Inflation, Deflation, Balance

Keith Rankin, 2 March 2015

Journalistic economics tends to see 'good' or 'bad' in the various economic measures that we frequently hear in the news. This motivated me to write a piece Normative Economic Journalism (28 Feb 2015) in *The Daily Blog* about the use of colour shading in a particular website www.tradingeconomics.com and how it made it look that Syria was by far the world's best performer on inflation. Syria's annual inflation rate was listed as minus 29 percent.

I also made various observations about how countries like Switzerland and Denmark which presently have negative interest rates also have deflation, and that very easy monetary policies is these and other countries were in fact facilitating deflation rather than stimulating inflation.

A couple of comments raised issues to which I responded. Here are those threads.

First reader comment: "It seems to me that QE did create a lot of inflation, just not in things that are included in consumer price indexes – the traditional measure to inflation. Real estate, stocks, etc have increased in price a lot lately, is that not inflation?"

My response (slightly edited):

> Buying financial assets is saving, not spending. QE prevented financial asset prices from falling. New money is injected into the economy when banks (especially central banks) buy assets. In practice it allowed the rich to hold money as a form of asset. Increased inequality and miserliness mean that more income is directed into holding assets rather than buying stuff.
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> Money has become one of those assets, and, as Keynes showed, with deflation money becomes an increasingly attractive asset. The inflationary danger occurs if too many people holding money as a form of saving suddenly decide to spend that money. Those people would be competing with workers and capitalists for goods and services which the economy could supply only some of.
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> Money itself is not inflationary. It is the decision by many people simultaneously to switch from a saving strategy to a spending strategy – eg to spend their hoards of financial assets – that sparks inflation. Inflation will then occur – and on a substantial scale – if assets are already held as money, or if the asset hoards can be easily converted to money without those hoards losing value.
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> Inflation in economics is a process of rising prices of newly produced goods and services. It is neither about the prices of financial assets nor other items that already exist. So a surge in the prices of second-hand bicycles is not inflation. Unspent money is a financial asset. So is anything else, such as land or second-hand art, that serves as a means of parking income. Asset prices are presently inflating (financial inflation but not economic inflation) because too much income is being parked and not enough is being spent. So simultaneous asset price inflation and consumer price deflation are compatible, if not complementary.
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> At present there is no sign of any huge switch from saving to spending. There is no present sign that people already with substantial holdings of financial assets wish to liquidate those assets in favour of goods and services. The ructions that do take place are about changes in the preferred mixes of the assets that make up the hoards of the rich. The magma chamber of the inflationary super-volcano is those asset hoards, not the quantity of money in the banking system. QE has pacified any rumblings of that volcano. It's one volcano that's not about to blow. The dangers

> lurk elsewhere; implosion rather than explosion. The forces that drive the market economy are too weak, not too strong.

Second reader comment: "'The forces that drive the market economy are too weak, not too strong.' There is certainly always an explanation that appears to clarify why the market economy fails to produce desirable public goods. Having witnessed thirty years of market failures from the Rogergnomic reforms I no longer credit such facile excuses".

My response (slightly edited):

> When I say that “The forces that drive the market economy are too weak, not too strong”, I mean that market forces are too weak to drive markets. I am not making any normative comment about the virtues of the pure market economy.
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> I do however accept markets as an important reality; and I do not have sufficient imagination to conceive of a workable economic order that suppresses market forces.
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> We might consider which of the following are more likely to deliver dystopian outcomes: market forces too weak (persistently weak spending on goods and services); market forces far too strong (persistent and substantial overspending on goods and services creating serious inflation); or market forces of demand that balance the constraints of supply.
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> The balanced scenario not only averts implosion or explosion, it also creates the conditions (adequate or better incomes of ordinary households) through which households can choose to reduce their labour supply while still maintaining a balance between supply and demand. And this scenario can create the conditions through which people are willing to contribute to the creation of public goods; the vision is one of shared economic security with the help of public and collective goods, rather than one of private economic security through excessive private ‘rainy-day’ saving.
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> Something like public equity dividends or a universal basic income is necessary to allow this resource conservation-enabling balance to take place. Public equity benefits strengthen market forces that are too weak, making it easier for workers to say ‘no’ to exploitative labour contracts, and (through the resulting higher hourly wage rates) allow us to choose to work fewer hours, to save less, and to spend less on things we value less than our time.

When market forces ('spending power') are strong and well distributed, ordinary people are better able to make real choices. Our economic future looks brighter when it's possible for ordinary people to make real choices; eg choices that allow us to collectively work less, not more. And choices that facilitate shared security, rather than the deflationary choice of everyone seeking security through private savings.

Global market forces are weak at present; deflationary. Monetary policies cannot reverse this, and may even aggravate this condition. The way forward is to strengthen market forces by allowing people on lower incomes to spend more without having to borrow more. We need to strengthen our welfare states through the concept of public equity.
