetize our national debt, unfunded liabilities, and future deficit spending. In this scenario, gold prices could literally rise to infinity and there may never be a time for Americans to exit gold.

With the Dow Jones now having dipped as much as 13% from its April high, back down to 9,758, the mainstream media is now declaring that the U.S. economy could be at risk of a "double dip recession". Americans are now nervous that another collapse in stock prices could be ahead, just like we saw in late-2008/early-2009. In our opinion, another nominal crash in stock prices is very unlikely because

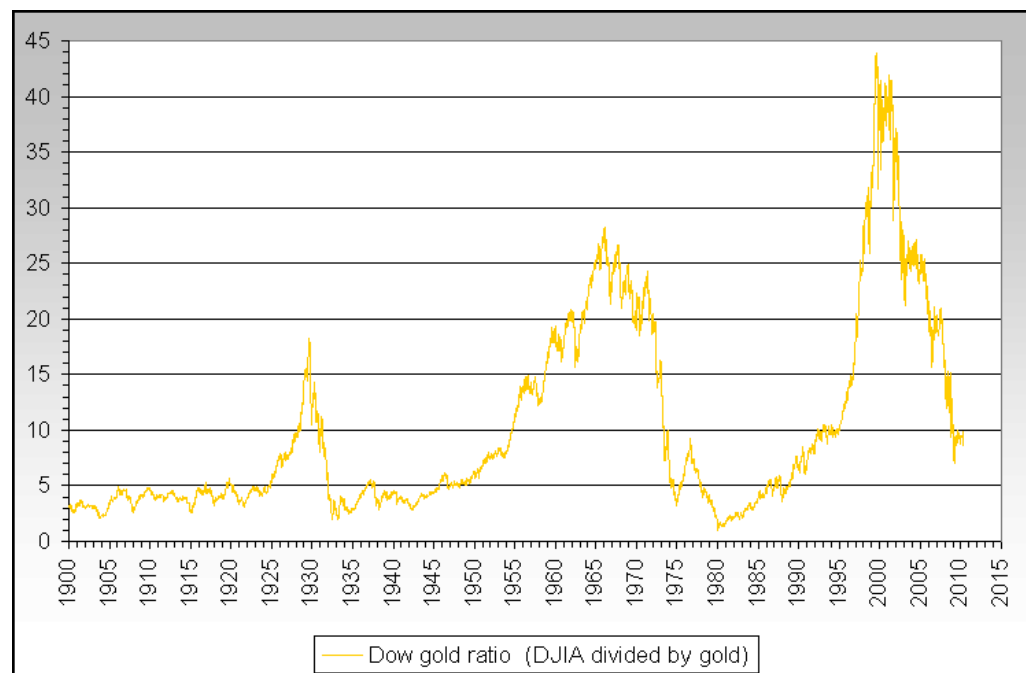
Washington is already calling for an additional \$200 billion stimulus package, in addition to the \$787 billion stimulus bill Congress passed last year.

While we certainly believe there is a risk of the Dow Jones declining by another 10% nominally, any further short-term decline in stocks will only encourage the Federal Reserve to leave interest rates near zero and implement additional quantitative easing. Therefore, we believe there will be a floor under stock prices at some point, but no floor under the U.S. dollar. Our next crisis won't be a crisis of declining stock prices, but it will instead be a currency crisis.

NIA considers nominal gains or losses in the Dow Jones to be meaningless. NIA cares most about how the Dow Jones performs in terms of gold. We determine this simply by dividing the price of the Dow Jones by the price of gold, which gives us the Dow/Gold ratio. In NIA's top 10 predictions for 2010, we said we believed that the Dow/Gold ratio would decline in 2010 from 9.3 to below 7. So far this year, it has declined from 9.3 down to a low of 7.9.

The Dow/Gold ratio chart is the most important chart in the world because it shows the cyclical nature of the battle between paper assets like stocks and hard assets like Gold. The Dow/Gold ratio trends upward during secular bull markets in paper assets when everybody is fixated on growth. The Dow/Gold ratio trends downward when the growth phase ends, and everybody's concern is to preserve their wealth.

