INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

www.mv-pt.org

Will inflation reach double-digits?

A presentation by Professor Tim Congdon CBE,

Chairperson of the Institute of International Monetary Research,

in October 2021

A quote from a 6th April 2020 special e-mail from the Institute

INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

www.mv-pt.org

Does the Fed understand what it is doing?

At some point – probably in mid- or late 2021 – the coronavirus crisis will be over…And what will then happen to the 'excess over normal' money balances created by public policy in 2020 and early 2021? The answer is that – as in the aftermath of wars – an inflationary boom in the world's leading economy has to be the central forecast. **It seems to me that a major increase in inflation due to this boom is inevitable. Whether that increase is to 5% or 10%, no one knows for certain yet…**

A quote from a 6th April 2020 special e-mail from the Institute

INSTITUTE OF INTERNATIONAL MONETARY RESEARCH

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

www.mv-pt.org

Does the Fed understand what it is doing?

But – given that the return to normalcy will be accompanied by bottlenecks and supply shortages, and given also that the current energy price slump may give way to an energy price surge – an inflation figure of over 10% would be a logical associate of an annual rate of money growth of between 15% and 20%. - *(So bottlenecks and supply shortages were mentioned in our research almost 18 months ago.)*

Paul Krugman in his
New York Times column
on 21st June, ***2021***

"…[F]or those paying closer attention to the flow of new information, **inflation panic, is, you know, so last week**. Seriously, both recent data and recent statements from the Federal Reserve have, well, deflated the case for a sustained outbreak of inflation."

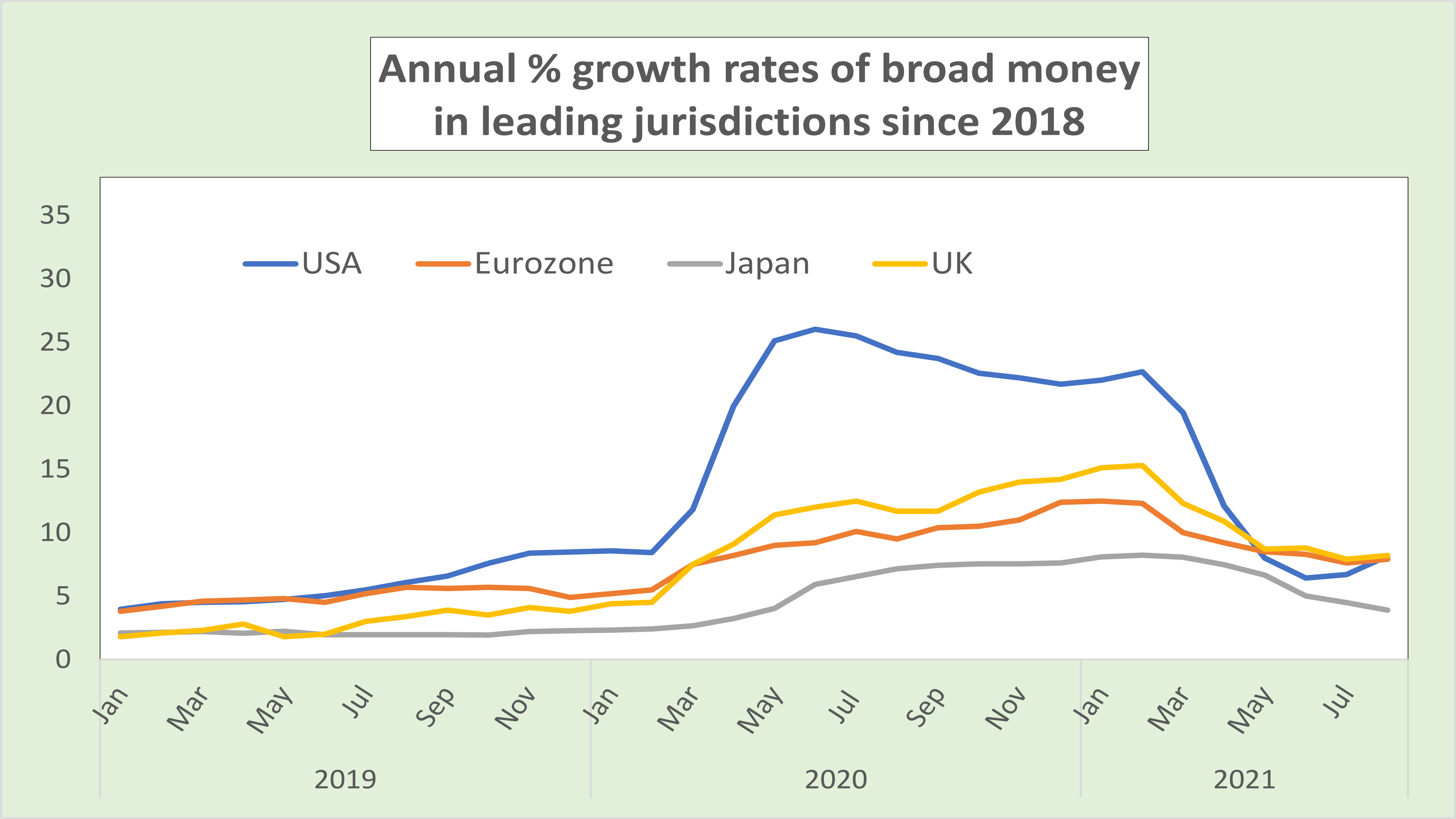
- Krugman does not give a specific inflation number over any definite period, but his endorsement of the Fed has to be interpreted as agreement with the Fed's current view.

