

INFLATION



US Economic Update

Provisors Walnut Creek 3

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NEED
April 12, 2023



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Outline

- Economic Indicators
- Inflation/Federal Reserve/Banks
- The Debt Ceiling

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Economic Indicators



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Headline (9 months ago...):

G.D.P. Report Shows a Drop, Fanning Fears of a U.S. Recession

- A key measure of economic output fell for the second straight quarter, raising fears that the United States could be entering a recession.
- Gross domestic product, adjusted for inflation, fell 0.2 percent in the second quarter, the equivalent of a 0.9 percent annual rate of decline. Follow updates.



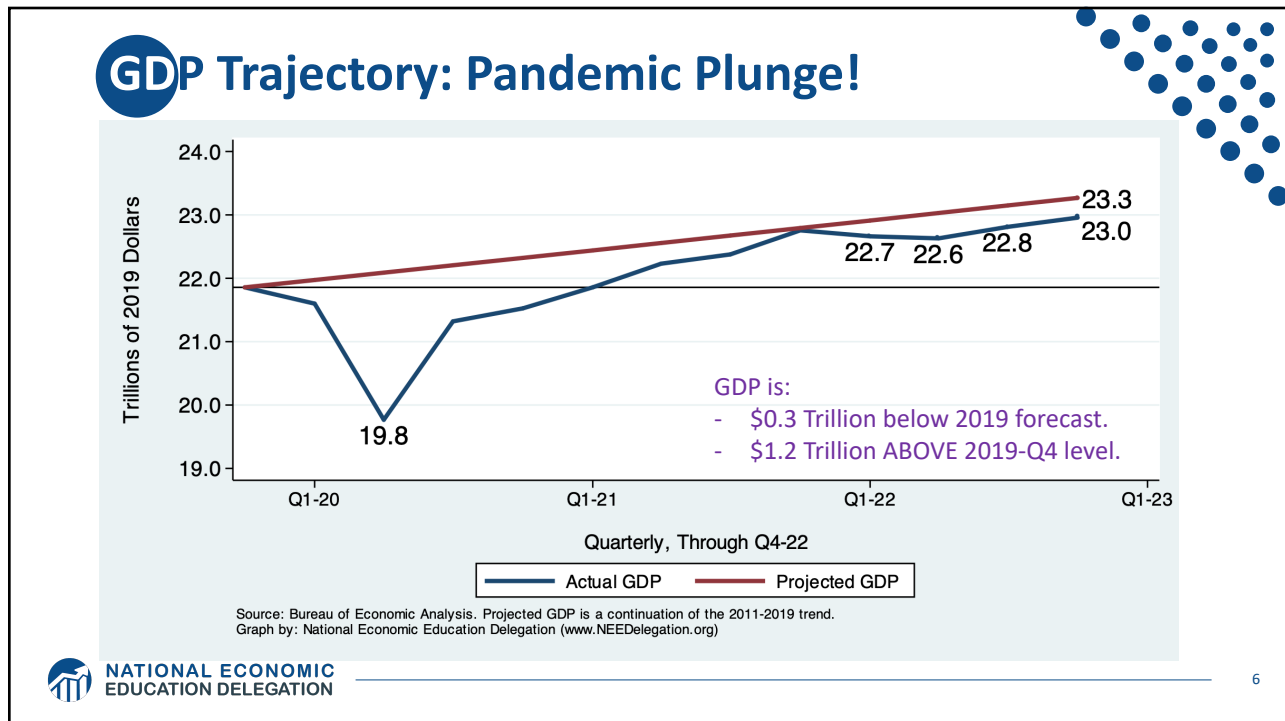
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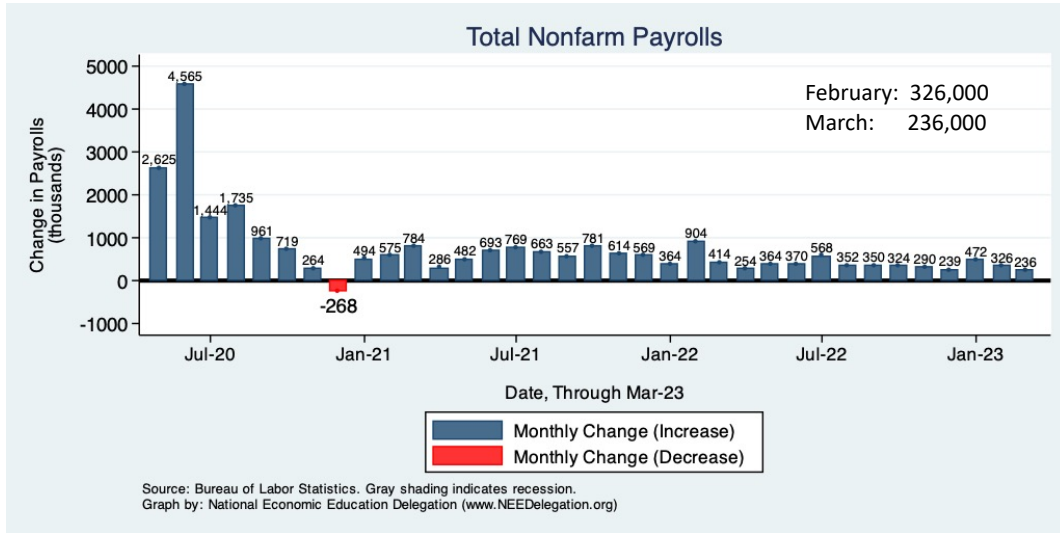


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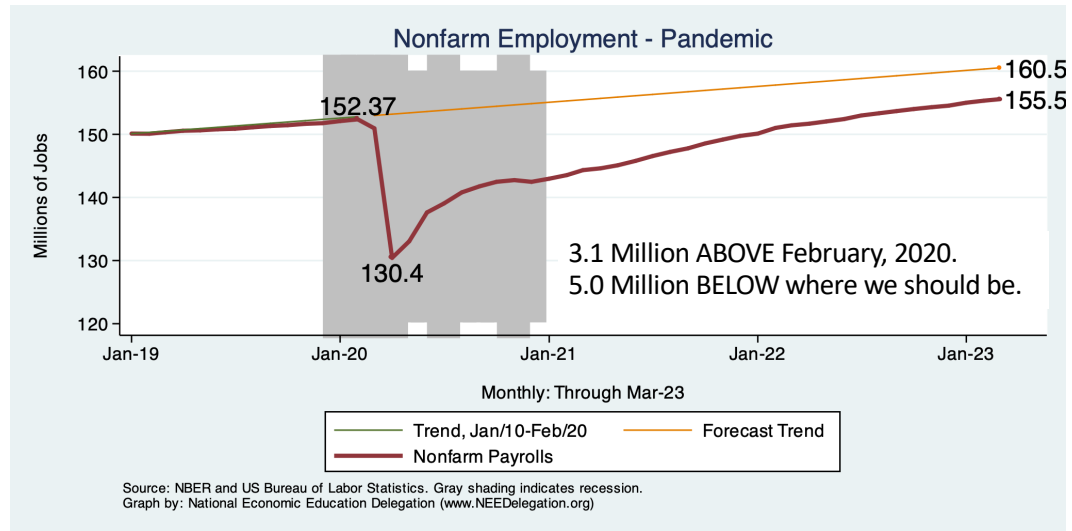
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Monthly Changes in Nonfarm Employment



