

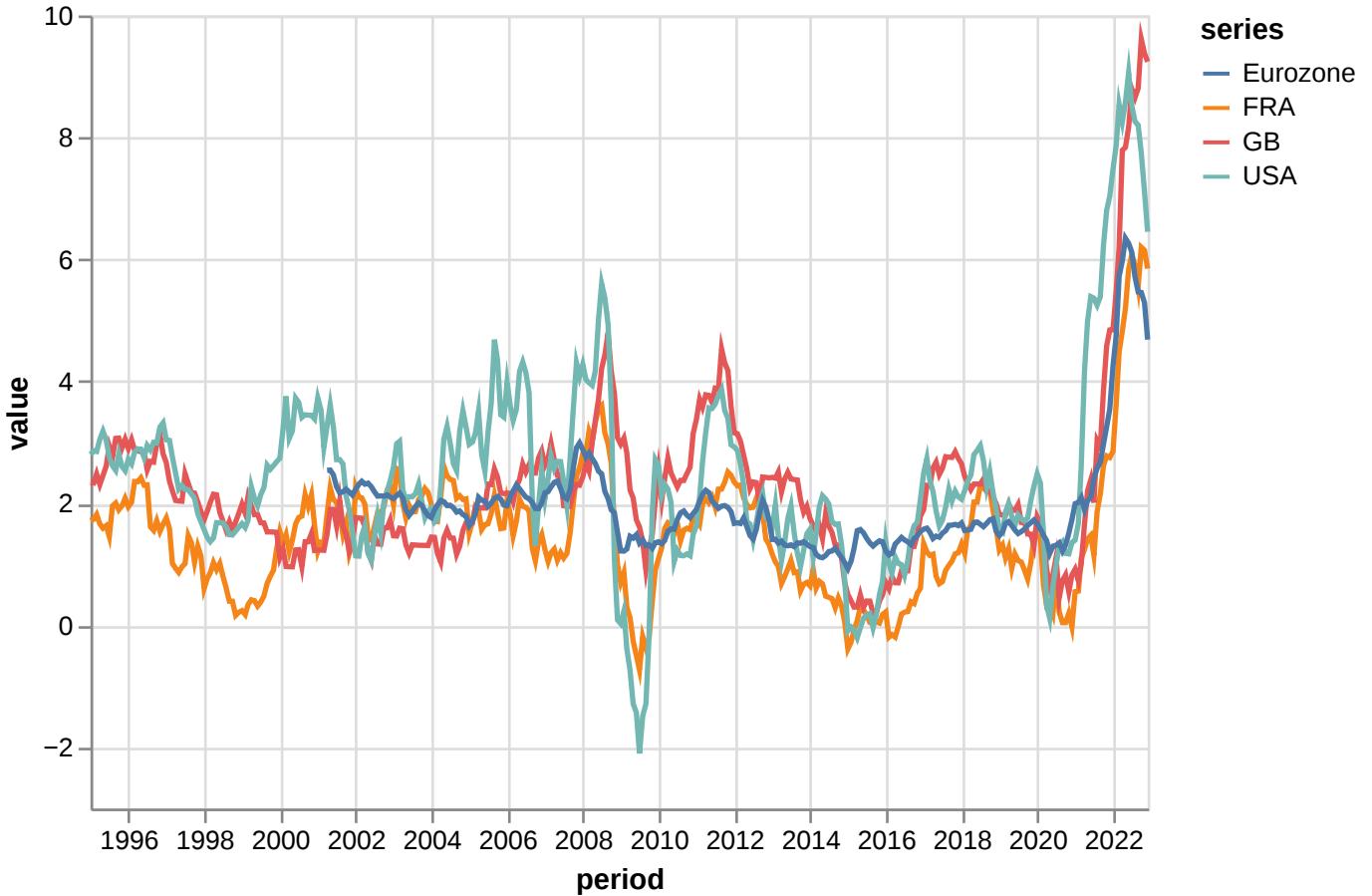
The return of the big bad inflation?



