First Trust
Monday Morning OUTLOOK

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Fed Being Tempted Into SIN

Narratives get more energy these days because of social media and cable TV, but they've always existed. Back in the 1970s, one narrative was that inflation was not caused by too much money creation by the Fed, as Milton Friedman argued. Instead, it was caused by OPEC or "inflation expectations." And politicians came up with a plan…it proved disastrous.

In October 1974, with inflation running at about 12% (no, not a typo), President Ford announced a plan to "Whip Inflation Now," which was supposed to reduce inflation, not by tightening monetary policy, but by changing consumers' habits. Consumers were encouraged to wear "WIN" buttons.

The good news was that this approach was a more free-market method than the government-enforced wage & price controls imposed under President Nixon. The bad news was that by ignoring monetary policy as the ultimate source of inflation it was destined to fail.

The theory behind the WIN campaign was that inflation was caused by consumers spending too much money, so reducing inflation required consumers to save more and spend less, by, for example, growing their own vegetables, car-pooling, and using less energy in their homes. The idea was that changing consumer spending habits would wrestle inflation under control.

It's easy to look back now and laugh at this absurd attempt to reduce inflation. Alan Greenspan, who worked for Ford in the White House, wrote in his book "The Age of Turbulence" that, at that time, he was thinking, "this is unbelievably stupid."

These days it appears the Fed has come full circle and is trying to create more inflation. We decided to give the campaign a name : Start Inflation Now. And maybe the Fed should print some SIN buttons.

That, in a nutshell is the policy proposal published by David Wilcox, a former influential research director at the Federal Reserve, and David Reifschneider, a former Fed economist and adviser to Treasury Secretary Janet Yellen (who backs the reappointment of Jerome Powell).

In particular, Wilcox and Reifschneider want the Fed to raise its 2.0% inflation target to 3.0%, which would let the central bank run a looser monetary policy. They believe this looser monetary policy would help create more jobs, reduce unemployment, and even reduce racial inequities.

We think consistently higher inflation is a bad idea. Printing more money is not a path to sustainable prosperity. Higher inflation would make business planning more difficult and reduce the "real" (inflation-adjusted) wages of workers, particularly those with the least bargaining power, including lower-income workers.

Nevertheless, we think a higher inflation target is being discussed internally at the Fed. What this means is that even though the Fed is talking about "tapering," it is highly likely to maintain a far easier monetary policy than what otherwise is warranted. Even if the Fed moves toward tapering its bond buying, short-term interest rates will still be near zero. The Fed is still going to be loose even when QE is done.

For now, the Fed still says it expects inflation at about 2.0% next year as well as in the years beyond. We think inflation will be higher than that next year and, if the Fed doesn't explicitly reject the idea of a new higher 3.0% target, may be higher for many years to come.

Money is a contract between government and the people. A stable currency is essential for a stable economy. With the M2 measure of money now 33% higher than it was in February 2020, total spending – prices plus real output -- will end up 33% higher. That doesn't mean a 33% increase in the CPI; after all productivity is growing. But this is more extra money than the US economy has absorbed since the 1970s. We may have more than one book written by advisors in DC today that echo what Alan Greenspan thought back in the 1970s.

Narratives work for political entities in the short-run, but often lead to disastrous outcomes over time. We will be watching the new SIN policy closely in the years ahead.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-23 / 9:00 am	Existing Home Sales – Jul	5.830 Mil	**5.860 Mil**	5.990 Mil	5.860 Mil
8-24 / 9:00 am	New Home Sales – Jul	0.699 Mil	**0.701 Mil**		0.676 Mil
8-25 / 7:30 am	Durable Goods – Jul	-0.2%	**-2.0%**		0.9%
7:30 am	Durable Goods (Ex-Trans) – Jul	+0.5%	**+0.5%**		+0.5%
8-26 / 7:30 am	Initial Claims – Aug 22	350K	**355K**		348K
7:30 am	Q2 GDP Preliminary Report	6.7%	**6.9%**		6.5%
7:30 am	Q2 GDP Chain Price Index	6.0%	**6.0%**		6.0%
8-27 / 7:30 am	Personal Income – Jul	+0.2%	**+0.2%**		+0.1%
7:30 am	Personal Spending – Jul	+0.4%	**+0.2%**		+1.0%
9:00 am	U. Mich Consumer Sentiment- Aug	70.9	**71.0**		70.2