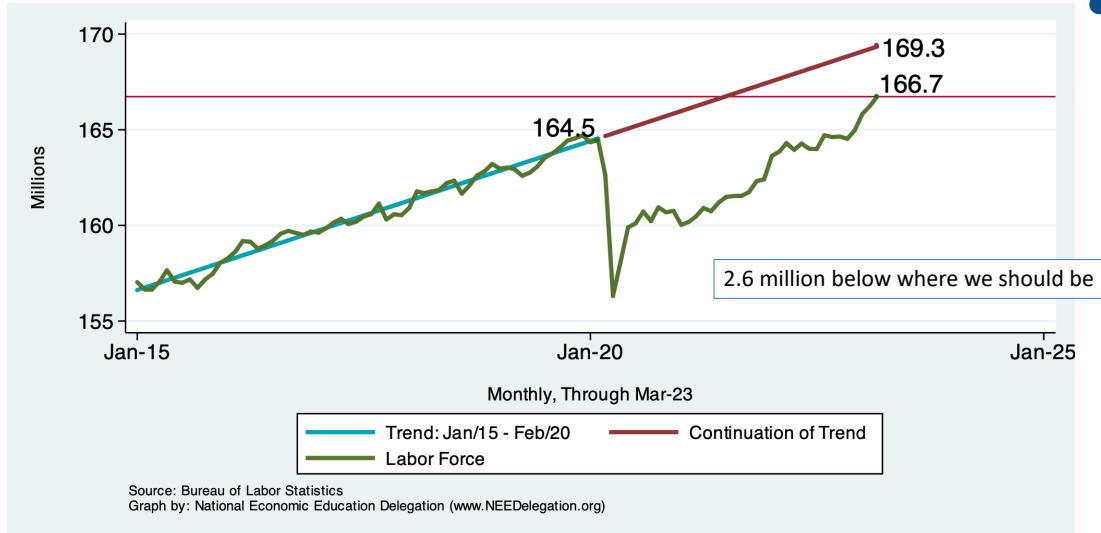
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Employment Gap

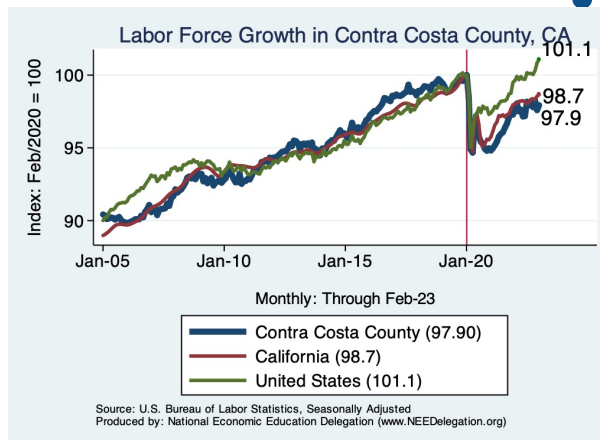
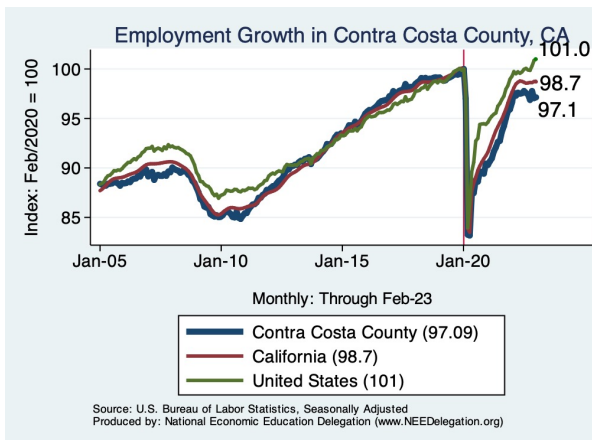


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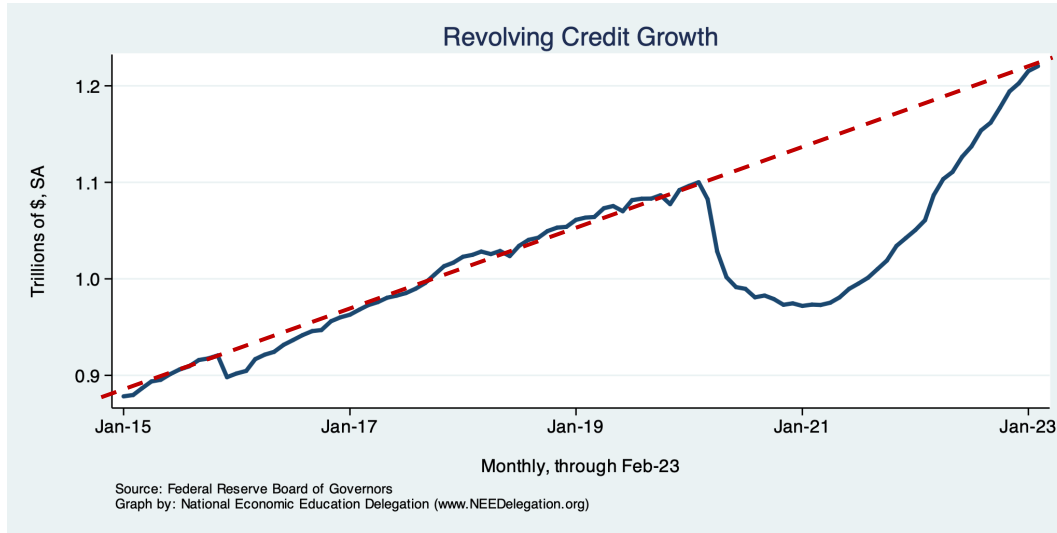
Where Have All the Workers Gone?