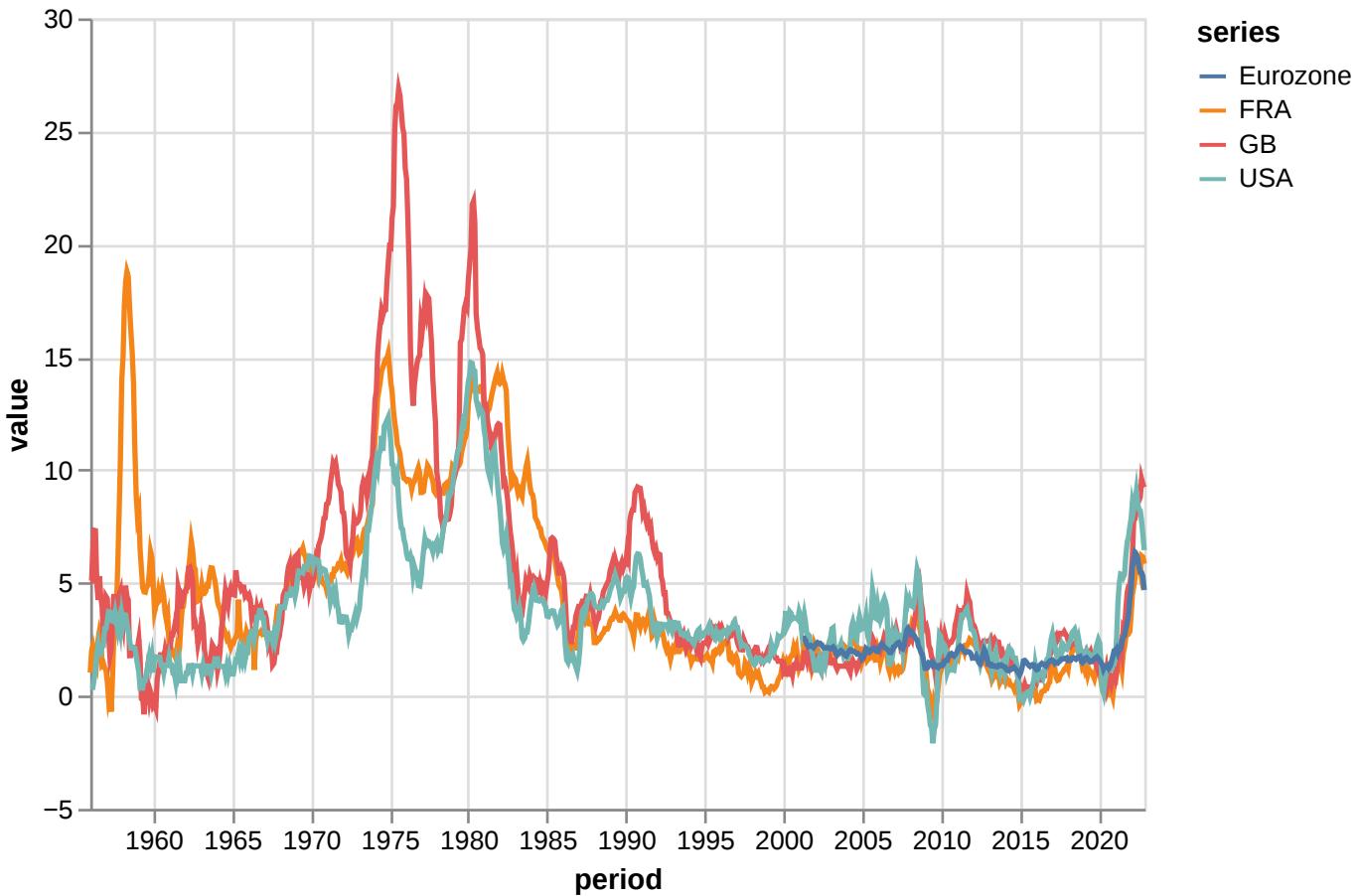
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Is Inflation Coming back?

