Inflation, Employment And I Told You So

The Failure To Create Jobs By Printing Money Was Predictable

I am forever telling people no one likes to hear, "I told you so." But please consider this passage from October 2010's Fed Is Wrong in Thinking Inflation Will Solve Unemployment:

> *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.*

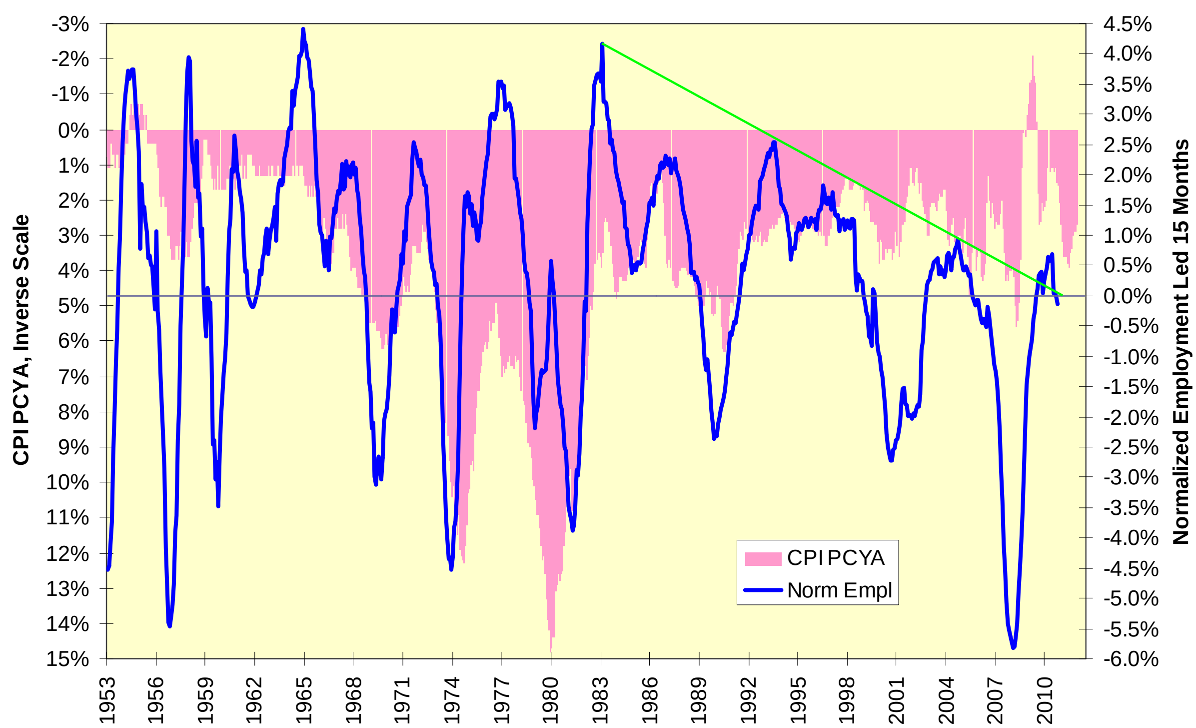
That was written during the happy, carefree days between Ben Bernanke's Jackson Hole speech and the actual execution of QE2 in November 2010. The dovish faction on the FOMC, including Bernanke, Janet Yellen, Bill Dudley and John Williams along with my hometown hero Charles Evans riding the pines as a non-voting member this year believe in the Phillips Curve tradeoff between inflation and unemployment with a quasi-religious fervor. Evans in particular has advocated monetary expansion until unemployment drops below or inflation rises above key target levels; longtime observers understand the follies involved here. Not only are these economic reports subject to revision, but the Federal Reserve's own history is one of moving the goalposts to get in the way of the kick.

Wrong-Way Corrigan Would Be Proud

The worst part about claiming higher inflation will lead to lower unemployment is my six decades of data showing the exact opposite. The relationship is unequivocal: Decreasing inflation, plotted inversely below, leads increases is normalized employment growth or changes in nonfarm payrolls adjusted for changes in the non-institutionalized civilian population, by five calendar quarters. The increase in the CPI starting in January 2011 has led to a decline in normalized employment growth right on schedule.

Even more depressing is the secular downtrend in this normalized employment growth measure going back to November 1983. I have highlighted this downtrend line because this is an investing Website and who amongst us does not enjoy a good trendline every now and then?

Decreasing Inflation Leads Changes In Normalized Employment



I mentioned yesterday how the Federal Reserve's manipulation of the yield curve was discouraging investment and raising the cost of doing business. That lower level of investment translates into lower employment growth just as higher inflation erodes the value of existing assets. If there is a reason to continue the absurd policy of thinking near-0% interest rates are stimulative, or a reason other than it reduces the costs of servicing the federal debt, I have yet to see it demonstrated. We have been near 0% for three and one-half years and have engaged in two rounds of direct money-printing along with a few indirect rounds involving international central bank coordination.

We are past Einstein's definition of insanity, of doing the same thing over and over and expecting different results. Perhaps it is time to try something else before all of the major financial players ranging downward from J.P. Morgan Chase (JPM) and Bank of America (BAC) and all of the major consumer-related issues ranging downward from Wal-Mart (WMT) and Costco (COST) start withering on the vine.