



INSTITUTE OF
INTERNATIONAL
MONETARY RESEARCH

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

Has “policy” been responsible for the current upturn in inflation?

*A presentation by Professor Tim Congdon CBE,
Chair of the Institute of International Monetary Research,
in February 2022*

Professor Krugman on the current inflation

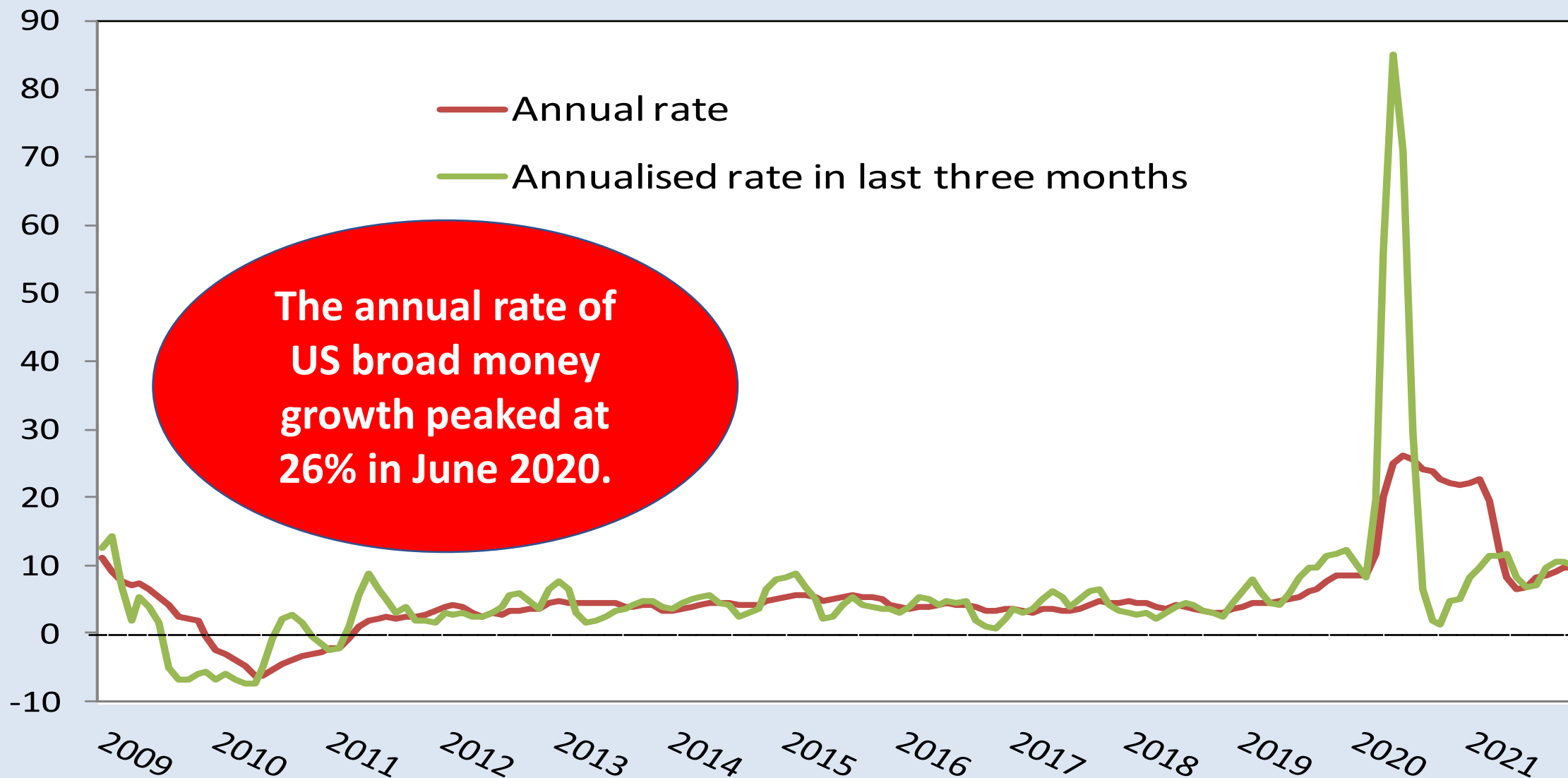
- Quotation from Paul Krugman's *New York Times* column ('Wonking out: how global is inflation?') of 12th November, 2021.
"The important point is that we've seen broadly similar inflation surges in many countries. Which tells you that what's happening in the United States isn't mainly about policy."