Paul Krugman in his *New York Times* column on 15th October, ***2021***

The New York Times

“What’s happening to inflation?...Inflation is high right now,...but is this a blip?...Economists are deeply divided. I’m basically on what has come to be known as Team Transitory, **but I might be wrong** – and the data are sufficiently ambiguous that both sides can claim that the evidence supports their take.”

- Krugman’s climbdown from his position in June 2021 is huge and the reference to the alleged ‘ambiguity’ of the data is silly. But he would still deny that the behaviour of money growth is relevant to the inflation prospect.



Annual % growth rates of broad money in leading jurisdictions since 2018
USA
Eurozone
Japan
UK
35
30
25
20
15
10
5
0
Jan
Mar
May
Jul
Sep
Nov
Jan
Mar
May
Jul
Sep
Nov
Jan
Mar
May
Jul
2019
2020
2021

Conclusions from the money growth chart

- The acceleration in money growth, mostly (but not entirely) pandemic-related, was sharpest and most well-defined in the USA. **Logically, this is where an annual % rate of double-digit inflation is most likely.**
- Money growth in the Eurozone and the UK did accelerate from Feb/March 2020, but the annual rate of increase was in double digits only for about a year and not by a wide margin. (The UK peak was 15.3%.)
- Japan did experience a money growth uptick in spring 2020, but it was minor and – if the monetary theory of the price level is correct – the impact on inflation should indeed be small and transitory.

Further comments

- **The annual trend rate of output growth is higher in the USA – at perhaps 2% – than in the Eurozone or the UK, where it can be only ½ % - 1%, because of the continuing increase in regulation and demographic developments.**
- Is this too pessimistic about European trend growth? The drive towards net zero carbon emissions – whatever the wider merits of this policy – is costly, and will reduce productivity. Meanwhile the age-ing of the populations will reduce the population of working age in most European nations for the next 10/20 years. (The UK is least affected in Europe by this demographic change.)
- The faster trend growth rate in the USA will moderate the inflationary impact of excessive money growth, although only to a small extent.

