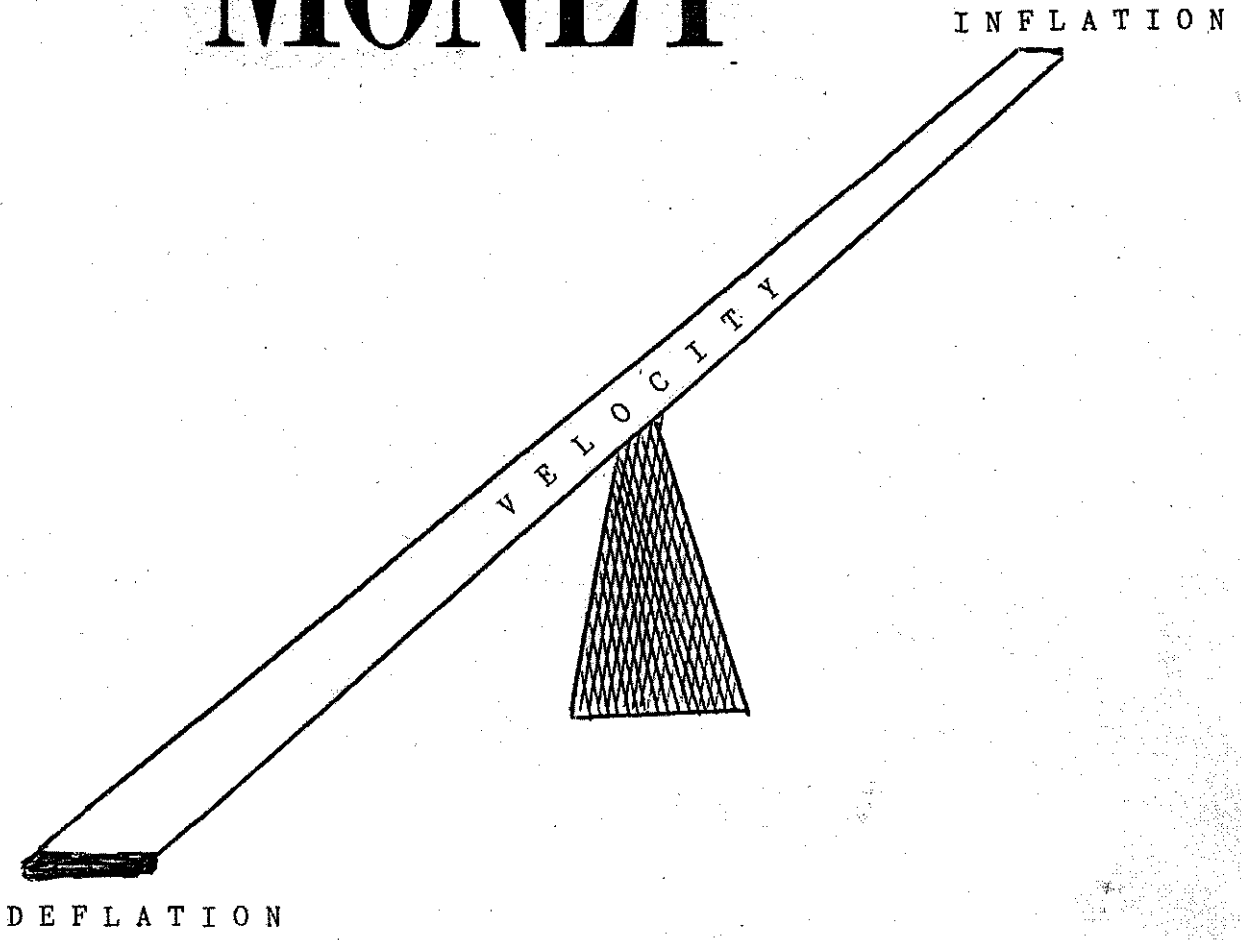


Armstrong Economics™

THE MONEY



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A C K N O W L E D G E M E N T S

I would like to thank all the former employees, associates, sources, and contacts for their continued support and efforts to contribute to the writings I have been able to continue through their great efforts. I would also like to thank those who have looked after not just myself, but my family, and shown them support and kindness.