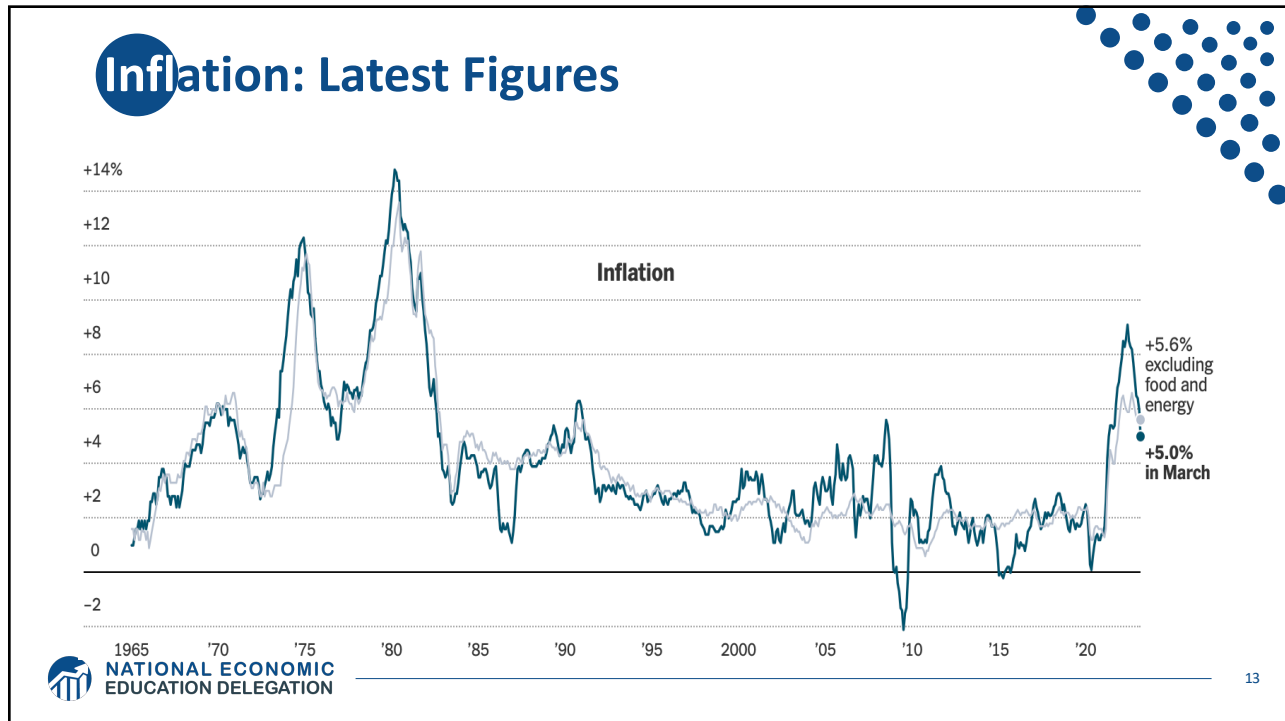
Employment in Contra Costa County?