The Dow/Gold ratio overshot to the upside in 1999 when it reached a high of 44, signaling the end of the greatest



bull market for stocks in history. Since then, it has been in free fall and we are 100% sure that the current decline in the Dow/Gold ratio is far from over. After the inflationary crisis of the 1970s, the Dow/Gold ratio bottomed at 1. In the 1930s during the Great Depression, the Dow/Gold ratio bottomed at 2. NIA projects we will see the Dow/Gold ratio decline to a range of between 1 and 2 within the next 3 to 5 years. This means we expect to see another 76% to 88% decline in stock prices, in terms of real money.

NIA never makes projections for stock prices in terms of dollars because it's impossible for anybody to know exactly how much monetary inflation Bernanke will create. If the Federal Reserve prints enough money, the Dow Jones could rise to 50,000 within a few years. Our point is, if the Dow Jones rises to 50,000, gold will likely rise to between \$25,000 and \$50,000 per ounce. Therefore, people who own stocks would actually be losing a large percentage of their purchasing power, while the people who own gold retain their purchasing power.

Stocks provide some protection against inflation, but only to the extent that the companies you invest in own real underlying assets backing up their shares. Although we expect the overwhelming majority of stocks to lose their purchasing power in terms of gold, we believe a select few stocks have the potential to outperform gold, mainly the stocks of companies that mine for precious metals. Buying stock in gold and silver miners could provide you with a great deal of leverage because most producing gold and silver miners have market caps that are only a fraction of the value of their reserves in the ground. This is because it is very costly to extract gold and silver from the ground and there are many risks when mining for precious metals.

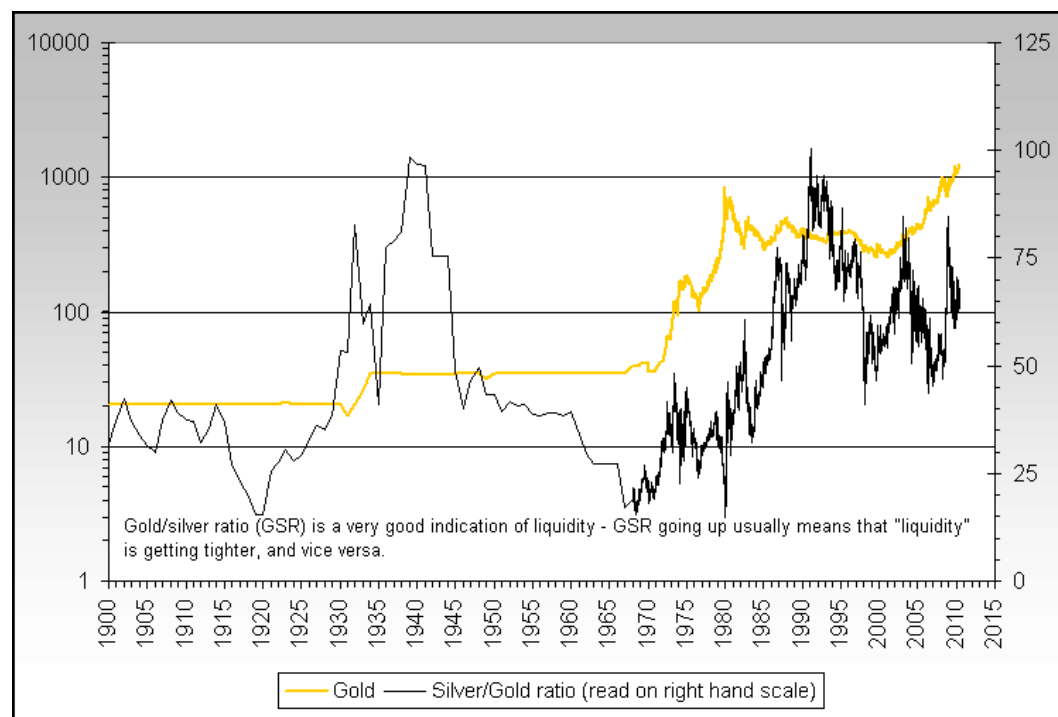
Newmont Mining, for example, currently has a market cap of \$26.39 billion with 91.8 million ounces of proven and probable gold reserves. This means their gold reserves are being valued at only \$287 per ounce or less than 1/4 of the current price of gold.