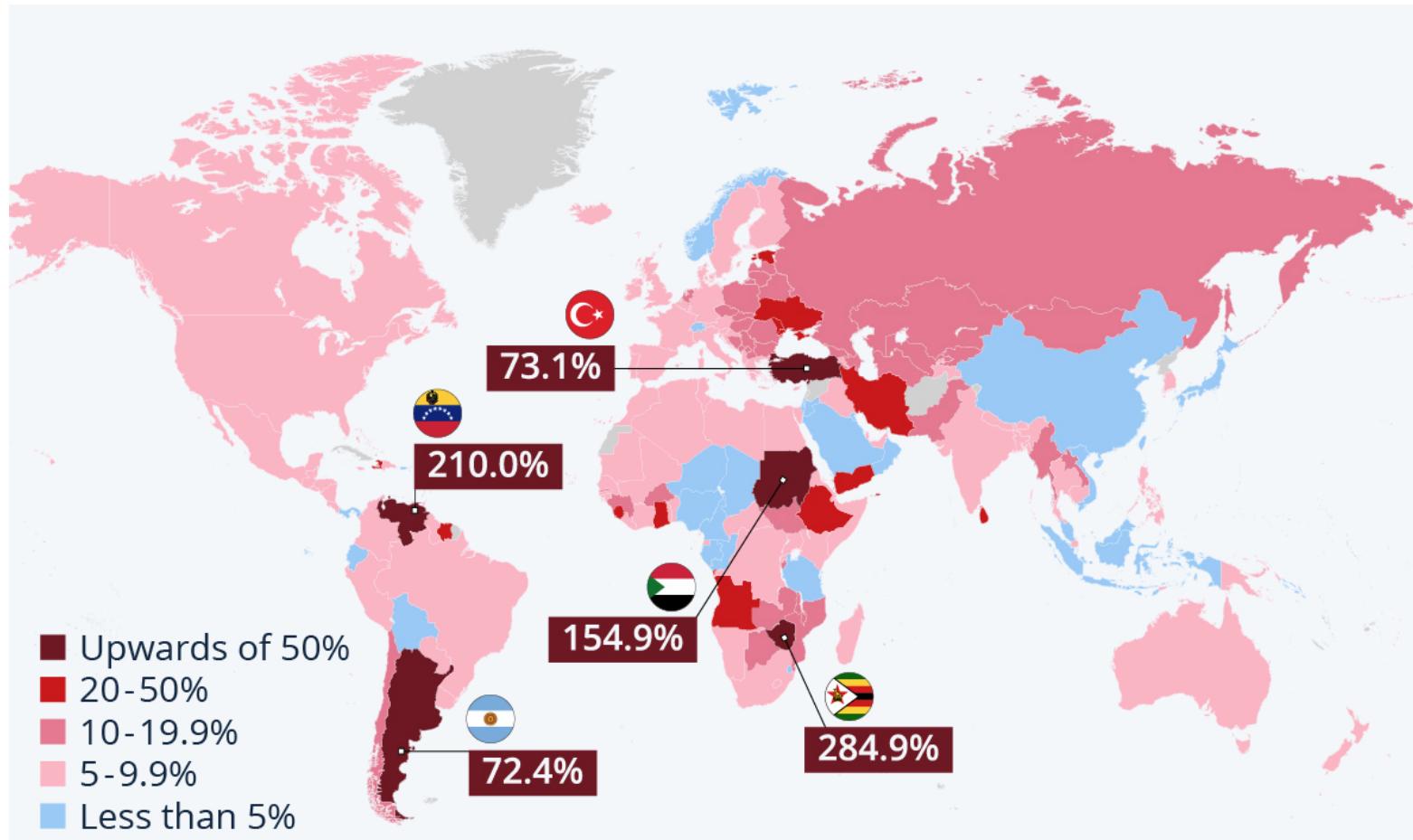
Inflation