Is inflation “mainly about policy” or not?: Our attempt to answer the question by an inter-country comparison

- We will contrast money growth patterns in ‘**the West**’ (i.e., the USA, the Eurozone and the UK) and ‘**Asia**’ (i.e., China, Japan and India).
- We will be using charts of money growth – on both annual and three-month annualised bases – for these economies. In looking at the charts ***it is important to pay attention to the values on the left-hand axis.***

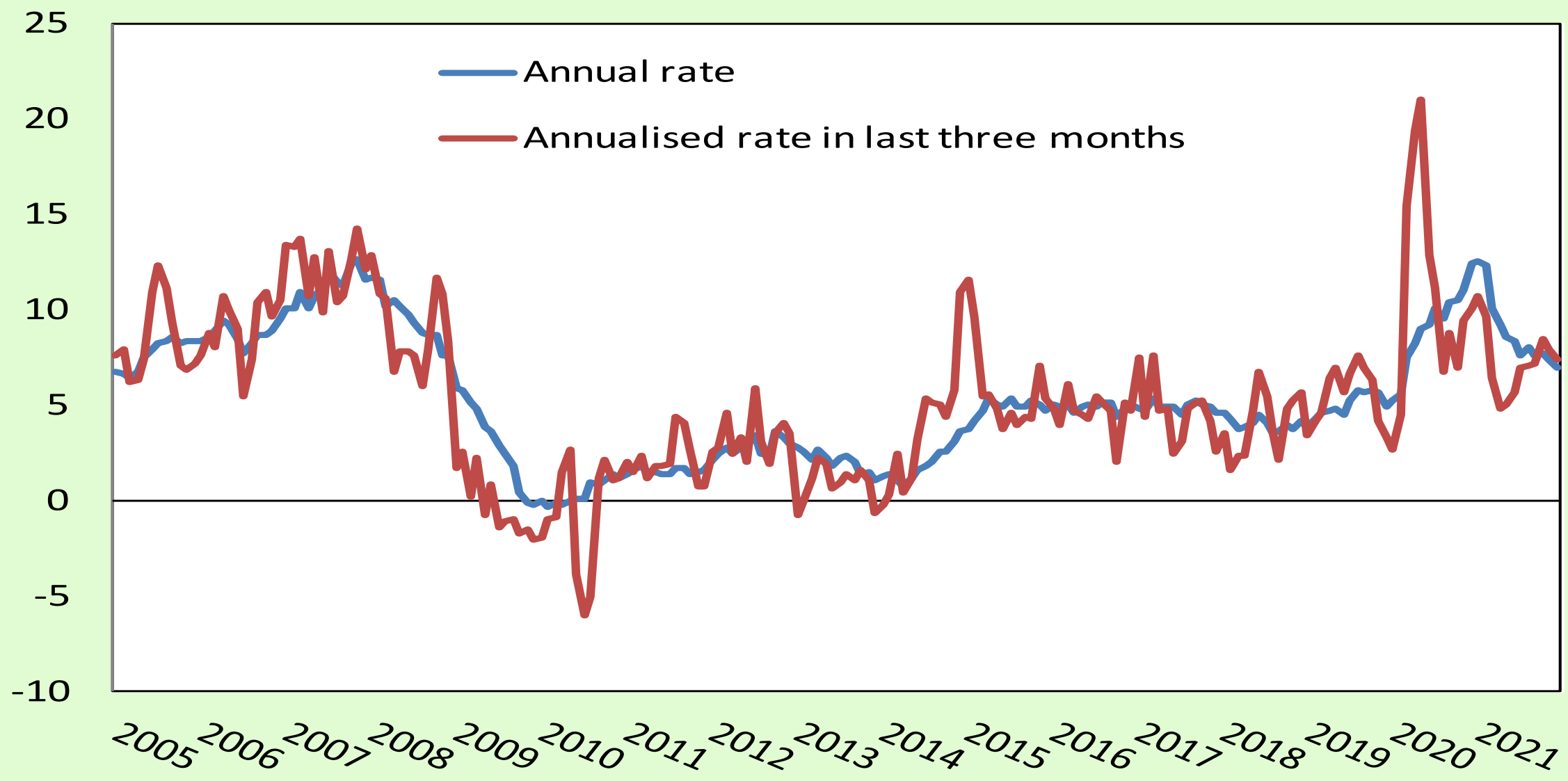
Recent trends in US money growth

% M3 growth rates, with M3 estimated by Shadow Government Statistics



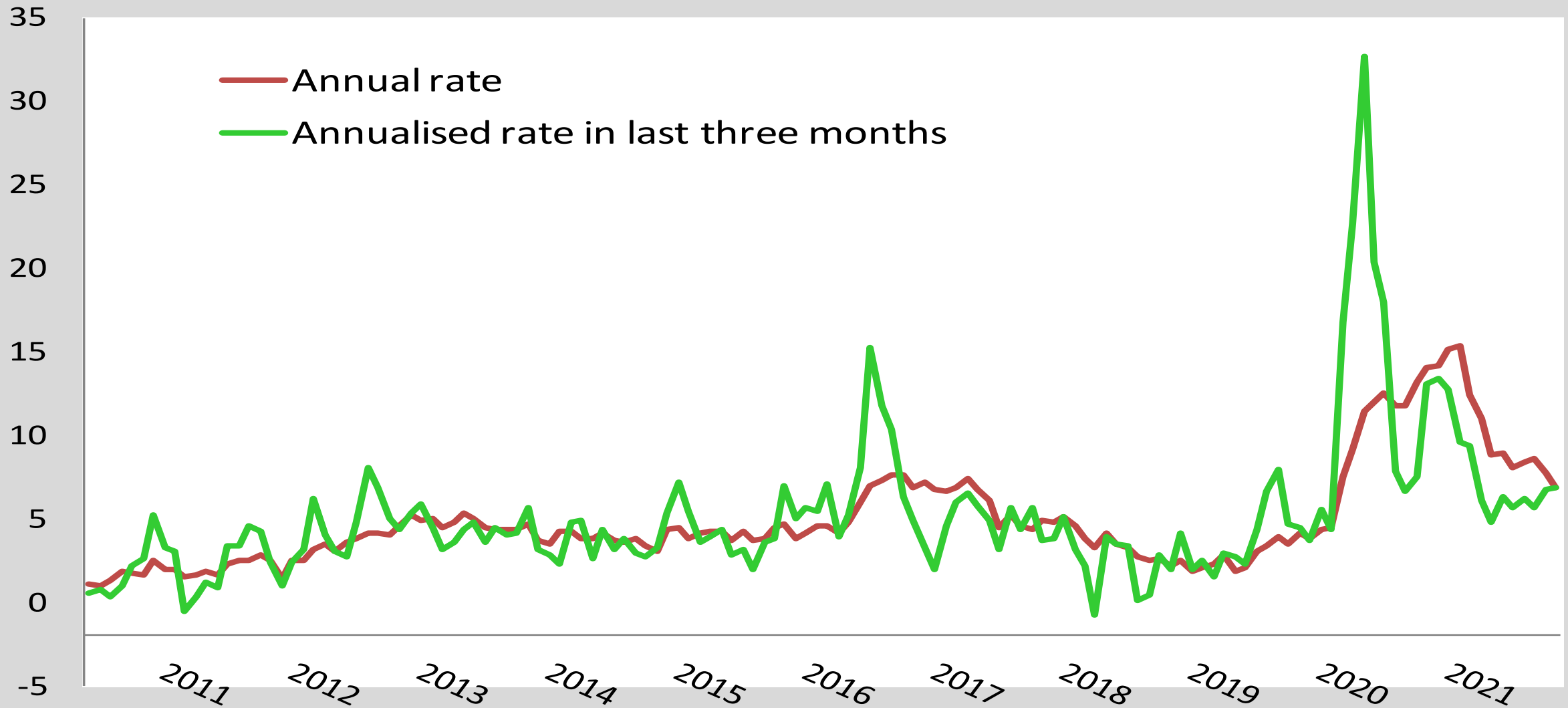
Recent trends in Eurozone money growth

% M3 growth rates, data from the European Central Bank



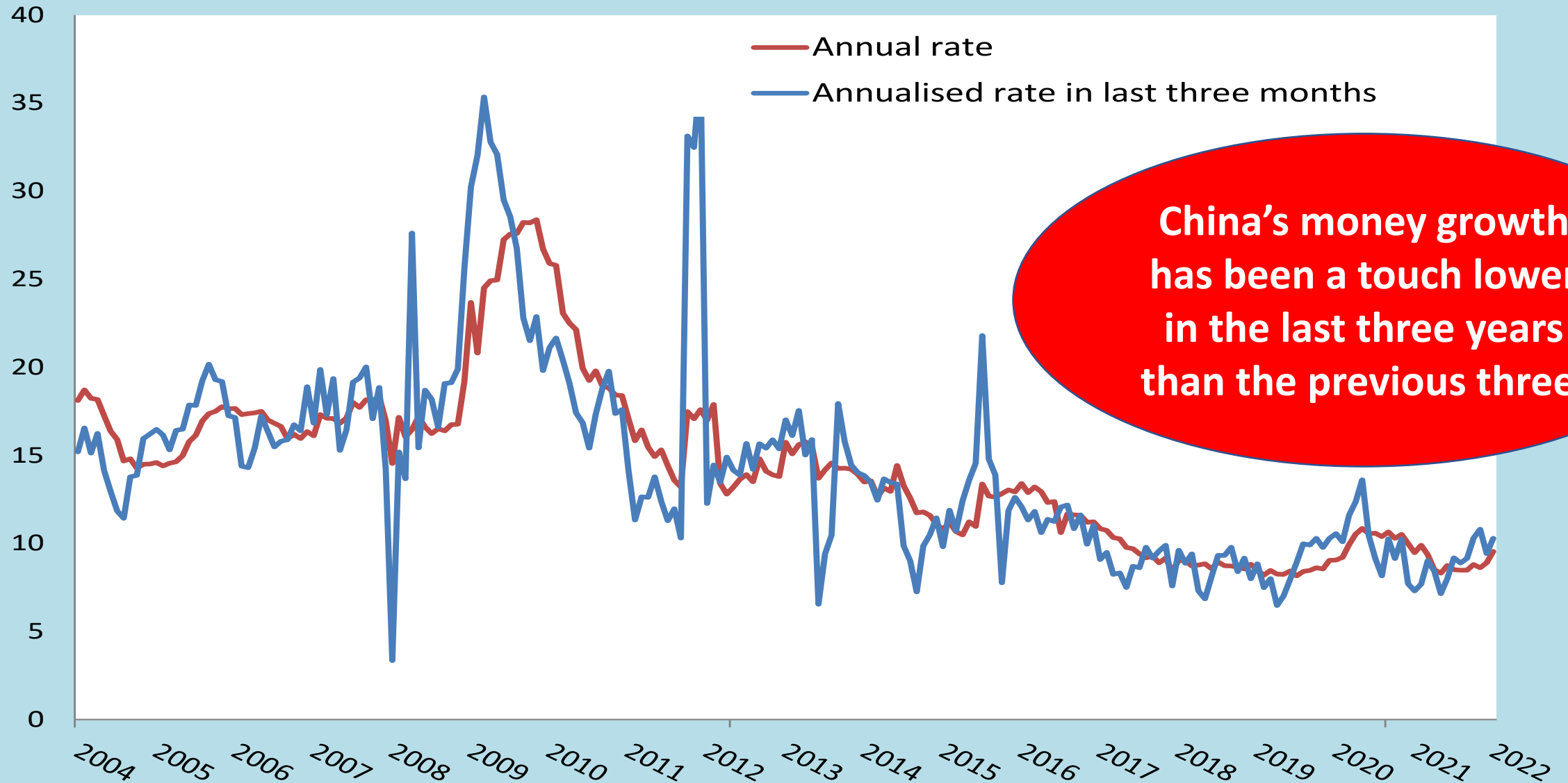
Recent trends in UK money growth

% M4x growth rates, data from the Bank of England



