



INSTITUTE OF
INTERNATIONAL
MONETARY RESEARCH

Analysis and insight into trends in money and banking,
and their impact on the world's leading economies

Will the coronavirus pandemic cause an inflationary boom?

A presentation by Professor Tim Congdon CBE,

*Chairman of the Institute of International Monetary Research,
in March 2020*



The coronavirus pandemic: parallels with 'war'

In an announcement (reported on Bloomberg)
**on 17 March, the French Finance Minister, Bruno
Le Maire, says “it is economic, financial war”**

- France is tearing up its budget program and plans huge spending as the coronavirus outbreak sends the economy into a deep slump. Le Maire will present an emergency budget on Wednesday (18 March) that will include 45 billion euros (\$50 billion) of spending plus 300 billion euros of loan guarantees. France's debt will rise above 100% of economic output.



The coronavirus pandemic: parallels with 'war'

Again from Bloomberg,

U.K. Gets Green Light for 'Wartime' Stimulus in Virus Fight

By [Tim Ross](#) and [Lucy Meakin](#)

March 17, 2020, 1:02 PM GMT

- **Fiscal watchdog tells Sunak not to be 'squeamish' about debt**
- Senior MP urges government to spend what's needed now



The coronavirus pandemic: parallels with 'war'

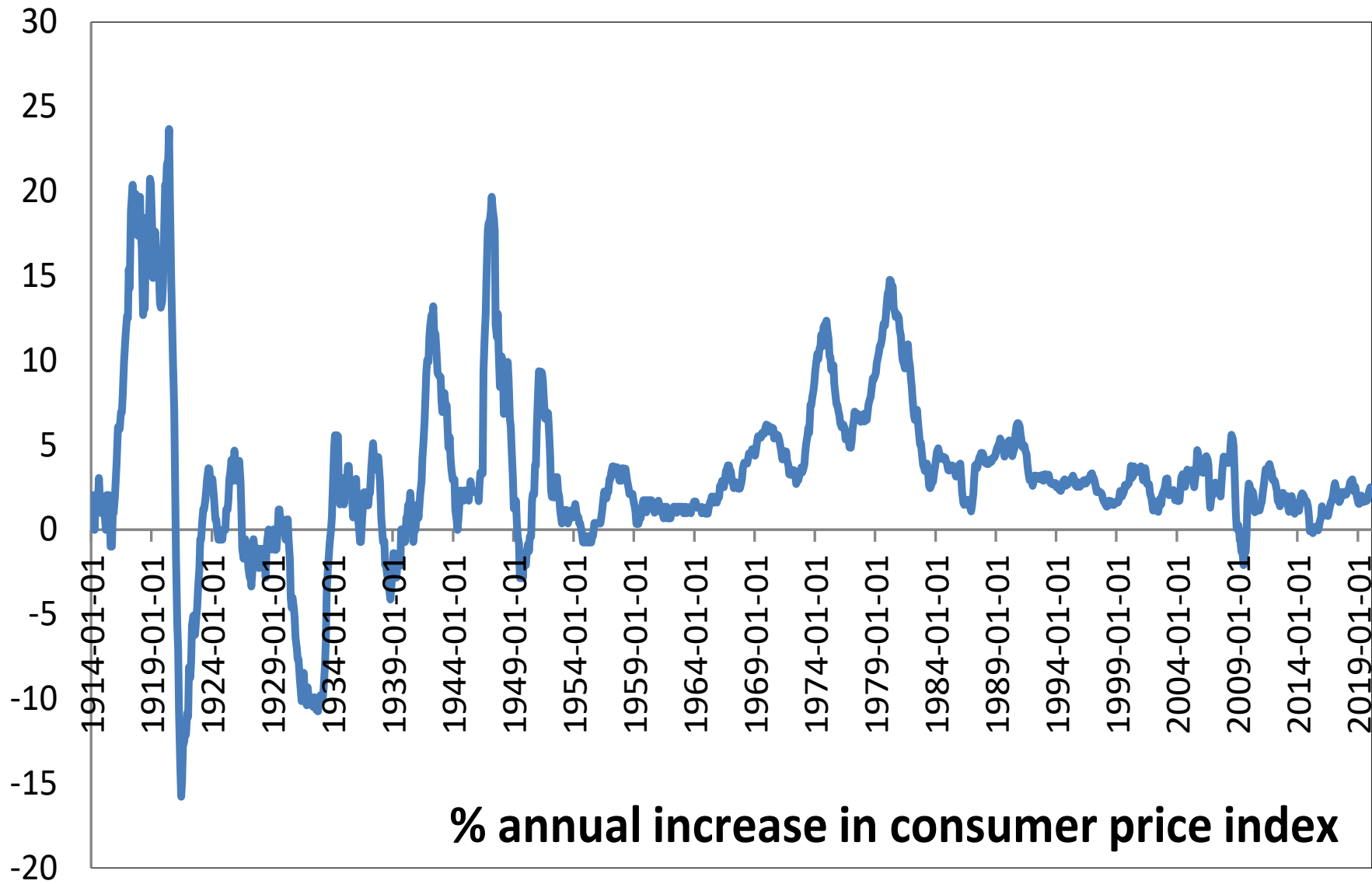
Democrats Call for 'War' on Coronavirus....

