

GERMANS AND INFLATION¹

Michael Scott Moore©

One truism of European finance is that Germans loathe inflation. They supposedly have a folk memory of the 1920s, when their grandparents had to push wheelbarrows full of worthless paper to the bakery just for a loaf of bread. Economic trouble in general, and inflation in particular, led to Hitler, according to this notion, so Germans hate loose policies that might usher in some similar nightmare.

Last year's "stress tests" of American banks and the more recent tests of European banks had a lot in common. Both were largely theater, meant to restore confidence in a credit system riddled with junk. But there's one obvious difference, namely the question of whether the European Central Bank can, or will, follow the Fed's example of printing money to prop up its most troubled banks.

Conventional wisdom says it won't. The ECB is modeled on the notoriously tight German Bundesbank, which has followed an anti-inflationary line for most of its life since World War II. The ECB's new head next summer, Axel Weber, is head of the Bundesbank now. Weber was named to succeed Jean-Claude Trichet, the current ECB chief, in a political deal. He was the price of Berlin's cooperation in the euro "bailout package" announced in May. The \$1 trillion package, of course, was not a bailout so much as a line of credit to buck up the euro, in part by purchasing "troubled assets" (or garbage) from government balance sheets. It was, in other words, a way to print money.

So the ECB is not a hard-line institution. It could change its mind again. It could offer to buy up garbage from bank balance sheets, for example – assuming the "stress test" results from last week fail to restore confidence. One big scenario missing from those stress tests was the (still likely) event of a Greek default, and if Greece misses a few financial targets at the end of August, there may be panic in the credit markets again, with no one left to help besides the ECB.

Should it, though? The German experience is two-pronged. Most Germans do have a cultural aversion to inflation because of those folk memories of the 1920s. But it's not quite true that the hyperinflation ushered Hitler to power. Berlin brought it under control by the late '20s and found a disciplined way in the '30s to print money without causing inflation. Offensive as it sounds, that's one thing the Nazis did right.

Largely because of a central banker named Hjalmar Schacht, who served before Hitler as well as under him, the German economy recovered briskly after 1933. Hitler combined a policy of government-printed money (through Schacht) with a feverish public-works program that provided both jobs and new infrastructure, like a modern Autobahn. "Within two years, Germany's unemployment problem had been solved and the country was back on its feet," writes Ellen Hodgson Brown, a lawyer and author of *Web of Debt*. "It had a solid, stable currency, and no inflation, at a time when millions of people in the United States and other Western countries were still out of work and living on welfare."

¹ Miller-McCune newsletter, July 28, 2010.

Schacht argued that the difference between the growth of the 1930s and the hyperinflation of the 1920s was the use to which the printed money was put. In the '30s, it was productive stimulus. In the '20s, it paid for speculation and debt. A short-selling frenzy on the German mark in the early '20s “was made possible,” according to Brown, “because private banks made massive amounts of currency available for borrowing, marks that were created on demand and lent to investors, returning a profitable interest to the banks.” Richard Werner makes a similar point in *Princes of the Yen*, where he argues that the Bank of Japan learned a lot about central monetary control from Schacht's command of the Reichsbank, but failed to absorb the vital lesson of pumping government-printed money into real stuff, meaning productive industry. Japan's failure to do so after the '80s, Werner argues, led to the Lost Decade of the '90s.

So this argument can be made — thankfully — without resorting to Nazi precedent. But from the German point of view, monetary policy on both sides of the Atlantic right now still looks dangerously bank-centered and soft.