

## FEATURE

# Why Didn't QE Lead to Hyperinflation?

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<https://www.investopedia.com/articles/investing/022615/why-didnt-quantitative-easing-lead-hyperinflation.asp#:~:text=Why%20QE%20Didn%27t%20Cause%20Hyperinflation,-As%20the%20Great&text=When%20money%20is%20hoarded%2C%20it,order%20to%20clear%20their%20inventories.&text=The%20first%20reason%2C%20then%2C%20why,already%20deflationary%20when%20it%20began>

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For more than six years, the U.S. [Federal Reserve](#) administered round after round of [Quantitative Easing](#) (QE), and only in recent years decided to scale back its operations. If the Fed had not acted in 2008, chances are the U.S. economy would have entered a deep depression, much worse than what was experienced.

When QE was first put on the table following the financial collapse that gave way to the Great Recession, [many people feared that it would ultimately lead to runaway inflation like the kind seen in Zimbabwe \(and its 1 trillion dollar bill\), Argentina, Hungary, or the German Weimar Republic.](#)

Prices did rise modestly during that period, but by historical measures, inflation was subdued, and a far cry from being hyperinflation. Why aren't we all pushing around wheelbarrows full of banknotes to the supermarket?

## KEY TAKEAWAYS

Prices did rise modestly in the low-interest rate environment that followed the Great Recession, but not nearly enough to be considered anything close to a hyperinflation.

Hyperinflation is an exponential rise in prices and is generally associated with a collapse in the underlying economy.

During the Great Recession banks still had bad loans and toxic assets on their balance sheets as a result of the housing bubble burst and its aftershocks.

While the central bank did increase the money supply sharply, banks used these funds to shore up their balance sheets and buffer toxic assets, rather than creating new loans.

## Why QE Didn't Cause Hyperinflation

As the Great Recession set in, the Fed [dropped its interest rate](#) target to close to zero, and then was forced to use unconventional monetary policy tools including [quantitative easing](#). It is important to realize that [QE was an emergency measure used to stimulate the economy](#) and prevent it from tumbling into a deflationary spiral.

When financial institutions collapse and there is a high degree of economic uncertainty, people and businesses choose to hoard their money rather than risk investment and potential loss. When money is hoarded, it is not spent and so producers are forced to lower prices in order to clear their inventories. But why would somebody spend a dollar today when they expect that prices will be lower—and their dollar can buy effectively more—tomorrow? The result is that hoarding continues, prices keep falling, and the economy grinds to a halt.

[The first reason](#), then, why QE did not lead to hyperinflation is because the state of the economy was already deflationary when it began. After QE1, the fed underwent a second round of

quantitative easing, QE2. Here the central bank undertook [open market operations](#) where it purchased assets from banks in return for dollars.

*People won't risk investment losses when there is great uncertainty and, instead, will hoard their money.*

### The Monetary Base

It is true the monetary base spiked during these initial rounds of QE, **but the second reason** QE didn't lead to hyperinflation is we live under a fractional reserve banking system whereby the money supply is more than just the amount of physical coins, paper money, and bank deposits in the system.

The monetary base, or [M0](#), is what most people think about when it comes to the amount of money in circulation, but banks are in the business of making loans with the deposits on hand. The money from those loans are then deposited back into the banking system and re-loaned, over and over again. This is the so-called [money multiplier effect](#).

If the multiplier is 10x, for every \$100 deposited into a bank up to \$1,000 of new credit money is created through this mechanism. The [M2](#) measure of the money supply, which includes the effects of fractional reserve banking and credit, was actually quite [stable during this period](#).

So where did all the M0 money go if it wasn't multiplied through the credit system?

The answer is that banks and financial institutions hoarded the money in order to shore

up their own balance sheets and regain profitability. Banks still had bad loans and toxic assets on their balance sheets as a result of the housing bubble burst and its aftershocks. The extra cash on hand made their financial picture look a whole lot better. As the economy has recovered and the fed has begun tapering its interventions, the money being held by banks is being returned to the Fed slowly in the form of interest payments on the debts purchased during QE. Meanwhile, the U.S. economy, on the whole, has remained productive and growing.

### The Bottom Line

Many feared that QE would spell hyperinflation for the U.S. economy following the economic crisis of 2008. [The crisis, however, was largely a deflationary phenomenon](#) and the money being injected into the system by QE, as seen by the spike in the M0 monetary base, was by and large retained by the financial sector, with the more important M2 money supply remained fairly stable.

Hyperinflation is an exponential rise in prices and tends to occur not when countries print too much money; instead, it is associated with a collapse in the real underlying economy. The printing of money is a desperate effort to maintain stability and prevent production from coming to a halt, as what happened in post-WWI Germany and during the 2000s when Mugabe headed the government of Zimbabwe. On the other hand, the U.S. economy remained productive during the period of the Great Recession and only saw very modest increases in inflation.