But Military Says Help is Limited

by Katie Bo Williams Senior National Security Correspondent of 'Defense One' website, "A growing number of prominent Democrats are calling for President Donald Trump to deploy the U.S. military to help respond to the coronavirus pandemic..."



Rapid inflation in the USA occurred during the two big wars of the 20th century



Why do wars cause inflation?

- Governments increase their borrowing in order to finance extra expenditure.
- **The extra borrowing is financed in part from the banking system, creating new bank deposits.** (Only part – usually a tiny part – is financed by ‘money printing’, in the sense of newly-printed notes.)
- **The extra money creation boosts money growth to levels above – perhaps far above – the increase in the quantity of goods and services** (i.e., in real national output).



Signs of extra government borrowing in the USA

1. The \$8.3b. of extra expenditure in the initial Trump/Congress response.

“The bill provides a total of \$7.7 billion in new discretionary spending and authorizes an additional \$490 million in mandatory spending through a Medicare change.”

2. Trump urges federal help for airlines

“We’re going to back the airlines 100%,” Trump told a news conference. “It’s not their fault.” The trade group for most of the largest carriers, Airlines for America, requested \$25 billion in grants for passenger airlines, \$25 billion in loan guarantees and tax relief for the first three months of the year....



Signs of extra government borrowing in the USA

3. \$1,000-per-person payment now being recommended.

On Monday, Sen. Mitt Romney (R-Utah) joined a growing chorus of liberal and conservative economists are lining up behind a proposal published in the *Wall Street Journal* by Harvard professor Jason Furman, who chaired the Council of Economic Advisers (CEA) under President Obama, that calls for direct government payments of \$1,000 to every American adult....\$500 per child, and possible repeated in 2021.



Signs of extra government borrowing in the USA

3. \$1,000-per-person payment now being recommended.

US adult population is about 250 million, with a further 80 million children. The cost of the proposed '\$1,000 spending voucher' would therefore be about \$300 billion.