Because many of Newmont's mining costs are fixed, it's possible that as the price of gold increases and Newmont's revenues rise, their operating profit margin will increase on a percentage basis. Already, Newmont saw their operating profit margin rise from 20% in calendar year 2008 to 38% in calendar year 2009.

One of the largest expenses for gold mining companies is oil. Although oil is certainly not a fixed cost and we expect oil prices to eventually rise back above \$100 per barrel, the gold/oil ratio is now 17, well above the historical average of 10. This is very bullish for gold miners and could help many of them beat profit expectations in the quarters ahead. Another one of the largest expenses for gold miners is wages and we are sure no gold miners (or companies in any industry for that matter) will increase their wages at the same rate as rising gold prices.

Gold is the best possible hedge against inflation because it is the most liquid asset in the world. If you own gold, it will always be possible to exchange it for any fiat currency instantaneously. Gold is easy to transport, easily dividable, very durable, fungible (one piece is equivalent to another - which is why diamonds can't be used as a money), difficult to counterfeit, easily recognizable, expensive to produce (it can't be printed), and it's easy to determine its value at any time.

Silver has all of these same qualities making it just as good of an inflation hedge as gold. The price of gold is currently 67 times more expensive than silver, despite the fact that throughout world history only 10 times more silver has



been produced than gold and almost all of the silver ever produced has been consumed for industrial purposes.

If you go back to the beginning of the 11th century, gold was worth 10 times more than silver until year 1250, when the gold/silver ratio slowly started its rise up to 15 in year 1792. The Coinage Act of 1792 officially defined a gold/silver ratio of 15, which lasted for 42 years until the Coinage Act of 1834 increased the gold/silver ratio to 16. The gold/silver ratio stayed at 16 for 39 years until silver was demonetized in 1873.

The gold/silver ratio remained in between 10 and 16 for 873 years! During the past 100 years, the gold/silver ratio declined to 16 on three separate occasions. Most recently, after the inflationary crisis of the 1970s, the gold/silver ratio briefly touched 16 in 1980 at roughly the same time as the Dow/Gold ratio reached its low of 1.

NIA believes silver is the best investment for this decade. Silver is currently receiving almost no monetary premium and is being valued for its industrial uses only. When the gold/silver ratio inevitably returns to 16, those who own silver will see a 4.1875 times increase in their purchasing power compared to those who own gold.

It's estimated that only 1 billion ounces of above ground silver bullion exist in the world today, worth a total of \$18 billion. Meanwhile, it is estimated that there are 2 billion ounces of above ground gold bullion in existence, worth a total of \$2.4 trillion. This means the total value of available gold bullion in the world is worth 133 times more than the available silver bullion.

The U.S. Mint sold 3,636,500 American Eagle silver coins during the month of May 2010, a new monthly record. The U.S. mint also sold 190,000 American Eagle gold coins during the month of May 2010, the most sold in a month since 1999. Based on May's sales, the U.S. Mint is now selling 43,638,000 American Eagle silver coins and 2,280,000 American Eagle gold coins on an annualized basis. The dollar value of these annualized sales is \$785.5 million for silver and \$2.7 billion for gold. This means 3.44 times more money is being invested into American Eagle gold coins than silver coins.

Think about this, the dollar value of the world's total available gold bullion is 133 times more than the world's total available silver bullion, but U.S. investment demand for gold is only 3.44 times greater than silver. Silver might not only be the best investment for this decade, it might also be the greatest investment opportunity in world history!

