
Chart of the week

Despite recent experiences in the United States and the Eurozone, it might be advisable to always keep an eye on the money supply.

Among central banks and market observers alike, monetarism seems to have gone out of fashion. That seems a touch premature. Take a broader look at the recent inflation experience in different parts of the world, and the link between money-supply growth and inflation is (still) there.

This will come as no surprise to market veterans. In the 1980s and 1990s, the development of various measures of money supply still attracted a great deal of attention, similar to today's employment and unemployment figures. Since then, monetarism has receded as an economic doctrine; those who nowadays look at the growth of the money supply and emphasize its relevance risk being mocked. This might partly reflect the developments in many parts of the developed world since the financial crisis of 2008. Despite an almost doubling of the money supply within ten years, the United States and the Eurozone continue to have remarkably low inflation rates.

Looked at differently, however, the same data can tell a very different and quite monetarist story, as our "Chart of the Week" shows. We compare the annualized growth of the money supply M2 in the period 2007 to 2017 and the consumer price index (CPI) 2017 for several countries. It shows that money-supply growth remains an important determinant of inflation. This is especially so for countries with a particularly strong propensity for fast money multiplication, including emerging economies such as Argentina, Egypt, Ukraine and Turkey. These have seen especially rapid increases in money supply. Unsurprisingly to a monetarist, the results have been double-digit inflation rates.

By contrast, monetary discipline in other emerging markets such as South Africa paid off in the form of moderate inflation. The Eurozone and the United States may similarly still be reaping the benefits of the previous epic struggle to get inflation down – for all their recent monetary experiments, inflation expectations remain well-anchored.

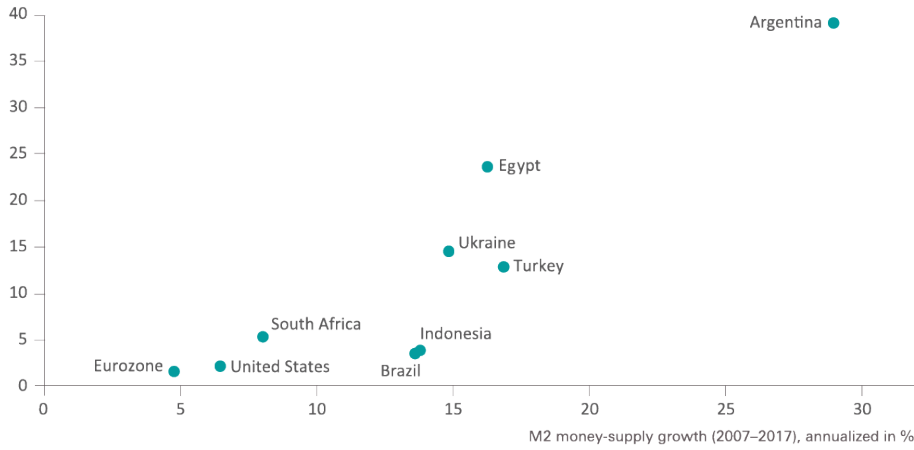
This leads to the timeless, not at all unfashionable conclusion: In countries with a rapidly growing money supply, price stability is highly endangered. Pushed beyond a certain point, it is lost. Figuring out when this point is reached is tricky – not least because correctly measuring money supply is far from straight forward. To avoid nasty surprises, it might be advisable to always keep an eye on the money supply.

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CIO View

Consumer price index 2017, year-on-year change in %



Sources: International Monetary Fund for money supply, Bloomberg Finance L.P. for consumer price inflation data; Deutsche Asset Management Investment GmbH as of 8/23/18

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Glossary

Consumer price index (CPI)

The **consumer price index (CPI)** measures the price inflation as a percentage, year over year, of a basket of products and services that is based on the typical consumption of a private household.

Emerging markets (EM)

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

Eurozone

The **Eurozone** is formed of 19 European Union member states that have adopted the euro as their common currency and sole legal tender.

Inflation

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

M2

M2 is a money-supply measure that includes physical money, bank deposits as well as other less liquid funds like savings that can quickly be converted to money.

Monetarism

Monetarism is a theory that explains changes in inflation by over- or undershooting in the money supply.

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