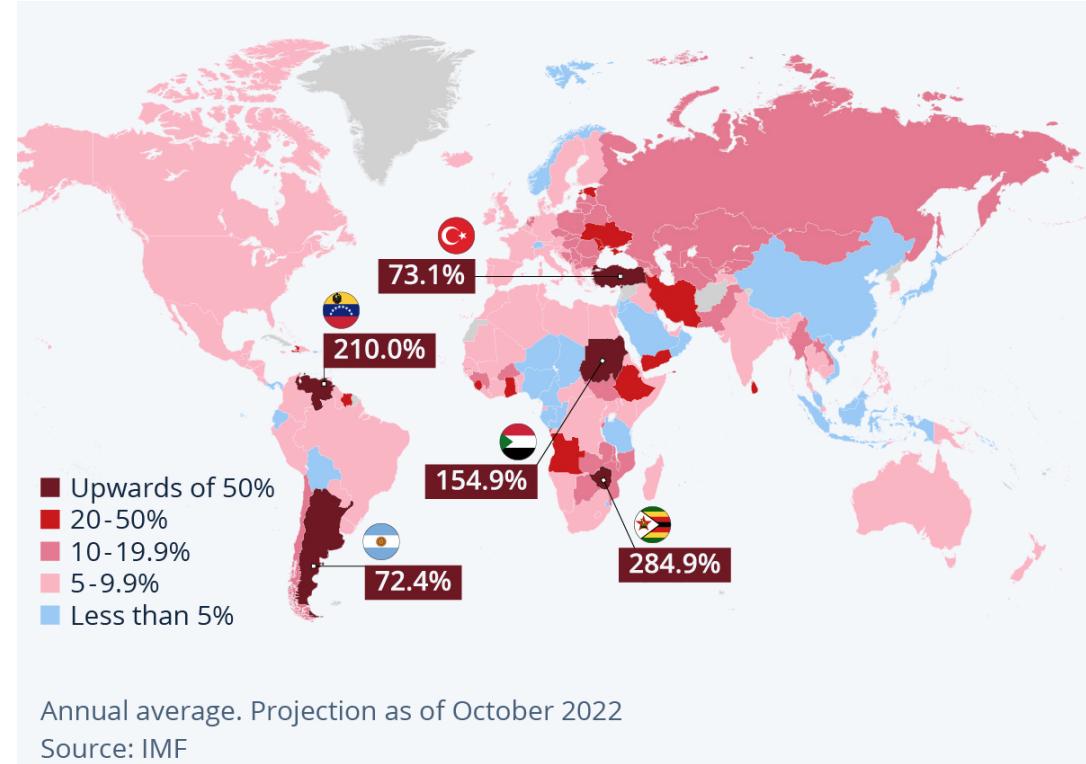
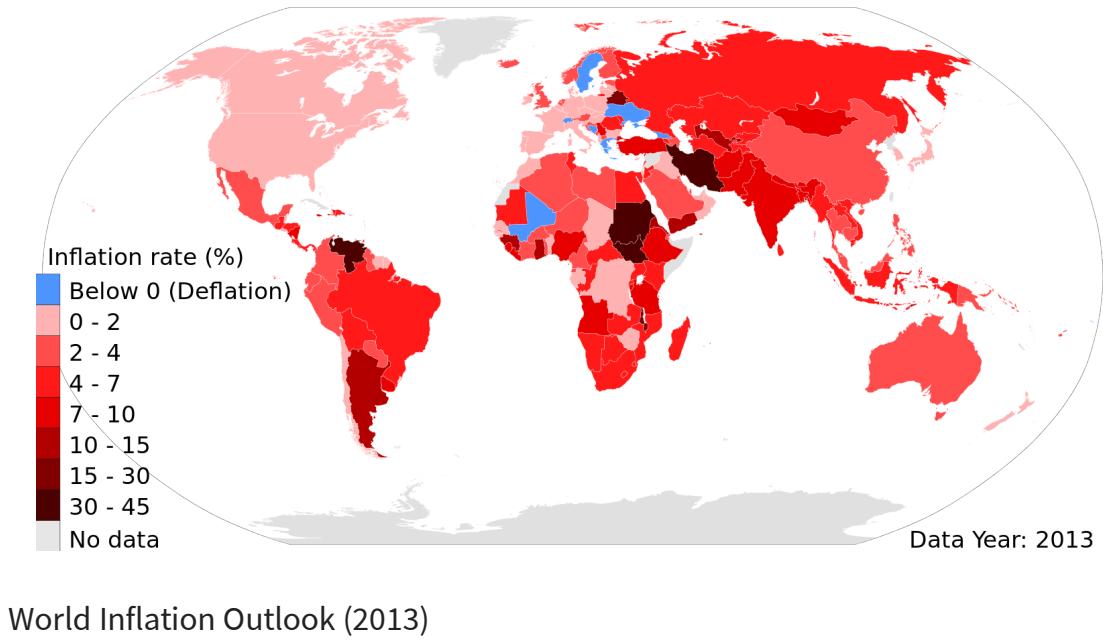
Inflation