All U.S. mines combined only produce approximately 40 million ounces of silver annually, which is not enough to cover the current annualized investment demand for

American Eagle silver coins. Once you take into account how industrial applications and photography consume about 90% of the silver produced each year from both mining and recycling, a major physical silver shortage could be imminent. When investors who own paper silver contracts begin calling for physical delivery of silver, we could see the largest short squeeze in the history of all commodities and an explosion in silver prices like the world has never seen before in any type of asset.

NIA considers it to be hideous that CNBC and other mainstream media outlets continue to invite on and give credibility to people like Dave Ramsey. Ramsey calls precious metals, "dumb", "speculative", "volatile", and one of the "weirdest" investments. He recommends to his viewers that they purchase CDs and tells them that once they save up enough money they should buy rental properties because, "People always need housing."

On the surface, U.S. dollars appear to people like Ramsey to be a safe and stable asset because they have a number on them that always stays the same. They fail to realize that when gold prices jump around, it's not the value of gold that's changing. What volatility in the price of gold is actually showing us is the unstableness of the U.S. dollar.

Gold is the most stable asset the world has ever seen. In 1970 you could buy a nice men's suit for 1 ounce of gold or \$35. Today, you can still buy a nice men's suit for 1 ounce of gold, but \$35 will only buy you a nice t-shirt.

If the U.S. dollar was stable like Ramsey thinks it is, gold would still be \$35 per ounce. Gold rising from \$35 to above \$1,200 shows us that the U.S. dollar has lost over 97% of its purchasing power in terms of gold. His recommendation to buy CDs is completely idiotic, when short-term CDs are paying only 0.3% in interest. If you buy CDs, you are guaranteed to lose about 5% of your purchasing power each year (based on the current rate of price inflation), which is why we are so confident banks will soon start lending their \$1.045 trillion in excess reserves.

In regards to owning rental properties, Ramsey needs to look back at what happened to landlords in Weimar Germany during hyperinflation. During the years 1912-1913 in Weimar Germany before hyperinflation occurred, the average household spent 30.2% of their monthly expenditures on rent. By the third quarter of 1923, rents fell to just 0.2% of the average household's monthly expenditures. At the height of hyperinflation in Weimar Germany, households were spending 91.6% of their monthly expenditures on food, making it impossible for landlords to raise rents in any meaningful way. With a piece of fruit costing more than a month's rent, landlords saw their real rental income

evaporate.

Unfortunately, the majority of Americans don't think for themselves. They get suckered into believing the financial advice of Ramsey and others who spew the same nonsense. Ramsey, who should've been chastised for being so wrong about the U.S. economy for so many years, is now quoted in the media more often than ever and was rewarded by FOX Business with his own television show.

Real Estate is not a good hedge against inflation because it's an asset that is very difficult to sell. In today's market it usually takes at least 12 to 18 months to sell a house and the transaction involves inspections, mortgage approvals, contracts, brokers commissions, etc.

NIA pays very close attention to the median U.S. home price/silver ratio. The national median home price is currently \$166,100 or 9,100 ounces of silver. When silver reached its all time high in January of 1980 of \$49.45 per ounce, the median U.S. home price at the time was \$62,900 or 1,272 ounces of silver. If we see the median U.S. home price/silver ratio return to its low from 1980, we will see another 86% decline in Real Estate prices, in terms of silver. NIA believes if you invest your cash into silver today, instead of Real Estate, you will be able to afford a house that is at least 7 times nicer within the next 5 years or so.

There is currently a huge shadow inventory of homes that have been foreclosed on but held off the market as banks setup the infrastructure necessary to sell them and wait for housing demand to recover (wishful thinking). NIA believes this shadow inventory is now up to approximately 2 to 3 million homes and many of them could begin hitting the market in the second half of 2010.

As the millions of homes in the shadow inventory begin hitting the market, those who have been patiently trying to sell their home for the past 12 to 18 months without receiving an offer that is acceptable to them, will rush to lower their asking prices in order to dump their homes as quickly as possible. Currently, about 1/4 of all mortgages are underwater, but as homeowners readjust their asking prices, the underwater rate could quickly reach 1/2 of all mortgages.