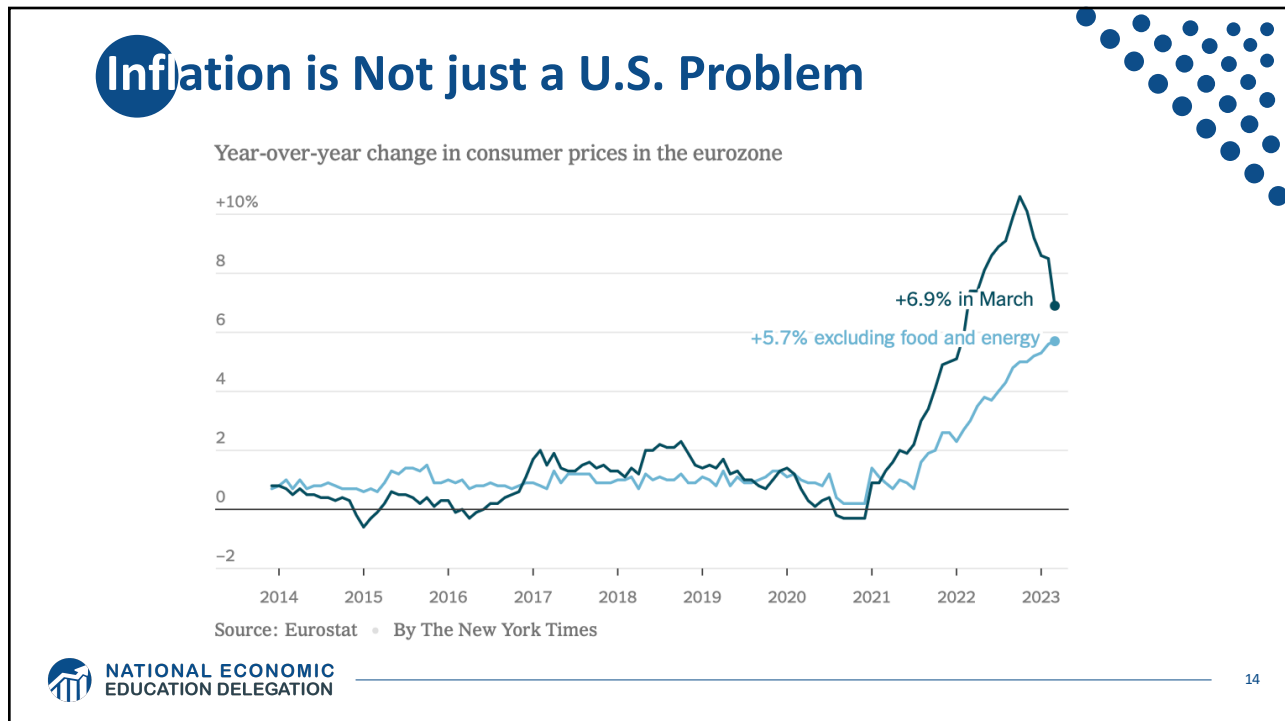
Borrowing on Credit Has Recovered



Inflation

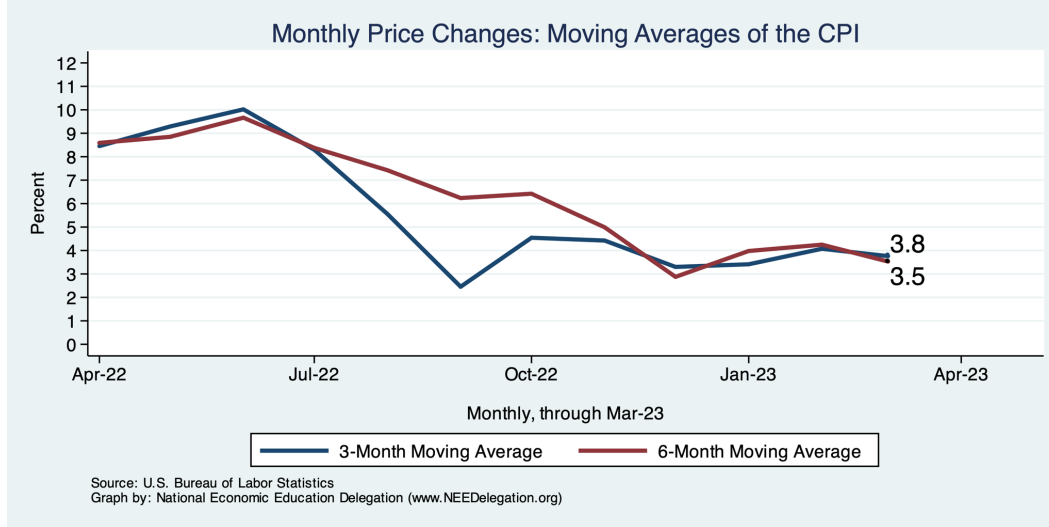


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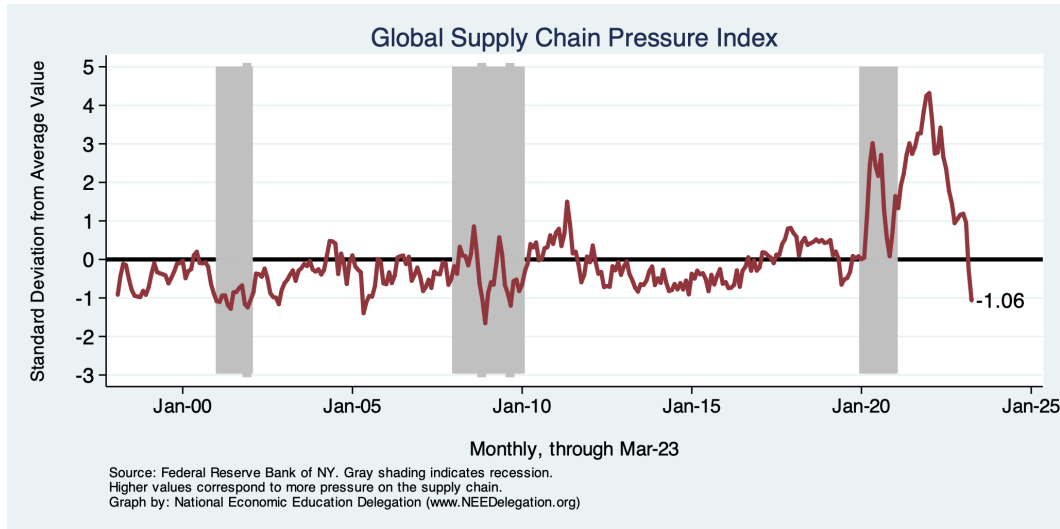
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Inflation in the Last 6 Months – Closer to 4%!



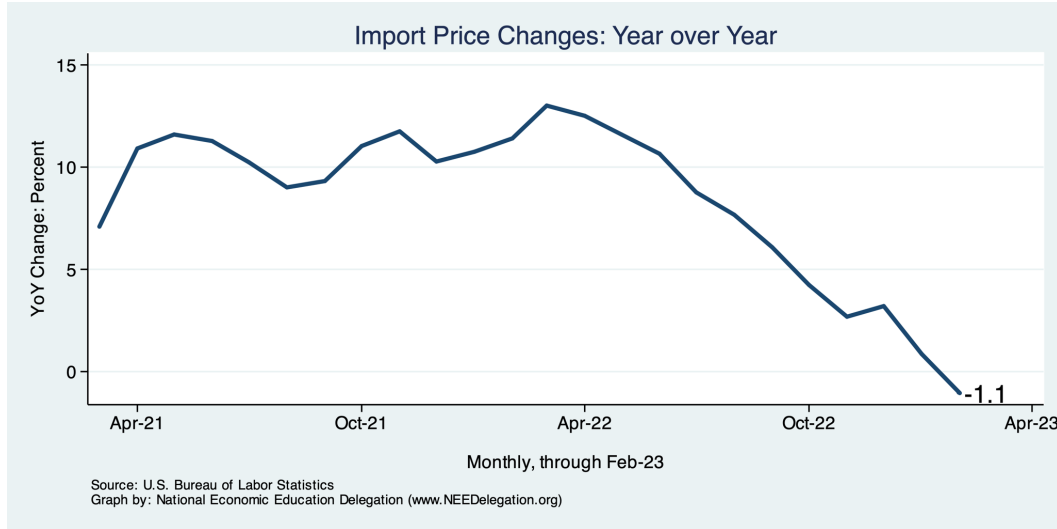
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Supply Chains



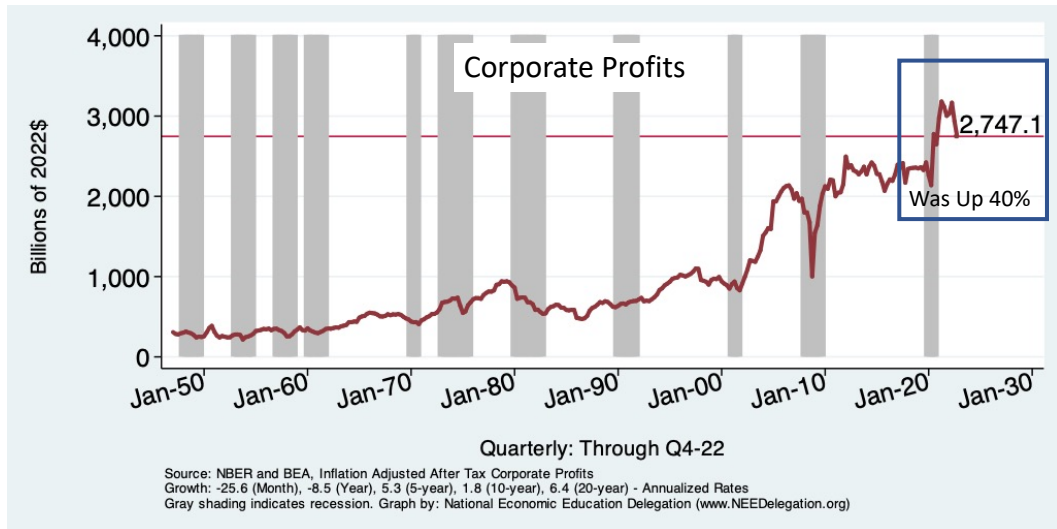
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Import Price Inflation WAS Very High



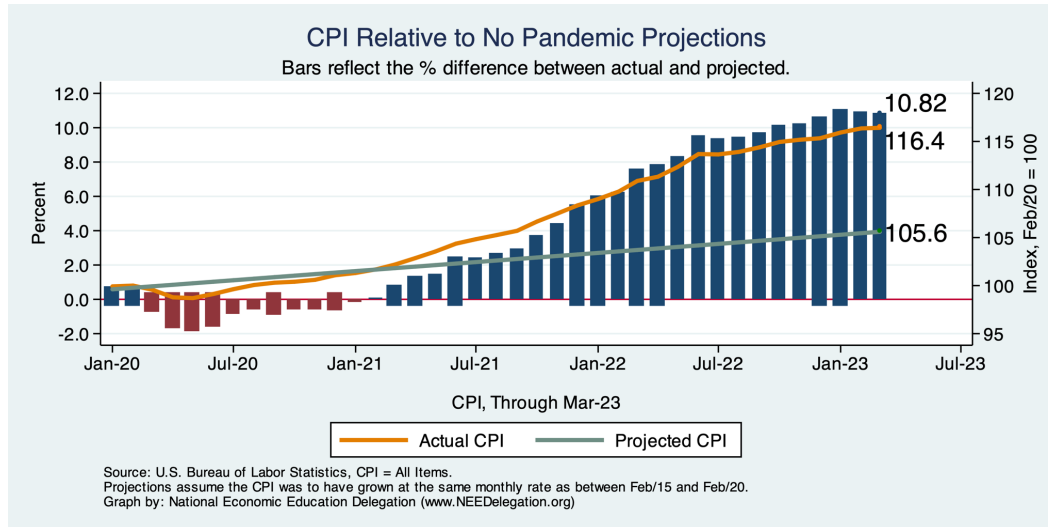
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Corporations Have Pricing Power!



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How Elevated Are Prices?