Emerging / Developed Markets



Emerging / Developed Markets



- Inflation has never disappeared from the world
- The problem is quite different in developed and emerging countries¹

1. Among issues that are specific to developing countries: institutions credibility, exchange rate vulnerabilities...

Why should we fear inflation?



Keynesian Dog. (Dall E-2)



Ricardian Cat. (Dall E-2)

- increase in cost of living

LES SUPER- POUVOIRS D'ACHAT

E.Leclerc L

DU 18 AU 29 SEPTEMBRE 2018

VOTRE BUDGET
N'A PLUS RIEN
À CRAINdre !

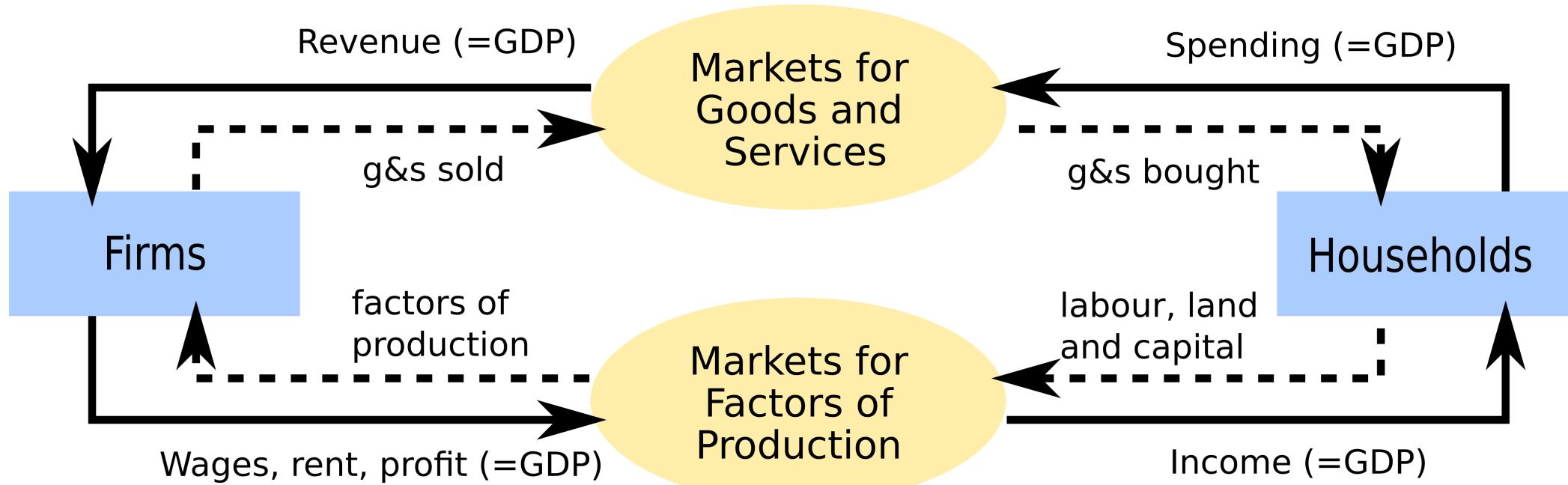


nutella



Cost of Living

The Money Illusion



The Circle Flow Diagram

- By definition: total real income equals total revenue

Redistributive Effects of Inflation

Inflation has *redistributive* effects through different channels¹:

- consumption channel
- wealth redistribution channel
- renegotiation channel

1. Data comes from *Inflation and Inequality* by Xavier Jaravel and *The costs of being poor: inflation inequality leads to three million more people in poverty 2022*, by Wimer Collyer and Jaravel.