We estimate that between 25% and 50% of Americans who are underwater in their mortgages, will likely choose to walk away from their homes. Combined with many adjustable-rate mortgages that are getting ready to reset, the U.S. will likely experience a second wave of mortgage defaults in the near future. Along with the recent expiration of the government's \$8,000 tax credit for new home buyers, which was helping to artificially prop Real Estate prices up, it's possible that Real Estate prices will soon resume their downward spiral and won't reach a bottom until they hit a

new all time inflation adjusted low.

For anyone who is still not convinced we are already experiencing annual price inflation of at least 5.02% to 6.02% in the U.S. today, look at college tuition costs, look at health insurance costs - even the government admits these costs are rising out of control each year, yet nobody in the media connects the dots and says that it's a result of the Federal Reserve's monetary inflation. Sure, there are hundreds of factors that are driving college tuition and health care costs sky high, but the Federal Reserve is the root cause of it all.

Inflation gravitates towards every part of the economy at different rates and times. Oil's rise to \$147 per barrel in 2008 was also a result of the Federal Reserve's inflationary policies, which allowed hedge funds to speculate on huge amounts of leverage. If the free market was allowed to function without the Federal Reserve manipulating interest rates, we wouldn't have had any of the recent oil, college tuition, and health care crises.

On October 30th, 2009, NIA published an article entitled, "U.S. Inflation to Appear Next in Food and Agriculture". Since then, wholesale food prices have been up 6 months in a row including a 2.4% increase in March, the largest monthly increase in 26 years. Some of the startling wholesale food price increases on a year-over-year basis include, fresh and dry vegetables up 56.1%, fresh fruits and melons up 28.8%, eggs for fresh use up 33.6%, pork up 19.1%, beef and veal up 10.7% and dairy products up 9.7%. Wholesale food price increases foreshadow price increases to come later in retail stores. With unemployment as high as it is, many retailers have been reluctant to pass along food price increases to consumers, but soon they will be forced to if they want to avoid huge losses.

Our fear is that if we experience hyperinflation in the U.S., rather than politicians dealing with the root cause (their deficit spending and the Federal Reserve's monetary inflation), they will instead implement price controls and force retail stores to sell food at government mandated prices. As experienced in Zimbabwe, when a government implements price controls to battle hyperinflation, it always leads to empty store shelves.

From 1980 to 2000, the country of Zimbabwe experienced an average annual price inflation rate of just 23.6%. However, in February of 2006, Zimbabwe President Robert Mugabe ordered their central bank to print Z\$20.5 trillion to pay off IMF debt. This caused prices to go through the roof and in May of 2006 their central bank printed another Z\$60 trillion to pay for a 300% salary increase for soldiers and policemen. In August of 2006, three zeroes were chopped off of Zimbabwe's currency to form a new Zimbabwe

dollar. In June of 2007, Zimbabwe's central bank printed ZW\$1 trillion of their new currency to pay for a 900% salary increase for soldiers and policemen. By February of 2008, the total Zimbabwe money supply reached ZW\$800 trillion and it cost ZW\$100 billion just to buy three eggs.

Price inflation in Zimbabwe grew from 1,281.11% in 2006, to 66,212.3% in 2007, and 231,150,888.87% in 2008. In April of 2009, the Zimbabwe dollar was declared dead and completely worthless. Zimbabweans were forced to spend their days panning rivers for gold. Each person in Zimbabwe needed to find 0.3 grams of gold per day to buy enough food to survive.

Yugoslavia financed their budget deficit by printing money and saw their prices increase by 5 quadrillion percent, making it the worst case of hyperinflation in history. Similar to Zimbabwe, Yugoslavia's government implemented price controls which led to empty store shelves, gas stations closing, thieves robbing hospitals of scarce drugs and selling them outside the same hospitals they robbed, and the government postponing turning on heat in state apartment buildings (where most people lived). In one hospital, 87 patients died in one month from having no heat, food, or medicine. One man announced plans to commit suicide by dousing himself with gasoline outside of a government building and igniting it.