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My Thoughts on the Sources of Inflation

- **Supply Chain issues were significant – less so now.**
- **Composition of spending changed significantly.**
 - Is now bouncing back, as are prices.
- **Corporations have used the cover of inflation to raise prices more.**
- **But there was too much total spending.**
 - Fiscal stimulus led households to increase saving over 2021 by more than \$2 trillion. Strong retail sales numbers suggest they are prepared to spend it.
- **Who is to Blame: ARP probably too big, but the Fed could have acted sooner.**
- **Bottom line: Recovery from a dramatic economic disruption is seldom painless.**



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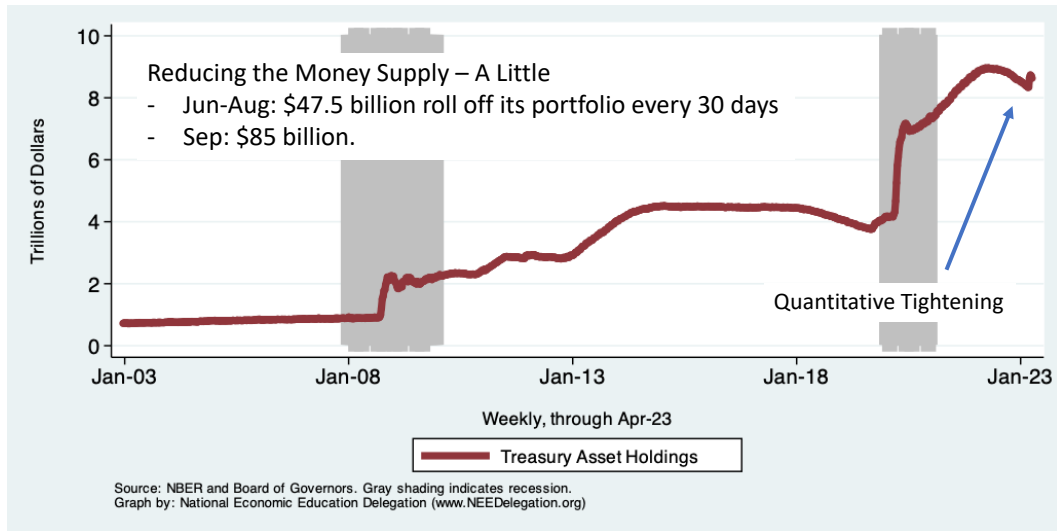
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What's the Fed Doing About It?

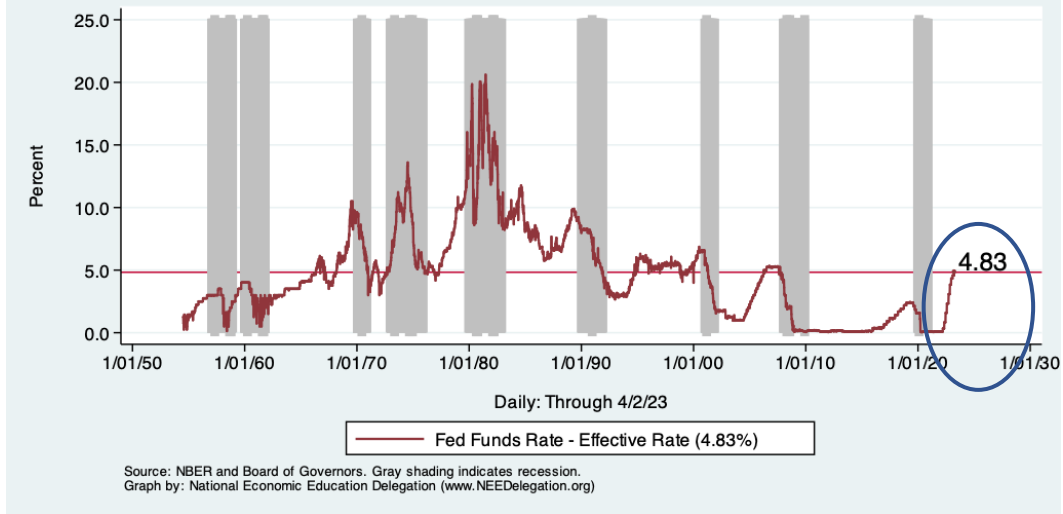
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Fed: Reducing its Asset Holdings



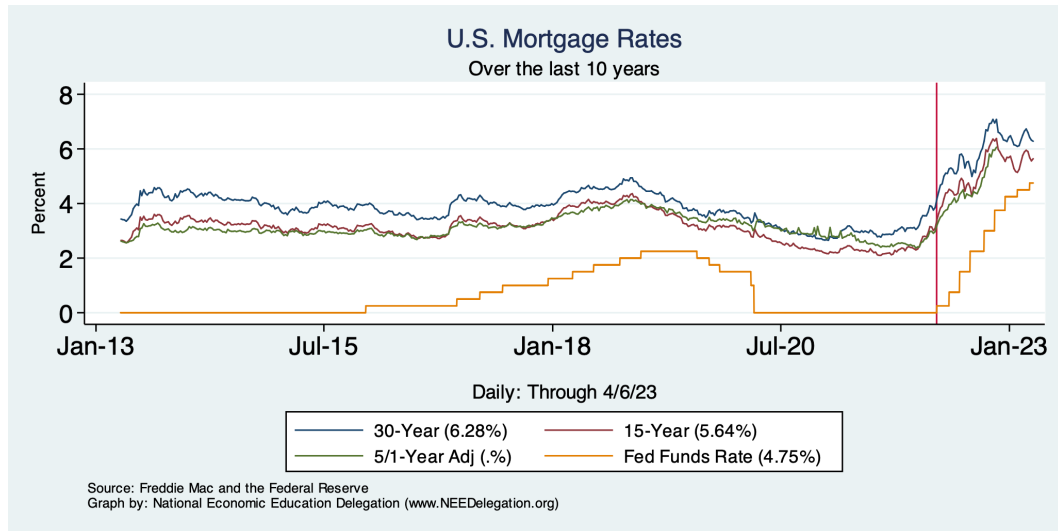
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Raising the Federal Funds Rate



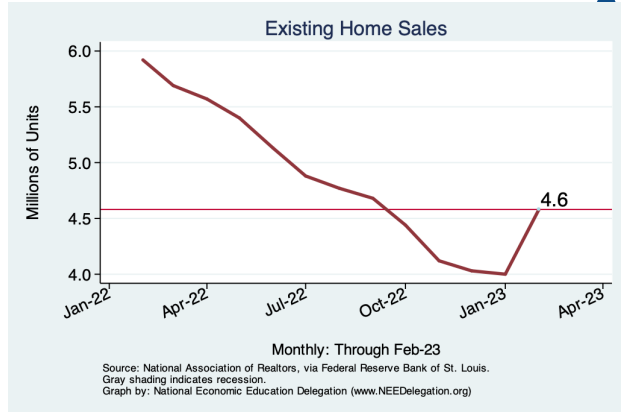
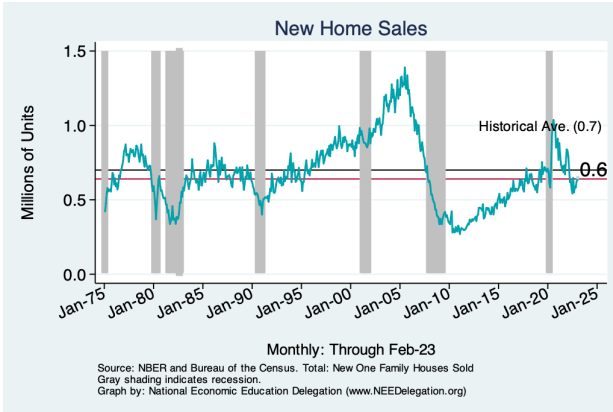
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Mortgage Rates



