

## Increasing the money supply does not create inflation

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I am grateful to Frances Coppola for drawing my attention to [a paper by Hiroshi Yoshikawa, Hideaki Aoyama, Yoshi Fujiwara and Hiroshi Iyetomi entitled Deflation and Money](#)

Their conclusion, based on research in Japan, is pretty clear and so worth reproducing in full:

*Deflation and inflation are macroeconomic phenomena. However, we cannot fully understand them by only exploring macro data because the behavior of aggregate prices such as the Consumer Price Index depends crucially on the interactions of micro prices. On the other hand, all in all, the results we obtained have confirmed that aggregate prices significantly change, either upward or downward, as the level of real output changes. The correlation between aggregate prices and money, on the other hand, is not significant. The major factors affecting aggregate prices other than the level of real economic activity are the exchange rate and the prices of raw materials represented by the price of oil. Japan suffered from deflation for more than a decade beginning at the end of the last century. More recently, Europe faces a threat of deflation. Our analysis suggests that it is difficult to combat deflation only by expanding the money supply.*

I have [written on inflation recently](#) and suggested, simply based on my own reasoning, that this is likely to be the case. The fact that [\\$6.5 or so trillion of QE has not delivered inflation](#) whilst real wages have been static very strongly supports this idea.

I am quite sure it is true: and what it implies is that monetary policy is, as I have also recently suggested, dead for all practical purposes and that it is fiscal policy that delivers real growth in the actual economy that is needed if inflation is to be created and deflation is to be prevented.

What has this to do with People's Quantitative Easing? Three things.

First, the QE financing mechanism cannot be inflationary. All the financing mechanism does is buy bonds issued by a National Investment Bank. In effect this is little different

from QE: it would be splitting hairs to pretend otherwise. And as the authors noted say, this does not cause inflation. But since PQE is cheaper than bonds it remains worthwhile.

So, secondly, it is instead the fiscal impact of the PQE that matters i.e. the fact that it will be used to fund real investment in real assets creating real jobs for real people in every constituency in the UK that is its significance and which makes it different from QE, which simply creates financial asset bubbles.

And, thirdly, as the authors say, this investment in real activity could be inflationary if it sought to over-expand the economy (i.e. push it beyond full employment, which does not take into account all the available pools of labour). But, until such time is reached PQE has massively beneficial impact. It delivers real growth, not bubbles. It creates employment (and so delivers a more balanced economy). It delivers long term gain in the form of the assets created. And it may deliver some inflation, which I would remind anyone, has been official policy for the Bank of England since 1998 when it became independent and which we do not have at present.

As I keep arguing, PQE is the policy we need to control the economy, deliverable at the lowest possible cost. And in, and of, itself the funding is not inflationary.

Might we lay that to rest now?