"From Virus to Vitamin" Newsletter

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Inflation on the horizon: cloud or dragon?

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Observatoire de la Finance

16, chemin des Clochettes
1206 Genève, Suisse
Tél.: +41 22 346 30 35

www.obsfin.ch
E-mail: office@obsfin.ch

QUESTION UNDER DISCUSSION

"After trillions of dollars have been injected to contain the economic damage from the pandemic, inflation has suddenly come back on the radar and it may not be transitory as central banks early hoped. While inflation may hurt the interests of savers and creditors, it may also be beneficial for debtors (eg. business or governments). In your view, what are the main the threats, but also possibly the main opportunities related to inflation."

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EDITORIAL

Inflation on the horizon: cloud or dragon?

Since the re-opening of the economy, inflation has been rising around the world. This change of macroeconomic environment caught policy-makers off-guard in terms of adapting inflation forecasting models and assessing the causes of this evolution. Against this background, old debates resurface on the risks and opportunities of inflation and on how best to restore price stability.

Despite the rapid surge, current inflation was not totally unexpected since it is partially attributable to measures taken to re-open the economy, resulting in increased demand and disruptions of supply chains and production (Archana Sinha). In this sense, the current inflationary environment differs from the one of the late 1970s and may prove only transitory.

There are, however, other drivers of current inflation that may prove more long lasting: decarbonisation and economic concentration allowing excessive pricing power (Domingo Sugranyes); rising property and stock prices, as well as the increase of raw material prices (Etienne Perrot). As a result, as Valerio Bruno explains, central banks' instruments, such as raising interest rates, may not suffice to reverse current inflationary pressures and "we can therefore expect a long period of high inflation." This being said, it is far from certain that central banks are willing to use these instruments because of their concern with financial stability that a sell-off on financial markets may jeopardise.

From a socioeconomic perspective, Andrew Cornford recalls that inflation is not a "uniform problem" since its effects vary among countries, sectors and groups. The main problem, Valerio Bruno points out, is that "the wages of workers, in particular the middle class, suffer greatly from a declining purchasing power. If wages are not adjusted to inflation, consumptions and companies' profits are affected, leading to a possible economic recession."

On the other hand, inflation may benefit debtors by depreciating their debts. However, Cédric Tille warns, "any persistent inflation will raise the cost of additional borrowing in the future and therefore "any gain from inflation for some actors is likely to be temporary". For instance, "many weaker debtors will find growing difficulty in refinancing at higher interest rates." (Domingo Sugranyes).

Current rise of inflation pressure may prove to be only temporary – not inflation in the pure sense – however it has to be taken seriously because it could dash hopes of economic recovery and weigh on the morale of populations exhausted by waves of social restrictions.!

Virgile Perret & Paul H. Dembinski

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"… inflation is not new …"

Inflation is not new; it was hidden behind rising property and stock prices, leading to properties disparities. As international competition has diminished, the rise in energy and raw material prices has a direct impact on consumer goods. Its social effects (on pensioners and various marginal groups), as well as its economic consequences for long-term investments (distortions) and interest rates (rise), must be taken into account. On the other hand, inflation favours for a time companies, indebted households and massively borrowing States. Debtors become more credible in financing the investments needed for the ecological transition.

Etienne Perrot

Jesuit, Dr. Economics sciences, editorial board of the magazine Choisir (Geneva), editorial adviser of the journal Études (Paris)

"… any gain from inflation for some actors is likely to be temporary …"

While inflation has a short-run benefit for debtors, one must bear in mind that these debtors will borrow additional amounts in the future. Any persistent inflation will raise the cost of these additional borrowing, including a term premium. **Therefore, any gain from inflation for some actors is likely to be temporary. Looking through the inflation movements of the coming months, which hopefully will prove temporary, the reasons underpinning central banks' mandates of symmetric price stability remain as valid as they have ever been.**

Cédric Tille

Professor of macroeconomics at the Graduate Institute of International and Development Studies in Geneva

"… inflation does not entail any real benefit …"

Inflation does not entail any real benefit for most governments and businesses: although debts may be depreciated in the long term, many weaker debtors will find growing difficulty in refinancing at higher interest rates and will see financial flows fleeing towards "safer" harbours. There are objective reasons for cost increase, like decarbonization or restructuring of supply chains, which should lead us to admit that we are slightly poorer than we thought. Concentration also may allow business excessive pricing power. The vicious circle of inflation is an illusionary way of denying these facts, leading to even worse impoverishment. Some governments may be tempted to "print money", there will be growing pressure for automatic indexation of salaries and pensions. Difficult challenges!

Domingo Sugranyes

Director of a seminar on ethics and technology at Pablo VI Foundation, past Executive Vice-Chairman of MAPFRE international insurance group

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"… policy responses must address distributional dimensions …"

Inflation is not a uniform problem. It varies among countries (high-, middle-, and low-income), among income groups within countries, among goods and thus producing sectors (eg. energy and primary commodities used for food), and amongst services (eg. health-related, finance, and travel). **As is generally acknowledged, policy responses – both national and those involving international finance and aid – must address distributional dimensions, avoiding links to austerity and other attached conditions likely to increase poverty. In developed countries, policy design will frequently be handicapped by lack of pertinent data especially regarding wealth in the form of financial assets and tax liabilities.** An option here would be a once-and-for-all capital levy high enough to help a government to deal with immediate increases in its financial liabilities, while leaving permanent solutions to the problem of enormous inequalities of wealth to be attained as part of a future response to longer-term needs and objectives.