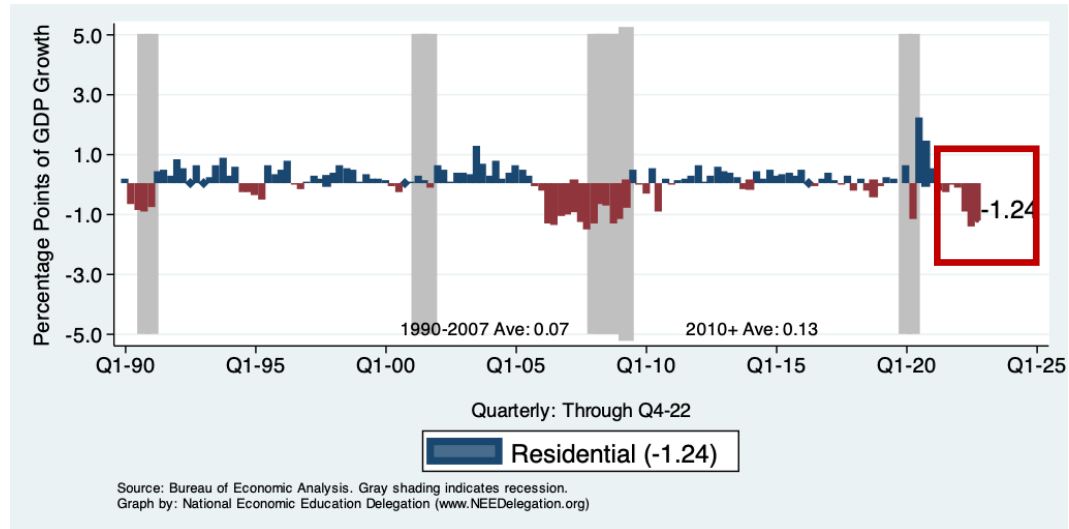
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Home Sales Falling...Well, They Had Been



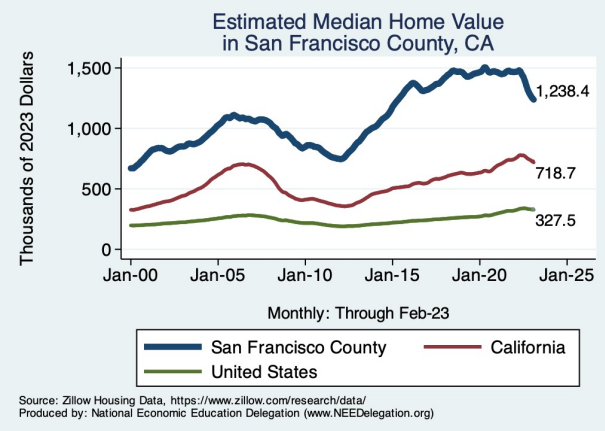
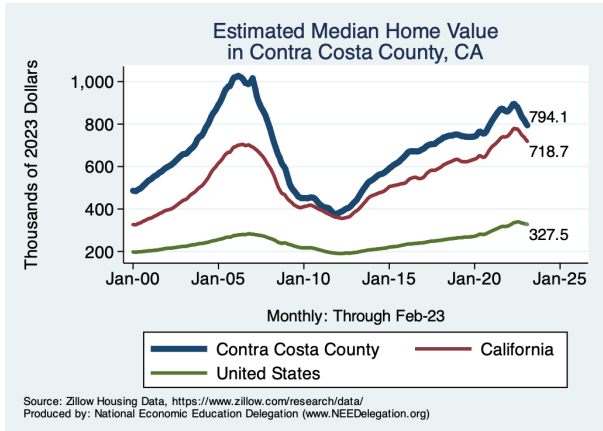
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Contributions to GDP: Residential Investment



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Home Prices ... Falling Throughout CA



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And Then Banks Started Falling...

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Silicon Valley Bank

- Regional mid-sized bank with \$212b in assets; \$6billion in capitalization (15th largest).
- Focused on loans to venture capital and managing the deposit accounts of startups.
- Very rapid growth in deposits and assets between 2021 and 2022, which led to big investments in “safe” long-term Treasury bond.
- The market value of these bonds fell drastically due to the Fed’s rise in interest rates.
- No problem! The bank does not incur “losses” unless it sells the bonds before maturity.



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Whoops!

- Concentrated and sophisticated depositors see the problem and want to get their money out (FDIC insurance guarantees deposits up to \$250 thousand, and 90% above this amount!).
- Deposit withdrawals force SVB to sell those bonds.
- Precipitating a classic bank run and leading to the FDIC seizing the bank on Friday, a month ago.



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FDIC Bank Closures, in General

1. "Auction" off the failed bank; all depositors paid in full.
2. Payoff insured deposits and liquidate bank assets
 - Under Dodd-Frank, the FDIC is supposed to use the cheaper procedure.
 - In either case, funding comes from banks payments of deposit insurance premium.



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But, in This Case:

- Janet Yellen announced that all depositors would be paid in full, and there would be complete insurance of all bank deposits for a year.
- Senior Executives all fired.
- Fed created a new lending program, so that banks can borrow against Treasury bonds without realizing losses.
- The rationale was to prevent bank run spreading to other midsize banks.
 - One other bank recently closed, others were struggling.
 - Stock prices of a number of similar sized banks have plummeted, but are recovering.



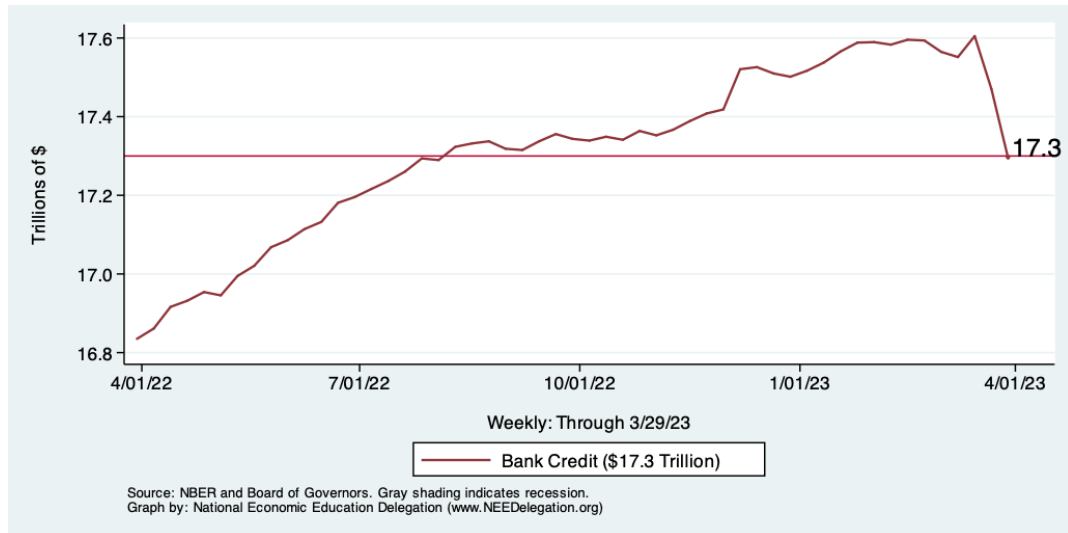
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Problems with the Bailout