The U.S. could have easily survived a depression in 2001 or even another Great Depression in 2008, but it won't be able to survive a Hyperinflationary Great Depression. At least during the Great Depression of the 1930s, prices were falling and it was cheaper for Americans to live. Bernanke believes the government didn't do enough in the 1930s to prevent a Great Depression, when in fact the government did intervene and made the Great Depression, great, by increasing the duration and magnitude of it.

The Great Depression came as a result of the bursting bubble of the Roaring Twenties, a bubble that was fueled by loose monetary policies by the Federal Reserve. During the Great Depression, as millions of Americans were starving, the government created the Agriculture Adjustment Administration and paid farmers to destroy their crops in an attempt to boost crop prices up. The government also created the Federal Emergency Relief Administration,

which paid out \$500 million to bailout bankrupt state and local governments, and implemented other measures to prop up failing businesses, support prices and wages, and provide funds for public works projects.

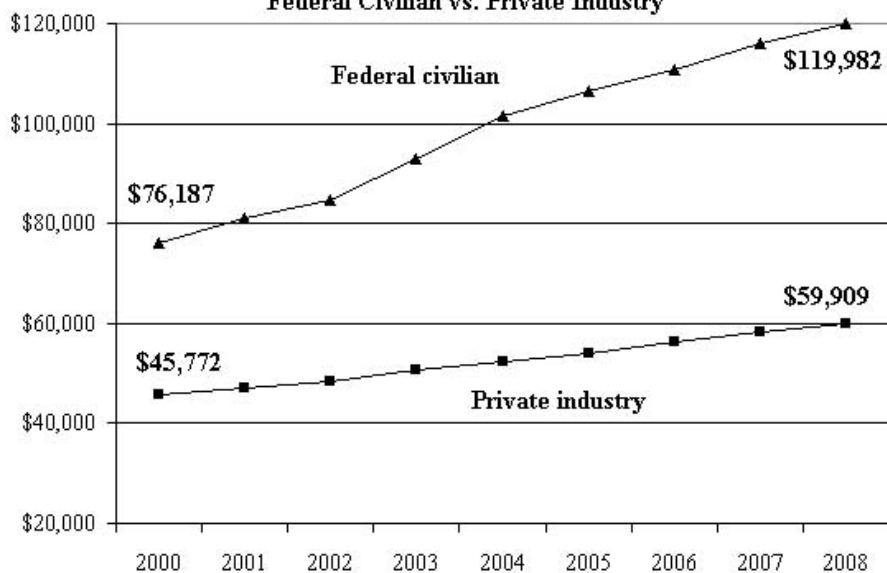
You probably never heard of the Great Depression of 1920 because the government did the right thing and allowed the free market to work without interference. The first year of this depression was worse than the depression of the 1930s (in terms of unemployment and production), but rather than pass stimulus bills and bailouts, the government cut its spending in half. By the summer of 1921, the U.S. economy experienced a robust recovery.

Eventually the U.S. government will realize that you can't solve problems that were created by too much debt, but getting deeper into debt at a much faster rate than before. When you have an artificial boom, there needs to be a recession. By trying to avoid a necessary recession by increasing government spending through borrowing and printing money, the U.S. government is only creating a currency crisis that will lead to the destruction of the U.S. dollar.

The Federal Government is now the single largest employer in the U.S. The average federal worker is now earning \$119,982 per year with benefits, compared to average annual earnings of only \$59,909 per year with benefits in the private sector. While incomes in the private sector are contracting, federal workers are receiving a 2% pay raise in 2010, after receiving a 3.9% pay raise in 2009.

Growth in government is a drain on the private sector. While the U.S. Treasury sold \$78 billion in new government debt in May, companies sold only \$66.1 billion in corporate debt, the least since December of 2000. The extra yield

Figure 2. Average Compensation (Wages and Benefits), Federal Civilian vs. Private Industry



investors demand to own corporate bonds over government bonds increased by 44 basis points in May to 193 basis points, its largest increase since November of 2008.