Redistributive Effects of Inflation: the consumption channel



1. using economists' jargon, we say that consumption preferences are nonhomogenous (or not scale invariant)

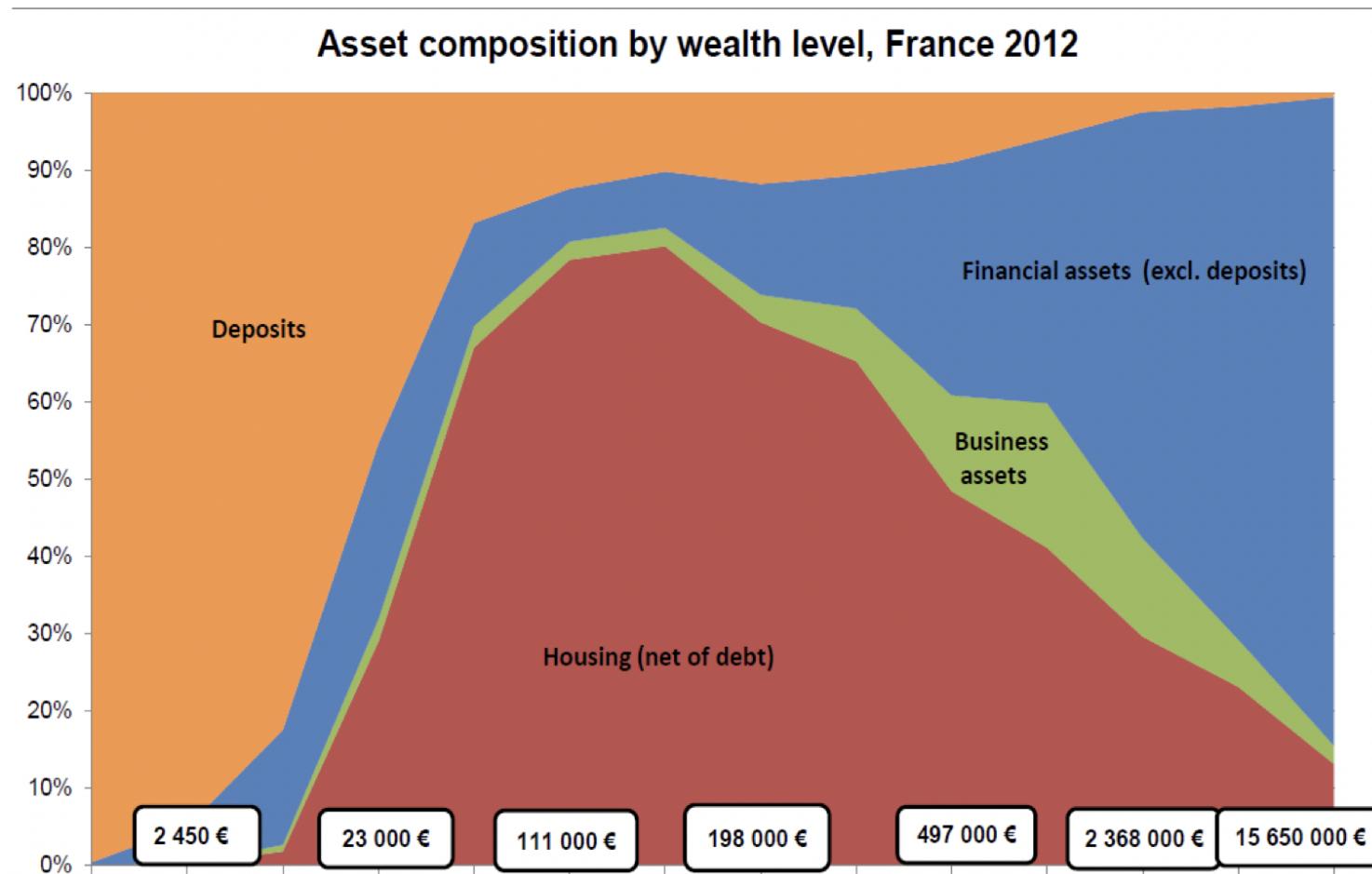
- Not everybody consumes the same consumption goods¹