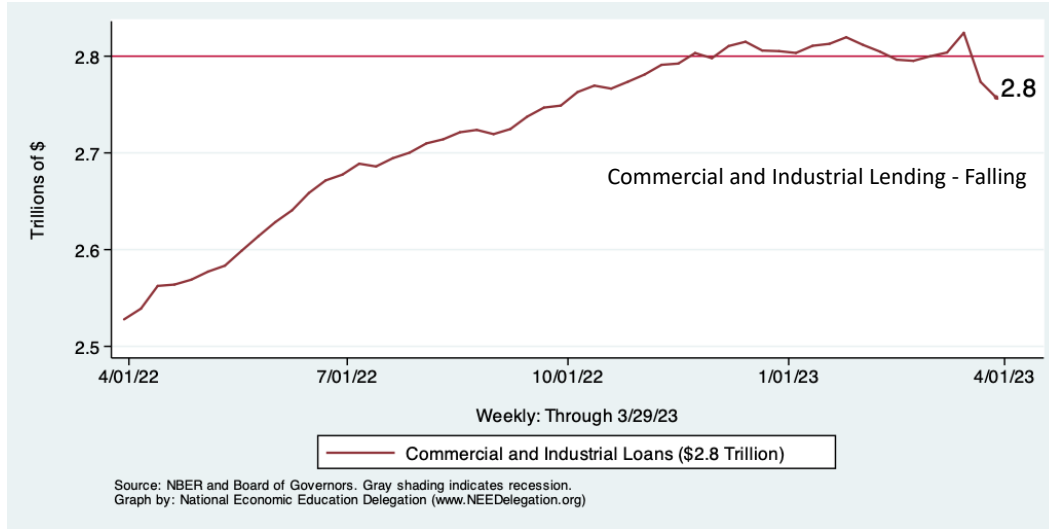
- **Political:**
 - Did political favoritism play a role in bailing out well connected, sophisticated silicon valley depositors.
 - Why didn't bank regulators see this coming?
- **Economic:** has the moral hazard of "too big to fail" been increased.
- **For the Fed:** Will the Fed have to scale back its interest rate increases to prevent wide scale financial crisis?



Banking Crisis and Bank Credit



Is This a Problem?

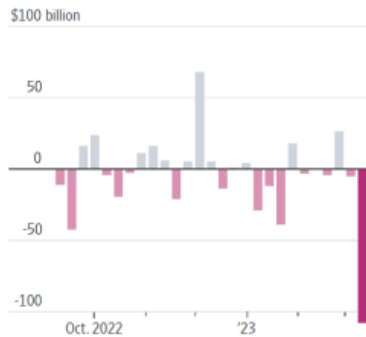


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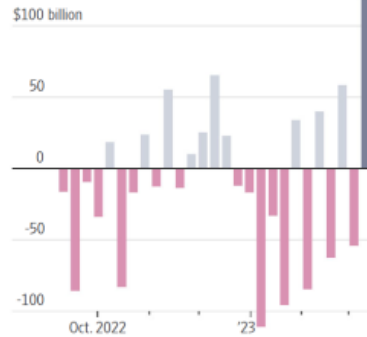
What About This?

Deposits, change from a week earlier

SMALL BANKS



LARGE BANKS



Note: Includes domestically chartered commercial banks. Large banks are defined as the top 25 ranked by domestic assets. Small banks are those not in the top 25.
Source: Federal Reserve
Nate Rattner/THE WALL STREET JOURNAL

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DC: Shall We Create Our Own Financial Crisis?

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Existential Threat: Coming This June!



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5 Things to Know about the Debt Ceiling

1. The debt limit has been raised continually for more than a century.
2. Raising the debt limit is not about new spending; it is about paying for previous choices policymakers legislated.
3. The uselessness of a debt limit is exhibited by the fact that only one other advanced country—Denmark—has a separate debt limit rule like ours.
4. If debt hits the ceiling, the Treasury Department uses several accounting gimmicks to postpone the day of reckoning, but these typically last only a few months.
5. The economic consequences of a large-scale, intentional default are unknown, but predictions range from bad to catastrophic.



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Source: <https://www.brookings.edu/2023/01/19/7-things-to-know-about-the-debt-limit/>

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Lessons from 2011

- **Government shutdown was very costly:**
 - Stock markets plunged (17%).
 - Employment growth stuttered.
 - Treasuries – downgraded credit ratings.
 - Borrowing costs rose.
- **The Debt Ceiling may be a very effective bargaining tool, but...**
 - It is costly.
 - It is unnecessary.
- **Accidental partial default in 1979:**
 - increased borrowing costs by \$40 Billion!



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Takeaways

- **Is a recession on the horizon?**

- Perhaps, but shallow?
- Many indicators are still in the black.
 - o 2022-Q4 GDP growth was pretty good!

- **Threats to continued growth:**

- If inflation stays high, which seems unlikely.
- Layoff contagion.
- Debt ceiling negotiations
 - o Significant cuts to government budgets may well result.
- Broader banking crisis.



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Thank you!

Any Questions?

www.NEEDelegation.org

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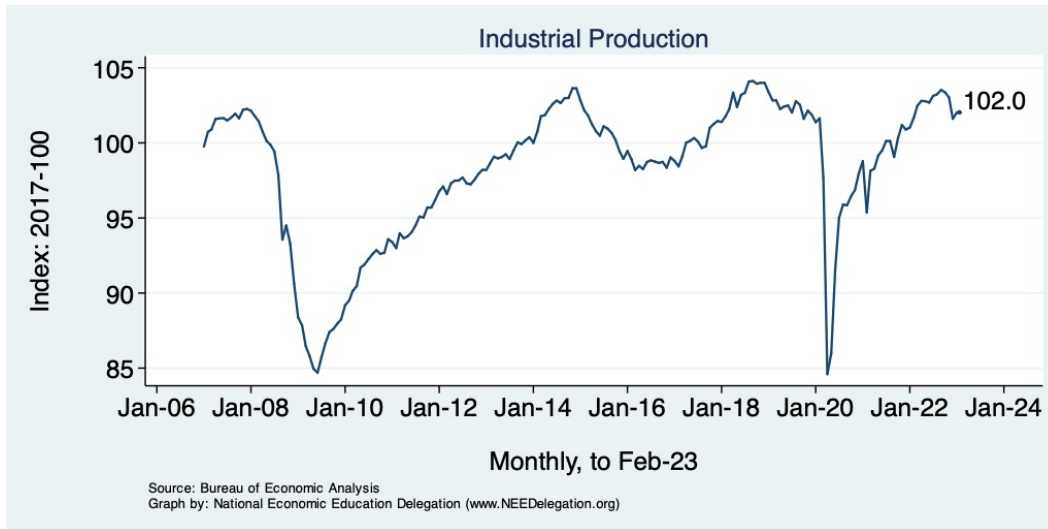
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www.NEEDelegation.org/LocalGraphs

