US & WORLD ECONOMIES ECONOMIC TERMS

Hyperinflation: Its Causes and Effects With Examples

Could You Survive Hyperinflation?

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Hyperinflation is when the prices of goods and services rise more than 50% per month. At that rate, a loaf of bread could cost one amount in the morning and a higher one in the afternoon. The severity of cost increases distinguishes it from the other types of inflation. The next worst, galloping inflation, sends prices up 10% or more per year.

Causes of Hyperinflation

Hyperinflation has two main causes: an increase in the money supply and demand-pull inflation. The former happens when a country's government begins printing money to pay for its spending. As it increases the money supply, prices rise as in regular inflation.

The other cause, demand-pull inflation, occurs when a surge in demand outstrips supply, sending prices higher. This can happen due to increased consumer spending due to a growing economy, a sudden rise in exports, or more government spending.[1]

The two often go hand-in-hand. Instead of tightening the money supply to stop inflation, the government or central bank might continue to print more money. With too much currency sloshing around, prices skyrocket. Once consumers realize what is happening, they expect continued inflation. They buy more now to avoid paying a higher price later. That excessive demand aggravates inflation. It's even worse if consumers stockpile goods and create shortages.

Key Takeaways

- When prices soar over 50% in one month, the economy is experiencing hyperinflation.
- This is can be caused by a government that prints more money than its nation’s GDP can support.
- Hyperinflation tends to occur during a period of economic turmoil or depression.
- Demand-pull inflation can also cause hyperinflation. Soaring prices cause people to hoard, creating a rapid rise in demand chasing too few goods. The hoarding may create shortages, and thus aggravate the rate of inflation.
- Countries that have suffered horrendous inflation rates include Germany, Venezuela, Zimbabwe, and the Confederacy during the Civil War. Venezuela is still trying to cope with its hyperinflation.

Effects of Hyperinflation

When hyperinflation is in effect, consumer behavior adjusts. To keep from paying more for goods tomorrow, people begin hoarding today. That stockpiling creates shortages. Hoarding can start with durable goods, such as automobiles and washing machines. If hyperinflation continues, people hoard perishable goods, like bread and milk. These daily supplies become scarce, and more expensive, and the economy falls apart.

People lose their savings as cash loses its value. For that reason, the elderly are often the most vulnerable to hyperinflation. Soon, banks and lenders go bankrupt, because their loans lose value. They run out of cash as people stop making deposits.

Hyperinflation sends the value of the currency plummeting in foreign exchange markets. The nation's importers go out of business as the cost of foreign goods skyrockets. Unemployment rises as companies fold. Government tax revenues fall and it has trouble providing basic services. The government prints more money to pay its bills, worsening the hyperinflation.[2]

There are two winners in hyperinflation. The first beneficiaries are those who took out loans and find that the collapsing value of the currency makes their debt worthless by comparison until it is virtually wiped out. Exporters are also winners because the falling value of the local currency makes exports cheaper compared to foreign competitors. Additionally, exporters receive hard foreign currency, which increases in value as the local currency falls.

Hyperinflation in Weimar Germany

The most well-known example of hyperinflation was during the Weimar Republic in Germany in the 1920s. Through World War I, the amount of German paper marks increased by a factor of four. By the end of 1923, it had increased by billions of times. From the outbreak of the war until November 1923, the German Reichsbank issued 92.8 quintillion paper marks. In that period, the value of the mark fell from about four to the dollar to one trillion to the dollar.[3][4]

At first, this fiscal stimulus lowered the cost of exports and increased economic growth.

When the war ended, the Allies saddled Germany with another 132 billion marks in war reparations. Production collapsed, leading to a shortage of goods, especially food. Because there was excess cash in circulation, and few goods, the price of everyday items doubled every 3.7 days. The inflation rate was 20.9% per day.[5] Farmers and others who produced goods did well, but most people either lived in poverty or left the country.

