The Quantitative Reality versus the Hyperinflation Hysteria

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Introduction

The past 100 years of monetary & fiscal policy evolution have shown us that in economics, everything is relative and cetirus paribus applies now more than ever. What if there was a way for countries to turn debt directly into jobs? Sounds crazy, yes? Well, it's happening already.

Financial innovations in the markets have been, albeit slowly, matched by equally audacious and creative monetary interventions that were used to restore market stability, also for economic stimulus purposes. The Federal Reserve’s QE program was designed to allow the state to essentially purchase bad debts such as mortgages (CDO’s), mortgages-linked insurance obligations (CDS’s) and derivative synthetic products linked to consumer debt. Several other major economies designed similar unique interventions. Obama’s package was USD 700 billion. Trumps package is USD 2,2Trillion …. Still, markets even fell after the day of announcement. No consumer inflation. In contrast, as a result of the 2008 Global Financial Crisis countries like South Africa, with its conservative and orthodox economic policies, still managed to lose 1 million jobs experienced moderate inflation… you get my point.

A very simplified analogy: If the South African Reserve Bank was to say eliminate the City of Johannesburg’s local Rand-denominated debt by using debit entries on the SAMOS system, and that money redeemed to local debt holders (say, mostly pension funds) was paid out on condition that 90% of the funds must be invested in the local capital markets - won't everyone be better off? Will action in any conceivable way, create consumer price inflation? How will the depressed financial asset prices benefit? Will the City of Joburg not be able to create more jobs through spending? Will SARS mind the extra VAT, PAYE, and Company Tax increase that will be generated or will they prefer to deal with year-end losses being rolled over as tax credits into the new financial year?

The Great Deception

All money printing leads to hyperinflation”, “Developing countries do not have the fiscal space to carry out a QE program”, and “the only way to fund the Corvid-19 relief measures is by borrowing from the IMF, reprioritizing state funds, and by tax relief” …

Whilst this unscientific view may be tempting to believe, it is simply not true. There are several reasons for this, and most of them are in plain sight. This article will prove three things for people who are unfortunate enough to believe the opening paragraph;

I. The notion that ANY increase in the money supply will lead to a general increase in the inflation rate is completely false, non-factual, and actually quite irrational.

II. On planet earth approximately 92% % of all money in the system was artificially created (primarily by the central banks, commercial banks, and by the creation of bespoke financial instruments), including the issued by international lenders – and yet many of the major money printing economies have actually experienced deflation, stagnant wage levels, and negative real interest rates over the past decade.

III. There are mechanisms by which developing countries are able to pay for the Coivd-19 relief efforts, stimulate economic activity, and re-industrialize without using debt. Essentially the money supply has to be increased, however, the way in which this is done needs to be structured according to the unique attributes of the implementing country.

Deflating the Inflation Theory

Firstly we need to separate Consumer Price Inflation (CPI) from Asset Price Inflation (API), Imported Inflation (II) as well as Producer Price Inflation (PPI).

CPI Index is a measure of the general price levels as measured by a composite basket of basic goods and services, over comparable time periods. Printing money for the sole purpose of providing "helicopter drops" to the vulnerable masses might lead to inflation, however, the process is not automatic. Inflation only will occur if :

1. The funds spent are huge – in relation to the size and velocity of money within the local economy.
2. The financial leakage (via corporate & PAYE tax debits and savings made by the service providers, importation, savings, etc) is weak/low.
3. The spending on relief does not lead to job creation or job retention (due to automation and the existence of capital-intensive industries)

The reason why so many of the QE programs that are carried out by major central banks have such a long lag time is due to the fact that a lot of the liquidity injected leads up to Asset Price Inflation, not CPI i.e the prices of equities, properties, and other financial assets. For example, if JP Morgan Bank can borrow at 0.25% and buy US Treasury notes which are currently yielding say 3.2%, then why on earth would they want to risk investing their capital by loaning out to financially distressed consumers? Due to the presence of a huge and stable middle class in those economies, the household wealth increase eventually leads to borrowing and ultimately higher business activity.

Even if developing economies refrain from increasing their money supply, imported inflation remains a very real threat. For example, the inevitable rise in future oil prices from zero, the fleeing to "safe markets and safe assets" by investors, and the expected reduction in non-essential export receipts (due to global economic recession fears) will result in the downward pressure on the Rand which in turn will lead to inflationary pressures – as has happened many times over.

Monetary & Fiscal Policy Contradictions

All conventional approaches to monetary and fiscal stimulus policy that do not incorporate some sort of net money supply increase will result in one or more of the following;

a. A neutral economic impact if the funds injected are either:

- Redirected from other state spending priorities
- Used (hypothetically speaking) to fund tax relief and tax shortfall measures & expectations, respectively

b. More debt obligations, further rating downgrade, and downward pressure on the Rand due to expected increases in USD debt repayments. Not to mention the stringent “structural adjustment” conditions that are attached to this type of debt.

Now herein lies the contradiction;

I. If the USD 100 billion Investment drive that was advocated by President Cyril Ramaphosa (Roughly R1,6 Trillion at the time of announcement) would not lead to inflation, then why would locally induced money do so? To add insult to injury, most of the USD funds would have been created by the US’s banking fractional reserve system anyhow.

II. Assuming there are credit-worthy customers and the cash reserve ratio is at 2%, then the South African banks will be able to create R100,000 loans from R20,000 deposits. The reserves that banks have to keep have gone down, meaning now the banks can create even more money – in DEBT though!

III. Part of conventional thinking was the announcement by the government that they will guarantee up to R200 billion in new bank loans. This is a “damned if they lend, damned if they don’t lend” situation due to the fact that if there is no real net money supply stimulation, there will be only bad customers to lend to. If the banks actually lend out (they are notoriously conservative and their lending requirements are very prohibitive) and clients default, then the state will have to end up borrowing, printing money, or leaking out funds to cover the guaranteed loan book.

A New Way, A Better Way

So the question is, can the money supply be increased for the purposes of relief, stimulus, restructuring of the economy, deindustrialization, and growth - without that process leading to inflation?

In short, the answer is yes. The following conditions would have to apply;

1. The money supply is created without debt i.e via the central bank’s reserve management & settlement mechanisms - not through physical cash or treasury bills/bonds

2. The money would have to mostly go towards

- Debt eradication for state entities, local governments, and via businesses that employ many people and for those that are significant tax (PAYE, VAT & Company Tax) contributors ?

Directed state spending on small business that is tax compliant, have a manufacturing component, have export potential, and are labor-intensive.
- The stimulation of import substitution and industrialization of the local economy.
- Much needed job-creating (although temporary) infrastructure spending. The localization of medical devices, equipment, and medication manufacturing wouldn't hurt either.
- Rapid digitalization of the education system. This would imply support for the improving county's telecommunications infrastructure.
- The rapid acceleration of the RDP housing, electricity access, amenities, and water provision program

3. A committee made up of the banks, labor, academics regulators and other relevant stakeholders should be put in place to audit the spending. In addition, their role would be to make decisions on how and when to leak out any excess money from the system via the elimination of any inflationary surplus treasury funds – the same way the funds were created. The SARB would have to be ready to use conventional tools such as the repo rate, reserves, capital controls, and others in order to keep any CPI in check.

You can read a full description of what the alternative monetary policy could look like

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