

Inflation Distractions

It's hard to keep track of all the theories about inflation. Remember policymakers and analysts blaming the surge in inflation in 2021-22 on supply-chain disruptions, too much government spending, and Putin invading Ukraine? Now some are saying that tariffs and deportations are going to cause a second surge in inflation.

The problem with all these theories is that they ignore the ultimate cause of inflation, which is too much money chasing too few goods. Why did inflation surge in 2020-21? Because in the 25 months ending in March 2022 the M2 measure of the money supply rose an unprecedented 40.6%. That's why!

We're not saying supply-chain disruptions were meaningless. If businesses couldn't get a hold of the inputs they needed to make a product then of course the price for that particular item went up. But if consumers had to pay more for that item then that meant less money left over to buy other items – and roughly zero net change to inflation – unless the Federal Reserve changed the growth rate of the money supply, which is exactly what happened.

The same goes for the link between more government spending and inflation. Yes, without that spending some of the extra inflation might not have happened, but the spending itself wasn't the key behind higher inflation: the key factor was that the Fed accommodated politicians' desire for more spending by letting the money supply rip.

But now there are new theories to contend with, like the oncoming Trump tariffs or deportations of illegal immigrants causing a resurgence in inflation. There is plenty of room to argue about the merits of these

policies on other grounds, but general price inflation is not one of them. President Trump raised tariffs and reduced immigration back in his first term, and CPI inflation averaged 1.9% annualized.

Yes, tariffs on certain goods will put upward pressure on prices for those particular goods. But unless the Fed starts increasing the money supply faster, that will mean countervailing downward pressure on prices for other goods and services.

The argument that low immigration (or even negative immigration) would boost inflation is even worse. Advocates of high immigration have always argued that newcomers don't take jobs away from natives or reduce their wages because immigrants bring not only labor supply but also labor demand. Fair enough. But if that's true, shouldn't deportations reduce not only supply but demand, as well?

Immigration has surged since early 2021 and yet inflation has averaged 5.0% per year, the most in decades. If we can have high immigration and high inflation, we think the Fed can get to low inflation with low immigration, as well.

None of this is to argue that inflation hasn't been a problem or won't continue to be a problem in the years ahead. We think the bipartisan low inflation consensus that prevailed prior to the Great Recession and Financial Crisis of 2008-09 is dead and expect inflation will average 2.5% or more in the decade to come. But that's because we think the Fed will conduct a looser monetary policy, not because of tariffs, government spending, deportations, supply-chains, or Putin.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-2 / 9:00 am	ISM Index – Nov	47.5	47.6	48.4	46.5
9:00 am	Construction Spending – Oct	+0.2%	+0.5%	+0.4%	+0.1%
12-3 / <i>afternoon</i>	Total Car/Truck Sales – Nov	16.0 Mil	15.9 Mil		16.0 Mil
<i>afternoon</i>	Domestic Car/Truck Sales – Nov	12.4 Mil	12.3 Mil		12.4 Mil
12-4 / 9:00 am	ISM Non Mfg Index – Nov	55.6	55.6		56.0
9:00 am	Factory Orders – Oct	+0.4%	+0.4%		-0.5%
12-5 / 7:30 am	Initial Claims – Nov 30	215K	215K		213K
7:30 am	Int'l Trade Balance – Oct	-\$74.9 Bil	-\$75.2 Bil		-\$84.4 Bil
12-6 / 7:30 am	Non-Farm Payrolls – Nov	200K	215K		12K
7:30 am	Private Payrolls – Nov	200K	205K		-28K
7:30 am	Manufacturing Payrolls – Nov	30K	20K		-46K
7:30 am	Unemployment Rate – Nov	4.1%	4.2%		4.1%
7:30 am	Average Hourly Earnings – Nov	+0.3%	+0.3%		+0.4%
7:30 am	Average Weekly Hours – Nov	34.3	34.3		34.3
2:00 pm	Consumer Credit – Oct	\$10.0 Bil	\$9.2 Bil		\$6.0 Bil