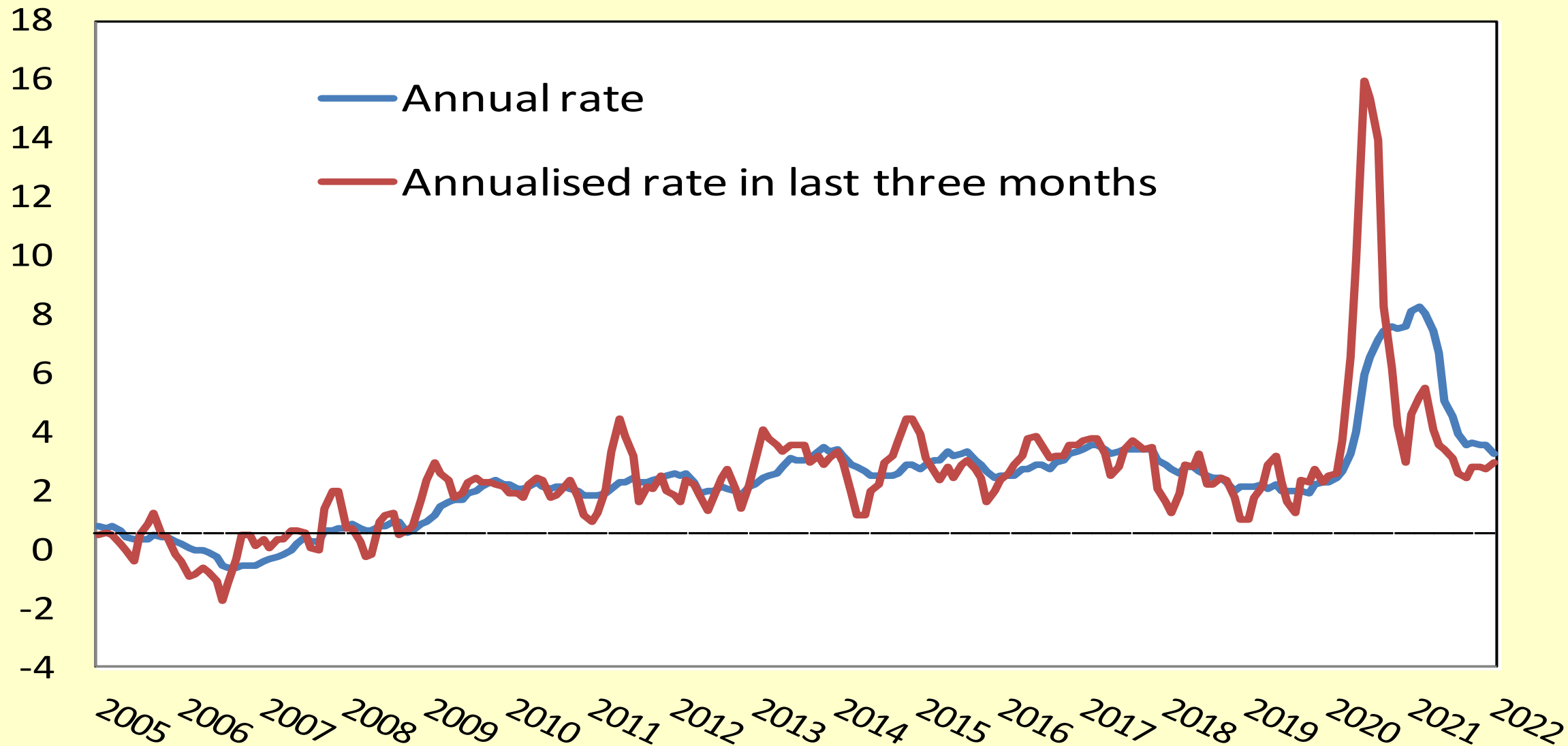
Recent trends in China's money growth

% growth rates in M2, data from the People's Bank of China



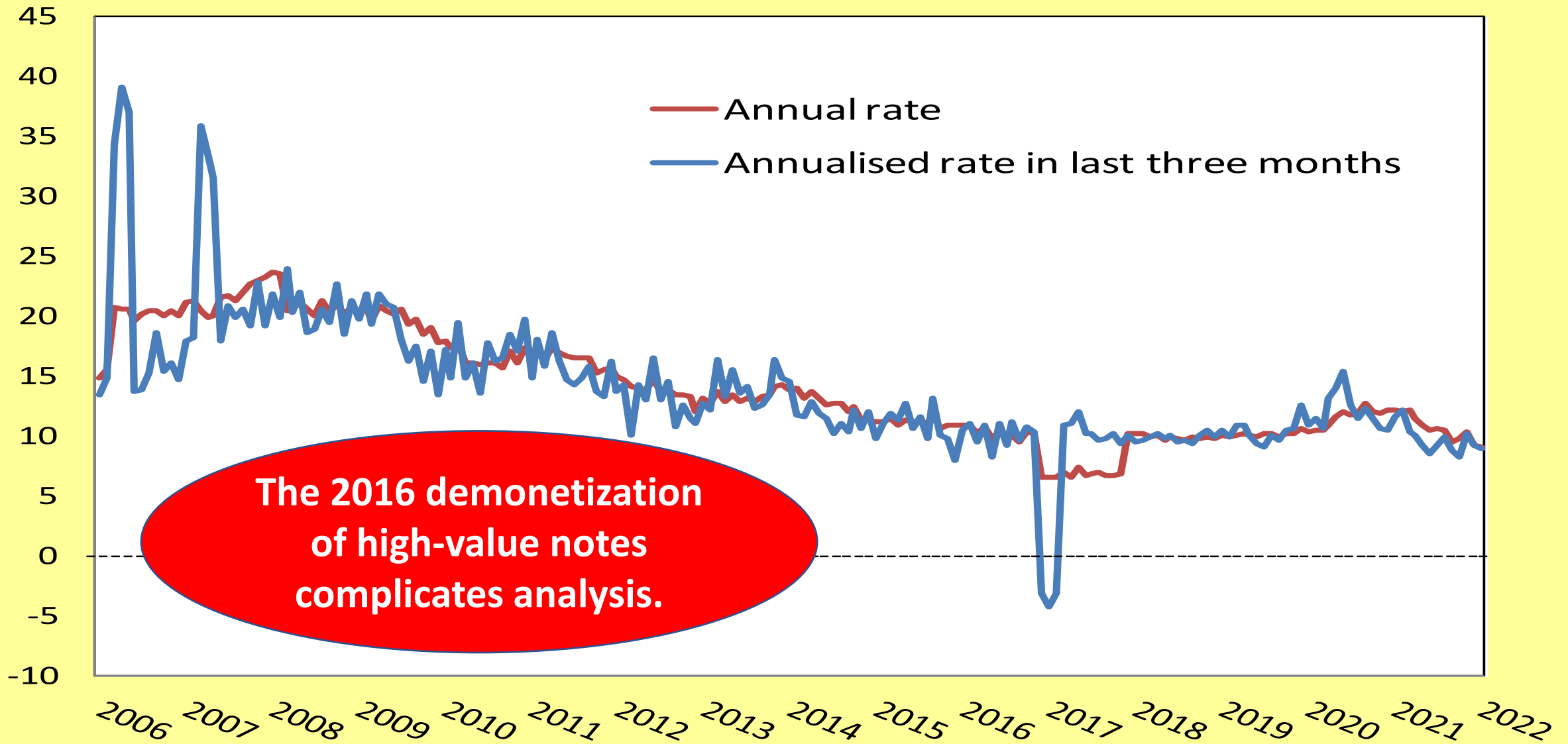
Recent trends in Japanese money growth

% M3 growth rates, data from Bank of Japan






Recent trends in Indian money growth

% M3 growth rates, data from the Reserve Bank of India






Money growth in 'the West' in recent years

| | Increase in broad money, %, over three years | | Compound annual % increase in broad money | | Difference between rates of annual increase, %, in two periods |
|----------|--|--------------------|---|--------------------|---|
| | <i>To end-2018</i> | <i>To end-2021</i> | <i>To end-2018</i> | <i>To end-2021</i> | |
| USA | 12.4 | 45.0 | 4.0 | 13.2 |  +9.2 |
| Eurozone | 14.1 | 25.2 | 4.5 | 7.8 |  +3.3 |
| UK | 15.8 | 26.0 | 5.0 | 8.0 |  +3.0 |

