Click here for Full Issue of EIR Volume 33, Number 16, April 21, 2006

Weimar Hyperinflation Takes Off in 2006

by Richard Freeman

The surge in world commodities prices signals the near-term onset of Weimar-style hyperinflation. During 2006, on a daily basis on the commodity markets, copper, zinc, gold, nickel, and some other commodities have hit a 10-year, 20-year, or all-time record high. During the past three months, the process has shifted into a new phase: an *increase in the rate of increase* of the inflation of commodities, which defines a hyperinflationary blowout. Lyndon LaRouche's forecast, "Hyperinflationary Patterns: Inflation Runs Wild" (*EIR,* Sept. 30, 2005), with its Riemannian shock-front model (**Figure 1**), is unfolding in the commodities field.

The hedge funds are a leading force driving the shock front, by funnelling funds into the commodities markets. These funds manage investments of the wealthy families who seek to accumulate hard commodities to control a post-crash world, but also those of the misguided pension funds and the "mickey" investors who eagerly—and stupidly—want to "get in on the hot new investments." None of these parties understand the alarming new processes that have been created, which will not only shatter the commodities bubble, but the hedge funds themselves, and the overstretched U.S. housing bubble.

Daily, fools pour money into commodities at each twitch of the market. "There is a wall of investment money moving into commodities markets," said UBS analyst John Reade on April 12. "We estimate around $100 billion was invested via the Goldman Sachs index, the Dow Jones/AIG index, and products tracking those [commodities] indices at the end of 2005." The cited investment funds are called "passive funds," because they invest their funds in a way that mimics the performance of a basket of commodities contained in the Goldman Sachs or other commodity-based index. From a level of $15 billion three years ago, these passive commodity investment funds now have $100 billion under management. The name passive is misleading: It refers to the type of fund—but they pack a real, active effect on the market.

In addition, there are "active funds" and other investor hedge funds, which have hundreds of billions of dollars more under management, which, if they take long positions, aggressively push up commodity prices. The size of all investment in commodities combined could be one-quarter trillion dollars or more; moreover, this is coupled with sizeable leverage, which could ratchet up the total investment three- to four-fold.

Like 1923 Weimar Germany

The speculative commodities' spike intersected the other large speculative bubbles that Alan Greenspan's fostering of the "carry-trade" since 1987 had generated. The emerging process is not a linear inflation, but, like that of 1923 Weimar Germany, non-linear hyperbolic growth. During each new period, there is an increase in the rate of the rate of increase—that is, hyperinflation.

The evidence is multiplying. For example, between March 31, 2003 and Dec. 30, 2005 (the last day of trading), the price of palladium rose from $170 to $257 per ounce. For that whole 33-month period, its rate of price increase was 51.1%; its average rate of increase came out to a hefty 18.6% *per year* during that span. However, since the start of 2006, palladium's price had jumped from $257 to $348 per ounce by April 12, which, were it to continue, would come out to a 132% increase for 2006.

Between March 31, 2003 and Dec. 30, 2005, a metric ton of aluminum increased in price at 13% per year; for 2006, its annual rate of increase is 72%. For a metric ton of zinc, between March 31, 2003 and Dec. 30, 2005, its price increased at an already inflationary 55% per year; for 2006, its annual rate of increase is 220%.

It's Weimar-style hyperinflation, exactly as LaRouche forecast last September.

Copper Spike

The hedge funds' role in shoving up commodities prices is dramatized in the case of copper.

Copper for three-month future delivery, shot up to $6,077 per metric ton at the April 12 closing on the London Metals Exchange, the world's leading metals market. Copper's price has doubled since early 2005, and quadrupled since November 2001.