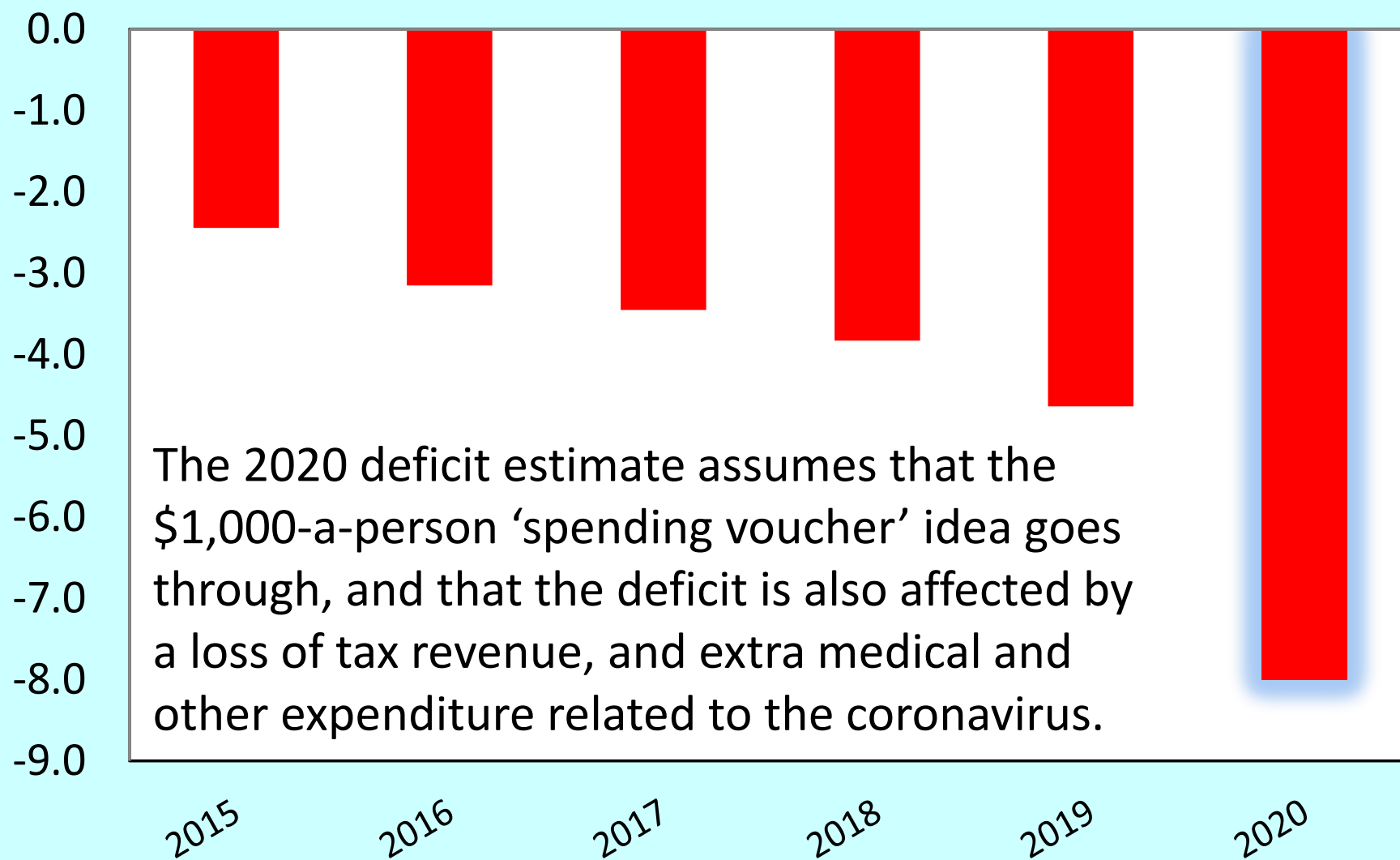


Signs of extra government borrowing in the USA

How large will the US budget deficit be in 2020?

In 2019 the Federal deficit was \$984 billion. Even before the coronavirus epidemic hit, it was expected to rise in 2020 to \$1,020b. **If the \$1,000-a-person proposal goes through, the Federal deficit could move into the \$1,500b. - \$2,000b. area.**

US Federal deficit - as % of GDP



US money trends in 2020

- Will money growth rise further in 2020?
- **Bank credit to the private sector will continue to grow in 2020**, not least because banks are under pressure from the Federal Reserve to help companies through cash-flow strains arising from the coronavirus.
- **Meanwhile US banks' holdings of US Treasuries might increase in 2020 by \$600b. - \$800b. because of the need to finance the enormous budget deficit.** That by itself will add roughly 3% - 4% to US broad money.
- **A reasonable view is that in 2020 US broad money will increase by 8% - 10%, at least matching the 2019 money growth acceleration.**

What about money growth trends elsewhere?

- How much will governments borrow from the banks in 2020?

Budget deficits will rise everywhere, even in the deficit-averse Eurozone, in response to the pandemic...and, as in the USA, the deficits will be financed to a significant extent from banking systems.