Everything at Princeton Economics that was our mission to gather information, and bring together the most widely covered global economic perspective, has been a effort that is now bringing us to that fateful crossroads in history. There are those who are trapped by the past and cannot see the dynamic evolution that causes history to repeat, but like lightning, never quite precisely the same way twice. In 1914, Britain reached its peak as the center of the global economy. It passed that torch to the United States who by 1929 became the leading world economy and was also a CREDITOR nation just as China is today. There will be no 1930s style depression, for the cards are nowhere near the same. Yet China will become the leading world economy by 2016, and then suffer its 1929. The West is doomed and it will collapse from its own debt. We borrow with no intent of ever paying off the debt, and somehow both Congress and the majority ignore this fact just as they had ignored the problems in mortgages that violated common sense.

No matter what country you live in, it is the duty that falls upon the shoulders of every reader to do what you can to get reality to manifest. Feel free to send this report to every government, friend, and member of the press around the world. If we do not get the debate started, we stand no chance of saving the future for ourselves and our posterity. We can reach that next never in political-economic evolution only through the hard work of everyone. For this reason, this is provided as a free service.

There is a NEW DATABASE that will be used for special updates provided exclusively to those who register. I want to thank you all once more for your support and for your contribution to try to help society survive the coming storm.

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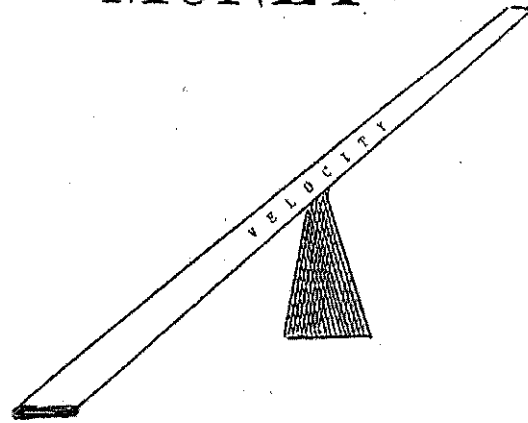
YOU MAY FORWARD ANY REPORT TO A FRIEND OR TO ANY
GOVERNMENT TO GET POLITICAL CHANGE MOVING

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This Report may be forwarded as you like without charge to individuals or governments around the world. It is provided as a Public Service at this time without cost because of the critical facts that we now faced economically. The contents and designs of the systems are in fact copyrighted. At a future date, a new edition of the 1986 The Greatest Bull Market In History will be released and a new book will soon be published on the model itself - The Geometry of Time. It is vital that we do not forget this is a world economy and the arrogance that any nation can dictate to the world is just insanity. Every nation effects all others no different than if one nation were to pour all its toxic waste into the ocean. Everything is interlinked and solutions are never isolated events.

THE MONEY

I N F L A T I O N



D E F L A T I O N

By: Martin A. Armstrong

Former Chairman of Princeton Economics International, Ltd.
and the Foundation For The Study of Cycles

ONCE UPON A TIME there used to be definitive explanations of how the global economy developed. The world used to be simple. There was the chicken or egg rationale and everything fit neatly into a some linear design. The world made sense like taking a walk, each foot progresses in a linear manner one after the other. Then as the world economy began to develop, people began to notice that things didn't always make sense. Something had changed. But what? The high flying schools merely kept regurgitating the same ideas over and over again without testing to see if they honestly still worked in a new global economy that was emerging more as a complex adaptive system that was as distant from economic theories as the latest discovery of the farthest galaxy.

Nothing is truly simple. Even people ask can there be a deflationary trend simultaneously with an inflationary trend? The 1970s saw the convergence of these two trends after the OPEC price shocks. In other words, the rise in the price of oil was clearly inflationary, yet unemployment was rising and the prices of homes collapsed. The period was the birth of the new term S T A G F L A T I O N!

What was happening was that the rise in the price of oil was in fact creating a surge in inflation. However, because the cost of energy was a structural underlying aspect, the rise in inflation in the cost of production became offset by a reduction in other key

costs. Thus, there was a rise in inflation in energy that was displacing other segments by forcing the reduction in costs of other sectors. This had the effect of also simply creating rising unemployment that was a cut in labor costs offset by the rise in energy costs.

The answer is YES! There can be two opposing trends simultaneously so we can have deflation in housing prices coexisting with the rise in other sectors. This does not suggest we are facing hyperinflation due to the lack of a gold standard. It is not likely that we will see hyperinflation instead of just a default.

