History lessons on money supply and demand

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Sir, John Authers points, in his medical analogy “Two cheers for the return of volatility” (February 17), to the problem that a return to inflation and an economy back to something like normal may result in seizure and death. To the extent that an analysis of supply and demand of money still matters for the determination of the level of an interest rate, history provides a strong case for his conclusion.

As for the decreased money supply, the monetary policy reform of October 6 1979 undertaken by Federal Reserve chairman Paul Volcker as an experiment entailed to reduce money supply well corresponds to the tapering activities planned by the Fed. As for the increased money demand, the result of the expansionary policy of President Ronald Reagan and his tax reform in 1981 matches very well the tax reform and expansionary fiscal policy pursued today by President Donald Trump. The lesson to learn from the historical example is that the interest rates to prime borrowers in a very short period of time with decreased money supply and increased money demand more than doubled, peaking slightly above 20 per cent. The increase was contagious and the close international integration of financial markets made this of great concern to actors all over the world.

With the bulk of investments of today launched and evaluated at an extremely low interest rate, few investments will survive a double-digit percentage points rate increase. The dynamics of the interest rate hike will make the increase hit all asset classes. To avoid history repeating itself, the tapering should be on hold until there is clarity as regards the magnitude of the expansionary fiscal policy by Mr Trump.

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