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Long-term transitional inflation

Sources: The economist gadfly

The world economy is the most efficient expression of organized crime (Eduardo Galeano)

Economists in general, but above all those who respond to the *establishment*, have a serious drawback to trying to hide what is in sight, distort it, dilute it and exchange it for something much less clear and transparent. That is why there are puns or phrases made that at another time would be absurd, but today they do not sound so bad. For example, given the idea and the narrative that inflation would be limited in time, it was described as punctual inflation, now, due to its persistence, it is a ***long-lasting transitory inflation,*** clearly an ***absurdity.***

This idea begins to blur taking on a life of its own, going from being inflation to ***Putin's inflation*** or, worse, as the president of the European Commission Ursula Von der Leyen said, Russia manipulates the European electricity market. That is, what is in doubt is not the efficiency of the markets but the market itself, even more, the projections, causes and solutions to inflation, that is, the variations in the interest rate and the utility of central banks to face the sustained rise in prices.

In this context of succession of blunders, the US president celebrated the announcement ***of the Inflation Reduction Act***, a broad package with a very funny title, which addresses: health care, climate change and taxes on large corporations. But it does so with inflation that, according to the latest report of the Consumer Price Index, shows that food prices rose by 11.4% in the year, the largest annual increase since 1979, which would force the Fed to raise the interest rate, according to its logic, between 0.75 and 1%. But the doubts of consolidating the recession fly overhead, when there were already two negative quarters, and this third quarter, as the table shows, went from a projection of 1.3% growth to fall 0.8% in a week, reaching 0.5% on September 15, according to the Atlanta Fed. To which we must add the data that indicates that the mortgage rate exceeds 6%, the largest increase since 2008.

Inflation in the eurozone also continues to soar to all-time highs, reaching 9.1% in August, according to the latest data. This figure is up from 8.9% in July, 8.6% in June, to 8.1% in May, while Europeans continue to see energy and food prices soar. The preliminary estimate by Eurostat, the European Union's statistical office, is the highest since eurozone records began in 1997.

Because of these data, according to the media related to Brussels, the ECB has declared total war on inflation with the largest increase in interest rates ever made in the almost 24 years of history of the institution. The monetary authority has decided to increase the price of money by 0.75% to bring it to 1.25%. With this increase, Christine Lagarde seeks to encapsulate a puzzling price rise in the euro zone, despite the signs of recession that are already looming. Late, the ECB raised interest rates to 1.25% when in the US they are at

2.5% and will go to 3.25% shortly, which affects the arbitrage between dollar-euro, and causes funds to flow to the dollar by removing parity with the euro and increasing the cost of all imports valued in the US currency (read energy).

But in this game there is a lot of fabric to cut, because the answers are not easy or soft. In the latest political opinion poll *DeutschlandTrend* highlights that a slim majority of Germans (53%) continued to pronounce themselves in favor of sanctions against Russia, "even if this means an increase in prices, electricity cuts and problems for the German economy", but in March the approval was 66%. Compliance with sanctions is expected to decline with rising energy prices, even more so when at the end of July the survey showed that in Germany, France, Poland and the United Kingdom, the most important problem was the cost of living. 33% in the UK, 38% in Germany, 47% in Poland and 57% in France say they can barely cope with prices or can no longer cope.

Many expect strikes and social unrest. In France, 65% expect strikes to increase, 63% in Poland, 57% in the UK, 44% in Germany. In France, even 40% would like the yellow vest protests to return. Meanwhile, reality takes its toll. The Swedish Prime Minister, the Social Democrat Magdalena Andersson, **presented her resignation** after the defeat of the center-left bloc against the right-wing and far-right opposition was confirmed in the legislative elections last Sunday. The Italian far right would win the elections on September **25 with 45.5% of the votes,** where the Brothers of Italy, of the far-right Giorgia Meloni, would be the most voted. Both French President Emmanuel Macron and German Chancellor Olaf Scholz are facing a crisis of approval, neither exceeding 30% positive management; the UK lost its democracy and Spain fights every day against the far right.

Thus, discussions begin to go through the consequences of interest rate hikes to stop inflation, and whether this mechanism can really deactivate it on both sides of the Atlantic. On the other hand, curbing the price of energy and European dependence has led to a carnival of economic failures, some so basic that they could lead GDP, employment, wages, and the well-being of the Union into a deep abyss.

The European Union, fully aligned with the US, has adopted seven packages of sanctions against Moscow. However, to date, many of these sanctions have contributed, directly or indirectly, to fueling and aggravating an unprecedented inflationary crisis in Europe, while causing less damage to the Russian economy than expected. The rise in inflation began in the second half of 2021. The clash between Western countries and Russia, however, has eliminated any chance that the inflationary spiral will end naturally over the course of 2022 or 2023.

