Funding the Future

Why does anyone want to make the fear of inflation the ...

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The Financial Times published an article on Friday with this headline:

The economy is too weak for inflation to return

They commenced by noting that:

It has been almost 40 years since the US and most of Europe grappled with serious inflation. Over the past decade the greater risk on both sides of the Atlantic has been that prices will fall.

I agree with them. What I do not agree with is their next sentence, which said:

Since the coronavirus pandemic, however, rampant spending by central banks and governments has led to expectations that change is afoot.

They noted the increase in gold prices, and broad money supply (but failed to note that massive decline in the velocity of circulation of only, rather implying that they do not think that an issue any more) before saying:

The threat of widespread and persistent price rises matters now more than ever. Inflation exacerbates social divides, affecting the worst off the most. It also weighs on confidence and decision-making – hardly ideal in an environment where businesses are understandably hesitant.

They speculated that:

As lockdowns ease, prices could jump. Businesses may want to make the most of pent-up demand as rules on social distancing are relaxed. Shocks to supply chains could bump up costs.

And at that point their sense of reality kicked back in. As they then noted:

But if those pressures are to prove persistent and dangerous, wages must rise, too. A *driver of double-digit inflation in the 1970s was that expectations of price rises were so entrenched that ever-higher prices were met with ever-louder calls for higher wages. A hallmark of the low inflation era, meanwhile, has been low wage growth, despite low unemployment. That has left inflation largely confined to asset prices, with the full impact of central banks' money printing still to be felt in the cost of everyday goods and services.*

Quite so. The destruction of workforce power - a deliberate result of neoliberal policy - has delivered this legacy.

But as they noted there has been another factor: and that has been the desire for low inflation and low-interest rates. Central bankers would like to claim that the elimination of inflation is all their own work. But as the FT noted it was not: it took political will, for example, to allow QE, with its impact on this process. And it will take continuing will to continue to deliver low rates. As they note:

Some governments have locked in low borrowing costs by issuing bonds that will not mature for another 30, 50 or even 100 years, but not all have been so wise.

Quite so. Those that have done so - and those who could do so - will reap the rewards of locking down the issue of so-called debt for such periods. But as MMT notes, this policy is deliverable with interest rate control using QE and the regulation of rates on central bank reserves which in combination can guarantee zero effective interest rates in near perpetuity. Low interest rates are fundamental to a strong economy.

But then the FT concluded their piece saying this:

When the time comes for central banks to raise rates, this generation of policymakers – like their forebears – will face pressure. If they buckle, then inflation could finally return.

And yet, quite bizarrely, they gave not a hint as to why those higher rates or that inflation should return, at least in a form that any type of fiscal or monetary policy can control.

So let's deal with this issue, because it's something people ask about modern monetary theory (MMT), which they believe will give rise to inflation risk because they claim more debt will be issued.

So, let me start with some simple facts.

First, as the FT notes, we have not had a serious inflation issue for 40 years.

Second, serious inflation requires wage inflation, and that is now almost unknown, and with maybe five plus million unemployed likely in the UK soon inflationary wage pressure is not going to be seen for a very long time to come.

So third, the real risk is deflation.

And fourth, debt is not a risk: if QE has done anything (and what it has achieved is debatable) it has definitely proved that debt is a choice and not a necessity.

And, fifth, nor is there a risk of stagflation, last really seen in the late 70s, because that required a) an external price shock b) attempts to hold exchange rates steady rather than to let them float, which is the essential reaction that we now know is necessary in such situations, and c) the cycle of inflation compensating pay rises that were normal in the 70s and have not been since, all of which mean that inflation for this reason is now very unlikely.

Finally, sixth, the inflationary effect of interest rate rises, which were once commonplace, can also be avoided now for the reasons noted already.

So where does the FT think the risk of inflation is hoping to come from? I genuinely have no clue. All they are assuming is that one day either it must, or the desire to raise rates will occur anyway, and neither appears to have any economic logic to it.

In fact, that final FT comment is much like the commonplace reaction from all MMT critics that 'you wait, it will create inflation' when a little inflation might be exactly what we need to avoid the risk of deflati0n. What it really suggests is the presence of an author ‘enslaved by some defunct economist'.

I am not saying inflation could not happen. I am saying it is incredibly unlikely to happen in any foreseeable future, just as it has not happened in any serious way in the lifetime of most people now alive in developed economies.

And in that case I ask the obvious question, which is why do some seek to dictate economic policy on the basis of the remote possibility of inflation when the need for current employment opportunities is so very obviously the real pressing policy priority? To put it another way, why is inflation paranoia allowed to trump the possibility of delivering work, hope and the chance for people to deliver their potential? Could it be that some are so frightened that this would liberate labour to deliver whilst proving that capital is not the factor in short supply that they will do anything to maintain the existing structures of power?