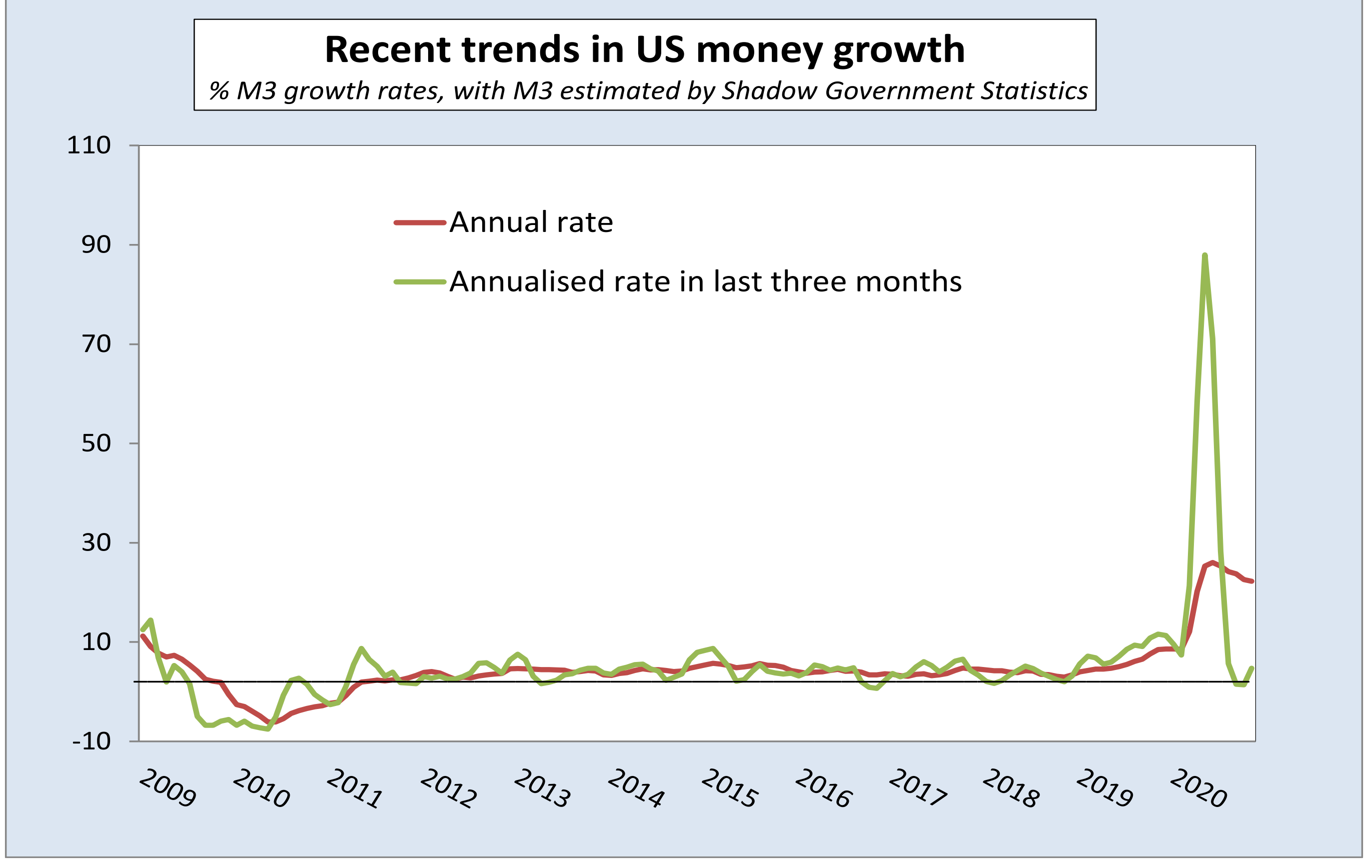
Equilibrium national income depends on the quantity of money and the desired ratio of money to incomes (i.e., the inverse of money veloci

June 2021 analysis

Income velocity of M3 in the USA: actual, with an extrapolation

		Velocity - actual	Velocity - trend behaviour
1	2018	1.094	1.066
2		1.099	1.065
3		1.099	1.064
4		1.103	1.062
1	2019	1.095	1.061
2		1.090	1.060
3		1.076	1.058
4		1.057	1.057
1	2020	1.029	1.056
2		0.796	1.054
3		0.852	1.053
4		0.855	1.052
1	2021	0.857	1.050
2		?	1.049
3		?	1.048
4		?	1.046
1	2022	?	1.045
2		?	1.044
3		?	1.043
4		*1.041* *	1.041

* This value of velocity is assumed in the text.