Andrew Cornford

Counsellor, Observatoire de la Finance; past staff member of UNCTAD, with special responsibility for financial regulation and international trade in financial services

"… the risks of inflation far outweigh the possible benefits …"

It seems to me that the risks of inflation far outweigh the possible benefits. To make effective use of the tools available to central banks, it would be necessary to understand the real causes of inflation (a 'drugged' financial economy, monopolies and oligopolies, or the costs of raw materials). Unfortunately, central banks' instruments, such as raising interest rates, are not always sufficient to reverse this trend: we can therefore expect a long period of high inflation, with "classic" safe haven assets as gold reaching historic highs. **The main problem with inflation is that the wages of workers, in particular the middle class, suffer greatly from a declining purchasing power. If wages are not adjusted to inflation, consumptions and companies' profits companies are affected, leading to a possible economic recession.**

Valerio Alfonso Bruno

Researcher in politics and Senior Research Fellow at the Centre for Analysis of the Radical Right (CARR)

"… inflation at these levels is a cause for concern …"

Labour market conditions are improving but tempestuous, and the pandemic continues to threaten life and economic activity. The rapid reopening of the economy has brought a sharp advance in inflation. These are challenging times for the public. The dynamics of inflation are complex, and inflation can be assessed from a number of diverse perspectives, including absence of inflation pressures; moderating inflation in high inflation items; wages; and long term inflation expectations. **Businesses and consumers widely report upward pressure on prices and wages. Inflation at these levels is a cause for concern.** This assessment is a critical and ongoing one as we continue to monitor inflation data against each of these perspectives.

Archana Sinha

Head, Department of Women's Studies, Indian Social Institute, New Delhi, India.

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LIST OF CONTRIBUTORS

Valerio Alfonso Bruno is a Researcher in politics and a Senior Research Fellow at the Centre for Analysis of the Radical Right (CARR), member of AREF and AIESC. He provides regularly political analysis for, among others, the Fair Observer, Social Europe and Indus News.

Andrew Cornford (Counsellor, Observatoire de la Finance; from 1977 until 2003 staff member of UNCTAD, latterly with special responsibility for financial regulation and international trade in financial services)

Paul H. Dembinski is the initiator and Director of the Foundation of the Observatoire de la Finance. In parallel, he is partner and co-founder of Eco'Diagnostic, an independent economic research institute working for both government and private clients in Switzerland and elsewhere. Paul H. Dembinski is also Professor at the University of Fribourg.

Dr. **Virgile Perret** holds a Ph.D in Political Science from the University of Lausanne and he is specialized in the study of monetary innovation from an interdisciplinary perspective. He collaborates with the Observatoire de la Finance where he is responsible for managing the global Prize "Ethics & Trust in Finance for a Sustainable Future".

P. **Etienne Perrot**, Jesuit, Doctor in Economics sciences, member of the editorial board of the magazine Choisir (Geneva), editorial adviser of the journal Études (Paris).

Dr. **Archana Sinha**, a doctorate in Agricultural Economics, currently is Head, Department of Women's Studies, Indian Social Institute, New Delhi, India. She is responsible for implementing research on various women issues, rural and urban based issues on gender and development, agriculture related rural economy, livelihood, gender and social exclusion, women workers, food security, nutrition, health promotion, SDGs related issues.

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Domingo Sugranyes Bickel, KCSG. Graduated from the University of Fribourg, Switzerland. Secretary General of UNIAPAC, Brussels, from 1974 to 1981. With MAPFRE international insurance group from 1981, Executive Vice-Chairman until 2008. From 2009 to 2019, Chairman of Vatican-based Foundation Centesimus Annus Pro Pontifice. Knight Commander of the Pontifical Order of Saint Gregory the Great (April 2019).

Cédric Tille is Professor of macroeconomics at the Graduate Institute of International and Development Studies in Geneva. Before joining the Institute in 2007 he worked during nine years as an economist in the international research department of the Federal Reserve Bank of New York.

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"FROM VIRUS TO VITAMIN" – JOIN THE DISCUSSION

The Observatoire de la Finance intends to seize this period of pandemic to step back and take a fresh look at our global economic system, dare to ask new questions which the current crisis brings to the fore and propose innovative ways to rebuild a more resilient and sustainable economy and society. In brief, we want to turn the virus into a vitamin for the future.

Our Discussion Board "From Virus to Vitamin" focuses on commenting issues relevant to finance and economy in relations to society, ethics and the environment from a variety of perspectives, of practical experiences and of academic disciplines. It has been designed to share and discuss information and opinions expressed in a short and concise manner.

Contributors (Discover the list of contributors) are invited to react on a question/issue that is submitted in parallel to a limited group of experts. This happens on a regular basis, through a dedicated mailing list. After the deadline for submission, the reactions are edited and published with signatures in one document on the website of the Observatoire de la finance and on its Linkedin page. If you would like to join the discussion, you may send an email to the editor, Dr. Virgile Perret <perret@obsfin.ch>.

OF Discussion Board – Questions addressed so far

- Question 23 : Standing up to new challenges
- Question 22 : Who wants to foot the bill?
- Question 21 : Rowing together to trim down the Gini coefficient
- Question 20 : Turning up the heat: can private insurance alone mitigate climate change damages?
- Question 19 : From the gold window to the global casino
- Question 18 : Turning point for the planet: can the G7 be trusted?
- Question 17 : Sustainable Finance: Hype or Hope?
- Question 16 : Universal basic income – an idea boosted by the pandemic?
- Question 15 : Multi-polarity: the best guarantee against falling (again) into the Thucydides Trap
- Question 14 : Special Drawing Rights: a drop of liquidity in an ocean of needs
- Question 13 : Trump's economic heritage: false promises setting the stage for populist disruption

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