

## The Politics of Inflation



There's a huge problem in the world that no one is talking about:

We are living in a golden age of capitalism yet our political leaders know next to nothing about economics and finance!

In my mind, this has to be among the top 2 or 3 issues in the world right now. Right up there with climate change may-be. I say this because the risk of economic mismanagement threatens not only our standard of living but, ultimately, our way of life. In the annals of history, nothing much good follows from bad economics.

As inflation has become a bigger and bigger problem throughout the year, the profound degree of financial ignorance from our political class has been on full display. Consider for a second these gems of insight from our Nation's top leader:





With all due respect to the President, neither of these “policy” statements make any sense. For example, what exactly does “Lower everyday costs for Americans” actually mean? Yeah, we’d all love for that to happen but is there an actual policy here or have we devolved to just relying on magical thinking?



This [clip](#) of Vice President Harris is as stunning as it is cringeworthy. You can just tell from the beginning of her answer that she doesn’t have the slightest clue how to answer the question.

Similarly, Fed Chairman Powell, who spent all of last year telling us not to worry about inflation because it’s just “transitory” finally reluctantly admitted last month at an ECB policy meeting that: “We understand better how little we understand about inflation.” Right... This reminds me of that time when Secretary of Defense Rumsfeld responded to the mounting questions about the lack of weapons of mass destruction in Iraq with: “Reports that say that something hasn’t happened are always interesting to me, because as we know, there are known knowns; there are things we know we know. We also know there are known unknowns; that

is to say we know there are some things we do not know.” In other words, “I have no idea how to answer the question about WMD’s so let me just say something.” This is exactly what Powell did with his recent statement.

Lest you think I’m being too unfair to the Democrats, Republican leaders from Trump and McConnell on down are posting equally magical and non-sensical statements about how “if only they were in charge, inflation wouldn’t be a problem.” Again, right... They are, of course, completely ignoring the inconvenient truth that the seeds of this inflationary crisis go back to policies they once championed. It wasn’t that long ago when Trump was running massive tax-cut funded fiscal deficits, trash talking Powell for trying to normalize interest rates back in 2018 and celebrating the CARES Act, an unprecedented fiscal stimulus package. History sure has a sense of irony, doesn’t it? It was Trump that signed the trial balloon for Universal Basic Income, the stuff of Bernie’s dreams.

Anyway, one of the reasons I started writing this newsletter is that I felt like there was this big problem in the world—i.e. a lack of understanding of the truth of economics and finance and their relation to politics, history and culture—and I thought maybe with my writing I could at least attempt to make a positive difference. Many years ago, when I was a much younger man, I became convinced that to be an effective leader in our modern age, one simply had to understand economics and finance at the highest level. I think this is a consequence of coming of age at a time of extreme economic turbulence. I graduated college shortly after the tech bubble burst, was a month into my first job as a stock broker when 9/11 happened and was only a few years out of law school when our financial system almost completely collapsed. I watched as our leaders, on both sides of the aisle, stumbled through these crises, with hardly any coherence. I’ve always been inclined to believe in taking responsibility and vowed to myself that if someday I were given the chance to be such a leader I would at least be prepared.

These days, I find myself even more convinced of the paramount importance of financial understanding for modern life and find myself disheartened not only by the political dialogue but also the inane policy responses offered by our leaders. The economic and financial acumen problem is manifesting today at every level of government. We’ve already seen how bad things look at the Federal level. Well, I’m sad to report that things aren’t much better down in the states and cities either.

The states are busy leaning into what looks like an irreversible bias towards direct payments to households as the appropriate policy response. California is spending \$18B of its massive and unexpected \$49B budget surplus on inflation relief payments.

## \$18.1 BILLION INFLATION RELIEF PACKAGE

- ✓ \$11.5 BILLION FOR TAX REFUNDS TO HELP ADDRESS INFLATION
- ✓ \$2.7 BILLION FOR EMERGENCY RENTAL ASSISTANCE
- ✓ \$1.4 BILLION TO HELP CALIFORNIANS PAY UTILITY BILLS
- ✓ \$933 MILLION FOR HOSPITAL AND NURSING HOME STAFF
- ✓ \$750 MILLION FOR FREE PUBLIC TRANSIT
- ✓ \$304 MILLION TO MAKE HEALTH COVERAGE MORE AFFORDABLE FOR FAMILIES
- ✓ \$439 MILLION TO PAUSE THE DIESEL SALES TAX
- ✓ \$157 MILLION TO WAIVE CHILD CARE FEES FOR LOW-INCOME FAMILIES

THE CALIFORNIA BLUEPRINT

While this might help California families in the short-run, it most certainly is not going to help solve the inflation problem. If anything, it'll make things worse as there will be \$18B more chasing the same goods and services already under pressure. Other states are jumping into the fray as well. There are serious proposals under consideration in both Massachusetts and Indiana already and I expect we'll see more of this if inflation continues to be a problem.

The cities have less money to spend and fewer levers to pull but they are trying to do their part as well. Here in Los Angeles, they are holding on for dear life to some very renter friendly "emergency" policies introduced during COVID. We're talking about things like renters being able to self-certify that they are impacted by COVID and thus don't have to pay rent, preventing property owners from pursuing evictions based upon the non-payment of rent and not allowing for any annual rent increases whatsoever, despite their being rent control laws on the books already that allow for them. These feel pretty unconstitutional to me, especially when unemployment is at 3.6%. Cities like Los Angeles have been committing and re-committing to rent control as a solution to inflation since the end of the last big inflation scare in the 1970s. And yet despite the decades of evidence they have demonstrating clearly that rent control doesn't really work, they keep doubling down. We are definitely going to see more of this.

