The Quasi-Inflation of 2021-2022

A Case of Bad Ideas and Worse Policy

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What is "Inflation"?

- *Inflation is not* simply "the rate of change of prices over time" (Bernstein and Tedeschi 2021)
- It is unlike "unemployment," a practical policy term, measured by counting people, applicable only to industrial economies.
- Inflation can (in principle) happen anywhere.
- It is measured (for better or worse) by constructing an index number.

Pure Inflation

- "Pure inflation" is a textbook concept.
- It refers to the undifferentiated devaluation of the monetary unit with respect to all *newly-produced* goods and services;
- It corresponds to Friedman's "always and everywhere a monetary phenomenon."
- Rarely if ever encountered in the real world.
- OK, *maybe* in 16th century Europe...

Everyday Inflation

- “Everyday inflation” is typically the propagation of a price shock or shocks from one sector or commodity through the price structure;
- Typically originates in energy;
- Always produces effects on distribution;
- *May* be sustained via mechanisms such as staggered union contracts, yielding “persistent everyday inflation.” This was common in the 1970s, but has not been seen since.

Sources of Everyday Inflation in 2021-2022

- Energy, specifically oil
  - The price collapsed, then recovered, partly due to private equity ops in the Permian
- Automobiles, via semiconductors, the supply chain, and the used car market
  - New car prices rose a little
  - Used car prices rose a lot.
    - Used cars are in the CPI but not in GDP
- Housing, via rental contracts and *imputed* rents – which are paid to oneself.
  - A thin tail wagging a fat dog?

Illusions of Persistence

- Transmission from wholesale to retail, especially in the energy markets.
- Backward-looking, 12-month reporting of monthly changes in the CPI.
  - Again, very unlike unemployment
  - Has the advantage of smoothing out volatility in monthly statistics
  - Has the disadvantage of giving Larry Summers, Jason Furman and Ken Rogoff *11 extra Op-Ed opportunities* for each shock.

Some Examples

- Larry Summers, May 2021: “Inflationary pressures are mounting from the boost in demand created by the $2 trillion-plus in savings that Americans have accumulated during the pandemic; from large-scale Federal Reserve debt purchases, along with Fed forecasts of essentially zero interest rates into 2024; from roughly $3 trillion in fiscal stimulus passed by Congress; and from soaring stock and real estate prices.”

(No mention of oil or semiconductors...)

More Examples

- Ken Rogoff, May 2022: "a growing crescendo of commentary places the blame for the current surge in US inflation squarely on the Federal Reserve."
- Jason Furman, August 2022: "Recent price- and wage-growth data make it increasingly clear that the US economy's underlying inflation rate is at least 4% and more likely to be rising than falling. ... [T]he Federal Reserve will need to stick to its plan of rapid interest-rate hikes..."

(Remember "Martin, Barton and Fish"? Now it's "Jason, Larry and Ken".)

Yet Another Example

- Jason Furman, Sept 2022:

  "The scariest economics paper of 2022 argues that labor markets remain extremely tight, underlying inflation is high and possibly rising, and several years of very high unemployment may be necessary to get inflation under control. … To get the inflation rate to the Fed's target of 2% by then would require an average unemployment rate of about 6.5% in 2023 and 2024."

(Did Jason volunteer? He did not.)

Jason's Timing... Exquisite

Global Economy

Global inflation likely to have peaked, key data indicators suggest

Factory gate prices, shipping rates and expectations suggest headline price growth will slow

Shoppers in San Francisco seek Black Friday deals: inflationary pressures are easing according to data indicators that suggest shoppers around the world are likely to see slower price growth © Jessica Christian/AP

Valentina Romei in London YESTERDAY

Key data indicators suggest that this year's rampant global inflation has peaked and that the pace of headline price growth is set to slow in the coming months.