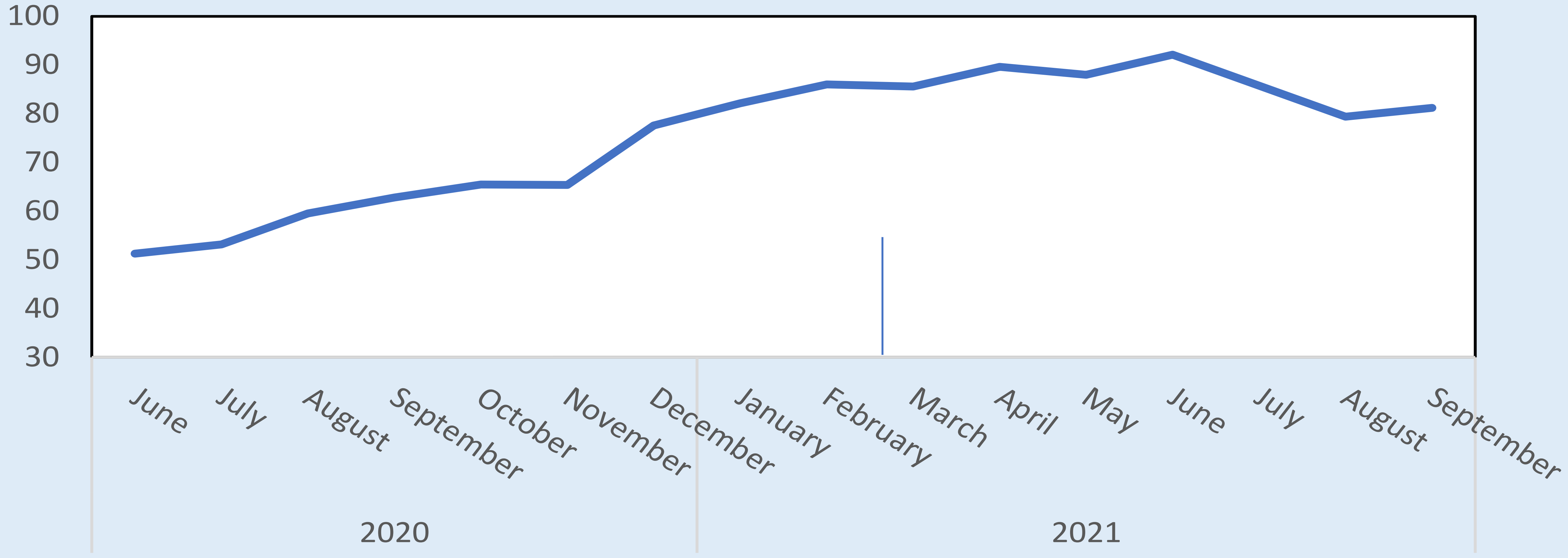
What does that tell us about the US economy in the next two years? (A June 2021 analysis)

