

Does Zimbabwe provide any lessons for QE?

- It is tempting to argue that the quantitative easing (QE) now being adopted in the US and the UK, among others, differs only in degree from the reckless printing of money that contributed to the hyper-inflation in Zimbabwe. A closer look shows that such comparisons are wildly overdone, but they do help to clarify some key points and to explain why policy-makers are likely to err on the side of caution.
- Zimbabwe's annual inflation rate first topped 100% in 2001 following the disastrous land reform policies that caused widespread food shortages and a collapse in foreign currency revenues. By 2006 inflation exceeded 1000%. Thereafter the figures simply exploded. The latest official figures, for July 2008, put the annual inflation rate at 231,000,000%. Conditions have since continued to deteriorate to the point that even the monthly numbers are mindboggling and the focus has shifted to a daily rate. **At the end of last year it was estimated that prices in Zimbabwe's shops were doubling every 24 hours.**
- The actions of the central bank have played a key part. **With the economy in free-fall, the Reserve Bank of Zimbabwe has been obliged to finance public spending itself, which it has done primarily by buying large amounts of Treasury paper directly from the government.** The government in turn has used this newly-created money to pay its own bills, including higher wages for the armed forces and civil servants, and to buy foreign exchange. The resulting surge in the money supply has clearly contributed to the loss of confidence in the currency and the conditions that have caused hyper-inflation.
- However, we are wary of drawing any lessons for other countries which might also be adopting measures that boost the money supply. **For a start, even if the only difference were one of degree, the scale of the monetary expansion in Zimbabwe has been so much larger that any comparison is pretty meaningless.** This is rather like bracketing together a gentle rain shower with a tropical monsoon. But in fact the differences are much more fundamental.
- First, **the inflation disaster in Zimbabwe is not just about the reckless printing of money. Instead, it reflects a complete failure of normal economic, legal and social relations.** Indeed, periods of hyper-inflation are invariably triggered by a political crisis (such as the fragility of the Weimar Republic or the break-up of Yugoslavia) rather than the actions of central banks. To view the resulting hyper-inflation as "purely a monetary phenomenon" is to ignore the underlying institutional causes.
- **The link between the central bank's supply of money and overall inflation is also much weaker in an economy like the US or the UK than in Zimbabwe.** Cash created by the central bank represents a much smaller proportion of the overall supply of money and credit in an advanced economy with a well-developed (if not necessarily well-functioning) financial sector. In addition, the collapse in Zimbabwe's economy was driven by policies that destroyed productive potential, whereas there is now plenty of spare capacity in the rest of the world. The upshot is that central banks would find it hard to generate a great deal of inflation, even if they wanted to. **In that respect, Japan's experience of QE between 2001 and 2006 is far more relevant – despite a surge in narrow money as the Bank of Japan bought government bonds, broad money and credit aggregates remained subdued, and deflation persisted.**
- Finally, **the policy backdrop is completely different.** Zimbabwe has had to print money to finance government spending in the absence of any other source of funding or any credible fiscal or monetary policy regime. In contrast, the likes of the US Fed and the Bank of England are contemplating buying government bonds in the secondary market to keep longer-term interest rates down and increase the flow of money and credit. There is no intention (at least not yet) to resort to money-financed fiscal expansion and the normal policy framework remains in place including, in the UK, inflation targeting.
- Indeed, the term "printing money" is misleading as a description of what is happening in the US or the UK, since it implies that the recipients are getting something for nothing. In practice, **QE is being implemented by targeted central bank purchases of assets from the private sector – this is very different in nature as well as degree from what has happened in Zimbabwe.**

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