# Inflation: Concern in Emerging Markets, Not in the United States

*Michael Mussa assesses the global trends in inflation but says that core inflation will remain low for a while in the United States despite rising commodity prices.*

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Steve Weisman: Inflation. Is it a concern for the United States and other countries? This is Steve Weisman at the Peterson Institute for International Economics, with Michael Mussa, senior fellow here at the Institute, to discuss that issue. Thank you, Mike.

Michael Mussa: My pleasure.

Steve Weisman: The chairman of the Federal Reserve, Ben Bernanke, testified recently that inflation, in the near term at least, is not a concern in the United States. But some who were listening to him were skeptical. Where do you stand on that?

Michael Mussa: I think in the near term and for the United States, inflation is not a concern that is influencing or should influence the near-term conduct of monetary policy here. Inflation obviously is a much more serious concern in a number of countries around the world already.

Steve Weisman: Which ones?

Michael Mussa: Primarily the emerging market countries -- in China, in India, in Brazil, probably in Turkey. In a number of countries, their central banks have already moved, in some cases fairly significantly, to tighten their monetary policies to deal with rising inflation.

Steve Weisman: We'll get back to that in a second, but first in the United States. A lot of people see prices rising at the gasoline pump, food prices, and the prices of some commodities rising in the United States. So it doesn't make sense to them to say that there is not an inflation concern. What's the disconnect?

Michael Mussa: Of course, the Federal Reserve focuses primarily--though not exclusively--on what is called core inflation, which excludes food and energy prices, which historically have tended to go up and down by relatively large amounts over relatively short periods. It doesn't make sense to try and smooth all of that out if changes in supply conditions are largely responsible for those movements. Obviously they do matter to consumers in their budgeting. And if you ignore them for too long, people think you aren't serious about inflation.

Steve Weisman: There have been stories in the papers that these are going to filter into the prices of commodities. You're saying, it's not a concern in terms of changing monetary policy now?

Michael Mussa: Right now. And if we look at the overall Consumer Price Index, which includes at the consumer level these commodities prices, it too has been relatively well contained. We're running at less than 2 percent on a 12-month basis. The core inflation rate is now running less than one percent. The Federal Reserve, I think, does understand that inflation is going to pick up at some point if they maintain a monetary policy that is anywhere near as easy as it presently is for an extended period.

Steve Weisman: What factor is the budget deficit in this? That's another theme on Capitol Hill -- that deficits are surely going to be inflationary.

Michael Mussa: Probably not directly. Not unless the Federal Reserve, as they say, monetizes those deficits in the longer term.

Steve Weisman: By increasing the money supply?

Michael Mussa: Yes, by continuing to increase the money supply -- or in this case, we had a large increase in the base money supply by failing to rein it back in as the economy recovers. Then we get into a situation where private sector spending has begun to pick up again and the government is still borrowing very large amounts of money. We will begin to generate significant upward price pressures.

Steve Weisman: When should the Fed start to adjust its policy?

Michael Mussa: Of course, my own view was that the most recent asset purchase program was not well advised. I would have left that out, which would still have meant an exceptionally easy monetary policy. I think once they announced that they're going to carry through with it, I would say no more after this June. And I would look for whatever signs there are--and I think there will be signs--that the pace of economic recovery is picking up to at least begin the process of tightening monetary policy, because it is a very long way to go to get back to something that is more or less neutral policy. So they can't wait too long and move very slowly, which is what they did in 2005, 2007.

Steve Weisman: What are the markets reflecting in terms of their inflation concerns, near term, medium term, maybe long term?

Michael Mussa: I wouldn't say that markets, as far as the U.S. is concerned, are reflecting high inflation fears. I think the concerns about inflation have gone up and this is apparent in the upward movement in interest rates and a modest upward movement in the spread between inflation-protected and ordinary treasuries. But the stock market has been quite buoyant, which is not consistent with a sharp increase in inflationary expectations. Inflation tends to be bad for the stock market.

So the fact the stock market remains relatively buoyant says "yes," there has been some increase in inflationary expectations. There is a worry out there and that worry will become more intense if the Fed continues to ease policy or fails to tighten policy if the recovery gathers strength.

Steve Weisman: How important is it that Congress deal with the budget deficits this year? Are you as concerned as Chairman Bernanke about a failure to pass the expansion of the debt limit in an orderly way?

Michael Mussa: An increase in the debt limit does need to be provided. Even if you cut the deficit substantially, you're still going to be adding more than a trillion dollars to the outstanding public debt. So if you don't want to increase the debt limit, you'd be producing a fiscal disaster. So that part of it is essential. It's a question of how fast to cut the deficit. And there are really two problems: one, we're enlarging the deficit in the current fiscal year due to the tax agreement of late 2010. And we really need to stop that and begin going in the other direction in a more serious way in 2012. That will probably happen because the Republican majority in the House is very determined to cut back on spending. While I doubt there are going to be substantial tax increases, I don't think there are going to be tax cuts. So the combination of some restraint on spending together with the natural recovery of tax revenue as the economy recovers will bring the deficit down, probably fairly significantly beginning in 2012.

The longer-term deficit problem, however, is not being addressed, certainly not in the President's budget and the Republicans really haven't spoken about that issue yet either.

Steve Weisman: Let's turn back to the international picture and the countries that are experiencing inflation and tightening their monetary policy. What effect will that have on the global economy and on the American economy?

Michael Mussa: We're going to see a slowdown in the global economic growth rate in 2011. I think primarily because the emerging market countries that have been growing very rapidly since the middle of 2009, recovering from the global recession very rapidly, have enjoyed the benefit of the initial jump-back and are now feeling some of the inflationary pressures of rapidly rising output. And the tightening of policy together with the natural slowdown in the process of recovery will cut their growth rates from seven percent on average, which is very high even for those countries, down to six percent on average, perhaps even a little lower.

Steve Weisman: And how will that affect American economic trends?

Michael Mussa: Export growth is important to America, and we've been exporting more to emerging market countries. So somewhat slower growth there will be a negative influence on growth in the United States. But I think other factors will tend to strengthen growth more for the United States at least so that on balance, 2011 will be a stronger year for the economy. We grew three percent last year. My guess is that we'll grow close to four percent this year from year-end to year-end, a little more worry about what may happen in 2012.

Steve Weisman: Thank you, Mike.