This becomes a complicated subject in and of itself. Suffice it to say, that DEFLATION and INFLATION are at opposite ends of a seesaw that represents VELOCITY. To a large extent, the rally into 1980 for gold was a localized view that the dollar would decline in value and this was caused by a fiat currency. The Fed itself mistakenly viewed inflation in the eyes of gold. This was due to the fact that gold had been the so called link to which all currency was convertible until 1971.

However, understanding INFLATION that is much like ice cream and comes in a 1,000 different flavors, is not always easy.

- (1) there can be the isolated rise in a specific commodity due to some catastrophe, or to a manipulation as was the case with oil and OPEC.
- (2) there can be a broad inflationary advance caused by a decline in the confidence of domestic citizens in the currency itself tied to the finances of the nation
- (3) there can be international inflation caused by the swing in the currency whereby ALL imports rise in direct proportion to the decline in the currency on world markets.

These are just the three primary areas from which inflation can rise. This is why a label that inflation is the rise in the price of goods and services is the official line because it shifts the responsibility from the government to the people. This is only one form of inflation. There can be a huge storm that wipes out the orange crop in Florida and will lead to a rise in the prices of all such products related thereto.

The rise in oil prices by OPEC during the 1970s, was a greater shock because of its broader impact that infiltrated into every sector of the economy. Thus, there can be varying degrees of inflation caused by the rise in the price of a particular commodity.

Even the rise in interest rates is a inflationary trend. Interest rates will track a bull market because when the economy is doing good, that is when confidence is high and people will borrow based upon their view of the FUTURE! The whole theory that rising interest rates will be bearish for the stock

market is just nonsense. Again, it is myopic and focuses ONLY upon speculation. It ignores the entire economy and even disturbs the true balance demographically. In other words, the retired segment live off their savings and will benefit with rising interest rates. When interest rates decline, they drastically now lower the income of the retired workers who are often the only people spending in a sharp economic decline.

If you plot interest rates against the stock market, you will find that they historically rise with bull markets and decline in bear markets. The theory that lowering the rate of interest will be bullish is based on the nonsense that people will now borrow more and thus the market will rise since low rates will lower margins helping speculators. The problem with this whole theory is it looks at the nominal rise and fall of interest rates and ignores the view of the economy. IT IS NOT THE NOMINAL LEVEL OF INTEREST RATES THAT MATTERS, BUT THE SPREAD BETWEEN RATES AND THE EXPECTATIONS OF PROFITS.

If you think gold will double in price in 1 year, you will pay 10%, 20%, or 25% rates of interest. It is the spread between expectations and the rate of interest that matters. Not the level of interest rates, nor the direction.

Yet interest rates are raising the cost of borrowing. This also attributes to the inflation within the economy. A private corporation will be forced to pay more in rates and offset that by reducing costs elsewhere. Thus, it is common to see unemployment rise with interest rates.

When we step into the public sector, the same trend appears. Rising interest rates will cause greater costs in local and state governments. They, however, can confiscate your house if you don't pay taxes. So they have no incentive to run as a corporation. What they do is raise taxes to compensate for the rise in the cost of money.

When we look at the Federal level, they print the money and thus a rise in rates now increases dramatically the cost of borrowing. Hence, raising interest rates to 17% to fight inflation into 1981, caused the national debt to rise from \$1 trillion in 1980 to nearly \$8 trillion by the end of 26 years. It was like shooting yourself in the foot.

Right now, we are witnessing the debt crisis in its early stages in Greece. The rates are rising because of its dependency upon the foreign sources to fund its budgets. America is in the same boat. Just as capital is scared and is unwilling to invest in Greece even when its currency is the Euro, shows how external forces of confidence impact domestic.

However, what is also revealed is the difference between a gold standard and a pure nonconvertible currency freely floating. The Euro is acting very much like gold during the 1930s. Greece is not able to devalue the Euro and thus the only other variable becomes the rise in interest rates. Greece has a choice between paying up or defaulting. This is how the Great Depression was set in motion. Nations could not sustain the gold standard and thus broke creating the 1931 currency crisis. This is where we are with the Euro, although it is not gold, its value is set external to Greece.

