Draft: Liquidity and Inflation Thesis

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Liquidity is understood as total money supply in a country. **Inflation** means rise in prices of commodities or products that we consume every day; such as consumer prices and wholesale prices.

Credit Ratios: Commercial Banks (also called as Retail Banks) have the ability to lend money by using credit ratios. For example, a company gets a 10million loan from a commercial bank, the bank has to keep a million as deposit to meet Reserve Banks' risk coverage requirement. In other words, if the commercial bank has deposits of 10 million, it can lend 100 million as loans.

Problems with liquidity: When liquidity increases in a system, inflation rises; because there is more money to buy things. What happens when liquidity rises several times but inflation surged marginally?

Liquidity is rising in multiples: As per my observation, the liquidity is surging constantly every year. If we compare last fifty years say 1970 to 2020 liquidity has increased more than 20 times in most of the countries. But Reserve Banks say that they have printed a very small amount of currency in this time period, so how can you say that liquidity has increased 20 times?

Source of liquidity: No matter how much of fresh currencies these Reserve Banks have released in last 50 years, the liquidity has risen several times because of Credit Ratios. This liquidity is not easily visible because of its temporary nature (the loans have to be returned to the lending bank). I call it a blind spot. In my words, we can say that commercial banks have the ability to issue fresh money to borrowers. If we look at the total sum of last 50 years, fresh money keeps accumulating instead of getting extinguished (by going back to lenders). We must compile some data on how much money has been lent (which is still in circulation) so far by all sorts of banks in our countries.

If there is excess liquidity, why the inflation has not surged 20 times?

Do we need to look somewhere else …?

Inflation of Investments: Instead of looking at inflation of consumer products and commodities, we can look at investment assets. People have started buying investment products instead of consumption products. In my observation, investment products are inflating in a similar proportion to liquidity. Property, gold (bullion), equity shares (stocks), monetary bonds are the examples of investment assets.

Inflation of Loans: the loans are also inflating; they are becoming cheaper because of excess availability of money in the system. Even when Reserve Banks are keeping higher interest rates, commercial banks are using market-based interest rates that are several times lower.

Advance stages – currency inflation: I have observed new trends in investment markets. Once investment assets are turning full they become overvalued. **People are then migrating to investing in Cash and currencies**.

People are preferring to keep their savings into few strongest currencies that are as good as cash. Furthermore, largest exporters are accumulating these strong currencies by not accepting payments in other currencies.

Impact of liquidity/Inflation on currencies: the problem with currency market is that it is relative. Which means in order to invest in one currency you have to sell another currency. This means that the few strongest currencies will keep inflating and the remaining currencies will keep deflating.

What happens when any one of these strongest currencies develop a perception of turning weaker!!

... will it lead to a Crash?

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