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SL: Jerome Powell Can’t Explain Inflation – Here’s Why

Dear Fellow Expat:

What does the Federal Reserve do?

That’s a basic question we must understand.

The central bank has two jobs as its so-called “dual mandate”: to pursue maximum U.S. employment and ensure price stability.

Ignore maximum employment for now. Today’s unemployment rate is cooked worse than your least favorite aunt’s Thanksgiving dinner. The official U.S. unemployment rate is 3.5%.

Why: Because a low number makes stupid politicians look good.

Real unemployment is *much, much* higher. How could it be that low when roughly 38% of the adult population is *out* of the workforce?

The official number doesn’t count people who take government assistance, or people who aren’t actively looking for work. There are other ways to cook the books and make the figure look lower. In addition, the government has incentivized many people not to work.

I could go on and on, but let’s focus on “price stability.”

That’s the real issue today: Tackling inflation in the economy.

The Fed’s goal is to “target” 2% inflation.

As I noted yesterday, Nobel Prize-winning economists are asking the Fed to declare victory and accept a 50% hike on the inflation target to a rate of 3%.

But let’s take a step back here and ask Powell to explain the 2% target…

This Is Pretty Embarrassing

At its core, the Fed *wants* inflation, but it doesn't want inflation to run "hotly" as it has for the last two years.

The official stance of the Fed is that 2% inflation target.

Why 2%?

Sen. Marie Cortez Masto (D-AZ) asked Jerome Powell this in March.

The following is a transcript from the conversation between the Senator and Powell, the leader of the most powerful central bank on the planet.

Let's go to the tape.

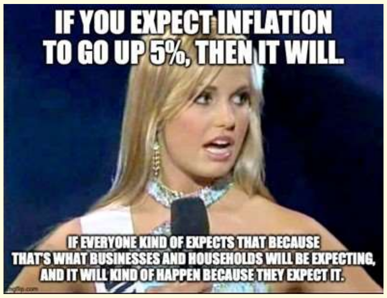
This is verbatim, **and the emphasis is mine.**

Masto: For the general public – for those working families. Why 2? Why is getting [inflation] to 2% so important?

Powell: Ummmmm… so that has become the globally agreed – essentially all major central banks target 2% inflation in one form or another… Ummmm… And um…

Masto: How does that help my Nevada families?

Powell: I'll tell you how it does. And it's um… I guess it's obviously not – it's not obvious how that is. But – what it -- 2% inflation. To have people believe that inflation's gonna go back to 2% really anchors inflation there. Because the evidence is, and the modern belief is, that people's expectations about inflation actually have a real effect on inflation. If you expect inflation to go up 5%, then it will. **If everyone kind of expects that because that's what businesses and households will be expecting, and it will kind of happen because they expect it.**



Now… I'm going to take a breath here… because "wow." Powell channels his inner 2007 Miss Teen South Carolina and her "maps."

This isn't a nervous teenager answering a geopolitical question in front of millions.

This is the head of the most important central bank in the world… explaining to Congress how the central bank is supposed to operate.

Most videos cut Powell off at that point on Twitter (or X)… but Powell does get around the point.

Here's the rest… *unpause.*

Powell: *Having a 2% inflation goal, which we had for many years, de facto, and we formally adopted it in 2012.* But for years before that, we were effectively targeting 2% inflation, which meant that one of the reasons inflation was low and predictable is having a real target and sticking to it, not changing it at convenient moments. So, we think it's really important that we do stick to a 2% inflation target and not consider changing it. We're not going to do that. People will be better off if the whole question of high inflation is not just part of their lives. That's kind of the definition of price stability. It's that people get to live their lives without thinking about inflation all the time.

Okay – that doesn't add up to price stability?

Does it?

Powell does a terrible job explaining, "Why 2%?"

So, Here's Why 2%

We have inept economists like Paul Krugman and economically inept writers saying that the target is too low.

But it doesn't change the fact that central bankers fear *de*flation more than *in*flation. Deflation is where prices move lower in the future than the price today.

In an era of technological acceleration in the 1990s, concerns emerged that deflation was the bigger threat. E-commerce and the first iteration of the Internet stood as major economic disruptors.

In a December 2021 article titled "**How I Learned to Stop Worrying and Love Deflation,**" I explained the origins of this policy through the research of Yale economist Robert Shiller.

Shiller has written extensively about the deflationary impact of technology. In a 2003 *Wall Street Journal* column, he worried that deflationary technology could cause "revenge effects" in an economy. He was especially concerned that there would be a "cascade of consequences from recent advances of information technology like the World Wide Web, which became available to the public in 1994."

That article was years before Google emerged as a public company.

I note Shiller's research in the article:

In a 2017 essay called "The Illusions Driving Up U.S. Asset Prices," [Robert] Shiller tackles the origins of monetary policy that result in the consequences Booth described. Like other central banks, Shiller notes that the Fed has been debasing its currency.

A Google search by Shiller indicated that "inflation-targeting" started appearing more often in the 1990s. He says the pursuit of positive inflation— or price stability—began after the 1991 recession. He also cited [economist] Larry Summers, who said Americans would display "irrational" resistance to falling nominal wages if the Fed targeted a "zero-inflation regime."

Summers appeared to have worried that if deflation hit the U.S. – it would – in theory – drive down the nominal cost of housing and nominal wages. Housing is the place where most Americans have their nest egg.

And wages are a person's time – their career.

Why would he call it "irrational?"

Well, even though *everything else* might come down in price… and the purchasing power might improve, economists in the 1990s argued that Americans would not accept the *nominal* increases in wages and other assets like housing.

So, for example, your house was worth $200,000, but now the nominal value is $190,000… but the cost of everything else in your life has gone down: Like food, technology, and much more.

Do people stop eating because of deflation? No.

Do people stop driving because of deflation? No.

Do people stop buying homes because of deflation or paying rent?

Of course not.

The things that matter go down.

There's another side to this as well. The debt-based system that keeps Americans drowning in mortgage, auto, and other costs… all that debt requires *more* debt to pay it off. The Keynesian argument is to inflate away previous debt, all while ignoring that the price of debt in the future will only increase – and everything else that matters for our existence.

Perhaps they would understand these lessons if we taught people economics early in life.

But they don't… either because of choice or because we don't offer everyone the opportunities.

And given the fact that most economics courses in college were always taught before 9 AM…

I assume they were intentionally trying to keep everything we really should know – about what they're doing – a secret.

In Conclusion

In the 1990s, the Fed began its process. And so did other central banks around the world. Combine that with loose mortgage standards, fiscal expansion, the rise of institutional asset ownership, and the rise of the EPA in the 1990s…

And we ended up embracing inflation – an embrace that's lasted 30 years and helped propel housing prices to their least affordable levels… ever.

So, in theory – to answer the Senator's question…

How does it help her Nevada families?

To be honest… *the 2% target doesn't.*

It just means the lower the target is, the less the central bank is stealing from Americans and devaluing their life's work.

That's all he should have said…

Instead, we got a word salad…

Stay positive,

Garrett Baldwin