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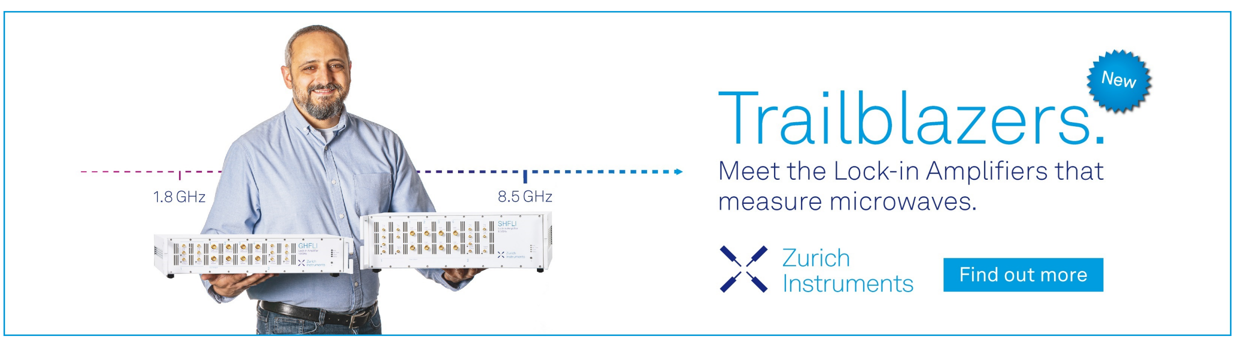

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False Inflation Spiral and the Banking Sector

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Abstract. The article speaks about the presence of the so-called «false inflationary spiral» (FIS), when inflation is created by producers of goods and services themselves. If inflation is not determined by market reasons, there is no need after the increase in prices to raise the key rate of the Central Bank, as well as the wages of workers by the inflation rate. It is also necessary to revise the inflation rate, because its impact on economic processes is clearly overestimated.

INTRODUCTION

Large modern organizations are faced with the need to annually index wages to their workers by inflation.

The relevance of this study can be explained by the need to revise the inflation rate, its impact on the most important macroeconomic processes, and, as a result, the absence of the need for annual indexation of employee salaries by the inflation rate, and the need to review the place of the banking sector in the country's economy and equalize its rights with the rights of consumers of banking services.

The objectives of this study are to:

- study the phenomenon of false inflationary spiral;
- examine the relationship between inflation and the key rate;
- assess the place of the banking sector in the country's economy;
- study the method of calculation the inflation index.

DISCUSSION

Inflation is a very important macroeconomic indicator, which measures the change in the general level of prices of goods and services [1]. Inflation in industrialized countries is largely a global phenomenon [2]. Inflation rate is the important input variables of a financial enterprise risk management [3]. Inflation expectations reflect the public views of the future inflation level, grasping inflation expectations can help the macroeconomic policy-making departments to accurately grasp the changes of savings, consumption, investment behavior and psychological expectations of residents [4]. The yearly inflation rate might not always be an appropriate measure of inflation, mainly due to the fact that it does not provide up-to-date information on the level of inflation [5]. There some ways to forecast inflation [6]. Inflation is an increase in the overall level of long-term prices. Due to inflation by the same amount of money, less and less goods can be bought over time. This definition of inflation does not take into account many factors, for example, the influence of scientific and technological progress, labour automation, the use of new materials, cheaper technologies, marketing activities related to the promotion of new goods to the market, reduction of transportation costs due to an increase in the number of transported products, etc.

At the same time, the increase in prices for some goods is offset by a drop in prices for others, which is primarily caused by scientific and technological progress (STP). For example, a drop in real estate prices can be caused by extreme factors, such as a Covid-2019 epidemic. At the same time, transport costs are always the «cornerstone», as petrol and oil are an exhausted, irreparable resource [7].

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So if we talk about a gradual rise in prices, then only about an insignificant and gradual one. This means that the graph of the dependence of the price index for goods on time can be represented by the straight line y = kx, where k≈0.5, until the next scientific and technological revolution, the discovery of new materials, a state of emergency, an epidemic such as Covid-2019, etc. (see Fig. 1).

