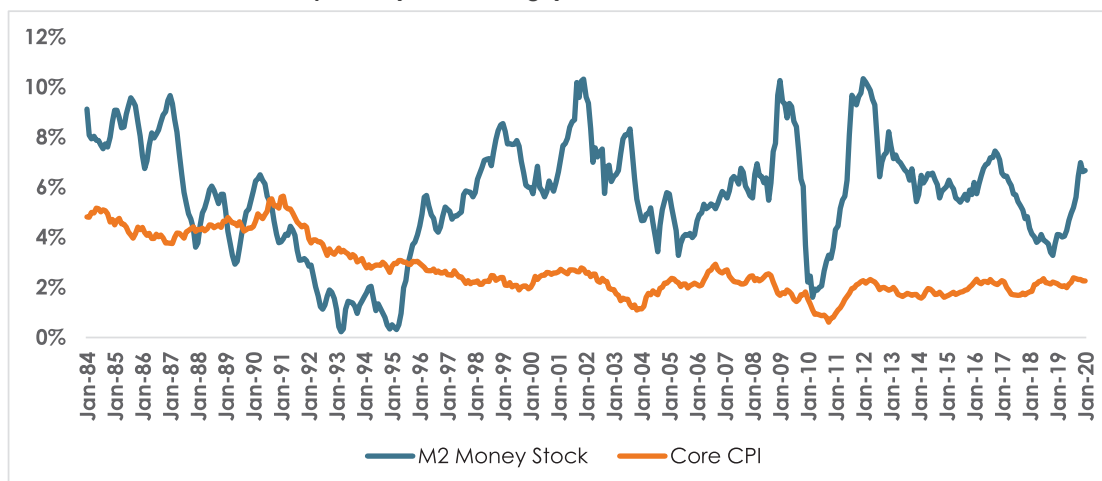


# WEALTH & INFLATION

Reading time ~ 7 min.

This is *Part II* of our *three-part* research note on *Money, Debt, Inflation & Wealth Preservation*. In part one we argued that we should not be paying too much attention to money supply (and money printing) statistics. As shown in Chart 1 below, the relationship between money supply and inflation broke down a long time ago.

Chart 1. Core CPI vs M2 Money Stock (YoY % change)

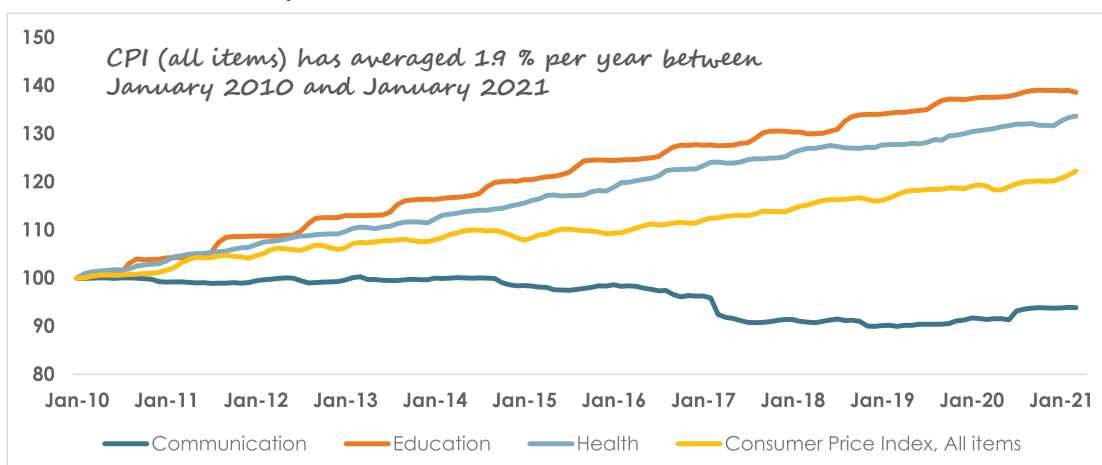


Source: FRED

So, what drives inflation in the contemporary world? This may sound paradoxical, but one of the most important determinants of inflation is *inflation expectations*. This is the main reason many developing economies have trouble controlling inflation – people's *inflation expectations* are unstable and the level of trust towards the government is very low. It is much easier to ignite inflationary scares in developing economies. *This is the first point we wanted to make.*

