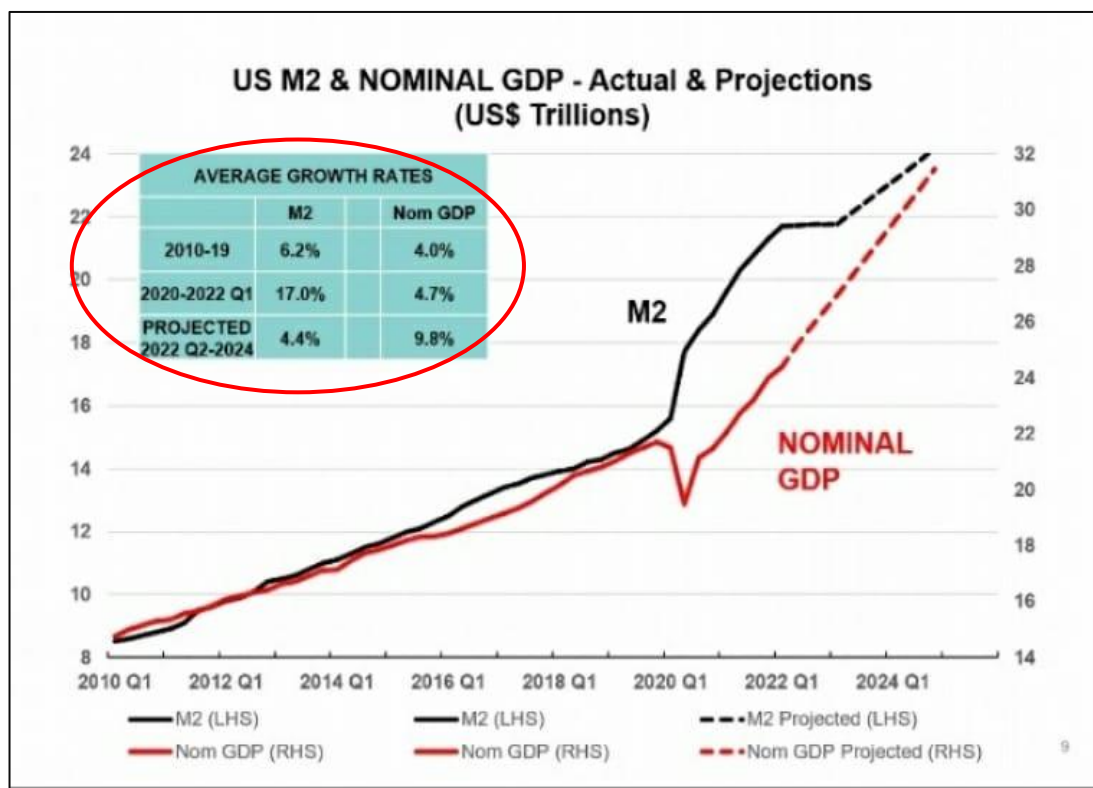




- There are 2 present views on the causes of high Inflation – (1) *Monetary* - excess money supply relative to GDP growth (2) *Ad Hoc* – *pandemic, Ukraine war, supply chain disruption, energy prices, wage spiral*. 2nd explanation seems more of narrative rather than establishing definite cause & effect relationship.
- Central bankers created excess money in 2020-21. It is this excess money that is fueling inflation. Typically, the lag effect between money creation (M2) & its impact on Inflation is ~ 2 years i.e., Inflation is expected to return to target ~2 years after this excess money is eliminated.
- If we see zero M2 supply growth in next 6 months; then, there is absolutely high probability of recession. Shrinking liquidity suddenly after ~17% YoY growth will cause crunch & economy to shrink. What is needed here is slow down in the pace of money growth rather than shutting off the tap completely.



- After GFC, M2 & GDP was growing steadily which was disrupted by pandemic with GDP crashing & M2 rising. To restore the relationship, nominal GDP has to grow rapidly & money supply has to de-accelerate. As real GDP can grow only by 2-3%, rest of growth in nominal GDP will have to be taken care by inflation.
- CBs abruptly raising rates & shrinking their balance sheets (QT) looking at inflation prints is similar to driving a car by looking at rear view mirror. Fed is trying to manage inflation by tools that's not designed for it. Instead of interest rate & balance sheet, its money in hands of people that causes inflation.
- The main risk is that sharp slowdowns of money will lead to steeper declines in output and bigger increases in unemployment than that required to bring inflation back to target. Fed has overkill on the expansion side looks like it will once again overkill on the tightening side.