

# The Inflation Myth

AND THE WONDERFUL WORLD  
OF DEFLATION

By Mark Mobius

WILEY

This edition first published 2021

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Originally published in German as "Die Wahrheit über Inflation: Warum Geldentwertung jeden etwas angeht, wie sie manipuliert wird und wie man es durchschaut" © 2019 Mark Mobius

*Registered office*

John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, United Kingdom

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*Library of Congress Cataloging-in-Publication Data*

Names: Mobius, Mark, author.

Title: The inflation myth and the wonderful world of deflation / by Mark Mobius.

Description: Hoboken, NJ : Wiley, 2021. | Includes index.

Identifiers: LCCN 2020020072 (print) | LCCN 2020020073 (ebook) | ISBN

9781119741428 (hardback) | ISBN 9781119741497 (ePDF) | ISBN

9781119741527 (ePub)

Subjects: LCSH: Inflation (Finance) | Deflation (Finance) | Pricing.

Classification: LCC HG229 .M73 2021 (print) | LCC HG229 (ebook) | DDC 332.4/1—dc23

LC record available at <https://lcn.loc.gov/2020020072>

LC ebook record available at <https://lcn.loc.gov/2020020073>

Cover Design: Wiley

Cover Image: © MarsYu/Getty Images

Set in 10/12pt ITCGaramondStd by SPi Global, Chennai, India

Printed in Great Britain by TJ International Ltd, Padstow, Cornwall, UK

10 9 8 7 6 5 4 3 2 1

*This book is dedicated to all of the people I have  
worked with in capital markets over the years.  
Many inspired me with new ideas and innovative  
concepts, laying the ground for me to think creatively  
and embark on new adventures.*

# INTRODUCTION

Inflation has been a subject for bankers, scholars, political leaders, and the general public for a long time. The rising prices of goods and services in currency terms have been condemned by people since time immemorial. There has been no let-up in everyone's desire to stop prices from rising, despite governments' continual actions to debase their currencies.

Very often governments, yielding to popular pressure, have taken draconian measures – such as prohibiting price rises and punishing those who disobeyed. In 1971, President Nixon announced a freeze on all prices and wages throughout the United States. Gerald Ford, his successor, distributed buttons with the slogan “whip inflation now.” Presidential candidate Ronald Reagan announced that inflation was *“as violent as a mugger, as frightening as an armed robber, and as deadly as a hit man.”*

In early 2020, it seemed that the tables had turned. Central bankers and economists were worrying that inflation was disappearing and we might even have been in a deflationary era. And despite their efforts to bring inflation up, as they believed that an inflation rate of at least 2% would render economies healthy and result in economic growth, their cures did not work. Dramatic decreases in interest rates and “quantitative easing” – or

money printing, with central banks buying bonds and even stocks (as in the case of Japan) to feed money into the system – failed.

But why were recognized theories not working anymore? For example, the famous Phillips Curve Theory – there is an inverse relationship between inflation and unemployment – did not seem to be valid anymore. Central bankers who promised that job growth would lead to inflation rising were proved wrong. The good news was that central bankers like Mario Draghi, the former head of the European Central Bank, and Mark Carney, governor of the Bank of England, warned that the economic policy consensus was no longer tenable. Jerome Powell, head of the US Federal Reserve, said that inflation was one of the “*major challenges of our time*”. . . and he was not referring to *too high* inflation but to *too low*. Times had really changed.

The question central banks and governments were asking themselves was what they could do to boost inflation when neither lowering interest rates (by 2020 rates in the major economies were either below 1% or, as in the case of Europe and Japan, negative) nor measures aimed at pumping liquidity into the economies were working.

One of the main reasons behind these shifts in economic practice and theory has been the acceleration of technological progress. It is driving productivity, which

in turn lowers the costs of goods and services even as governments devalue their currencies by printing more and more money. Probably the best example of this technology change is Amazon and similar online shopping firms who have pushed retail costs down and decimated many parts of the traditional “offline” retail scene. Studies showed that online prices were falling steadily from 2012 and were lower than they have been at the turn of the millennium. The so-called “Amazon Effect” was not limited to Amazon. We witnessed the phenomenon in transport (Uber), hotels (trivago.com), and travel (opodo.com). But the decline in prices could be attributed not only to those organizations directly serving the public at the retail level, but also to the producer level – where improvements in automation, workflow programming, and many other innovations were pushing the costs of production down. The invention of cell phones was just the start of the crash in communication prices. Those costs continued their downward trend with the invention of internet calling and faster, cheaper smartphones.

