



## **RELATION BETWEEN THE MONETARY MASS AND INFLATION**

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### **Rezumat**

Pornind de la conceptul de bază al administrării macroeconomice, conform căruia rolul activităților din economia reală este producerea de resurse necesare dezvoltării societății, problema actuală, la nivel general, a administrațiilor macroeconomice naționale este aceea de menținere a unei situații de echilibru, dar și de facilitare a constituirii resurselor, situație care se transpune în conceptul de „echilibru macroeconomic sustenabil” și care asigură atât urmărirea atingerii obiectivelor de dezvoltare, cât și pe a celor specifice administrării riscurilor.

Acest cumul de situații și direcții de acțiune este perfect asociat atât conceptului, cât și stării reale de „conjunctură”, calea administrativă utilizată fiind formată dintr-o mulțime de căi personalizate spațio-temporal.

Eficiența și eficacitatea maxime ale dezvoltării societății sunt atinse prin colaborarea strânsă între factorii decidenți determinanți ai acestei evoluții, respectiva abordare îndeplinind, în acest sens, cele mai multe dintre cerințele asociate obiectivelor de dezvoltare și de administrare a riscurilor.

### **Abstract**

Taking into consideration the main concept of the macroeconomic administrating according which the role of the economic real activities is to produce the necessary resources for the

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society development, the actual main problem of the macroeconomic national administrations is also to maintain an equilibrium situation and to facilitate the resources consolidation – situation which is named „sustainable macroeconomic equilibrium” main either for the reaching of the development objectives or for the risks administration.

This situations and directions system is very well associated to the concept and also to the real situation of „specific situation”, the administrative way being a system of many specific personalized ways.

The maximum efficiency and also the efficacy of the society development are reached by the very closely cooperation between the main decision factors of the named evolution, such thinking way being able to respect also the development objectives and the risks administration ones.

**Keywords:** balance, sustainability, risks, development, decision.

**JEL classification** 61

### **1. THEORETICAL APPROACH**

Knowing that all macroeconomic models are perfectible, that none of them has the capacity to reflect exactly the economic reality, this study will use, for reasons of research into the phenomenon stated in the title, to Fisher’s equation of the macroeconomic balance.

Before starting the theoretical analysis we must mention and argue, at the same time, the above point of view: incapacity of the economic models to reflect, closely, the reality comes both from the dynamic character of the real economy environment, and from the continuously increasing complexity, not always correlated with the strategic objectives, of the particular macroeconomic system, which induces the risk element. All these problems of the economic reality are a barrier to the identification of all the determined variables of the economic trend and to the identification and putting into equation of these administrated variables.

Reverting to Fisher’s equation,

$$M \times V = P \times T \tag{1}$$

where:

M = monetary mass in circulation;  
V = speed of money rotation within the economy;  
P = price level within the economy;  
T = production level within the economy

and using the condition for a developed (or developing) macroeconomic system:

$$V = \text{constant} \quad (2)$$

we reach the following equation:

$$\frac{P \times T}{M} = \text{ct.} \quad (4)$$

Reverting to the title of this study, we may ask the following question about equation (4): what happens at the level of the monetary policy?

In order to answer this question, we need to reanalyse equations (2) and (4) according to the following aspect: the equalities of this type presented at the theoretical level of approach, are understood at the applied level of approach, as approximative equalities because of the insufficient capacity of the theoretical models to show a faithful representation of the economic reality.

In this situation, the condition of a developed or developing macroeconomic system becomes:

$$V \approx \text{ct.} \quad (5)$$

and:

$$\frac{P \times T}{M} \approx \text{ct.} \quad (6)$$

Under these conditions, theoretically, the monetary policy assumes the objective of maintaining a relation of correspondence between the level of prices, the level of production and the monetary mass – relation which, under optimal conditions and in dynamics, must have a margin of error as small as possible, as a strictly necessary condition for the state of macroeconomic balance.

This statement, from the applied point of view this time, brings back into discussion the concept of “state of macroeconomic balance”. This means the adoption of macroeconomic balance at the level of objectives, knowing that theoretically, we have the following degrees of balance: stable balance, rather stable balance and unstable balance, which have subordinated states which correspond to the different degrees of balancing.

Reverting to the practical view on the concept of “state of macroeconomic balance”, the real economic activity, by its nature, is compelled to work with the following approach of the concept: “sustainable macroeconomic balance”; we still have to define the sustainability of the concept applied to the specific conditions of the particular real system. Starting from this conclusion, generally speaking, the state of sustainable macroeconomic balance can be used for the several systems which have a similar evolution and different time coordinates. However, this use is possible only in principle, referring to the qualitative aspects of the approach; strictly speaking, the state of sustainable macroeconomic balance is a single state, associated to a particular macroeconomic system, at a unique moment of its evolution. This type of utilization refers to the quantitative aspects of the approach as much as it refers to the qualitative aspects.

## **2. THE CASE OF ROMANIA**

Under these conditions, the analysis should start from defining the specific aspects of the state of sustainable macroeconomic balance. We need to start from the strategic objectives of the macroeconomic system:

- Preparation for accession to the Euro area;
- Go past the situation of crisis.

For the exactness of approach, particularly given the results of the above theoretical analysis regarding the uniqueness of

approaching the “concept of sustainable state of macroeconomic balance”, this study will focus on a single strategic objective without, however, ignoring the second one.

