Is There a Risk of Inflation?

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As we approach the end of the coronavirus scare, hopefully, here come the inflation hawks…again. They have plenty of ammunition to load their fear cannons. For example, the federal deficit is going to be about $4 trillion this year, multiples of what was expected just before the onset of the coronavirus. One reaction is the idea that we must balance the federal budget i.e. either cut spending or raise taxes or some combination of the two to not burden our children and grandchildren. Otherwise, we will destroy the value of our currency and trigger hyperinflation. These guardians of a balanced budget use examples of post WWI Germany and current day Venezuela where rates of inflation exceed two thousand percent or more. Those comparisons would scare anybody.

Economic textbooks define inflation as too much money chasing too few goods. Sometimes, governments have attempted to create as much money as possible to retain power and, in many cases, they did. True inflation was a result; it could have been 5% or 10% but it was inflation. An important distinction when attempting to generalize about inflation is to realize that prices change as an economy advances and prices of goods and services continually shift in response to changes in demand. These price changes are not inflationary, they are wealth shifts within an economy. When the price of a steak goes up, the butcher benefits and the consumer pays. When the price of a television falls, the consumer benefits and the producer does not.

One important observation is that such price changes should not reduce output. If overall output increases to meet or exceed demand, then there will be no inflation even though prices continue to change. Over the past eight years, the biggest contributor to lower prices has been the fall in the prices of oil and natural gas due to increased output -- two indispensable elements of economic growth. These commodities affect just about every aspect of production and are the reason why the Seventies were the period of highest inflation in America. OPEC curtailed output and raised prices for many years. There was no alternative except to pay the price or do without this necessary resource. From 1973 to 2012, OPEC dictated prices of oil and constricted supply to meet their personal price targets. When they lost control because fracking ballooned domestic output, global oil prices collapsed and inflation, for all intents and purposes, also collapsed. The level of inflation, as measured by traditional standards, fell below zero and central banks struggled to keep a bit of inflation in the global economy.

The explosion in domestic debt and debt around the world to combat the coronavirus is not the traditional binge by governments to maintain power and shower dollars or currencies on an economy to increase demand for a limited supply of goods and services. Current spending is designed to maintain a level of economic activity to bridge the gap to a return to normalcy. Thankfully, rapid advances in technology are assisting in the ability to produce goods and services on demand. There should not be any more monetary or fiscally induced shortages because of a profligate government that spends to remain in power.

The government lockdown in response to the coronavirus has caused enormous dislocations across the globe and there will be pent up demand for goods and services that people did not have access to during the shutdown. Do not mistake a possible temporary surge in prices that may be caused by that stifled demand. If the government decides to continue to write the check to pay for anything related to the coronavirus and its effects, there might be a resurgence of inflation. However, the Fed is likely to balance the need for stimulus with a resurgence in inflation.