THE WALL STREET JOURNAL.

Lessons From Iran's Hyperinflation

By ALEN MATTICH - October 5, 2012

This is an opinion column by Alen Mattich, who has been a columnist for Dow Jones for more than a decade. Write to him at alen.mattich@dowjones.com or on Twitter @AlenMattich

Does Iranian hyperinflation offer a lesson to a world in the throes of slowing growth and massive liquidity supply?

Yes. Albeit perhaps not the lesson those who immediately connect quantitative easing with impending hyperinflation will assume.

With Iranian consumer prices rising at some 70% a month, according to estimates by Steve Hanke at the Cato Institute, they easily qualify as hyperinflation. Maybe not yet of the scale suffered by Zimbabwe, which at one point in 2008 hit an annual inflation rate of 897 followed by 20 zeros percent, but in the order of other economically devastating hyperinflations.

What these and other hyperinflations have in common is a state of political extremes. Zimbabwe underwent political breakdown that was exacerbated by its inflation but wasn't primarily caused by the inflation. Weimar Germany was recovering from the First World War and trying to meet impossible reparations. Hungary was recovering from the Second World War and a communist overthrow. Yugoslavia suffered its civil war.

And Iran is undergoing the pain of an American-led commercial embargo, causing a supply crisis of goods--economic war in the words of Iranian President Mahmoud Ahmadinejad. A lack of dollars and other hard currencies, also because of the embargo, has exacerbated the flight out of the Iranian rial as people seek to protect what purchasing power they have, feeding the hyperinflation.

The hyperinflation is causing serious social strife in Iran as people are left struggling to buy life's necessities. Zimbabweans so lost faith in their currency and their central bank that the country had to abandon it altogether and adopt the U.S. dollar. The Iranian regime will find it very hard indeed to regain people's faith in its own currency. Without a credible currency as a medium of exchange, commerce collapses and so does social fabric. Iran is facing truly dangerous times.

So does that let developed countries off the hook? After all, if hyperinflation is solely the product of an extreme political environment and is usually associated with war or warlike circumstances they ought to be safe.

Not entirely.

True, hyperinflation has been used as a bogey by those worried by the hyper-easy monetary policy being pursued by central banks across the developed world as they try to lift their economies out of sub-trend growth or outright recession and back to full employment.

Those calling for more monetary accommodation use these fringe fears as a straw man argument, pointing out that not only has there been no hyperinflation, but that core inflation is at or near historic lows.

But the longer growth remains sub-trend in developed economies as households and firms continue to deleverage, the more extreme measures central banks will start to follow. Economists like Tim Duy at the University of Oregon have gone so far as to advocate outright debt monetization by central banks--in other words, that they should buy debt directly from governments rather than through the markets.

This is justified by a lack of aggregate demand. But once started, it becomes hard to reverse, because doing so then causes market interest rates to rise sharply, triggering another, perhaps deeper recession.

Governments facing year after year of sub-trend growth start to look abroad for culprits. Maybe countries that are following mercantilist export strategies--in other words subsidizing their exporters to destroy foreign competition. Of which, coincidentally, China is often accused.

Under pressure from their electorates, they can put up anti-trade barriers, tariffs or outright bans. Put this together with debt monetization and suddenly you have supply restrictions and extreme policymaking happening at the same time.

Which is roughly where Iran's problems started.