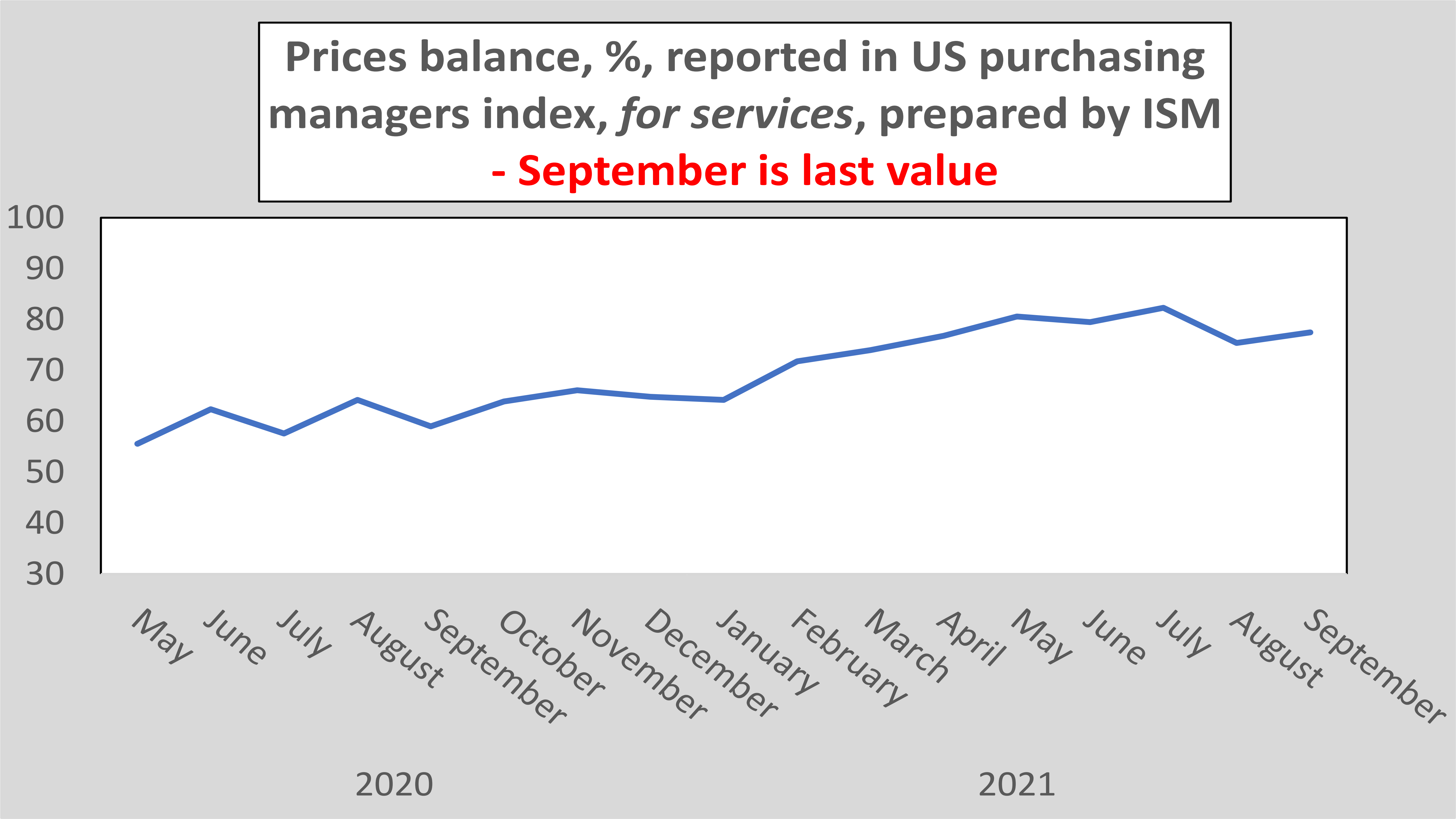
- Assume that 'life returns to normal' in a medical sense by the end of next year, i.e., the fourth quarter (Q4) of 2022.
- Assume that the velocity of circulation of money, broadly-defined (i.e., M3), is **5% lower** than on average in 2018 and 2019.
- Assume that the growth of money, broadly-defined, runs at 0.4% a month (i.e., a roughly 5% annual rate) from Q1 2021 to Q4 2022.
- THEN THE IMPLIED EQUILIBRIUM LEVEL OF U.S. NATIONAL INCOME IS ABOUT 30% HIGHER IN Q4 2022 THAN IN Q1 2021. ON THIS BASIS, THE INSTITUTE OF INTERNATIONAL MONETARY RESEARCH EXPECTS THE ANNUAL RATE OF U.S. CONSUMER INFLATION TO BE TYPICALLY IN THE 5% - 10% BAND IN THE NEXT TWO YEARS.

INSTITUTE OF INTERNATIONAL MONETARY RESEARCH
Analysis and insight into trends in money and banking, and their impact on the world's leading economies
www.mv-pt.org

Prices balance, %, reported in US purchasing managers index, *for manufacturing*, prepared by ISM

- September is last value




Prices balance, %, reported in US purchasing managers index, *for services*, prepared by ISM
- September is last value
100
90
80
70
60
50
40
30
May
June
July
August
September
October
November
December
January
February
March
April
May
June
July
August
September
2020
2021

The October energy price surge

- Since the end of August, **the oil price has risen by about 15% and the natural gas price in international markets has at least doubled.** (The precise numbers depend on the particular definition of the energy price and the particular period chosen.)
- While this effect holds (and it may indeed be ‘transitory’), it will add between 0.4% and 1.0% to the price level. (Again, the effect will vary between countries. Much gas is supplied on long-term contracts. Electricity prices have also shot up in wholesale markets.)

End-2021 projections (5 weeks ago), from the Institute of International Monetary Research

For the USA

- Much does depend – even so close to the end of the year – on commodity price movements, and especially on energy price movements, which can be erratic.
- All the same, enough information is available to justify forecasts that, in the year to December 2021,

\- **The increase in the US PCE deflator will be between 5 ½ % and 6%,** and

\- **The increase in the US consumer price index will be between 6 ½% and 7 ½ %.**

What about 2022?

- Unless policy changes radically (with a big and early rise in interest rates) and money growth collapses, **US inflation will be higher in 2022 than in 2021**.
- **The Institute has argued this in several places, but the heart of the argument is that agents (households, companies, etc.) have a stable underlying demand to hold money balances. As a result, the velocity of money has mean-reverting properties, which imply that – over the medium term – the growth rates of money and nominal GDP are similar.**

Has US money growth fallen enough in 2021?