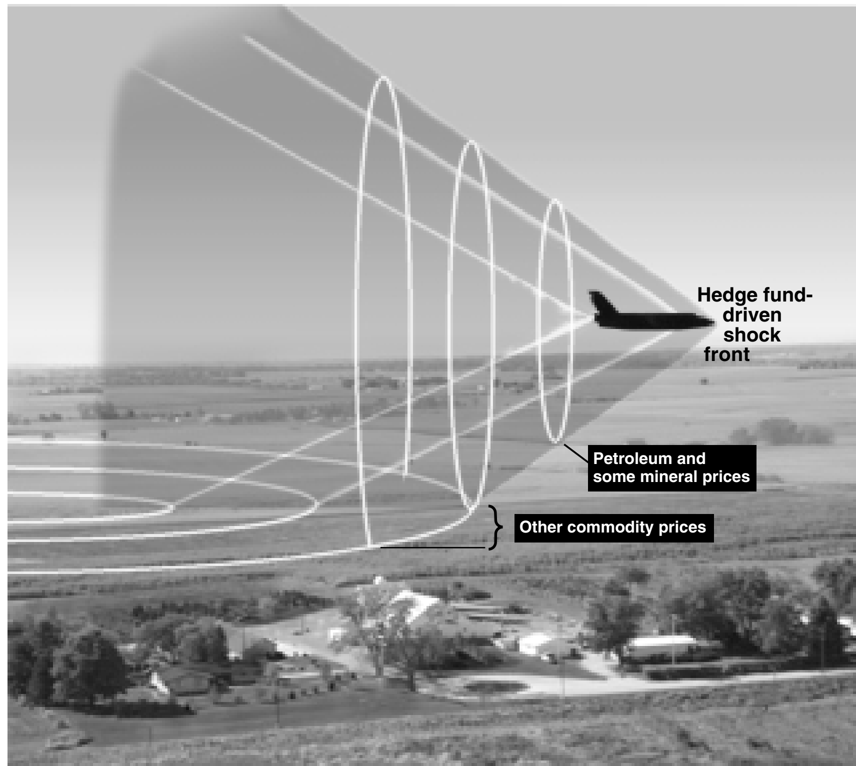
On April 10, the *Financial Times,* in an article titled "Fears Grow Among Copper Watchers," put aside its earlier snake-oil-salesman claims that "market forces" are pushing up prices, and reported on a survey of which companies are shoving up copper prices in a "super spike." They are all hedge funds: the U.S.-based Touradji Capital, which is "believed to hold a sizeable copper bet"; Armajaro Holdings (British); "Geologic, a smaller U.S. hedge fund with a copper bet, climbed 12.3% in March alone"; Ospraie Management (U.S.); Moore Capital (U.S.); Vega Asset Management (U.S.); Winton Capital (British); and Red Kite Management (British). These hedge funds are principally the operating arms of the City of London-Wall Street banks.

On April 12, the Dow Jones news service reported that John Bergthell of JP Morgan had declared that "most analysts [are] predicting a 200,000-300,000 ton copper surplus for 2006 and 2007." A Mexican copper mine strike would not have fundamentally altered that. Bergthell added that "the copper price surge" is related to a market bubble.

Still, the hedge funds compelled a doubling of the copper

© 2006 EIR News Service Inc. All Rights Reserved. Reproduction in whole or in part without permission strictly prohibited.

FIGURE 1



Today's hyperinflation, driven by the hedge-fund crisis, is comparable to a sonic boom moving across the landscape. At the tip of the cone, where the shock front forms, is the speculative bubble in hedge funds and related derivatives, orders of magnitude larger in monetary value than the physical economy. The commodity price inflation, led by petroleum and certain minerals, is dragged along in the opening conical tail, while prices of other commodities and consumer goods are diffused as they spread out in the conical opening.

price in just 15 months, to an unsustainable price of $6,000 per metric ton.

The commodities spike's activities have spread into food products. On April 10, orange juice shot up to $1.50 per pound, the highest level in 14 years; sugar grew to $17.12 per pound, tripling its price since the start of 2004.

Pension Funds

Those snapping up investment instruments in commodities, are two types of investor.

First, are wealthy financier families, who comprehend that the collapse of the world financial system, intermixed with some $750 trillion in derivatives and other speculative paper, is impending. They seek to accumulate industrial base metals, and energy and food supplies, increasing their control over the goods upon which life depends, which would enable them to dictate policy, when the dust clears in a post-crash world. They are buying commodities in such a way, that they either purchase the physical goods, or ownership shares of the companies that produce these goods.

The second type of investor is people who are attracted because commodities are the sexy investment that supposedly pays a high rate of return. Instead, they are poised to misinvest their pension funds, which would obliterate the funds. The April 10 *Financial Times* reported, "Unprecedented amounts of U.K. pension funds are flowing into commodities as pension fund managers seek ways of increasing returns and diversifying risk." Last month, J. Sainsbury, the big British supermarket chain, announced that it would invest 5% of its £5.5 billion pension fund into commodities, while at the end of last year, Hermes, manager of the U.K.'s largest pension fund, launched a commodities fund into which it invested £1 billion of its clients' money.

The U.S. pension funds are not far behind. The Pennsylvania State Employees' Retirement System (PSERS), with $27 billion in assets, typifies the activity. Peter Gilbert, the fund's manager, has invested 23% of PSERS funds into hedge funds, the highest percentage so invested by any state pension system. Greenwich Partners reported that 14% of all U.S. public pension plans are invested in hedge funds; 49% expect to increase their hedge-fund holdings during the next three years.

Since the hedge funds are investing an increasing share of their funds into commodities, U.S. pension funds are actually chasing the commodities bubble.

Hard Landing

The commodities-bubble-driven hyperinflation is set to bring down the world financial system, in a manner similar to the way that Weimar hyperinflation pulverized Germany. However, the bankers have built such a speculation-laced financial system, that whatever they do to try to save one bubble, will rupture another. The central banks could attempt to break the commodities price spiral by "traditional central banker methods"—i.e., raising interest rates. However, the U.S. housing bubble is beginning to contract, affected by the rise in mortgage interest rates during the past nine months. An increase of interest rates by 1 to 2 percentage points would puncture the U.S. housing mortgage bubble, which, counting the derivatives of Fannie Mae and Freddie Mac, totals $15 trillion. That explosion would interact with, and doom, the commodities bubble.