Forbes Online

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Disruptive Economics

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Does Inflation Hurt Savers?

Jul. 24 2011 - 9:32 pm | 302 views | 1 recommendation | 3 comments

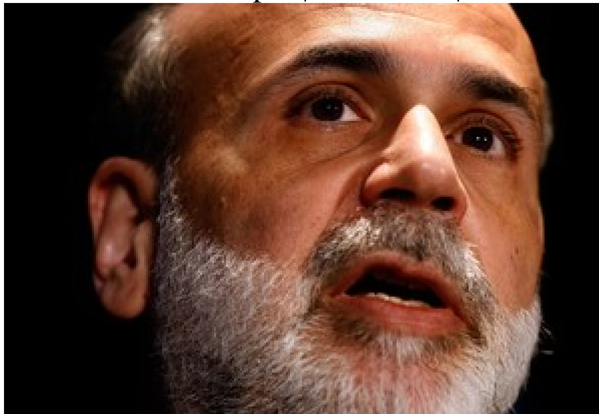

Image by Getty Images via @daylife

Reader vangelve responds to my recent post with an oft-repeated argument for libertarian inflation hawkishness:

Libertarians tend to be sticky about principles and the last time I looked robbing savers of purchasing power by creating money out of thin air was theft no matter how Dr. Friedman or the Keynesians would like to justify the practice. You either believe in the markets or you don't. If you do, you are against central banking and money printing. If you don't then you have to problem with monetary monopolies and the type of top down planning that Friedman tolerated and the Keynesians encouraged.

This is confusing two distinct questions. As I noted in my original post, it's obvious why libertarians would find arguments for abolishing the Federal Reserve appealing. But the Fed exists, and it's not going to disappear overnight, so even if you're against "monetary monopolies," you should still want the one we've got to do a good job while it exists.

And this requires that the Fed continue "creating money out of thin air." Thanks to a combination of population growth and rising per-capita income, the economy is almost always growing. If the Federal Reserve were to stop creating new money, the result would be not a stable price level but significant deflation. Indeed, a key argument in favor of a gold standard is that market forces will gradually expand the money supply in a way that produces a stable price level. So if your goal is to minimize the distortionary effects of Fed policies pending the Fed's abolition, you *want* the Fed to mimick this behavior by "creating money out of thin air."

In any event, the more substantive critique here is the point about inflation "robbing savers of purchasing power." This is an intuitively appealing concern, but it ignores how people actually save. If you save money by putting cash under your mattress, then inflation does indeed rob you of purchasing power. But if, like most of us, you hold your nest egg in a savings account, a money market fund, real estate, or a 401(k) plan then what you care about is your real rate of return, not the inflation rate per se.

The value of real assets like land and stock should rise with the general price level, so inflation doesn't hurt their holders on net. And in a more inflationary economy, lenders will demand, and get, higher nominal interest to compensate for the erosion of purchasing power. So inflation isn't necessarily bad for savers.

Now it's true that an *unexpected* increase in the inflation rate can unfairly hurt savers, since the inflation might not be factored into interest they receive. But this is a completely symmetrical situation. It's equally true that a sudden decrease in the inflation rate (like the one we saw in 2009) unfairly harms borrowers. Fairness demands that the Fed avoid big swings in the inflation rate in either direction.

But there's no particular reason to think modest, steady inflation reduces real returns for savers or investors. To the contrary, savers, like everyone else, have an interest in maximizing economic growth, since that will also maximize returns on their investments. So if (as many economists believe) inflation in the low single digits has the best macroeconomic results, then that's what savers should prefer. And regardless, this is an empirical question that has nothing in particular to do with one's beliefs about free markets or central planning.