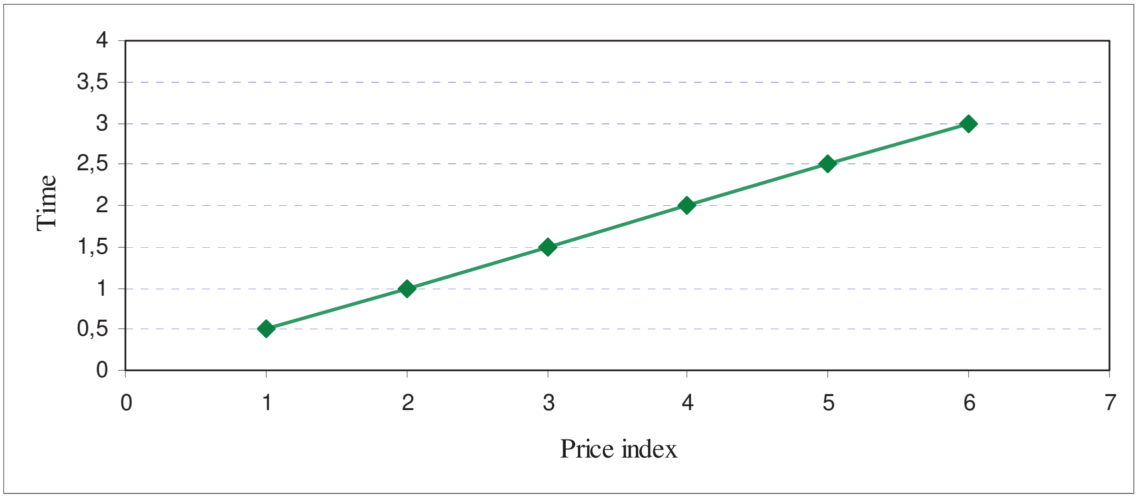

FIGURE 1. The graph of price index versus time.

The inflationary spiral is the interaction of two processes: rising prices for goods and services and rising wages for workers. Due to rising prices, employees ask them to increase their wages, and the increase in their income leads to an increase in the money supply in the country, which in turn leads to a further increase in prices, etc.

In the age of information technology, open access to absolutely any information, the psychology of manufacturers affects inflationary processes in the economy much more than the economic processes themselves.

Inflation is driven by the producers themselves, who, seeing an increase in the key rate, begin to additionally «put» the inflation index into the cost of their products, thereby accelerating «false» inflation, which leads to an even greater increase in the key rate and, consequently, to an even greater increase in prices etc. (see Fig. 2) [8].

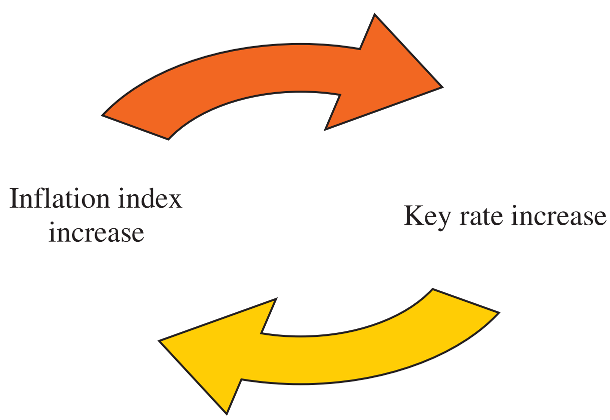

FIGURE 2. Interaction of inflation index and key rate.

This process will be stopped by the producers themselves, who, having noticed a drop in their sales volumes, will seek to reduce the prices of goods in order to return the previous sales volumes. Producers will reduce prices by an artificially introduced inflation rate. They will reduce the price until the price is driven by real costs and other costs, and not by an artificial, inflated inflation rate imposed by the greed of producers and their fear of losing their income in the future. A decrease in prices will lead to a gradual decrease in the key rate and to a limitation of the corridor of growth in commodity prices. Thus, a balance will be achieved when the price level is determined by objective reasons. And inflation will be due to objective reasons, and not dispersed by the greed of producers who understand the economy and expect an instant growth in the cost of their products and, accordingly, a rise in prices after the growth of the key rate.

After reading the media, producers, following the key rate, raise prices for their products, guided by the media, and not by real data about their production. Thus, producers themselves accelerate inflation, following the key rate by raising prices for their goods and services, and following the rise in prices, the key rate also grows, etc., therefore, a so-called «false inflationary spiral» arises. As a result, large firms become hostages of a «false inflationary spiral» due to the need to index the salaries of their employees annually.

A market economy based on free competition had to solve this problem of artificial price inflation. And she would have decided if the Central Bank had not started to increase the key rate following the price index. If the rate rises, prices rise, and the artificial rise in prices is followed by a real one, therefore, the inflationary spiral, whether false or real, is gaining momentum.

We do not live in a market economy, but in a mixed economy, when the state can intervene in economic processes, which in this case leads to an unreasonable increase in the key rate and to disastrous consequences for the economy.

Although in large companies, the profit from the «inflation index price increase» laid down by manufacturers far exceeds the cost of raising wages, even for thousands of workers. Thus, indirectly, the price increase is determined by the producers themselves, who are spinning a "false inflationary spiral". The solution to this problem is to abandon the annual increase in prices for the inflation index when determining the price of goods by producers and to increase the price of goods only with a real increase in the cost of production. So it is necessary to reject the annual indexing of prices by producers of goods without a real increase in its cost.

As a result, a mass psychosis of price growth begins with an increase in the key rate and producers unreasonably «put» the inflation index in the cost of production, without having any real grounds for this.