Money growth in 'the West' in recent years

- Annual rate of broad money growth ***in the USA*** was over 9% higher in the three years to end-2021 than in the previous three years. Given that inflation was positive, although low, in the late 2010s, there must be **a high risk of a double-digit annual inflation rate in the next two years**. (Much depends on policy – & money growth – from here.)
- Annual rate of broad money growth was 3% a year higher ***in the Eurozone and the UK*** in the three years to end-2021 than in the previous three years. A significant rise in inflation is likely, **with annual numbers above 5% for several quarters**. (Again, much depends on policy.)

Money growth in 'Asia' in recent years

| | Increase in broad money, %, over three years | | Compound annual % increase in broad money | | Difference between rates of annual increase, %, in two periods |
|-------|--|--------------------|---|--------------------|---|
| | <i>To end-2018</i> | <i>To end-2021</i> | <i>To end-2018</i> | <i>To end-2021</i> | |
| China | 31.2 | 30.4 | 9.5 | 9.3 |  -0.2 |
| Japan | 8.8 | 13.9 | 2.8 | 4.4 |  +1.6 |
| India | 29.2 | 35.8 | 8.9 | 10.7 |  +1.8 |

Money growth in 'Asia' in recent years

- In general, money growth rates in the last three years have differed only slightly from those in the previous three years.
- Notice that the Indian figures are affected by the demonetization of high-value rupee notes in 2016, which reduced the quantity of money. Without that, money growth rates would have been very similar in the two three-year periods.
- Inflation in these countries will be affected by global commodity price movements, as will inflation 'in the West'. But money growth rates in 'Asia' pre- and post-Covid have been similar and underlying inflation pressures should be little changed.