The whole Euro zone becomes impacted as the contagion spreads to Portugal, Spain and then Italy. Even Britain is starting to now spiral down into a debt vortex. Greece has no real viable option. Had it control over its own currency, it could devalue. Bondholders lose their investment in proportion to the decline in the currency. That option is now off the table with the Euro. The crisis turns to one of just default. Will Europe go down with the ship to save the Euro, or will it cut the umbilical cord and allow Greece to go its own?

The reason there was a DEFLATION in the 1930s in the United States was due to the fact that the US held to the gold standard. When money is gold, people hoarded money and that reduced VELOCITY. When FDR confiscated gold and devalued the dollar, he was now in fact injecting INFLATION. By removing the link to gold for DOMESTIC convertibility, a citizen was left with only dollars. Thus, in light of the stated policy of INFLATION, it then became better to spend than to save. The US did not go all the way toward the extreme being HYPERINFLATION, but we turned toward that direction and thus VELOCITY increased. It is a simple seesaw with DEFLATION on one end and INFLATION on the other with the pivot being VELOCITY.

TO SAVE, OR NOT TO SAVE (HOARD)
THAT IS THE QUESTION

Greece is impacted by the INTERNATIONAL capital forces. It cannot live within its means any more than the United States. Thus, the civil unrest could lead to a massive and serious revolution in Greece. This could spread to Southern Europe because the IMF and those sitting in the EU, failed to grasp the idea that there is a serious problem. The system is collapsing. We either face the music and deal with it, or we can hide with our head in the sand and pretend nothing is wrong.

The example of Spain between 1883 and 1913 is the answer. There was no gold standard. The currency floated. The annual rate of growth was 2% and the deficits were kept in check by responsible government. The whole system is broke and is going to crash and burn. No one should be investing in any government bonds of any country right now. Nobody has any intention of ever paying off the debt. This system is insane!

We need to monetize the debt through the issue of a coupon that forces capital to invest in that domestic economy. So every smuck who had Greek bonds, now gets coupons to convert that to private investment in Greece. That will spur a surge in employment domestically. The budget is then taken to reduce government civil workers. Eliminate income taxes, and the cost of government is then funded by the growth in currency that is limited constitutionally to 5% of GDP. Stop the borrowing. Interest rates will now drop and employment will rise. People will flock to Greece as the new financial holy land and the glory days of Athens will at last return.

The Great Depression ended in each nation once they abandoned the gold standard in 1931. The nations that suffered the longest were USA and France. Retaining the gold standard promoted hoarding and reduced the VELOCITY. The same is taking place for the Euro is acting like gold to the average Greek. Why spend, when the future is just uncertain? It is time to think out of the BOX before it is nailed shut. If we do NOT start to think rationally, we are headed toward civil wars and unrest that will only turn toward international unrest and the threat of war. ALL GOVERNMENT DEBT WILL BE FORCED INTO DEFAULT. That is what is on the horizon. It is time to face the reality and close the shutters for the storm is here.

Clinton's interest gimmick to make debt much worse

By MARTIN A. ARMSTRONG
Guest Columnist

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WHEN BILL CLINTON announced that he would cut the deficit by a projected \$500 billion over five years, there was no screaming or cries of pain. Lobbyists were not weeping in the streets and nobody in the media claimed that children would starve. This miracle of miracles was accomplished in part by raising taxes \$250 billion, but also via a parlor trick — shifting the funding of the national debt toward short-term maturities to save on interest expenditures.

In 1990, 88 percent of the national debt was funded at five years or less. In 1994, 74 percent of the debt was funded at that term, with nearly 33 percent funded at one year or less. This manipulation created nearly \$50 billion in savings on interest payments, since, at the end of 1993, 30-year bond rates stood at about twice that of one-year rates.

Multiply that by five years and you come up with a projected budget savings of \$250 billion (assuming no change in interest rates). Add the tax hike and you get a projected deficit reduction of \$500 billion over five years. This sleight of hand allowed Mr. Clinton to look like he was reducing government while in fact doing nothing of the sort.

The problem we now face is quite simple. Until the Clinton years, every administration since World War II tried to extend the national debt for as long as possible. This protected the budget from wild swings in interest rates while tending to reduce volatility as a whole. When the Fed sought to fight inflation, it had a two-to-four-year window before any interest-rate hike would cause a surge in the nation's deficit from interest expenditures. The Clinton debt manipulation has now endangered our economy, and the dramatic decline in bond prices last year is just the first warning sign.