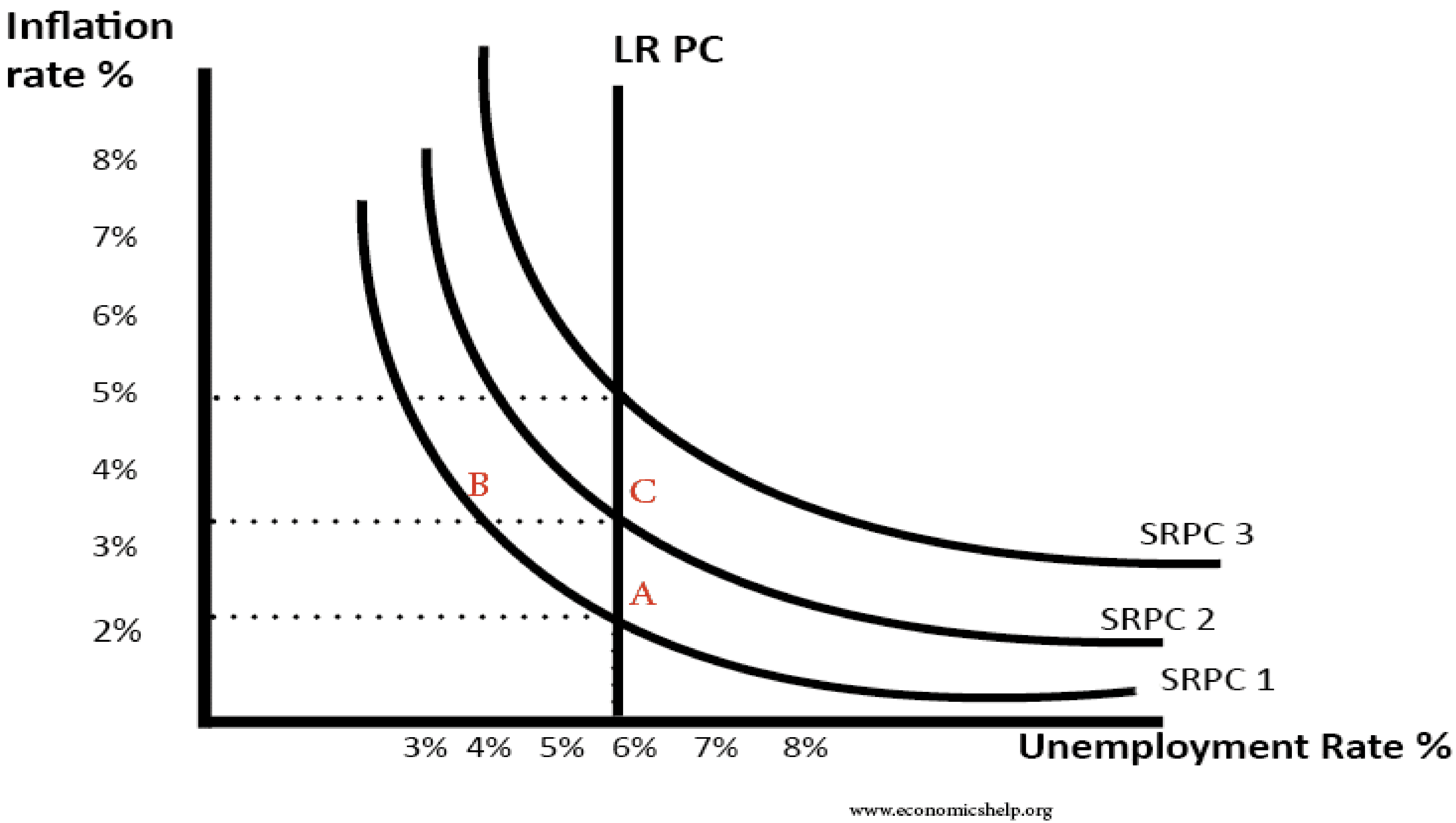
Factory gate prices, shipping rates, commodity prices and inflation expectations have all begun to subside from their recent record levels. These data series are widely watched by economists and policymakers as they provide an early indication of the trends that will shape the headline inflation calculation.

Financial Times, Nov 27, 2022

Obsolete Macro Thinking

- The Phillips Curve Conjecture
  - Samuelson-Solow, 1960
- Natural Rate or NAIRU
  - Phelps 1967, Friedman 1968
- The “Output Gap” Model
  - Supports stimulus policies
  - But undercuts large measures
  - Ignores permanent income hypothesis
  -

Phillips Curves...



These ideas not unchallenged...

