Trump-onomics

by Craig D. Hafer, President

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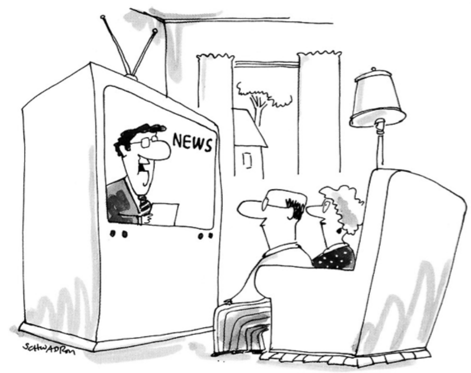
Each December, the Greater Reading Chamber Alliance hosts its Annual Economic Forecast Breakfast. For as long as anyone can remember, Jay Bryson, an economist at Wells Fargo, has been the featured speaker. Bryson is known for offering a carefully crafted presentation. This year, Bryson offered his standard economic review. However, at the end, he broke from routine and gave a criticism that was telling of just how much things have changed during the Trump administration.

At the end of Bryson's monologue, an audience member asked him when he thought President Trump would resolve the ongoing trade issues with China. Bryson gave a non-committal answer, but instead of ending his response at that point, he added one closing line. He said that for the past 20 years, while many people in the U.S. have benefited from free trade, many others have been hurt.



"In an effort to put a lid on inflation, Congress today voted to move the decimal point one digit to the left."

A 1982 cartoon in Punch Magazine, lampooning inflation rates in the early 1980's, which reached as high as 14.6%.

While this may not sound too controversial, think about what Bryson said. Bankers are not known for making fiery speeches or divisive remarks. Bryson said that for the past 20 years, free trade has hurt a lot of people, who were often overlooked by those who were benefiting. Didn't he realize that he was speaking to the Chamber of Commerce, a major proponent of free trade? And overlooked by whom? Presumably, by those who have benefited from free trade, which included many in the audience.

It has been almost three years since President Trump took office, and it is surprising how little has been written about the intent of his economic agenda. One can hardly go a day without hearing about the trade war with China, the 2017 tax cuts, or efforts to remove Obama-era environmental regulations, but few have looked at these policies as a whole, or asked the question: Is the Trump administration trying to encourage inflation?

Since taking office, this administration has passed the largest tax cut in history, moved to limit immigration, imposed tariffs on imports from China, reversed strong environmental laws and advocated for the Federal Reserve to further lower interest rates. Even with unemployment at its lowest rate since 1969, the administration has unabashedly proposed ideas to make the economy grow faster, meeting resistance from the Fed and political

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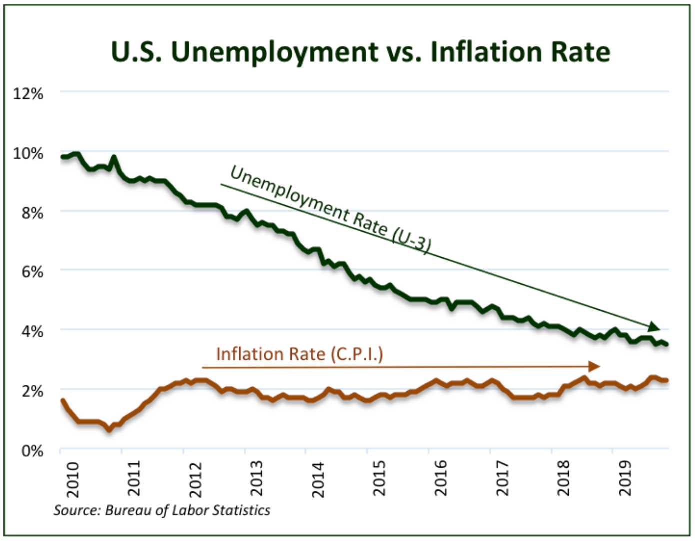
adversaries, who fear that accelerated economic growth could result in higher inflation, similar to what the U.S. experienced in the 1970's.

Inflation in the U.S. is determined by the Consumer Price Index (CPI). Each month, the Bureau of Labor Statistics measures a basket of goods that it has determined best reflects what an average consumer purchases. It then measures the price change that occurs with this basket to calculate an overall price change. At best, the CPI is an approximation of inflation, as each consumer's purchasing habits are different. What makes the CPI of value is that it is used by the Fed to determine interest rates. If inflation is high, the Fed will raise rates to cool the economy. If it is low, the Fed will lower rates to stimulate the economy.



Despite the unemployment rate declining and at a historic low, inflation has also remained low. For the Trump administration, this is a sign that the U.S. economy has room to grow.

Economists have long believed that one of the key drivers of inflation is the employment rate, which has a direct relationship to consumer demand, debt repayment and other factors that affect economic growth. Greater employment means greater consumption and a stronger economy. With the U.S. unemployment rate currently at 3.6%, one would assume that inflation would be rising; however, for the past seven years, the inflation rate has remained below 2%, as imported goods have driven down the prices of many items that were once produced in the U.S.

Low inflation may seem like a good thing, until one realizes that not only have the prices of many items (especially those now imported) remained low, but incomes have also languished as many workers have had to compete with those oversees.

When one looks at this administration's policies as a whole, it appears that the objective is higher inflation rates. While many in the press have characterized Trump's support of tariffs as an effort to protect the United States from China's unfair trade practices, few mention that for the trade deal to be "successful," the items now made in China would need to be made in the U.S. and would be more expensive to produce. This would cause prices to rise and would be a catalyst for growing inflation.

Another policy that encourages higher inflation is the 2017 Tax Cuts and Jobs Act, which the Treasury Dept. projected would boost annual economic growth to 2.9% for the next ten years. The administration believes that by lowering income taxes, the economy will grow faster and that any increase in debt that these tax cuts produce will be offset in the long run, as the government will collect more revenue as the result of a faster-growing economy.

While critics of Trump's economic policies interpret the administration's efforts as simply helping the rich, Robert Samuelson of the *The Washington Post* wrote that to do so "simplifies and misrepresents Trump's larger ambition." Trump, he argues, is trying to run a "hot" economy, an economy that is operating at its outer edge – exhausting its supply of workers and surplus of goods and services. In the 1960's, it was called a "high-pressure" economy, and caused the double-digit inflation of the 1970's, along with several recessions.

The prospect of high inflation may be of concern; however, it does not reflect present economic conditions: the current problem in the U.S. is not double-digit inflation, but historically *low* inflation. Low inflation rates have caused the Fed to keep interest rates at historic lows, worrying some economists about the possibility of negative interest rates (where people actually pay banks to hold their money) as has happened in Sweden and Japan. These historically low interest rates have hurt many retirees who are dependent on Social Security. Low inflation has also meant that home values and family incomes have not increased significantly. These are all examples of what Bryson was referring to when he said that free trade has hurt many Americans.

While it is premature to determine whether or not the Trump administration's efforts to super-charge the economy will pan out, what is clear is that after 30 years of policies of fighting inflation and championing the merits of free trade, economists are waking up to the fact that while many have benefited from these policies, others have been hurt. It is also clear that until signs of significant inflation emerge, this administration will most likely continue to implement policies that could lead to higher inflation rates, regardless of the potential consequences.