- **If the quantity theory of money is right, inflation 'in Asia' will be much less affected than 'in the West'. It may rise a little, but not dramatically.**

Implications of the contrast between 'the West' and 'Asia'

- Monetary policy in the Covid period has been very different in 'the West' and 'Asia'. **Whereas policy decisions (particularly central bank asset purchases) led to marked accelerations in money growth in the West, nothing comparable – in terms of scale – occurred in 'Asia'.**
- If inflation turns out lower in Asia in the next two/three years, then the validity of the monetary approach to the determination of national income and inflation receives confirmation – at least to some degree – from this important piece of evidence.

Some evidence so far: inflation rates in Asia

| | Latest annual rate of consumer price inflation, % (December 2021) | Average annual rate of consumer price inflation, %, 2016 - 21 |
|-------|---|---|
| China | 1.4 | 2.0 |
| Japan | 0.8 | 0.3 |
| India | 5.5 | 5.1 |

So far inflation in 'Asia' is much the same as in the last five years.

Policy and inflation: Paul Krugman is wrong

- **Policy decisions – by governments and central banks – affect the rate of money growth, and rate of money growth affects the rate of inflation.** This is basic economics. The emerging contrast between inflation rates in ‘the West’ and ‘Asia’ demonstrates the truth of these ideas.
- Paul Krugman is wrong to claim, in his very influential *New York Times* column, that “what’s happening in the United States [on the inflation front] isn’t mainly about policy”.
- **Policy matters vitally to the determination of inflation in all countries.** Good policy is always necessary to achieve price stability.