Time to Ditch the NAIRU

James K. Galbraith

JOURNAL OF ECONOMIC PERSPECTIVES
VOL. 11, NO. 1, WINTER 1997
(pp. 93-108)

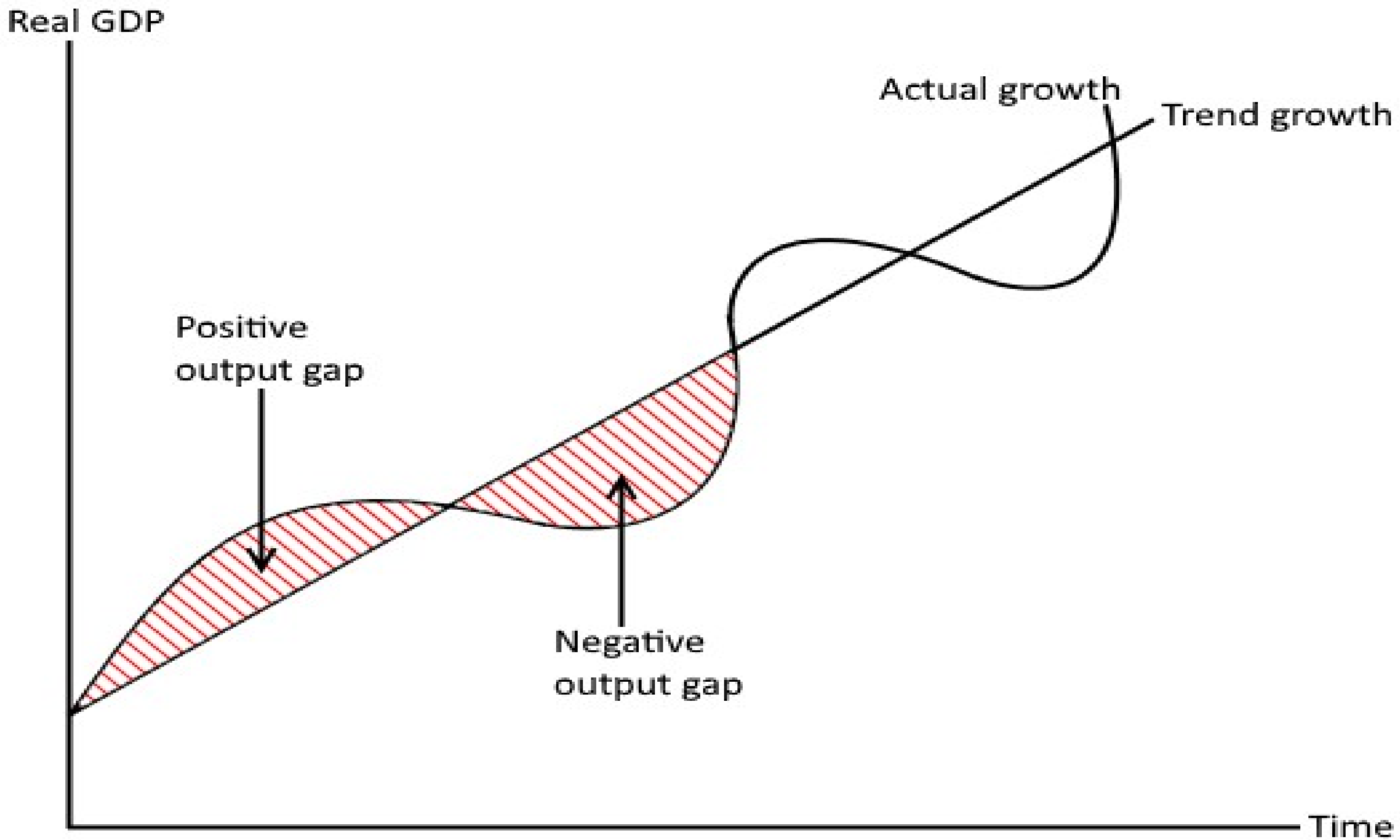
Should We Reject the Natural Rate Hypothesis?

Olivier Blanchard

JOURNAL OF ECONOMIC PERSPECTIVES
VOL. 32, NO. 1, WINTER 2018
(pp. 97-120)

(Better late than never, Olivier...)

Output Gaps...



Real GDP
Actual growth
Trend growth
Positive
output gap
Negative
output gap
Time

Inflation Targeting

- By whom? The Central Bank.
- Why?
  - Pain is always someone else's policy...
- At what level? Two percent...
  - Arbitrary, capricious, unfounded in law
- How?
  - Monetary Control or
  - Interest rates, plus “forward guidance”
    - An artifact of the congressional hearing process

Mea Culpa!

