Inflation And Employment

Sam Rayburn, the longtime Speaker of the House and, if I may editorialize someone whose common sense and political skills we could use today, was a font of pithy quotes. Consider this one:

> *"Son, always tell the truth. Then you'll never have to remember what you said the last time."*

I bring this up in regards to the nonstop campaign by the Federal Reserve to convince us of the dangers of deflation. It is somewhere, we are told, all you have to do is ignore all of those rising prices, inflated asset valuations, declining dollar exchange rates, taxes being imposed on American money being invested abroad and other indicators we shall choose to ignore at our convenience.

What, we should listen to the Federal Reserve's malarkey after they have been consistently wrong for almost a century? Hardly; I return with what Speaker Rayburn said to his protégé Lyndon Johnson with respect to the "best and brightest" crowd surrounding John Kennedy:

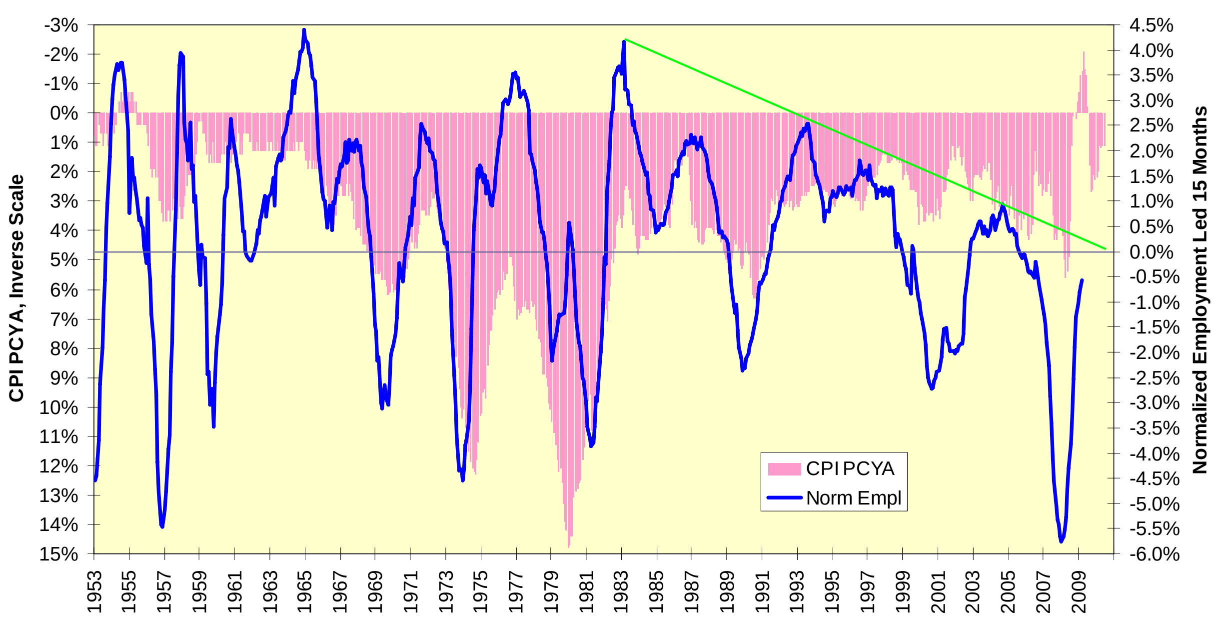
> *"They may be just as intelligent as you say. But I'd feel a helluva lot better if just one of them had ever run for sheriff."*

No Good Comes From Inflation

Messrs. Bernanke, Dudley and the rest of the crew are now trying razzle-dazzle us into believing they can solve the nation's employment miasma by creating more inflation and then, and at just the right time, they can withdraw a few trillion dollars from the system easily and painlessly before inflation gets out of control. Never mind this draws upon the never-once-right Phillips curve, the purported tradeoff between inflation and employment, or that this sort of braggadocio has led to premature tooth-loss at billiards parlors, but consider the sheer effrontery of just how incorrect the statement is.

Let's return to a concept displayed here on the employment issue and revisited soon thereafter in relation to non-residential fixed investment, the year-over-year change in employment growth normalized to the growth in the labor force itself. That concept has been declining in a series of lower highs since the early 1980s, as emphasized with the green trendline.

Decreasing Inflation Leads Changes In Normalized Employment



If we overlay the year-over-year changes in the Consumer Price index, plotted inversely, we find decreases in the CPI lead increases in normalized employment growth by fifteen months on average. Increases in the CPI lead decreases in normalized employment growth.

The data are unequivocal: Each increase in inflation, such as occurred during the 1970s, 1988-1989, 1999-2000 and 2004-2008 was followed five quarters later by a decrease in normalized employment growth. This is explicable by noting employees seek protection from inflation by higher compensation, and higher compensation leads to lower operating margins. Lower inflation makes employees more accepting of lower wage claims and therefore increases the demand for labor vis-à-vis other factors of production.

This is not a particularly difficult concept, is it?