The second point is to understand the difference between price increases in certain sectors and the overall inflation rate. As shown in **Chart 2**, different industries have had different levels of inflation during the last ten years. For example, between 2010 and 2021, prices in America's education sector have increased by around 40%. Within the same period, prices in the communications sector haven't increased at all. What matters is the combined level of inflation, across all sectors.

Chart 2. United States CPI by Industries



Source: IMF



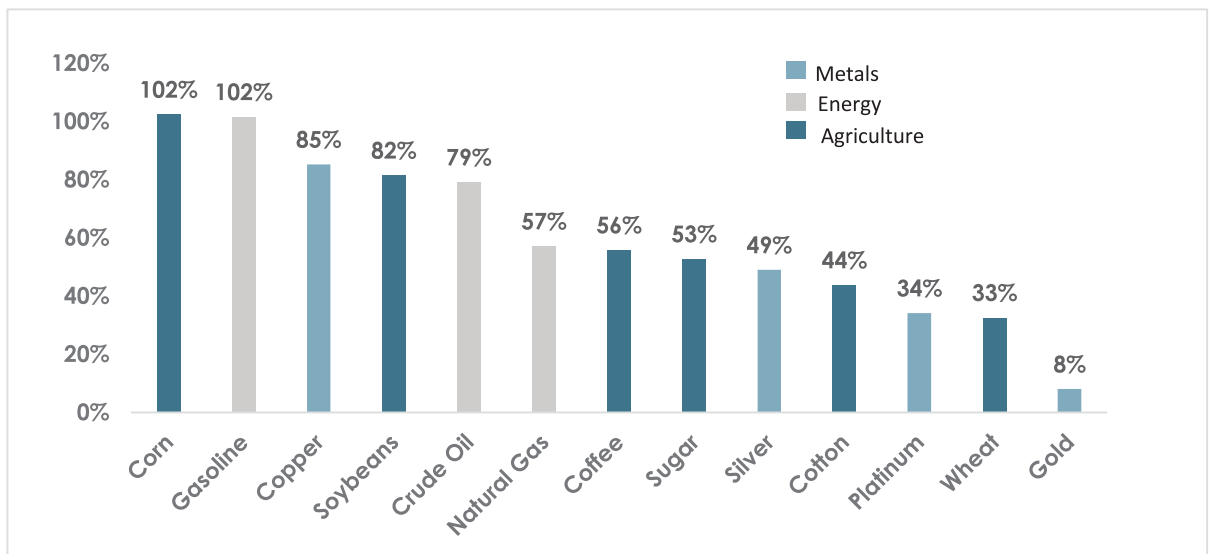
FUTURES STUDIO

Think to connect!

For example, a 50% increase in the price of copper is simply a transfer of wealth from copper consumers to copper producers. The same can be said about any other good or service, from natural resources to healthcare and education. A transfer of wealth from one industry to another should not be confused with widespread inflation. *This is the second point we wanted to make.*

Our third point is about inflation rates in 2021. Imagine a plastic bottle, full of water, with a narrow bottleneck. A squeeze of the bottle will result in a stream of water pouring out of the nozzle. The same is now happening with prices of certain goods and services – used cars, commodities such as copper, construction materials such as lumber and so on (see Chart 3).

**Chart 3. Commodity Prices (Futures Prices, Change From a Year Ago)**



Source: Yahoo Finance

A sharp increase in demand combined with disrupted logistics has simultaneously created a bottleneck and a squeeze. Supply always moves slower than demand. When supply catches up, prices will stabilise. The only question is will this lead to a widespread inflation, throughout all sectors? We don't think so and the market agrees with us. The bond yields on 10-Y US Treasuries have been stable since mid-March of 2021, at around 1.65%. This means the market is not worried about a widespread inflation.