Consumption Inequality in the United States

- In the last 20 years, the bottom earners had the lowest growth in real income. This is even clearer when

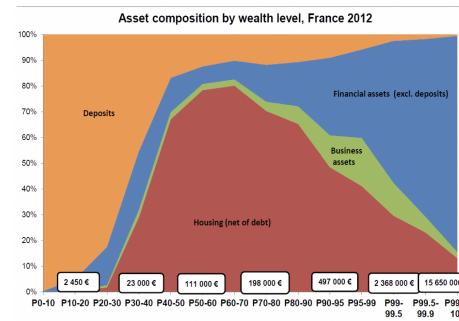
Redistributive Effects of Inflation

Savers and Borrowers



Redistributive Effects of Inflation

Savers and Borrowers



Composition of Assets across the Wealth Distribution

1. Seminal paper: *Monetary Policy According to HANK*, 2018, by Kaplan, Moll, Violante

- In general inflation benefits borrowers rather than savers

Redistributive Effects of Inflation: between different agents in the economy



Olivier Blanchard
@ojblanchard1

...

1/8. A point which is often lost in discussions of inflation and central bank policy. Inflation is fundamentally the outcome of the distributional conflict, between firms, workers, and taxpayers. It stops only when the various players are forced to accept the outcome.

[Traduire le Tweet](#)

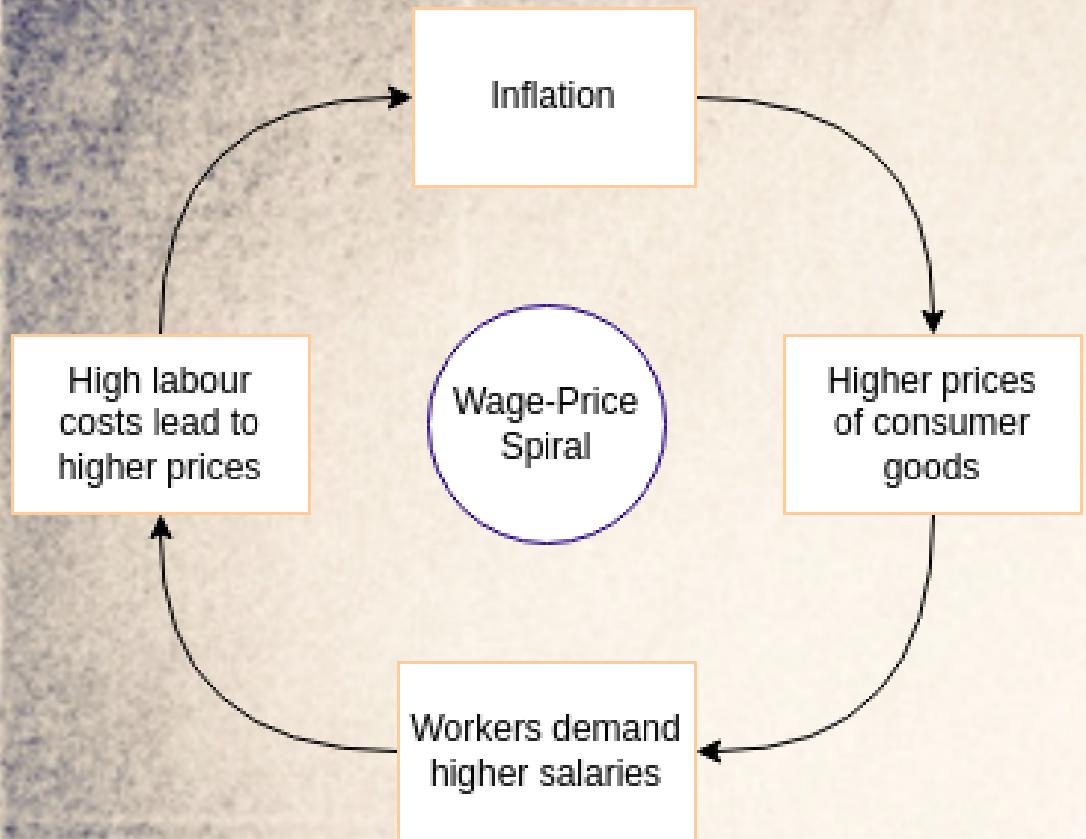
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Wages and salary



The inflation spiral



It lead economists to believe there was a wage-price inflation spiral...