WITH ABOUT 33 percent of the national debt now funded one year or less, and with short-term rates double those of a year ago, the deficit will rise far faster than anyone in Washington is prepared to forecast. The rise in interest expenditures could easily outpace the government's ability to reduce spending. For every one-percentage-point rise in short-term rates, another \$200 billion or more could be added to the debt by 1998. The immediate crisis in the dollar began when the balanced-budget amendment

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failed. The real international crisis is not currency, but debt. The widening deficit will once again become an issue for the capital markets.

To see the debt crisis in action, we need only look north to Canada, one of countless nations that have so squandered their national wealth that dramatic political change is forced upon them by the capital markets. Last year, 40 percent of every dollar the Canadian government spent went to interest. With virtually 40 percent of the entire national debt coming due by 1996 and short-term rates double those of a year ago, Canada's interest expenditures will soar to 50 percent of total spending or higher, joining the ranks of Italy, Sweden and Mexico.

The concern over government debt is building world-wide as all industrialized nations continue to run bigger deficits. The old maxim that a national debt is merely a borrowing from ourselves died when holders of the debt ceased exclusively to be a nation's own citizens. Interest expenditures of this magnitude are nothing more than a wholesale license to export the national wealth of a nation where government spending no longer stimulates the domestic economy.

DEBT BY ITSELF is not necessarily bad, and it certainly does not cause a financial disaster alone. What is most important is how the debt is being used. The governments that are falling first are those where the greatest amount of spending has gone to social programs. If government spending fails to create good-paying jobs, the net effect is not a stimulus but a drain on the economy. Welfare recipients do not receive enough in transfer payments to buy a new home, automobile or other higher-end durable goods that create jobs. Combine this with the vast expansion of government itself (to 33 percent of the civilian work force), and you have the real reason for political unrest in America.

How can we get out of this mess? The U.S. must:

- Make a concerted effort to shift the national debt back toward a long-term focus.

- Place an immediate freeze on government employment at all levels and start taking an honest approach to reducing the government work force

- Implement a tax amnesty, with the proceeds used to retire the national debt.

And, finally, the long-term goal should be to abolish the income tax and replace it with a national sales tax — not a VAT — that is capable of extracting revenues from the underground economy including illegal aliens. Under such a system, the upper class will naturally pay more, and exemptions for food and housing will protect the poor. This must be done with a simultaneous repeal of the 16th Amendment, which authorized the income tax.

SINCE THE MARKETPLACE will not allow the U.S. to shift its debt back toward long-term bonds without paying sharply higher interest rates, we must use another approach. Government bonds were always tax-free prior to World War II, save for partial taxation during World War I. To reverse the damage done by the Clinton administration, the Treasury should issue 10-to-30-year tax-free bonds in denominations as low as \$1,000. Foreign holders of debt pay next to nothing in taxes on the interest derived in the U.S. It is about time the American people had the same privilege.

These should be nonmarketable zero-coupon issues. This would not only extend the national debt but also help to bring the debt home and slash the deficit in the current fiscal year. A portion of the savings in interest expenditures should then be used to retire short-term debt. This program would have the same net effect as a company buying back its own stock. The price of bonds would rise and interest rates would fall. A separate gold-backed bond could be offered at half the normal yield. Those who remain gold bugs would find this a reasonable way to own gold and earn interest, too.

The Clinton debt crisis is real. This year, alone, interest expenditures may rise more than \$60 billion — far outpacing any spending reductions the Republicans have in mind. Government taxation on all levels has been growing faster than the economy itself. If we do not start managing our debt in a professional manner, the capital markets will do the job for us — and the entire public debt sector of the world will be thrown into chaos as we go into the end of this century.

Martin A. Armstrong is chairman of President's Economic Institute.

Above is an OP-Ed I wrote for the Wall Street Journal back in 1995. We have been in fact playing with the debt for so long, it is just time we face up to the facts and stop the bullshit. The Chinese are traders. They see the hand-writing of the wall. They have been shortening their maturity holdings knowing we have a serious debt crisis. Japan has risen back to the number one holder of US debt. But we are no different than Greece. We cannot live within our means. Whichever country is the first to take the step to a new way of running the economy, they will emerge as a financial leader. Debt and taxes are barbaric relics from the gold standard days. We must understand VELOCITY to survive.