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Inflation and Growth

How much inflation is too much?

In our last letter we mentioned that former Fed Chair Alan Greenspan (1987-2006) thought that the Fed's goal of stability justified an inflation target of Zero percent.

He said that he thought the goal of Fed policy was to make the inflation rate of no consequence in investor's planning decisions, that is, to eliminate the higher anticipated future cost calculation that could result in an ever-increasing higher cost estimation that could create the wage--price spiral. The possibility of this was, in his opinion, so destructive, that he justified ignoring the then current view that technology and the growth of the labor force would offset moderate inflationary forces. [1]

He further justified this view through his real--life experience. His immediate predecessor as Federal Reserve Chair, Paul Volcker (1979-1987), took seven years and two recessions to reduce inflation from 11.3% to 3.6%. This was a scenario Mr. Greenspan didn't want to repeat. [2]

Under Mr. Greenspan's direction, inflation went from 3.6% in 1987 to 3.2% in 2006, although later, under Chair Bernanke, with the help of the 2008 financial crisis it went to a negative, –1.4 % in 2009. [2]

Although I don't think Chair Powell or anyone else wants to create a recession or crisis to solve the excesses of the current inflation, there also doesn't seem to be any need to stimulate the economy by lowering interest rates at this time.

I think that Mr. Powell's current actions show that with his 2% inflation target, he is less aggressive or fearful than Mr. Greenspan, but well aware that he has more work to do in unwinding the excesses caused by the low interest rates created to fight the crises of the Pandemic as well as the 2008 financial unpleasantness.

Enabling businesses to cope more easily with change is not in the official mandate of the Federal Reserve. Price stability is.

It is, however, also in their interest to monitor the many nuances within the economy to determine if current conditions are going to contribute to a situation where their actions might be required.

What is perhaps even more difficult is the Fed's mission to convince a skeptical or even cynical public that the Fed can accomplish the task of preventing the ever-higher prices that businesses and individuals will build into their future plans and thereby create the very inflation spiral that they fear.

Although Powell's job is difficult, like former Chair Greenspan, his steadfast willingness to delay stimulative interest rate cuts may take a long time to work.

If so, I think that the business community, and with it the economy, as well as the stock market will react positively.

It is up to us, to take advantage of this.

Sincerely,

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1. Robert H. Rasche and Daniel L. Thornton, 'Greenspan's Unconventional View of the Long-Run Inflation/Output Trade-off', Economic Synopses, Federal reserve Bank of St. Louis, 2006, Number 1, https://research.stlouisfed.org>publications>
2 Historical Inflation Rates: 1914-2024, C I US Inflation Calculator, https://www.usinflationcalculator.com>inflation>historical>inflation>rates

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