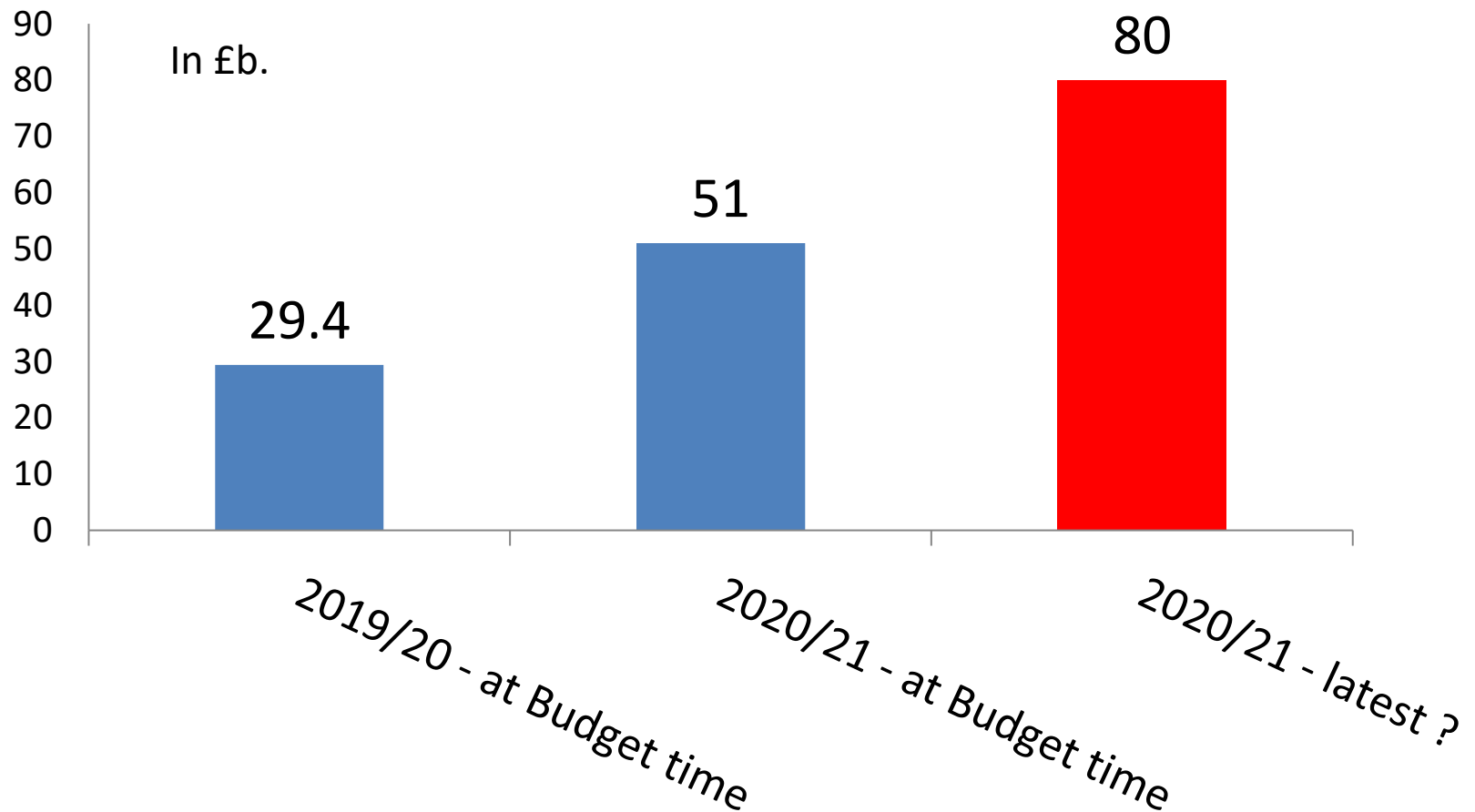


UK example

- In 2019/20 the UK's Debt Management Office had a remit to issue **£29.4b.** of 'short conventional' stock, but for 2020/21 the corresponding figure in the March 2020 remit was **£51.0b.** – and this was before the coronavirus scares of the last few days....and the Office for Budget Responsibility's remark that the government must not be 'squeamish' about debt.



UK example: Short-dated gilts are bought by UK and foreign banks, mostly





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- With M4x at just over £2,200b., an increase in government borrowing from the banking system of £50b. implies an increase in the quantity of money *by itself of* $2\frac{1}{4}\%$.
- Money growth is likely to be higher in 2020 than in 2019.

What about money growth trends elsewhere?

- How much will the private sector borrow from the banks in 2020?
 - In contrast to 2008, when central banks and regulators *tightened* banks' capital/asset ratios at the worst point of the downturn, in 2020 they are *easing* them.

What about money growth trends elsewhere?

- How much will the private sector borrow from the banks in 2020?
 - Companies are drawing down credit lines, so that their deposits are higher and available to meet commitments. To quote from the *FT* of 12 March, “We know there is going to be hoarding of liquidity, drawing down on credit lines,” said one top European banker. “We are examining where the stresses might be, do we have enough liquidity on standby if needed? Our treasury is the busiest division at the moment.”

What about money growth trends elsewhere?

- How much will the private sector borrow from the banks in 2020?
 - And central banks have made clear to those treasury departments that they will help if banks' treasuries have trouble financing inadvertant balance-sheet expansion. **This is in total contrast to 2008 and 2009.**



What about money growth trends elsewhere?

- How much will the private sector borrow from the banks in 2020?
- UK Prime Minister Boris Johnson said (17 March) the U.K. is fighting a war against the coronavirus outbreak as his government indicated a massive package of loans and grants to protect businesses from cash-flow interruptions.
- **Help was announced for home loan costs, airlines and the hospitality industry as ministers pledged £330 billion (\$398 billion) worth of government-backed loans for struggling companies.**
- “We must act like any wartime government and do whatever it takes to support our economy,” Johnson told reporters at a press conference in London.



What about money growth trends elsewhere?

- How much will the private sector borrow from the banks in 2020?

Germany earmarked in week beginning 9 March as much as **550 billion euros of state lending** to support companies and **France** on 16 March announced **300 billion euros of guarantees for loans to companies** and a 45 billion-euro aid program.

- from Bloomberg

How should we describe the falls in output now being seen?

- When the virus control measures become effective and the disruptions to supply are overcome, **the major economies will have large budget deficits and excessive money balances.**
- As in other 'war' contexts, the results of monetary financing of budget deficits and money growth acceleration will be **higher inflation**, perhaps in 2021, but most probably in 2022. (No one knows how policy will then evolve.)

How should we describe the falls in output now being seen?

- The falls in output now being seen – because of lockdowns, self-isolating, component shortages and so on – are not due to lack of demand.
- The falls in output do not represent ‘a recession’, as usually understood. They are instead best seen as the result of supply-side disruption.
- **But policy-makers are reacting as if this were a standard recession.**