

# Govt likes inflation. Here's why

When a govt borrows money, it brings down its value.  
It then pays back in the depreciated value

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If you are not feeling happy with the pay rise then don't blame your employer, blame the government policies which reduces the purchasing power of money, commonly referred

to as inflation. Inflation is stealth or invisible transfer of wealth from tax payer to tax collector. This is over and above the tax you are required to pay. The efficiency of government in usage of capital is widely debatable, unlike private sector, as it does not own that capital but merely produces it (printing), which results in increase in money supply or gets it as a transfer (taxation or

borrowing).

When we borrow money we have to pay it back. When the government borrows money, in perpetuity it just brings down the value of money so that it can pay you in depreciated value of that money. For example, if the government runs a huge public debt, the best way to get out of that debt (which Greece, Portugal, Spain and other euro countries can't do because they don't have a printing press to print euro) is to introduce controlled release of inflation so that it can pay back in currency whose value has depreci-

ated. Inflation is a by-product of inefficiency and wasteful expenditure which the common man funds unknowingly. While the government wastes money and as a corollary fuels inflation, efficient small and medium sized enterprises are being starved of cash. A good way to contain inflation is to maintain money supply at a growth rate in line with production. India's gross domestic product (GDP) has grown by 8.43% annualised over the last five years whereas public debt has bloated by 14.02% annualised over the same period. So growth in debt has outpaced growth in production of goods and services which is not a healthy sign. For simplicity purpose we have not added state government debt which will complicate the picture further.

This increase in public debt is government borrowing. In-

printing more money leads to first, a rise in prices first and then rise in interest rates.

The government many times will try to shock an economy back to life by throwing a lot of newly printed money into it. This measure has been effortlessly adopted by most developed economies — the US, Japan, etc. Governments will try this even though it rarely works because the influx of new money is an artificial stimulant. If an economy begins to respond to this stimulus then the government will try to pull out the extra money, but this is harder to do than putting the money into the system.

The purpose of this article is to make readers aware that it is important to take right investment decisions so as to maintain purchasing power because inflation is baked in future. Thus, a 30% rise in house prices over the last couple of years does not necessarily demand a pat on the back of the investor as a major part of the appreciation in the property prices may have to do with the value of money coming down.

Investors should look to diversifying from traditional investment avenues like equities and fixed income into precious metals like gold.

Gold has long been considered as an alternative currency and is slowly and gradually being looked upon as an investment asset class. Gold has maintained its role as an inflation hedge and thus in current inflationary periods it has assumed higher importance. The metal has also generated returns which are comparable to equity and fixed income. Gold prices rose for the tenth consecutive year in 2010. Thus in totality the asset class presents a combination of safety and returns to investors. Investors need to start inculcating gold as an asset class into their investment portfolios to hedge against government confiscating their purchasing power.

While there has been news of gold being in a bubble phase, we believe that with gold being under 2% of global assets currently as compared to 1981 (it was at an all-time high of \$850 then) when it was 26%, there is still a long way to go before we see the top.

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Increased government borrowing makes it difficult for the private enterprises to borrow money. Over a period of time, with the pool of money remaining the same, an increase in debt leads to rise in interest rates in the economy. If the government has ever to pay back its accumulated debt then it either chooses to borrow more or print more money. Both have their respective impacts on the economy. While borrowing more money leads to first, a general rise in interest rates and then rise in prices;