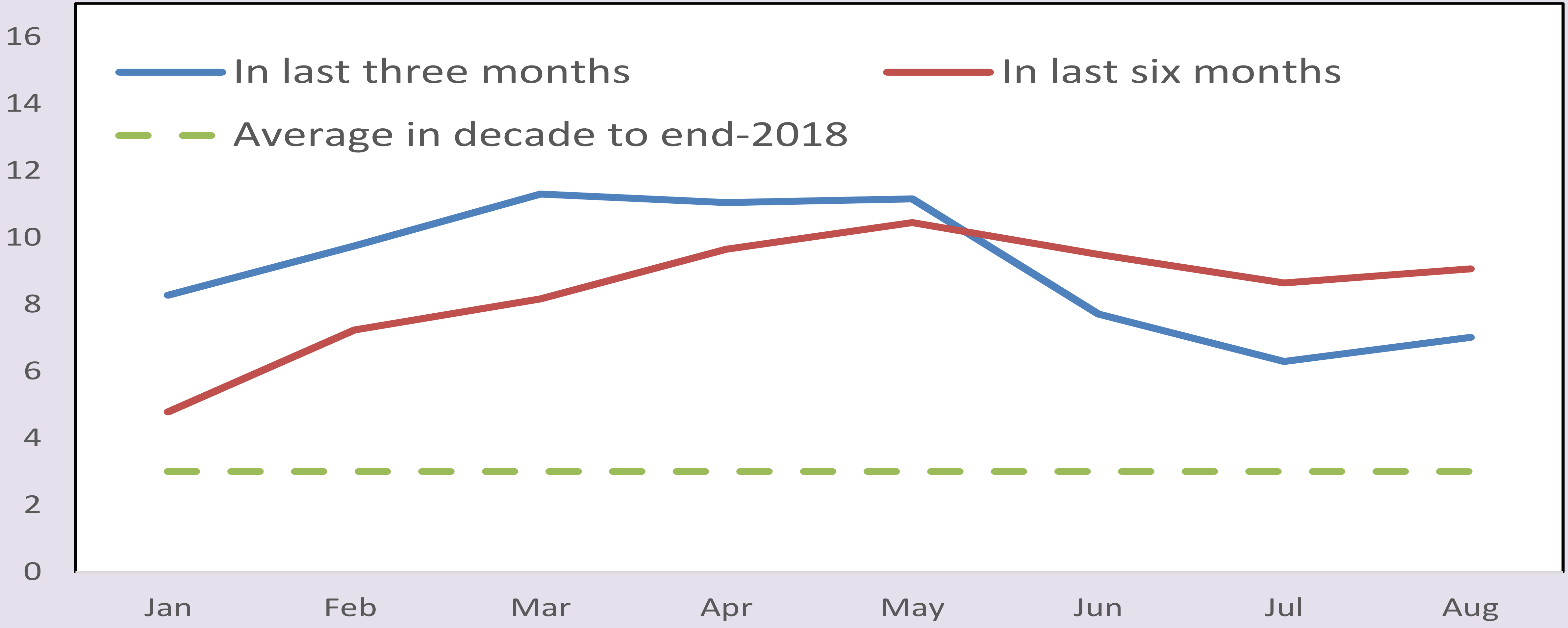
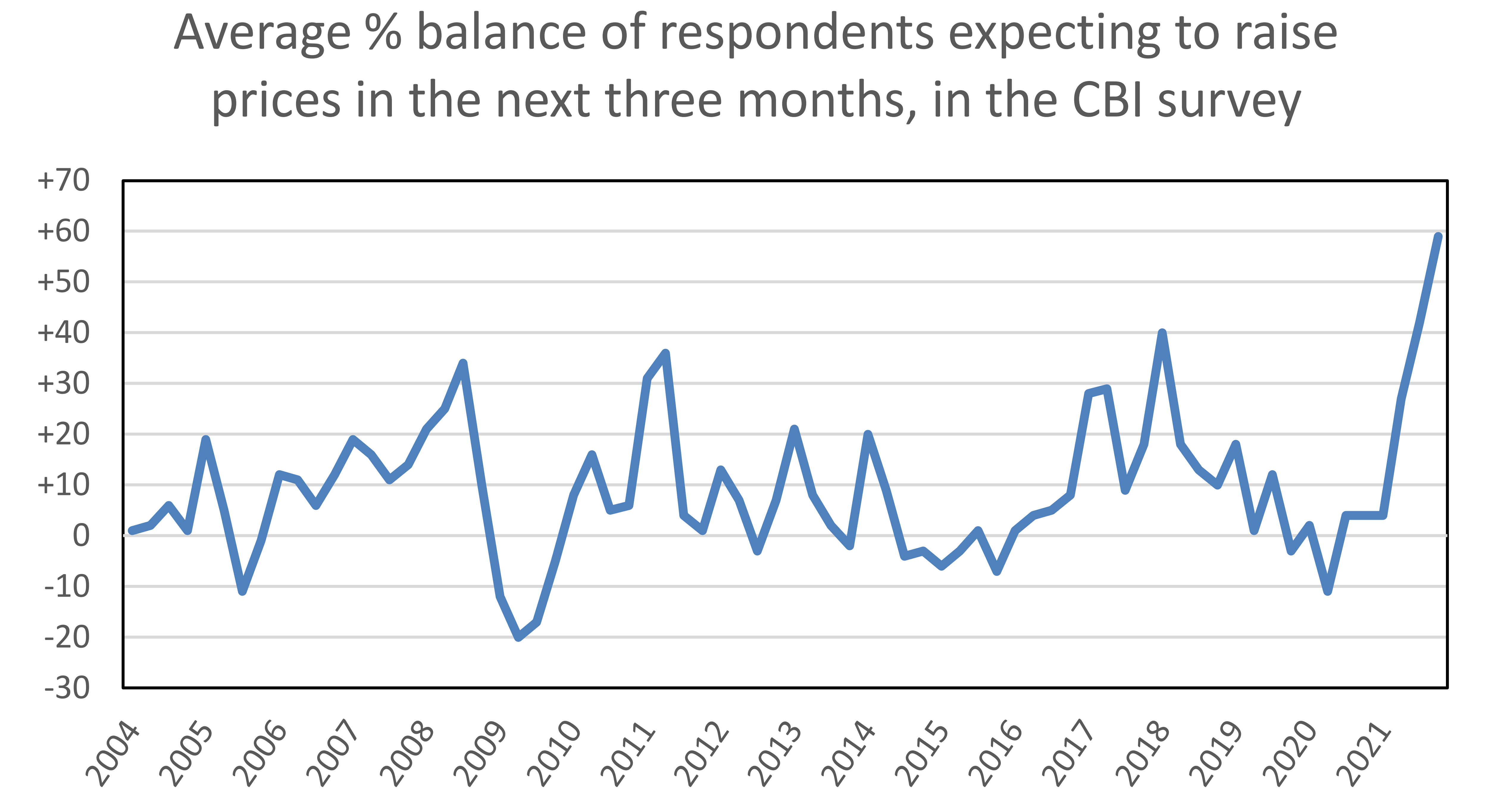


