Subject: Re: Modern Monetary Theory
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Randall Wray. Co author of The Modern Monetary Theory Workbook, gives clarity to the always fuzzy logic of economics. One of his "One Pagers" PDF's. The Causes Of Pandemic Inflation.

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The Covid pandemic caused a recession when the supply side of the economy collapsed because of workplace shutdowns and safety concerns. This then created a demand-side problem, as wages and other incomes fell due to rising unemployment and furloughs. Long and complex supply chains compounded the problem, and China's "zeroCovid" policy continues to delay full recovery. Pandemic relief in the United States and some other countries helped to restore demand, although spending patterns were unusual--more goods, fewer services (as consumers avoided contact).
The Covid recession was thus very unusual--brought on by a collapse of the supply side that produced a drop in demand. While demand has largely recovered, supply has not. The continuing inflation pressures still come mostly from the supply side--which is typical, at least for the United States. All of our high inflation periods since 1970 have been due to supply-side pressures produced by three components of the consumer basket: oil, food, and shelter (mostly rents and imputed rents of owner-occupied housing). So while the trigger for the recession was unusual, the inflation we face is not at all unusual--the same three culprits are driving US inflation today.
Beyond pandemic-related disruptions, the Ukrainian war also affects energy and food supplies, and thus prices. Also important, although less so, are weather-related impacts on production (especially of food) related to global climate change.
The evidence in the United States now is that inflation is not accelerating and is likely to gradually fall. Wages are not keeping up with inflation, so the danger of a wage-price spiral does not seem great. Federal government spending had already declined substantially before the Fed started raising interest rates, allowing the deficit to drop precipitously. Indeed, the budget was heading toward a surplus. In other words, we faced strong fiscal headwinds that were sucking demand out of the economy. I think we were already heading for a recession before the Fed raised rates. Rate hikes now make recession even more likely. The housing market has collapsed and financial markets are rattled both by higher interest rates and by debt and liquidity problems--as evidenced by the crypto meltdown. However, it will take more time for inflation to come down to the Fed's 2 percent target. I expect we will (again) suffer stagflation (rising unemployment with inflation), as we did when Chairman Volcker sharply increased rates in the early 1980s.

Europe is in a somewhat different situation because of the severe disruptions of the Ukraine war. Inflation pressures could be higher in Europe than in the United States. It is likely to be a cold winter with energy in short supply, and production will also suffer--meaning continuing supply-side problems. Much of the world looks poised for recession as Fed rate hikes caused currencies to fall against the dollar. Central banks around the world have had to raise their own interest rates to protect exchange rates. Nations indebted in dollars have been hit by debt problems--which will only become increasingly severe as debt burdens climb. The UK has already experienced troubles in its financial sector as markets price in higher interest rates.

Complex and even strange linkages are exposed as problems in one asset class generate a sell-off and price collapse of another asset class. Another global financial crisis like that of 200709 is possible as overleveraged financial institutions try to unwind risky positions.

Some falsely claim that Modern Money Theory (MMT) policy guided the Covid relief spending in the US and elsewhere--and that this is what has caused high inflation. It is true that Congress responded with two spending packages that totaled $5 trillion, without "payfors"--that is, without increasing taxes. Much of it took the form of mailing checks to every household. This was said to be MMT policy. In truth, MMT proponents argued against such policies, proposing instead targeted spending--spending to be directed to support those who lost their jobs, to those who were behind in their bills (rent, utilities), and to tackle the problems created by the Covid pandemic.

The important point is that relief should have been focused on restoring and improving the supply side of the economy rather than on restoring demand in the face of supply-side shortages. This could have mitigated inflation pressures and eliminated the pressure on the Fed to raise interest rate targets, thereby reducing the probability of entering a period of stagflation with the looming possibility of another global financial crisis.

We still face substantial supply constraints, in part due to Covid but also due to decades of underinvestment in infrastructure. This, in turn, has been due largely to misunderstanding of the true constraints and the nature of the inflation pressures that came from the supply side. Belief that the problem was excess demand led to the adoption of austere fiscal policy. If we abandon misguided austerity and replace it with well-designed investment and targeted social spending, we can not only reduce inflation pressures and restore growth, but will also be able to transition our economy to make it environmentally, socially, and financially sustainable.

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