The possible measures announced by EU member governments leave little room for imagination: rationing of gas supplies; reduction of the electricity supply in public spaces and private homes, a cap on the extra profits of energy companies; The european price cap, the most logical and strong, bury demand by lowering energy consumption by 10% at peak times. The utopia of putting a ceiling on Russian gas went down the sewer. What does not seem to be faced is the situation that demonstrates an irrefutable fact: Russian gas is irreplaceable for the EU market. Everyone is at risk of a real disaster that the European people will not be prepared to accept lightly.

The Association of Credit Reform Associations (Crefo) in Berlin has been in existence since 1879 and collects information on the solvency and financial structure of corporate clients. Without going into details, we will see the IMF's projections, but the association expects a large wave of bankruptcies in Berlin. In Italy, the worst forecast is a real "massacre of companies". On 9th September President Marco Granelli stated that "expensive energy puts at risk 881,264 micro and small enterprises with 3,529,000 employees, equivalent to 20.6% of the employment of the Italian business system", due to the increasingly widespread impact of gas and electricity prices on companies in 43 sectors.

Then Europe faces an inflationary problem and a crossroads of energy substitution that feed back, for which the solutions executed are increases in the interest rate, belatedly for the logic of the causes of inflation. The idea is to curb demand and inflation, in a kind of clamp between rising interest, on the one hand, and maximum prices for energy, oil at least, and caps on gas bills on the other, modifying the cost equation by taking out gas as a witness price.

Most orthodox economists will say that inflation is the result of excess demand, distributive bidding lost by wages long ago, or excess money (giving the machine, as the phrase "emission generates inflation" illustrates); that is, there is too much money hunting for too few products. The counterpart, that monopolies are the price fixers or the theory of maintaining levels of profitability through prices, I owe them, but the monetary logic is the one that prevails.

The idea here is how to reduce inflation and its total dependence on changes in interest rates. In fact, as has been seen in recent months around the world, interest rates have risen dramatically to this end. We are told that these interest hikes will deter consumers and businesses from spending, which in turn should increase unemployment, halt demand, and thus reduce inflation and lead to a soft landing of the economy. Here's the explanation for demand-based inflation: by restricting demand by raising interest rates, inflation should fall with little impact on economic activity and labor markets.

The truth is that, so far, the results have not been flattering, in the past, after great suffering, stagflation through, inflation was reduced. There is nowhere such a thing as a soft landing. The result is always a recession with high unemployment, loss of purchasing power, concentration of income, fall in GDP and above all loss of GDP per capita. The burden of the fight against inflation ***has always fallen on the backs of the workers, bulging the pockets of capital***.

But in this case, with the loss of profitability came the reduction of investment, and with it the transfer to consumers of any increase in intermediate inputs necessary for a greater production of goods demanded post-covid-19. Completing the picture are bottlenecks in supply chains, the lack of chips for computers and cars due to the closure of large parts of the world economy, the increase in food since 2021. None of these causes will disappear as a result of rising interest rates, which is even absurd. It sounds much more credible that rate hikes are related to maintaining inflation, piercing the social incentives of the pandemic through inflation, and shrinking the debts incurred and, as is clear, putting a brutal brake on the economy.

Apparently, deflating the demand balloon does not seem to be the solution, but, on the contrary, lowering interest rates could incentivize investments in all the bottlenecks that we show has no response from the supply side. Depressed demand does not project future profits, nor expected profits that invite investment.

On the energy side, will the maximum price weapon work? It seems to have a lot of holes. Russia might refuse to export oil at the lowest price, though that wouldn't just reduce one of its few sources of external revenue. It could also continue and accelerate exporting oil to countries that refuse to meet the G7 price cap, such as China and India. The United States, one of the winners, has increased gas exports to the EU by 68%, while Europe is on the verge of a much more serious energy, productive and social problem than expected.

The IMF analyzed "The Economic Impacts on Germany of a Potential Russian Gas Shutdown" in a July 2022 working paper. The idea is to present different scenarios of gas supply losses by Germany, which is already a fact. Even so, the fall in GDP of the first European economy will be -1.5% (2022), -2.7% (2023), 0.4% (2024). The same authors agree that, when comparing the projections with other more serious estimates, such as those of the OECD, the Bundesbank or others, due to the real extent of the gas shock, the data are alarming anyway.

Italy and Germany seem to be the hardest hit, but Britain is where things are worst. The Bank of England (BoE) forecasts that the inflation rate will peak at 13.3% in October and that the real disposable income of households will fall by 3.7% between 2022 and 2023, making those two years the worst on record. But it can be even worse than that. Citibank forecasts inflation is on track to rise to 18.6% in January, the highest peak in nearly half a century, due to rising wholesale gas prices. And Goldman Sachs goes further, as it expects even bigger gas increases, and now believes THAT UK inflation will peak at 22%!

The poor are the most affected. More than 40% of UK households will not be able to heat their homes properly in January, when energy bills rise again, according to Michael Roberts, leading to a clear scaffolding of the election of a new iron lady by a derisory percentage of the population. What is coming in Europe is something much more worrying than simple errors in the interest rate and sidereal profits of the energy companies.

Source: https://eltabanoeconomista.wordpress.com/2022/09/18/inflacion-transitoria-de-larga-duracion/

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