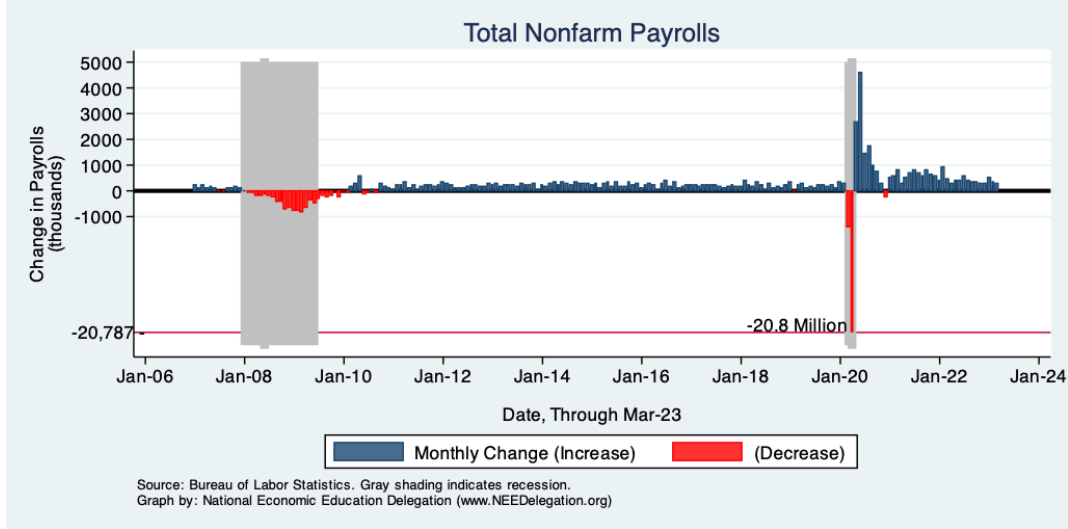
For every state and county in the United States.
Detailed graphs on employment, housing, moves, and other statistics.



Industrial Production (Manuf, Util, Mining)

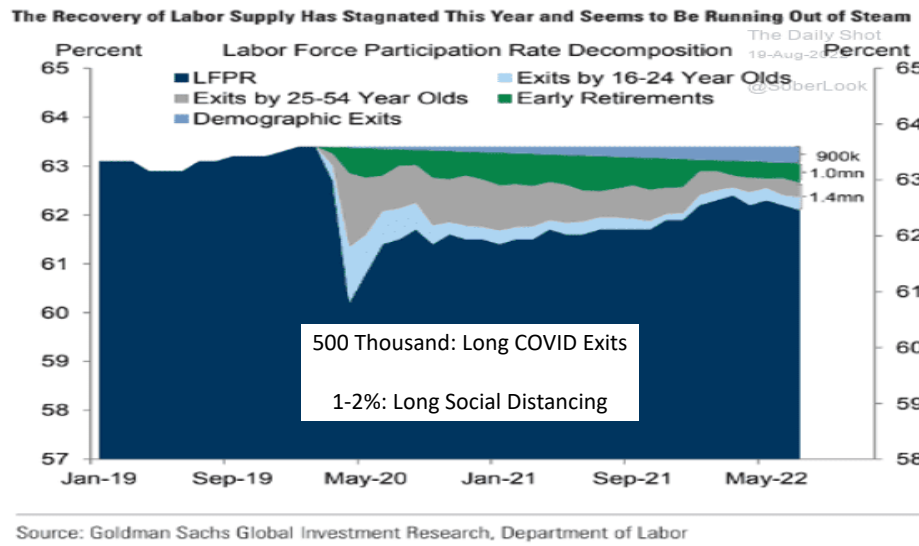


Monthly Changes in Nonfarm Employment



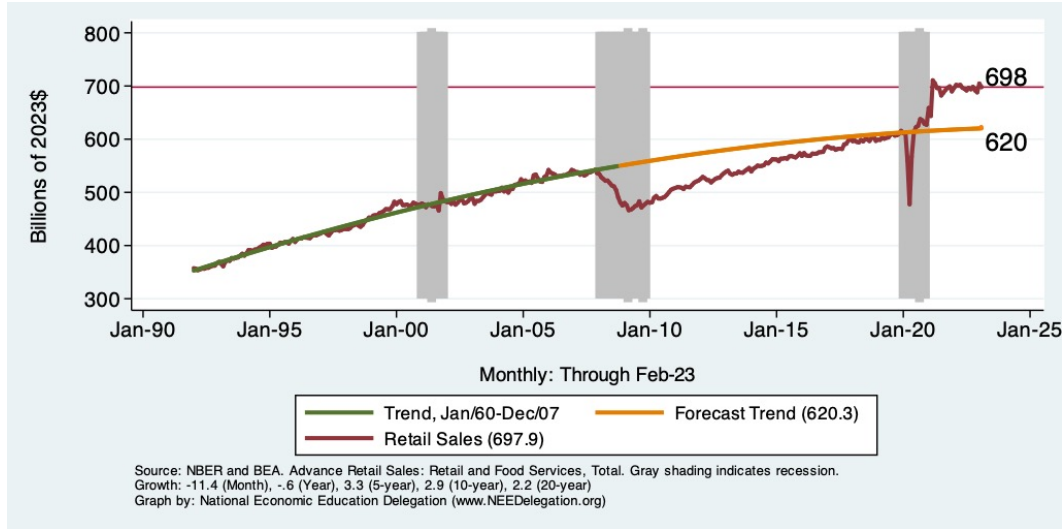
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Some Explanations



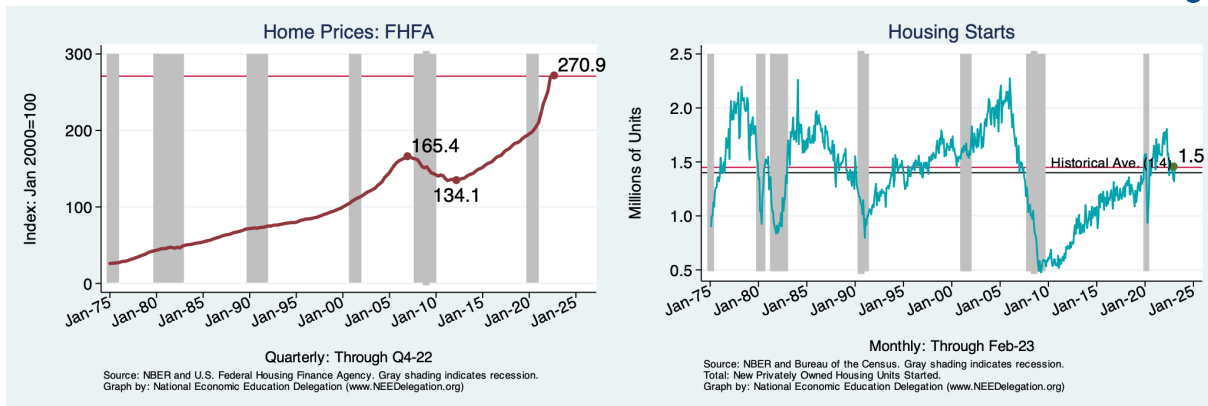
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But SUPER High to Begin With!



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Home Prices and Housing Starts



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