If you understand the «false» «psychological» causes of inflation, then there is no need to index wages and housing and communal services tariffs.

The key rate should not be tied to the inflation index, because it is not always due to trends in the economy, and much more often to the psychology of market participants, producers of goods and services, mass psychosis of price increases. Since the inflation index is not due to market processes, we cannot tie the key rate to it and ruthlessly spin it up with an increase in the inflation rate.

It is necessary to «untie» the key rate from the inflation index, because the main instrument of monetary policy of the state cannot depend on the psychology of producers, their greed or fear of losing incomes in the future.

Since the factors influencing inflation are often «false», not caused by economic processes, there is no need for the Central Bank to immediately turn the key rate up when information about price increases appears. The accelerated false inflationary spiral is gradually dying out. But its consequences have been felt in the economy for a long time - high credit and mortgage rates, low purchasing power of the population.

Perhaps a less frequent change in the key rate will lead to greater stability of the economy, in particular, less frequent changes in the key rate will more accurately reflect the economic processes in the country.

Since FIS is not due to real economic factors, an increase in the key rate in this case may be unnecessary. The increase in the key rate has huge consequences for the economy - both for consumers and producers of goods and services, and for the banking sector as well [9].

With inflation such as creeping, moderate, excessive increases in the key rate have a deplorable effect on the economy. But with galloping and hyperinflation, a quick correction of the economic situation with the help of a key rate is necessary.

Banks, like other organizations, seek to maximize their profits, can suffer losses, can be declared bankrupt. But since banks lend and save incomes of the population, increased attention is paid to them by state supervisory authorities, high requirements are placed on the necessary reserves of banks. With a serious increase in the key rate, many banks are on the verge of bankruptcy. Since the policy of the Central Bank of the Russian Federation is aimed primarily at protecting the interests of consumers, in this situation banks are an unprotected sector of the economy. And the state needs to strive for balance.

The banking sector, like ordinary consumers or organizations, firms seek to maximize their profits by increasing mortgage and consumer loan rates, reducing rates on consumer deposits, taking into account the actions of competitors. With the growth of the key rate, banks instantly increase rates on loans and mortgages and slowly rates on consumer deposits, providing themselves with profit in the short term. With a decrease in the key rate, banks lightning down rates on consumer deposits and slowly rates on mortgages and loans, again providing themselves with profit in the short term. Therefore, thoughtless growth or a reduction in the key rate undoubtedly affects the income of the banking sector.

With a rise in the key rate, consumers take less loans and save more, which reduces banks' income from consumer loans. And with a reduction in the key rate, consumers are more willing to take loans and save less on bank deposits, which increases banks' income from consumer loans. It should be noted that in Russia, with a key rate of 5%, the rate on loans for the population sometimes reaches 15% - this is how banks strive to protect themselves in case of loss of solvency of the client and provide themselves with overpayments. And with such loan rates, bank loans are, in principle, not profitable for the population.

Analysis of the balance of interests of various sectors of the economy is one of the topics for future research. Can the interests of the banking sector be superior to those of ordinary consumers and vice versa? I think that the state should strive for balance.

The method of calculating the inflation index is also controversial. To calculate inflation, statistics of the Central Bank of the Russian Federation use a consumer basket, which includes more than seven hundred goods and services, from bread to household appliances and cars. Monthly prices for these goods and services are considered both in retail and wholesale stores, as well as among producers and statisticians show an average value for the country. The consumer basket also includes expenses for travel, building materials, etc. The composition of the consumer basket is changed annually taking into account the real purchases of Russians.

Based on the consumer basket, the consumer price index is considered, which is compared with the index of last month and the inflation index is displayed. But as already said, the price index is considered based on prices in stores and wholesale prices of producers, which are set by producers of goods, often guided not by real market data, but by their personal desires. As a result, the inflation index is considered based on the wishes of the producers. And with an increase in the key rate, most producers automatically increase the prices of their goods, increasing the price index and «driving up» inflation.

When calculating the inflation index, Rosstat officially does not take into account prices in rural areas, the shadow market, the rental housing market, discounts and marketing campaigns. The marketing campaigns in a market economy are of great importance: most goods are bought by current consumers precisely at discounts. If Rosstat took into account marketing stocks, the inflation index would be lower.

CONCLUSION

The modern theory of inflationary processes is outdated and does not meet the trends of time. In particular, modern theory does not take into account that in the age of digital technologies and open information, inflation is largely due to the psychology of producers of goods and services, their desire to maximize profits by any means. Also, the state often does not take into account that the banking sector is a full participant of the financial market of the country, and, therefore, can suffer losses, seeks to maximize its profits by any legal and accessible means. There is great competition in the banking sector. The state often does not consider the banking sector as a market participant, primarily taking into account interests of ordinary consumers, forgetting that a developed banking sector is necessary for the stable functioning of the economy. Therefore, the banking sector also needs some state protection.

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