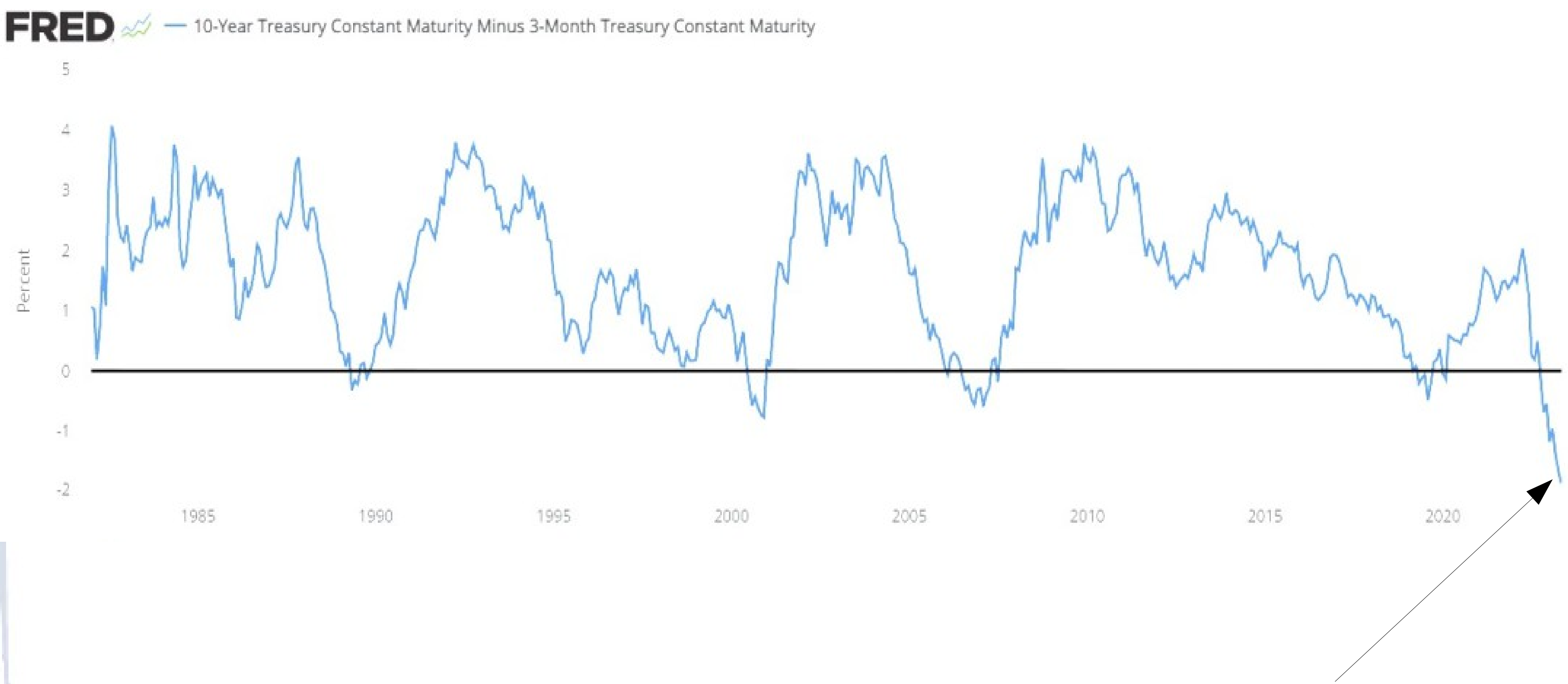
US Household Behavior under C-19

- The vast majority took the cash and tried to maintain their customary basic spending habits: rent, utilities, groceries, transport, schooling, etc.
  - This is not inflationary. The word is “survival.”
- The top tier saw their expenses on services curtailed, accumulated savings, and invested them in appliances, cars, real estate, stocks and other assets.
  - This is not inflation. The word is “boom.”

The Fed Waves Its Wand

- High interest rates hit construction, stocks, other asset prices.
- The yield curve went belly-up
  - An inverted yield curve reliably produces a slump eventually.
- The Fed is now stuck
  - Stay the course, drive off cliff, or...
  - Change the course, sink the dollar.

The Yield Curve...



Price Risks and Policy Needs

- Gross markup and profit-profit inflation
  - Obvious need for controls
- More energy shocks ahead?
  - Obvious need for an energy policy
- Pass-through of interest costs to prices.
  - Obvious need *not* to raise interest rates.
- Multipolarity
  - No obvious response available.

The Dollar and the FF rate

Oh, and the banking crisis

MARKETS

Regional bank stocks continue to slide on Thursday with PacWest leading the way down 54%

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In this article

PACW -2.79 (-43.44%)	FHN -5.04 (-33.46%)	WAL -10.51 (-35.54%)	ZION -2.64 (-11.65%)	KRE -2.00

Thank you.