Inflation or deflation?

PK
When the Fed began intervening to prop up first the banks, then the economy as a whole, there were many predictions of surging inflation

U.S. Inflation to Approach Zimbabwe Level, Faber Says (Update2)

By Chen Shiyan and Bernard Lo - May 27, 2009 00:54 EDT

May 27 (Bloomberg) -- The U.S. economy will enter “hyperinflation” approaching the levels in Zimbabwe because the Federal Reserve will be reluctant to raise interest rates, investor Marc Faber said.

Prices may increase at rates “close to” Zimbabwe’s gains, Faber said in an interview with Bloomberg Television in Hong Kong. Zimbabwe’s inflation rate reached 231 million percent in July, the last annual rate published by the statistic office.

“I am 100 percent sure that the U.S. will go into hyperinflation,” Faber said. “The problem with government debt growing so much is that when the time will come and the Fed should increase interest rates, they will be very reluctant to do so and so inflation will start to
Why? Very large increase in monetary base (currency plus bank reserves)
Historically, changes in the monetary base have tended to be reflected in roughly equal percentage changes in the money supply.
And changes in the money supply tend to be reflected one for one in prices
People often think of this in terms of some kind of “quantity theory”:

Broader money supply more or less proportional to monetary base (“money multiplier”)

Nominal GDP more or less proportional to money supply
How could this be wrong?
But this shouldn’t have been a surprise
Figure 3. U.S. Monetary Trends, 1929–39
Index, 1929 = 100

- **Monetary base**
- **M2 aggregate**
But where’s the *deflation*?
Inflation has stayed low, but not fallen that much, and not gone into deflation
This paper studies inflation dynamics during 25 historical episodes in advanced economies where output remained well below potential for an extended period. We find that such episodes generally brought about significant disinflation, underpinned by weak labor markets, slowing wage growth, and, in many cases, falling oil prices. Indeed, inflation declined by about the same fraction of the initial inflation rate across episodes. That said, disinflation has tended to taper off at very low positive inflation rates, arguably reflecting downward nominal rigidities and well-anchored inflation expectations. Temporary inflation increases during episodes were, in turn, systematically related to currency depreciation or higher oil prices. Overall, the historical patterns suggest little upside inflation risk in advanced economies facing the prospect of persistent large output gaps.
Figure 5. CPI Inflation at the Outset and End of PLOG Episodes 1/ (percent, sa)
But the Fed’s policies remained highly controversial

Open Letter to Ben Bernanke

The following is the text of an open letter to Federal Reserve Chairman Ben Bernanke signed by several economists, along with investors and political strategists, most of them close to Republicans:

We believe the Federal Reserve’s large-scale asset purchase plan (so-called “quantitative easing”) should be reconsidered and discontinued. We do not believe such a plan is necessary or advisable under current circumstances. The planned asset purchases risk currency debasement and inflation, and we do not think they will achieve the Fed’s objective of promoting employment.
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Michael J. Boskin
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Former Chairman, President’s C
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