CHART SHOWS ANNUALISED GROWTH RATES OF MONEY (i.e., M3).

So will US inflation hit double-digits?

- The annual rate of US consumer inflation will reach – or at least approach – 7% at the end of 2021.
- Strong arguments can be made that US inflation will proceed at a higher rate in 2022 than in 2021, i.e., with a possible peak of 8% or 9%. **The crux of these arguments is that the underlying stability of agent's money-holding preferences will cause the velocity of (broad) money to revert towards its trend value.**
- **All the same, a forecast of double-digit inflation is extreme. Money growth has moderated markedly from its spring 2020 highs. It has moderated enough to bring inflation back towards 5%, although not enough to lower it to the 2% figure which is the Fed's target.**


Average % balance of respondents expecting to raise prices in the next three months, in the CBI survey
+70
+60
+50
+40
+30
+20
+10
0
-10
-20
-30
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
2021

Inflation prospects in Europe and Japan

- Consumer inflation of over 5% will be seen in the Eurozone and the UK in the next few quarters, although the risk of a double-digit annual rate is less than in the USA.
- The European Central Bank and the Bank of England – like the Federal Reserve – are to blame for the bad inflation numbers, as they allowed excessive money growth in 2020 in their response to Covid-19.
- **More generally, the problem is an intellectual one, that these organizations pay no attention to the behaviour of money in their forecasts, despite the continuing and clear validity of the quantity theory of money.**
- Japan will avoid the inflation spike…although whether this reflects the BOJ's insight and cleverness is a matter for debate.