Right now, sadly, the Fed is the only governmental power doing anything that makes sense. But they waited so long to start raising rates that now their only real chance at stopping inflation is to drive the economy into recession. Good job everyone...

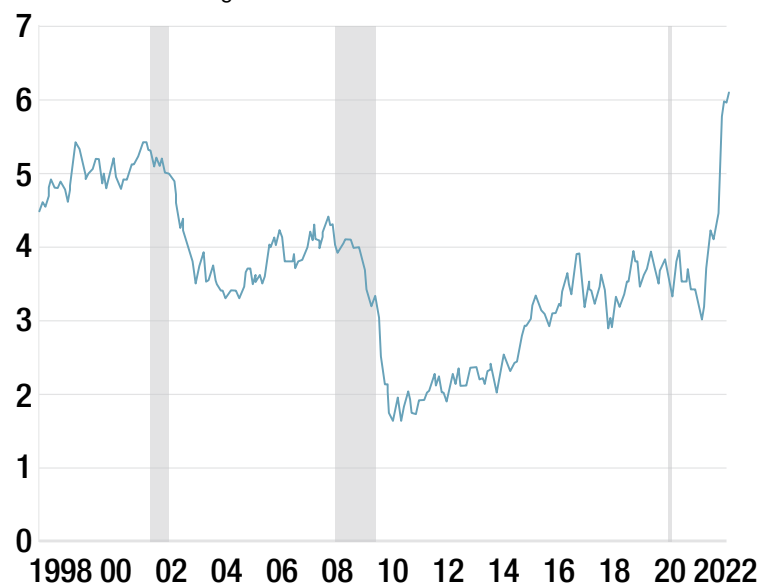
What's really frustrating about this situation is that a country like America actually has some legitimate policy options. We have a dynamic economy, a strong labor market, the ability to borrow at will, reserve currency status, abundant natural resources, the world's strongest military.... In no way are we not backed into a corner like a Sri Lanka or a Germany. If only our leaders had a clue. Take for example, the oil situation. America is sitting on an incredible strategic opportunity. With the improvements we've seen in shale oil production, America could basically crush energy inflation—which, by the way, makes up something like 40% of the growth in CPI this year—and probably even bring Russia and OPEC to its knees. All we would have to do is incentivize oil producers to ramp up production. Instead, we're content to pass more and more rules and regulations and make it harder and harder to produce oil. Now, there are some good reasons for not wanting to go super long on carbon-based energy—i.e. climate change—but how about a short-term, deliberately strategic policy coupled with some aggressive carbon offset investments? It's not the complicated, right?

Our leaders have bungled the policy response so much that now they find themselves in a rather awkward political position. You see, we've reached a stage in the inflation cycle where wages are actually going up! What politician will argue that this is a bad thing? Unfortunately, it's too little, too late for American workers. First of all, wages aren't going-up by enough to offset the damage from inflation.

### Wage Growth Tracker

three-month moving average of median wage growth, hourly data

— Overall unweighted

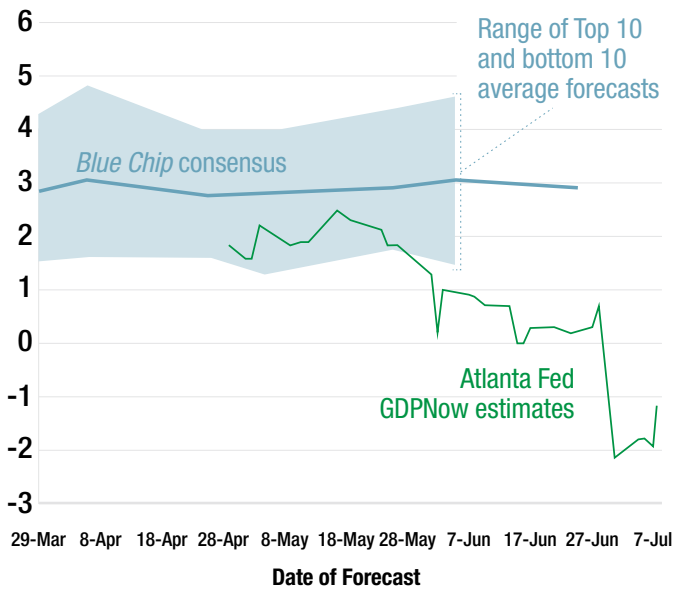


Sources: Current Populations Survey, Bureau of Labor Statistics

And secondly, the Fed is busy tightening financial conditions so fast they are driving the economy off a cliff.

## Evolution of Atlanta Fed GDPNow real GDP estimate for 2022: Q2

Quarterly percentage change



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts  
 Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip Survey.

Ironically...sadly, of all the possible manifestations of inflation the Fed is most afraid of wage inflation. Why? Well, what we've learned from previous inflationary periods is that ultimately it comes down to a matter of the mass psychology of inflation expectations. It works like this: once workers start demanding and actually achieving wage increases, it introduces the possibility for a self-fulfilling inflationary spiral. Prices go up so workers demand higher wages so companies start raising prices again to preserve their margins, so workers demand higher wages and on and on... I'm convinced that this is what the Fed is worried about right now and why they are willing to risk a recession to stop it. Of course, no one is ever going to say this out loud. Could you imagine President Biden saying "we've got to get these wages down!"? Well, actually, on second thought, I kind of can but that's another story altogether. □