[Why we have inflation – printing more money]

Modern Central Banks ironically do not think money matters. Most of them no longer target money supply, and many provide little or no commentary on it. This is surprising given the fashion they entertain to create more and more money to tip into circulation. They should understand that if you create more money and all else stays the same prices will rise, as more money will chase the same volume of goods and services. That is why money matters.

I guess their response is that as they create massive new amounts of money the velocity of circulation, the amount of use people make of that money, will fall. So it need not be inflationary. It is true that in the short term in the pandemic lockdowns more money was an offset to the collapse of demand, and use of the money tumbled as many people and companies hoarded what new found cash came their way.

It did however have a first round inflationary effect, as it was planned to do. It inflated asset prices, pushing up the price of government bonds which the money was used to buy. The people who sold the bonds to the Central Banks then often bought other assets like shares with that money, pushing their prices up even more than the bonds. So far so good. The governments could borrow loads of money on the cheap, and the inflation cheered up anyone with assets and did no harm to those without. I supported a vigorous Central Bank response to offset some of the worst economic consequences of the anti pandemic measures. I also thought governments would get away with a massive one off increase in borrowing, financing it at very low rates, all the time activity was so depressed. There did need to be a big offset and rescue packages given the economic severity of the policy.

If you carry on creating more and more Central Bank money to keep government borrowing rates low there becomes more danger that the money will start to find its way from asset markets into creating demand for goods and services. All those extra savings people made during lockdown as they saved their going to work costs whilst still banking their pay could be spent in a rush, driving up the velocity of money use. If commercial banks use the extra cash they have to expand credit that too creates more demand for goods and services. By these means more created money can lead to goods and services inflation if the money starts to create more potential demand than there is supply.

Central Banks in the USA, UK and the EU should stop their money printing and bond buying now to reduce this risk. They and the other bank regulators should ensure total money growth is sufficient to allow decent growth without encouraging too much extra inflation. That can best be secured by setting appropriate levels of permitted lending / balance sheet strength for the commercial banks using their existing powers. States should continue to cut back their deficits and borrowing substantially by promoting growth policies which will swell revenues and cut crisis spending.