Of course, the hapless gatherers of inflation statistics have been in a quandary because of the avalanche of new, innovative, or significantly improved products as a result of technological innovation. This has made the task of measuring inflation an impossible one. A study by economists Austan D. Goolsbee and Peter J. Klenow

found that even excluding clothing, 44% of online sales in an Adobe Analytics database were of goods that **did not exist the year before!** The net entry of new goods alone led to the CPI overstating true inflation by 1.5 to 2.5 percentage points per year. They also found that online prices for bedding and furniture fell by about 12% between January 2014 to June 2019 but the official consumer price index fell by only 2.1%.<sup>1</sup>

More importantly, the proliferation of free services throws any effort to measure inflation completely out of whack. I now can make a video call anywhere in the world, obtain information on any subject, and translate languages free of charge. Ten years ago, or even five years ago, would it have been free? And how much would those services have cost? Erik Brynjolfsson and his research team at MIT tried to measure the value to users of various free online services by withholding those services from respondents temporarily and asking them how much they would pay to get them back. Questioning several respondents, they found that, for example, the value of not giving up WhatsApp was worth about \$600 to the respondents. To give up free online search engines for a year, people on average responded that they would want to be paid over \$17,000.

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<sup>1</sup>[http://www.klenow.com/internet-rising-prices-falling\\_Goolsbee\\_Klenow.pdf](http://www.klenow.com/internet-rising-prices-falling_Goolsbee_Klenow.pdf).

David Byrne of the Federal Reserve and Carol Corrado of the Conference Board constructed a digital access services index that showed prices for internet services falling by 21% between 2007 and 2017 while the official price index for internet access showed prices rising by 4.5%.

Another factor in the deflation phenomenon is the spread of global trade. Despite the trade war between the US and China, the fact remains that world trade is on the rise – with a pause in 2020 as a result of the COVID-19 crisis. According to the World Bank trade grew from 39% as a share of the world GDP to 59% between 1990 and 2018. This explosion of trade resulted in global competition for lower production and distribution costs as well as a rapid rise in information exchange which spurred innovation and change. The spread of deflation covers the globe. When American oil men discovered a way to extract oil and gas from rock using innovative fracking methods, oil prices globally were driven down – even when their methods initially were more expensive than the production costs in Saudi Arabia.

In this book I want to lay out the following ideas.

**Firstly, inflation statistics are of immense interest to governments around the world because rising prices elicit a political response among their constituents.**

Governments often rise and fall on the perception people have about the prices of goods and services they consume.

Therefore, governments try their best to measure inflation. In doing so, they simplify, generalize, and – in some cases – falsify or try to control the numbers by taking many actions, such as placing price controls on various products and services, so people are not aware of the actual price changes – leading to a black market and shortages.

**Secondly, the measurement of inflation is severely** flawed; not because the diligent people who gather statistics regarding the prices of goods and services around the world are unqualified or unfaithful to their trade, but because they are not only shooting at a moving target – with prices changing up or down on a minute by minute basis – but also the very nature of the products and services they are trying to measure is continuously changing. The desire for simplification in constructing an index that will encompass the multitude of prices, and reflect the buying habits of the entire population, is a thankless task and one doomed to severe imperfections.

**Thirdly, currencies, the measuring stick used to monitor price changes, have throughout history been debased by every authority that issued them.** Many forms of currency have been tried: gold coins, silver coins, tin coins, copper coins, seashells, paper bills, and others have all fallen by the wayside as a result of debasement. Currencies are created by human beings, and thus can be degraded or upgraded by them to be worth more or less than the market believes. Thus, a unit of currency one

day will be different in the eyes of the buyer or seller on another day. On that note: Throughout this book we use the word “inflation” but each time the word is used “currency devaluation” should replace it. So-called “inflation” is really the loss in purchasing value of a currency.

**Fourthly, advances in technology and automation are leading to continuously falling costs for many goods and services.** At the same time, every year a multitude of completely new and innovative products enter the consumer stage and improve people’s lives around the world.

**Finally, incomes in currency terms or the buying power of consumers change continuously, and, in fact, for most of history, they have tended to match price increases.** Therefore, although it may seem that inflation is taking place for some products and services, they are actually getting cheaper in terms of the earning power of the consumer.

If you take all of the above together I am sure you will agree with me that our understanding of inflation is to say the least flawed. I would even go a step further: In my opinion the concept of inflation is a myth, a legend, a fable, and, yes, a falsehood for a number of reasons. What we are experiencing today is, in fact, a deflationary spiral driven by innovation and automation. This deflationary phenomenon is here to stay and will continue to improve our standard of living. Welcome to the wonderful world of deflation!