Moreover, in all developed countries, without a single exception, inflation rates and inflation expectations are well under control. The fifty economies, shown in **Table 1**, constitute more than 90% of the world economy. Only in five of these fifty countries the annual inflation rate is above 10%. In all of these five countries, the level of trust towards the government and its institutions is around zero. (See our last note on the [Value of Trust](#) available on our website).

Table 1. Inflation Rates of 50 Largest Economies (by GDP)

Countries	GDP (% of world GDP)		Inflation, average consumer prices, YoY %	
	2020	2019	2020	
UAEmirates	0.4%	-1.9%	-2.1%	
Malaysia	0.4%	0.7%	-1.1%	
Thailand	0.6%	0.7%	-0.8%	
Switzerland	0.9%	0.4%	-0.7%	
Israel	0.5%	0.8%	-0.6%	
Ireland	0.5%	0.9%	-0.5%	
Spain	1.5%	0.7%	-0.3%	
Singapore	0.4%	0.6%	-0.2%	
Taiwan	0.8%	0.5%	-0.2%	
Italy	2.2%	0.6%	-0.1%	
Japan	6.0%	0.5%	0.0%	
Hong Kong	0.4%	2.9%	0.3%	
Denmark	0.4%	0.7%	0.3%	
Germany	4.5%	1.4%	0.4%	
Finland	0.3%	1.1%	0.4%	
Belgium	0.6%	1.2%	0.4%	
France	3.1%	1.3%	0.5%	
Korea	1.9%	0.4%	0.5%	
Sweden	0.6%	1.6%	0.7%	
Canada	1.9%	1.9%	0.7%	
UK	3.2%	1.8%	0.9%	
Australia	1.6%	1.6%	0.9%	
Netherlands	1.1%	2.7%	1.1%	
Armenia*	0.0%	1.4%	1.2%	
US	24.8%	1.8%	1.2%	
Norway	0.4%	2.2%	1.3%	
Austria	0.5%	1.5%	1.4%	
Indonesia	1.3%	2.8%	2.0%	
China	17.4%	2.9%	2.4%	
Colombia	0.3%	3.5%	2.5%	
Philippines	0.4%	2.5%	2.6%	
Romania	0.3%	3.8%	2.6%	
Azerbaijan*	0.1%	2.7%	2.8%	
Chile	0.3%	2.3%	3.0%	
Czechia	0.3%	2.8%	3.2%	
Brazil	1.7%	3.7%	3.2%	
Vietnam	0.4%	2.8%	3.2%	
South Africa	0.4%	4.1%	3.3%	
Russia	1.7%	4.5%	3.4%	
Mexico	1.3%	3.6%	3.4%	
Poland	0.7%	2.3%	3.4%	
Saudi Arabia	0.8%	-2.1%	3.4%	
Georgia*	0.0%	4.9%	5.2%	
Bangladesh	0.4%	5.5%	5.6%	
Egypt	0.4%	13.9%	5.7%	
India	3.2%	4.8%	6.2%	
Pakistan	0.3%	6.7%	10.7%	
Turkey	0.9%	15.2%	12.3%	
Nigeria	0.5%	11.4%	13.2%	
Iran	0.8%	34.6%	36.5%	
Argentina	0.5%	53.5%	42.0%	
<b>Total/Average**</b>	<b>94%</b>	<b>4.4%</b>	<b>3.7%</b>	

\* These countries were added not because they are among 50 largest economies but because of our special interest in them

\*\* Average value is calculated for inflation

Source: World Economic Outlook, IMF

## Conclusion

One of the most important determinants of actual inflation is the stability of inflation expectations. We should not confuse a transfer of wealth from one industry to another with the overall inflation rate. A squeeze combined with bottlenecks leads to sharp price increases, but they are almost always temporary in nature.

In the next part (Part 3) of our report we will discuss the topic of *wealth preservation*, and will address our friend's question, from Part 1, about his inheritance.

## End of Part 2

*David Tavadian*  
Founding Partner

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