Division/Agency: Macroeconomic Modelling and Policy Division
Question No: 243
Topic: Consumer Price Index (CPI)
Reference: Written
Senator: Roberts, Malcolm

Question:

Is it the case that such money-supply-inflation has been the key driver, at least on the demand-side of the economy, of the rising Consumer Price Index (CPI) in recent decades?

Answer:

In responding to questions 243 and 245, Treasury seeks to clarify the relationship between money supply and inflation.

While most economists agree with the conjecture that in the long run inflation is a monetary phenomenon this proposition has been hard to prove empirically. See for example, De Grauwe and Polan (2005, Scandinavian Journal of Economics, Vol 107, No 2, pp. 239-259) and references therein. They find using a comprehensive cross-county data set spanning 30 years, that there is a strong relationship between the growth rate of money and inflation, however, this relationship is not proportional. In particular, they find the strong long-run relationship is entirely due to the presence of hyper-inflation in some countries in the sample. Importantly for Australia, the relationship between inflation and money growth for low-inflation countries is at best weak, if not absent.