Of the two strategic objectives presented, this study selects as priority strategic objective “going past the situation of crisis”, from the following reason:

- From the point of view of the temporal coordinates, the selected objective is more urgent than the objective of getting ready to access the Euro zone;
- From the point of view of the necessity to create the basics of getting ready for the Euro zone, the selected objective is a condition of the subsequent stages of evolution of the macroeconomic system;
- From the point of view of the risks associated to failing either objective, the selected objective has priority compared to the second objective, first of all from the perspective of the need to administer these risks

Given these arguments, in the acceptance of this study, we don't consider necessary to approach two scenarios of analysis, to be dealt with in order of priority; rather, we consider enough to approach the priority strategic objective of getting past the crisis. On the basis of this priority strategic objective we will define the specific state of sustainable macroeconomic balance.

In the current stage of economic development of Romania, one can notice that in 2011, the incomes and the consumption of the population decreased continuously<sup>1</sup>, which supports the deflationist process, but which is, at the same time, a factor opposed to the trends of economic growth.

Where from this decreasing trend?

This trend has nothing to do with the monetary policy; rather, it is the mixed result of some measures of budgetary, fiscal and microeconomic policy which, even if they are not coordinated and correlated at the level of a system of macroeconomic policies, with the monetary policy, come thus in support of the deflationist orientation of the monetary policy. All these together form elements of

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<sup>1</sup> See BNR quarterly report in inflation - November 2011

macroeconomic policy of austerity and generate, outside the scope of this study, the question: is such imposed trend in agreement with the priority strategic objective approached by this study, i.e. getting passed the crisis situation?

Reverting to the subject of our study, from the perspective of the points of view associated to it, the macroeconomic policies, besides being coordinated at the level of objectives and coordinated at the level of measures within a system of macroeconomic policies, they should be directed towards two main objectives subordinated to the selected strategic priority objective:

- Risk administration;
- Facilitating the establishment of driving factors for the economic revival,

These objectives have nothing to do with the macroeconomic austerity, actually being diametrically opposed, requiring the establishment of facilities and opportunities for development, under the conditions approaching the economic-social development at the macroeconomic level as result of the perfect collaboration between the macroeconomic administrative system – the coordinating factor, and the real economy – the driving force. The two systems have the following roles:

- The macroeconomic administrative system sets the strategy and plans of action starting from the general needs for the future development of society and taking into consideration the specific resources of the real economy and its prediction aspects;
- The real economy ensures the necessary support for the development of the society using the general framework of development represented by the strategy set by the macroeconomic system and by the legislative framework, starting from the resources available on the market.

Starting from the subject of this study, we aim to answer the following question: can the monetary mass can be an inflationist factor?

Approaching the subject at the general theoretical level, the answer would be “categorically NO”, because the monetary mass, which belongs to the system of main macroeconomic variables and which, at the same time, directly linked through the instrument called “adjustment of the volume of monetary mass in circulation” of the

monetary policy, has no means to become an inflationist factor, being permanently monitored, particularly in a specific work environment such as the present situation of Romania – situation in which the monetary policy approaches a strategy based on the direct inflation targeting.

However, considering the practical aspect of the problem regarding the validity of the macroeconomic models, we must not expect after measures of monetary policy to adjust the monetary mass in circulation, things to go exactly as shown by Fisher's equation of the macroeconomic balance and its derivatives. This is because the model, as any other model, has a purely theoretical value and actually aids orientation towards the development of practical solutions. The use of such a method presumes, necessarily, the use of continuous discernment: knowing exactly how and when to put the theory into practice. Acting by measures of monetary policy in factor M, not always, or better said, most often, the proper effects of the theory are displayed on factors P and T, just because of the external factors, with the character of risk, which surely interpose in the macroeconomic evolution generating, decisively, the behaviour of the market actors.

Returning to the above question, for the meaning of our analysis, question is whether there would be the possibility that the actions of the monetary policy on the monetary mass in circulation (increase of the monetary mass in circulation) may transform it into an inflationist factor.

As previously mentioned, in practice we don't yet expect things to go according to the theoretical model. However, starting the analysis from the stage in which things go exactly according to the theoretical model, which corresponds to a possibly previous stage of economic development and comparing it with the present state of economic development, it is sure that if the monetary mass in circulation would increase following a decision of monetary policy, correctly based on macroeconomic forecasts, not all the surplus of monetary mass in circulation will be found in the increase of production due to the higher demand. This is due to the various behaviours or sudden changes of behaviour of the market actors (actors which are the decision factors influencing the operation of the transmission channels of the monetary mass in the economy) possible due to the

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facilities and opportunities offered by the current state of development of the economic relations and possibly used by the market actors both to develop the basic activity and to administer the risk – decisions whose orientation is taken into calculation, implicitly with quite a large margin of error, by the decision-making factor of the monetary policy.

If the selected priority strategic factor is selected, the monetary policy is forced to work at a very high rate of incertitude of forecasting the decisions of the market actors. This high level of incertitude may be decreased, but not fully eliminated, by a partnership between the macroeconomic administrative factor and the decision-making factor in the real economy. The further reduction of this level of incertitude is given by the operation, at the macroeconomic administrative level, of a consolidated system of the macroeconomic policies sized to fit the situation of the real economy.