



Why Is Inflation Picking Up So Quickly?

By: Joe the Investor

The key is to understand what inflation is. The definition of inflation that economists use is “too much money chasing too few goods.” If you break this down, you will notice two parts. There is the quantity money part and the goods part. The word “goods” means anything that you purchase with money, which could be things, services, expertise etc. Notice that there is a relationship between the money and the goods. This relationship is governed by supply and demand, but an easy way to think of it is that there has to be a balance between the two things in order to have the value of goods remain stable.

How can too much money come to pass? The question that comes from this is: How does money get created? Today’s money is called fiat money. Fiat means “by decree” or “by law”. When you see the words used “by law”; this can be interpreted as “by force”. Since laws are enforced by the police or the military which literally means they will cause you harm if the laws are not followed. Think of the mafia but legal. This means that we don’t have any choice with respect to the money we are using if we want to follow the law. By definition, other forms of money cannot be used for transactions or purchase of goods. Try using gold or silver coins or cryptocurrencies to pay taxes in Canada. Only Canadian dollars can be used. The other key term to remember is that today’s money is a debt unit. When you hear the word debt, it means someone is owed the money that has been created, as in a loan. There is interest tied to that loan, similar to all other forms of debt. Since the interest is on a country’s currency, the interest is borne by the country – which means the taxpayers of the country. This is where the income tax system comes in. Have you noticed in the last 2 years how much extra money has been “created” around the world? Is there a limit to how much money can be created? There is not, and this is why too much money can be created rather easily and without much oversight.

What about the goods? Due to the government response to the pandemic, people cannot produce the goods that they used to produce because they are forced to stay home or close their businesses. The workers are also paid to stay home instead of producing. You can add reduced demand from people not being able to shop and the amount of goods being produced will continue to shrink. Recently, there are shortages of parts and shipping delays. Due to the just in time headache that is logistics today, any tiny disruption will create a ripple effect that will compound exponentially the time lag of getting goods produced. The more complex the product and the more reliant it is on logistics, the longer the delays and the larger the disruption.

What you are witnessing now is both forces coming together at once – too much money *and* too few goods. Is this going to last? Given that the governments are going to create more debt to pay off the old debt, this creates an exponential effect that will approach an unlimited amount of money being created. This also means that the current fiat currency will become more worthless and may be abandoned. The inflation will last until the form of money is changed to something scarce and finite, and the goods produced are stabilized. The two parts of the equation would then into balance again. To counteract the forces of inflation, this means less monetary or debt creation combined with more goods being produced.