There are many government departments that deserve to be eliminated like the Department of Energy (DOE). The original stated purpose of the DOE when it was created in 1977 was to end our dependence on foreign oil. Back in 1977, the U.S. imported 46.5% of its oil. Now we import nearly 70% of our oil. The DOE spent \$24.1 billion in 2009 and our country hasn't benefited anything from it.

We also need to abolish the Department of Education (DoED). Ever since the Federal Government has gotten involved in education, the quality of education in the U.S. has gone down with the cost going up. The DoED spent \$63.5 billion in 2009 up 37% from the \$46.3 billion it spent in 2002. It's no coincidence that average annual private college tuition costs rose by 41% from \$18,596 to \$26,273 during this same time period.

Our nation's most prestigious ivy league schools don't even understand inflation. Harvard professors are now teaching their students that health care costs are rising due to technological advances. The truth is, health care costs are rising due to government involvement. The government isn't involved in producing cell phones, laptop computers, and plasma TVs, yet costs for these items are going down as the technology gets better. Procedures in the medical industry that aren't covered by health insurance like laser eye surgery, plastic surgery, and braces, have been declining in price as the technology gets better, because the free market is allowed to set prices without government interference.

When Medicare was created in 1966 it cost \$3 billion per year and the House Ways and Means Committee estimated that the cost would rise to \$12 billion in 1990. The actual cost of Medicare in 1990 was \$107 billion, 792% more than projected, and today it costs \$408 billion annually. The government projects that the recently passed health care bill will cost \$940 billion over the next 10 years and help lower our budget deficit. History has proven that it is impossible to reduce deficits by adding more layers of government bureaucracy. Most likely, the health care bill will cost trillions of dollars over the next 10 years, leading to higher deficits and an outbreak of hyperinflation a lot sooner than most people think is possible.

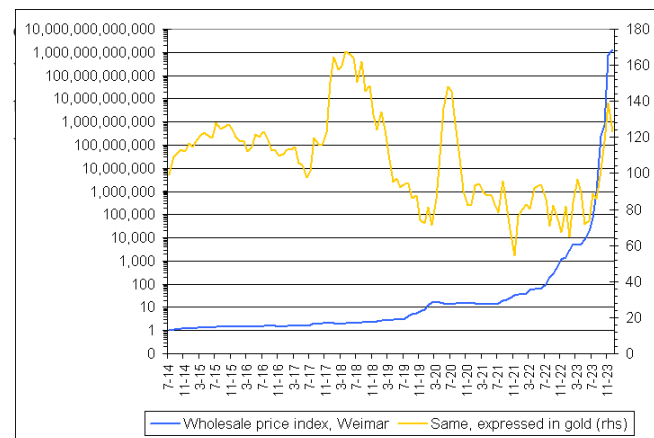
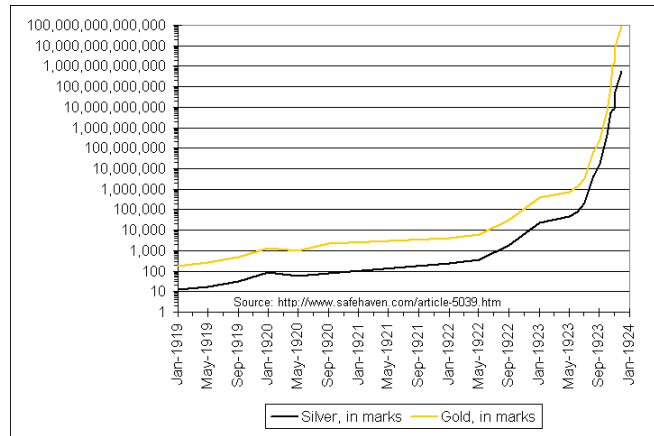
President Obama recently proposed a government discretionary spending freeze to begin in 2011, but this spending freeze is meaningless because it excludes military spending. At the beginning of the Iraq War, the White House estimated that it would have a total cost of \$50 to \$60 billion. The actual cost of the Iraq War has now reached \$726 billion,

over 1,100% more than projected. Total U.S. defense spending in fiscal year 2010 is expected to reach \$1 trillion, about 46% of projected U.S. tax receipts, and equal to the rest of the world's defense spending combined.

