



Popular Economics

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WHERE IS INFLATION?

Why should the Federal Reserve raise interest rates, anyway, with the latest unemployment report “disappointing”? Chairman Greenspan recently warned that the Fed might have to become more aggressive in tightening credit if inflation looked like a serious problem. “We cannot be certain that this benign environment (i.e., good growth with low inflation) will persist and that there are not more deep-seated forces emerging as a consequence of prolonged monetary accommodation,” he said in his July congressional testimony.

The Fed has been keeping interest rates low by printing lots of money (i.e., its monetary accommodation). Interest is the cost of money, after all, so only when it is scarce will its cost—hence interest rates—rise. And businesses like lots of cheap money. It keeps their borrowing costs down. Alas, but too much money in circulation also cheapens the value of our dollar, and in fact general inflation has become our way of life at least since the 1970s, when President Nixon abandoned the gold standard.

And does anyone remember that steaks at New York’s Delmonicos Restaurant were 10 cents during the Depression? Europe has become more expensive lately for Americans because the euro has risen more than 30 percent in value against the dollar. A cheaper dollar is also bad for our huge budget and balance of payments deficits, since it means foreign investors see a drop in the value of U.S. investments contra their own currencies!

So what causes inflation? Rising oil prices, for one, since so much of our economy is driven by oil. Or, there might be too much money in circulation for the amount of consumer goods produced. This could happen when more guns than butter are required that takes away resources and capital from the consumer sector, so that it cannot keep up with consumer demands for goods.

These are only examples of a very complex phenomenon. It is the Fed’s job, needless to say, to keep inflation under control, and one they have become very good at maintaining until now. The core rate of inflation (without fluctuating food and energy prices) has remained between 1 and 2 percent since 1995. But what is causing the current weakness in job formation?

The July jobless report damaged the stock market, but bonds rallied on the chance that this might be the last one-quarter percent rise before the Nov. 2 election. Much of the damage was in retail, as consumers cut back in spending (reported earlier in the Q2 Gross Domestic Product growth estimate), which caused stores to lay off 19,000 workers. CBS Marketwatch commented that hiring slowed in most industries with 49.5 percent of industries adding jobs, down from 60.1 percent in June.

This enabled the 30-year mortgage rate to fall to 5.50 percent, for a 1 pt. origination fee, and real estate sales to continue their record breaking pace. Condominiums have broken records as well, to no ones surprise. Their sales rose 15 percent above second quarter 2003, the previous record, to 996,000 annualized units. The nationwide condo median existing price rose 12 percent, to \$189,000.

Unemployment

July’s unemployment rate actually fell to 5.5 percent from 5.6 percent, even though private payrolls only added 32,000 jobs. How so? The Establishment Data survey queries employers’ payrolls, while the much smaller Household survey that includes the self-employed is used to calculate the actual unemployment rate. It added 629,000 to the employment rolls. But that is not considered very accurate by no less than the Federal Reserve, since one cannot track just how much a self-employed person earns, or what in fact

they do.

Labor Productivity

Greater worker efficiency is a two-edged sword. On the one hand, workers have to work longer and harder hours. And so their owner's profits increase. This has been the case in the current recovery; with 4 consecutive 20 percent quarterly profit increases for employers. There is always the promise that the greater workload will ultimately result in higher incomes. But when? Personal incomes for those 80 percent who are salaried have risen less than one percent since 2001, and one percent less than inflation in the past year, according to economist Irwin Kellner.

Personal Income

June real personal income (i.e., after inflation) fell 0.9 percent and real disposable income (after inflation and taxes) was unchanged, making June the weakest month since Sept 2001, according to CBS Marketwatch.

Professor Kellner says in a CBS Marketwatch column that the rise in oil prices will hurt us much more this time around, just because personal incomes and employment have not kept up with the recovery. That is to say, the economy may be in a "briar patch", instead of a "soft patch." This is while consumers are already stretched because of a record debt load amid rising healthcare costs.

Higher employment is the main engine of income growth, and it has not kept up because higher labor productivity means employers can produce more with fewer workers. And so we are still one million jobs shy of the employment peak set in 2001. It seems those jobs have disappeared in the new economy. Yet without additional jobs personal incomes cannot rise. It is a vicious circle, maintains Professor Kellner.

So why does this administration then continue to advocate more economic aid (read tax cuts) to employers and the wealthy, instead of wage-earners (who are 80 percent of our consumers) as well as the cash-strapped state and local governments who employ many of them? Consumers make up two-thirds of all economic activity, and like the proverbial mule, won't budge when the load is unbearable. More discussion on these issues next week.

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