- prices increase
- ⇒ workers demand higher wages
- ⇒ production costs increase
- ⇒ prices increase,

The inflation spiral



Reagan against the inflation spiral

...And advocate policy measures to limit inflation

- Nixon: 1970, price-freeze on wage and prices
- to no avail

This inflation stopped with the Volcker plan

- Fed raised interest rates from 11% to 20% !
- inflation was brought under control at the cost of a deep recession in 1982/1983

On the bright side: it has demonstrated a central bank can get rid of inflation

The inflation spiral



The wage-price inflation spiral as a painting in the style of Andy Warhol. Dall-E 2

Nowadays out of control wage-price spirals are believed to be unlikely events

- agents correctly anticipate future inflation
- incorporate these expectations into wage- and price-setting
- when all markets are in equilibrium, inflation returns towards equilibrium

But the nexus wage / price still remains relevant:

Summary

Covid19 was both

- a demand shock
- a supply shock

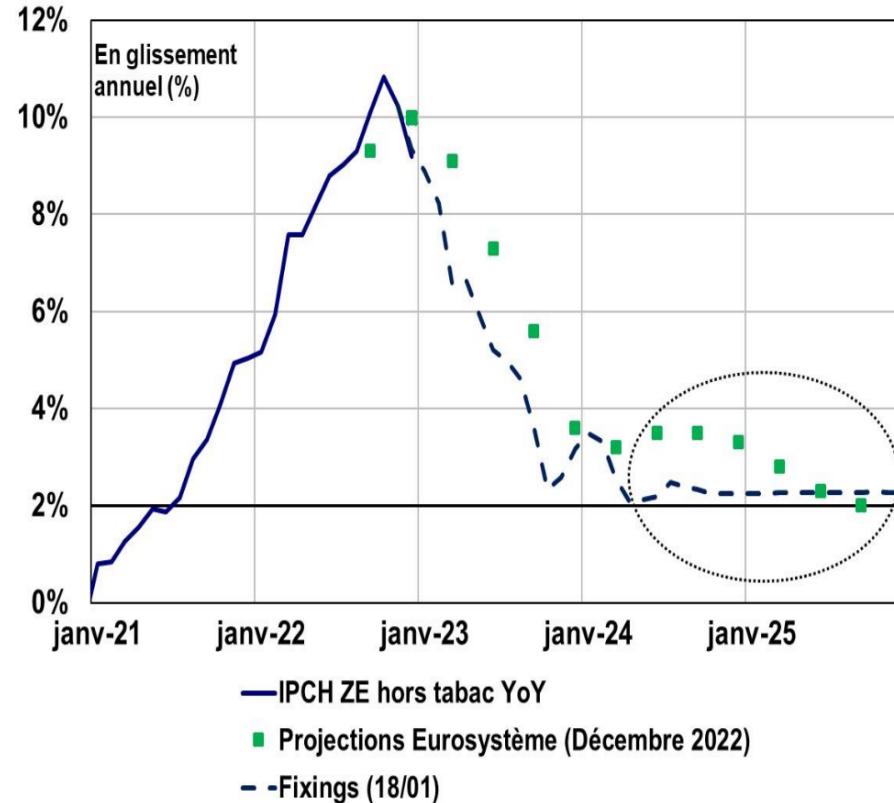
which offsetted each other.

After covid and Ukraine's

- demand recovered fully
- but there are persistent supply shocks
 - labour market shortages
 - increased cost of energy
 - disorganization of supply chain

All these effects add up

- to create inflationary pressures



The Market bets on future inflation using swaps. The price of these swaps provide an implicit probability estimate of the market.

- The Market expects inflation to decrease and back to its target in the middle of 2024
- It also expects central bank not to raise interest rates after mid 23