THE CORNER

SPAIN | EUROPE | WORLD | MARKETS | INTERVIEWS | OPINION | IR Spain

TOP STORIES 18TH AUGUST 2022 | REPSOL TEAMS UP WITH SANTOS TO INVEST €2.555 BN IN ALASKA

HOME | IN THE WORLD | WORLD ECONOMY

Globalisation Ensures Low Inflation For A Long Time To Come

TOPICS: Inflation

Globalisation Ensures Low Inflation For A Long Time To Come

TOPICS: Inflation

POSTED BY: OFELIA MARÍN LOZANO 23RD APRIL 2021

Ofelia Marín Lozano | Expectations of a rapid and sharp rise in inflation, which would be the prelude to a rate hike is perhaps the central issue of the current debate in the financial markets. **A lot of money has been issued, yes, but this has not and will not generate inflation.** Because the money that has been issued, and put (via subsidies, grants, permanent or temporary unemployment payments) into the hands of consumers, against an increase in public debt, has not artificially increased aggregate demand to levels above pre-crisis levels. In fact, it has barely managed to keep it at the same levels.

Monetarism, in the last quarter of the last century, placed the money supply as the key factor in the modulation of inflation. Low rates, high inflation, high rates, low inflation. Inflation differentials between the major developed countries were very noticeable in the 1970s and 1980s.

In the United States in particular, inflation rebounded spectacularly in the 1970s, with annualised rates of 8%. In Germany, price increases were much more moderate, in the order of 5% (the memory of the inter-war hyperinflation was strong). In Spain, which at the time had sovereignty over the issue of notes in pesetas, the annualised rate of inflation between 1970 and 1980 was over 15%. In the end, and seen in a multi-year perspective, those who cheated with their own currency (by raising prices by 15% in pesetas, or 8% in dollars, compared to a meagre 5% in Deutschmarks), saw how the market value of their currency was adjusted downwards. **All the incremental price increases in each currency were corrected, over two decades, by a fall of similar magnitude in their exchange rate.**

The underlying reason for the consistently close to double-digit inflation in the United States in the 1970s, was not so much the rise in oil prices. (They rose sharply for a couple of years, then fell for another two years before rebounding and stabilising in the future). It was more to do with policies of upward revision of wages (union pressure, relatively closed domestic markets, both in terms **of goods and labour availability), which fuelled large inflationary pressures.**

Monetary policy marginally influences inflation. We will not deny that low interest rates, and with them the increased availability of money (with low rates people tend to borrow rather than save, and vice versa), do not have a certain effect on the demand for goods and services (whose sharp rise or fall in the short run is what generates inflation or unemployment, according to Keynes).

But not as much as is claimed. The vast majority of the population (and we are not talking about 50%, but probably more than 90%), barely make ends meet. 90% of the population will not save more because they are paid 5% interest instead of 2%. And the 10% of the population with the greatest saving capacity will not spend much more if the bank gives them 2% interest instead of 5%.

The interest rate policy (or, in a broader sense, the monetary policy) of central banks is much more focused on solving political problems (financing of public deficits to temporarily preserve social peace, abrupt currency devaluations), rather than modulating the demand for goods and services (and thus prices). **In short: only wage increases structurally cause inflation.**

Interest rates do not have as noticeable an effect on inflation as many claim. They do, however, have an impact on asset prices. At low rates, bonds, shares and real estate are worth more (the required return on interest, dividends or rents is lower, because the risk-free return to which this income is compared is also lower). And vice versa.

In March, April and May this year we will see inflation rates published which are close to or above 2% year-on-year. But this can simply be explained by the rise in oil prices. Crude oil, which a year ago, at the height of its confinement, fell to levels of around 30 dollars per barrel, is now trading at over 60 dollars per barrel. I**nflation could pick up notably in the second quarter of 2021, with year-on-year readings above the 2% that the US Federal Reserve and the ECB have set as a benchmark for the long term. However, in our opinion, the underlying inflationary risks remain well under control and support the maintenance of an accommodative monetary policy for a prolonged period of time.** Simply put: **core inflation**

only rises consistently if wages rise and, with higher unemployment, it is very difficult for that to happen.

We now have a rate curve of between 0% and 1% in Spain (and up to 2% at very long maturities in the United States). Once the pandemic is over, this curve may rise by one percentage point. But not much more. And a yield curve of 1% for one year to 3% for 10 years, if it were to come, would not be a disincentive for equity markets. (Quite the contrary, it would restore rationality to fixed income markets and would be representative of a much more normalised perception of risk).

ABOUT THE AUTHOR

Ofelia Marín Lozano

Ofelia Marín-Lozano is as financial analyst and CEO at 1962 Capital SICAV. She holds a Ph.D. in Economics and is Professor of Global Business Environment and Financial Analysis in Madrid's Icade Business School.

THE CORNER TEAM