



By: Daniel Lacalle

Inflation expectations rise because government spending is too high



Inflation expectations in the United States are on the rise as we enter 2025, raising concerns about the optimistic expectations of disinflation and the potential impact on monetary policy. U.S. citizens expect higher prices for longer.

The University of Michigan's Consumer Sentiment Survey for January 2025 **reveals** a significant increase in inflation expectations. Consumers' one-year inflation expectations soared to 3.3%, the highest level since May 2024.

This represents a significant increase from 2.8% in December 2024, suggesting a growing concern among consumers about potential price pressures in the future.

The rise in inflation expectations was particularly pronounced among lower-income consumers and political independents, according to the survey.

This suggests that concerns about rising prices are becoming more widespread across different demographic groups. Furthermore, it means that the average U.S. citizen is expecting a prolonged erosion of their purchasing power.

This rise in inflation expectations is not a coincidence. Inflation is always a monetary phenomenon caused by the increase in the quantity of money.

Annual money supply growth in November rose to 2.35 percent, a 27-month high and the largest year-over-year increase since September 2022, as Ryan McMaken at Mises **explains**.

Government spending

Where does this increase in money growth come from? Mostly government spending, which soared 10 percent in fiscal year 2024, to \$6.8 trillion, **according** to the Congressional Budget Office.

The trend in inflation is particularly negative.

While annualised inflation has moderated since its peak, it remains significantly above the Federal Reserve's 2% target.

The Fed's preferred inflation measure showed a core rate of 2.4% in November 2024. In fact, there were minimal indications of disinflation in the past six months, except for the energy component.

From these figures, we can infer several conclusions:

The only significant elements of disinflation in the past year were the energy component and the base effect

The Inflation Reduction Act was in fact the inflation perpetuation act. Higher government spending and a record deficit have eroded the US dollar's purchasing power, despite its relative strength compared to other global currencies.

The only significant elements of disinflation in the past year were the energy component and the base effect. Now, the base effect works against the disinflation trend, and energy stopped declining once the Fed decided to cut rates too fast and early.

The Fed panicked in June, delaying the normalisation of its balance sheet and worsening the situation by cutting rates too fast in the middle of an election year. These policy changes effectively supported an increasingly irresponsible government spending trend.

In September 2024, the Federal Reserve cut rates at a time when the United States financial conditions index was at its loosest level since 2022. Thus, feeding fuel to the fire.

The Treasury sabotaged most of the Fed's actions to curb inflation throughout 2023 and 2024, increasing the debt issuance and maintaining a completely unsustainable deficit spending level.

U.S. citizens face another year of persistent inflation due to the combination of irresponsible government spending and the Fed's unnecessarily loose stance.

Inflation expectations

The United States is not the only country experiencing an increase in inflation expectations. The European Central Bank's Consumer Expectations Survey for November 2024 **showed** an increase in both short-term and long-term inflation expectations.

However, the cause is the same: massive government spending and monetisation of part of the Next Generation EU Fund.

The evidence of persistent inflation and uncontrolled government spending is creating significant turmoil in the currency and bond markets. Countries that have announced aggressive spending plans are suffering. The UK sterling has fallen to one-year lows and the ten- and thirty-year bond yields have risen to multi-decade highs.

Central banks may act on these figures by delaying rate cuts, thus making it even more difficult for families and businesses to thrive. The Federal Reserve, in its December 2024 meeting, had already revised its projections for interest rate cuts in 2025, reducing the anticipated decreases from four to two.

Central banks have maintained the liquidity injections needed to disguise rising government imbalances but have increased rates to combat inflation. As such, governments have continued with an irresponsible fiscal policy, increasing taxes and spending, while the entire burden of monetary policy normalisation falls on the shoulders of families and small businesses.

The insanity of this period is that governments kept large and unnecessary spending plans in 2021, creating the inflation we suffer today. Central banks also implemented aggressive quantitative easing measures to disguise the rising solvency problems of major

governments.

The significant increase in the money supply triggered a surge in inflation, and investors and citizens are now realising that this issue is unlikely to resolve anytime soon.

Inflation is a "de facto" default

Governments do not create reserves, and spending does not create deposits. Currency is debt, like any asset, and only a reserve if the issuer is solvent.

Fiscal irresponsibility constantly destroys its value, rendering it no longer a reserve. That is why more central banks are buying gold and selling government bonds.



Once the spiral of currency devaluation and insolvency evidence commences, no amount of fiscal or legal repression can halt its progression - Daniel Lacalle

Governments are limited in their ability to issue currency-debt.

Economic limit: When new units of public debt weaken productive economic growth.

Fiscal limit: When interest expense becomes one of the largest items in the budget despite rate and money supply manipulation.

Inflationary limit: When, on top of the other two, inflation is persistent.

When governments perceive themselves as omnipotent, imposing a currency, legislation, and taxes with the intention of perpetuating

government imbalances at the expense of the private sector, the confidence in the currency and sovereign bonds erodes, solvency deteriorates, and the inflationary and debt spiral accelerates.

Persistent inflation, rising public debt, and weakening productive growth are all signs of an issuer that is slowly defaulting. Once the spiral of currency devaluation and insolvency evidence commences, no amount of fiscal or legal repression can halt its progression.

Only cutting government spending and indebtedness stops inflation and restores a currency's purchasing power.