Hyperinflation in Venezuela

The most recent example of hyperinflation is in Venezuela. Prices rose 41% in 2013, and by 2018 inflation was at 65,000%.[6] In 2017, the government increased the money supply by 14%.[7] It is promoting a new cryptocurrency, the "Petro," because the bolivar lost almost all of its value against the U.S. dollar.[8] Unemployment rose to over 20%, similar to the U.S. rate during the Great Depression.[9]

How did Venezuela find itself in such a mess? Former President Hugo Chávez had instituted price controls for food and medicine. But mandated prices were so low it forced domestic companies out of business. In response, the government paid for imports. In 2014, oil prices plummeted, eroding revenues to the government-owned oil companies. When the government ran out of cash, it started printing more.[10]

As of 2016, Venezuela's foreign debt was about $100 billion.[7] The annual inflation rate for consumer prices was at 2,300% percent in early 2020.[11] With the continued collapse of its economy, the country is facing a monumental problem of debt repayment. By late 2021, Venezuela continues to suffer hyperinflation.[12]

Hyperinflation in Zimbabwe

Zimbabwe experienced hyperinflation between 2004 and 2009. The government printed money to pay for the war in the Congo. Also, droughts and farm confiscation restricted the supply of food and other locally produced goods. As a result, hyperinflation was worse than in Germany. The inflation rate was 98% a day, and prices doubled every 24 hours.[13] It finally ended when the country retired its currency and replaced it with a system that used multiple foreign currencies, predominantly the U.S. dollar.[14][15][16]

Hyperinflation in the United States

The only time the U.S. suffered hyperinflation was during the Civil War when the Confederate government printed money to pay for the war.[17][18] If hyperinflation were to reoccur in the U.S., the Consumer Price Index would measure it. The current inflation rate shows that the U.S. is nowhere near hyperinflation (it isn't even in the double digits).[19]

In fact, inflation may be too low, as [mild inflation can be good for economic growth].

The Federal Reserve prevents hyperinflation in America with monetary policy. The Fed's primary job is to control inflation while avoiding recession. It does this by tightening or relaxing the money supply, which is the amount of money allowed into the market.[20] Tightening the money supply reduces the risk of inflation while loosening it increases the risk of inflation.[21]

The Fed has an inflation target of 2% per year. That's the core inflation rate, which leaves out volatile oil prices and gas prices. Those commodities move up and down rapidly depending on commodities trading. That affects the price of food that trucks transport long distances. For this reason, the CPI also removes food prices from the core inflation rate.[22]

If the core inflation rate exceeds 2%, the Fed will raise the fed funds rate. It will use its other monetary policy tools to tighten the money supply and lower prices again.[23]

Most of the funds the Federal Reserve has injected into the banking system in the years since the Great Recession sits in bank reserves. It has not gone into circulation. If the banks start to lend too much, the Fed can quickly raise its reserve requirement and lower the money supply.

Enduring Hyperinflation

Despite the rarity of hyperinflation, many people are still worried about it. So, if it were to happen, what should you do? There are a couple of ways you can protect yourself from any kind of inflation. Sound financial habits would help you get through a period of hyperinflation, too.

First, be prepared by having your assets well-diversified. You should balance your assets among U.S. stock and bonds, international stocks and bonds, gold and other hard assets, and real estate.

Second, keep your passport current. You may need it if hyperinflation in your country makes your standard of living intolerable.

Frequently Asked Questions (FAQs)

What happens to debt during periods of hyperinflation?

Hyperinflation makes debt expensive for new borrowers. Fewer lenders will be willing to offer debt as economic conditions sour, so borrowers will be expected to pay higher interest rates. On the other hand, if someone takes on debt before hyperinflation begins, then the borrower benefits because the value of the currency falls. In theory, it should be easier to pay back a set sum of cash, because the borrower can earn more for their goods and services.

What happens to real estate during hyperinflation?

Real estate prices may rise rapidly during a period of hyperinflation. Property values may not move in perfect correlation with inflation trends, but they are an asset, and the cost of most assets could be expected to rise in inflationary environments.

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