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April 4, 2024

A New Quarter, Confusion and Optimism

In a perfect world or a perfect economy, what should the rate of inflation be?

A 1% rate would more or less mean that prices would rise at 1% a year.

Using the rule of 72, the interest rate divided into the number 72 indicates how many years it takes for an initial sum to double. A 2% inflation rate would result in a price doubling in 36 years.¹

A 3% rate would double in 24 years, and a 6% rate would double in 12 years which could make one think about 7% mortgages.¹

What rate of inflation is acceptable? At what point does the Federal Reserve think it is fulfilling its mandate for ‘stable prices’?

Former Fed Chairman Alan Greenspan is reported to have said that price stability is “that state in which expected changes in the general price level do not effectively alter business and household decisions”.²

In another article, he is quoted as saying, “I have emphasized the importance of reducing the rate of inflation to a level at which it no longer has economic significance--that is, one so low that people no longer feel the need to make any allowance for inflation in their decisions about purchasing real or financial assets.”³

In a paper published by the St. Louis Federal Reserve Bank in 2006, it was written that Chairman Greenspan's principle proposed that "maximum sustainable economic growth is achieved at zero inflation". It is also suggested that this was, in 2006, not the current conventional economic thinking.⁴

The counter-argument was that the economy's growth rate was governed by outside factors such as labor-force growth, technological advances, and increased manufacturing efficiency, all of which may be unaffected by monetary policy.⁴

Sebastian Mallaby, in his 2016 biography of Chairman Alan Greenspan, repeats famed economist Milton Friedman's quote that "Alan Greenspan's great achievement is to have demonstrated that it is possible to maintain stable prices."⁵

That achievement was, that during the 18 1/2 years of Greenspan's chairmanship, an average annual inflation rate of 2.4% had been maintained.⁵

Jerome Powell, the current Fed Chairman, wants to bring the currently reported 2.8% PCE inflation to 2% and is widely expected to remain stubbornly wedded to this less inflationary interest rate of 2% and won't lower the fed funds rate until he is confident that it will be achieved.

The 2% inflation figure that Chairman Powell and the FOMC is seeking, is according to a Brookings Institution article from 2015 by former Fed Chair Ben Bernanke, is one that is generally accepted as defining 'price stability'.⁶

Achieving stability now, may take less time than it has in the past, but the Fed's current 'dot plot' examination every 6 weeks, in my opinion, contributes to, rather than adds the desired decision-making transparency.

We may now, in my opinion, after the trials of the last 4 years, be in a position where there is enough stability and enough faith in the continued consistency of the Fed to encourage both individuals and businesses to plan for the future.

If so, the economy should continue to grow and individual companies to prosper.

Please call if you would like to discuss specific ones that may fit your investment objectives.

Sincerely,



James P Dretler
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1. Rule of 72: What it Is And How to Use It, Bankrate' <https://www.bankrate.com/investing/what-is-the-rule-of-72/#:~:text=The%20Rule%20is,...>
2. 'The Hutchins Center Explains: The framework for monetary policy', Michael Ng and David Wessel, January 4, 2018, <https://www.brookings.edu/articles/the-hutchins-center-explains-the-framework-for-monetary-policy/>
3. Peter T. Kilborn, Special To the New York Times, March 28, 1989, 'Greenspan Willing to Wait For Years for 'Zero' Inflation', <https://www.nytimes.com/1989/03/28/business/greenspan-willing-to-wait-for-years-for-zero-inflation.html>
4. Robert H. Rasche and Daniel L. Thornton, 'Greenspan's Unconventional View of the Long-Run Inflation/Output Trade-off', Economic Synopses, , research.stlouisfed.org , 2006. Number 1
5. Sebastian Mallaby, "The Man Who Knew: The Life and Times of Alan Greenspan", Oct. 11, 2016
6. <https://www.brookings.edu/blog/ben-bernanke/2015/04/15/monetary-policy-in-the-future/>

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