The U.S. now has 700 military bases in 140 countries around the world. Our military needs to be scaled back immediately if we want to prevent hyperinflation. The inflation that will need to be created to continue funding out of control U.S. military spending, will ultimately make our country less safe as a result.

The U.S. is currently in a brief period of euphoria where the government's monetary inflation has created the illusion of an economy recovery, without the devastating effects of massive price inflation. The mainstream media is now working in collusion with the government to help sustain the current dollar bubble for a little while longer, without creating hyperinflation. The Federal Reserve is doing everything in their power to prevent deflation by debasing the U.S. dollar, but will have no possible way of containing hyperinflation, once it arrives.

In Weimar Germany during hyperinflation, the price of gold rose from 170 marks per ounce to 87 trillion marks per ounce, while the price of silver rose from 12 marks per



ounce to 543 billion marks per ounce in five years. Germans who put their savings into gold and silver before hyperinflation arrived, maintained their purchasing power, while those with marks lost everything.

NIA gets frequently asked by its members about the U.S. gold reserves and if they will be enough to help our country survive hyperinflation. After all, the U.S. gold reserves of 8,133.5 tonnes are the largest in the world. Unfortunately, our gold reserves haven't been audited since 1954. Considering that the U.S. defaulted on its gold obligations when President Nixon ended the gold standard in 1971, there is no way of knowing for sure if our gold reserves still exist. Even if the U.S. still owns the gold it is supposed to, the value of this gold based on the current price of gold is only around \$310 billion. That's enough to cover only about 70 days of our current rate of cash deficit spending. The U.S. dollar would have to be devalued by about 98% for our gold reserves to be worth enough to pay back just the official U.S. national debt of \$13 trillion.

The U.S. has gone from being on a "gold standard", which enforced discipline on U.S. politicians and made the government live within its means, to a "debt standard", which has allowed for unconstrained government spending and the rapid debasement of the U.S. dollar. The only way for the government to sustain our debt standard is through inflation and the worst mistake any American can make is to underestimate Bernanke's ability to create inflation. Creating inflation is the only thing in the world Bernanke knows how to do and is good at.

In the unlikely event banks don't begin lending their \$1.045 trillion in excess reserves anytime soon, we could see the U.S. Treasury send a check for \$3,400 out to every single American with the backing of the Federal Reserve. Bush already tried this with the Economic Stimulus Act of 2008, which sent \$300 to \$600 checks to individuals and \$600 to \$1,200 checks to married couples.

When Bush's stimulus bill was passed on February 7th 2008, oil was trading for \$86 per barrel. On July 11th 2008, the very day the last Bush stimulus check went out, oil reached its all time high of \$147 per barrel. Oil prices rose by as much as \$61 per barrel during this time period. Oil didn't decline back down to \$86 per barrel until October 9th 2008. Oil prices were artificially high for a total of 246 days.

During those 246 days, Americans consumed about 4.8 billion barrels of oil. If we take the median oil price during this time period of \$116.50 per barrel, for a rise of \$30.50 per barrel, Americans overpaid for oil by \$146.4 billion. This is shockingly close to the total cost of Bush's stimulus

bill of \$152 billion.

Wall Street's cheap credit from the Federal Reserve allowed them to use huge leverage to drive oil prices up knowing that no matter how high oil went, Americans would be able to afford it with the arrival of their stimulus checks. As soon as Americans were done spending their stimulus checks filling their tanks with gas, demand for oil fell and prices plummeted.

If Bernanke decides to bypass Wall Street and directly inject Main Street with inflation, Wall Street will once again find a way to profit handsomely. No matter how inflation is created, it always transfers wealth from the unprepared middle class to already rich bankers. Please print this report out and give copies of it to everybody you know. Americans need to prepare for hyperinflation now by getting their money out of the U.S. dollar and becoming their own central bank by buying gold and silver.

To be kept up-to-date with the latest facts and truth about the U.S. economy and inflation, please sign-up today to become a member of NIA for free at

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