First Trust
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Jackson Hole: A Recipe for Inflation

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On Thursday, The Federal Reserve Bank of Kansas City's annual retreat in Jackson Hole, WY will start. The topic of discussion is: "Re-Evaluating Labor Market Dynamics."

The title itself says a lot about the Fed's current mindset. Economists have been studying labor market dynamics for many, many decades, if not centuries. So, why does the Fed need to do any re-evaluating?

The answer: the unemployment rate is still 6.2% and other measures of the labor market are far from robust. This is true even though the Fed has spent trillions on bonds, boosted its balance sheet to record levels and cut interest rates to zero.

Maybe the Fed should "re-evaluate monetary policy," or study "the impact of fiscal policy on the economy" or find "the actual efficacy of QE." With all those juicy, and important, policy topics available, why study the labor market?

Back when Ben Bernanke was Chairman of the Fed, he targeted a 6.5% unemployment rate to start tightening. Now, Fed Chair Janet Yellen says it's more complicated than that. There are more important measures of labor market health.

What's interesting about all of this is that the Fed is becoming a poster child for "mission creep." When the Fed first started in 1913, its job was to protect the value of the US currency. Then, with passage of the Federal Reserve Reform Act of 1977, the Fed received a dual mandate – to keep "the unemployment rate" and inflation low.

This dual mandate was a mistake. The Fed has control over one thing – the amount of money circulating in the economy. But, money itself cannot create jobs, or fewer part-time jobs, or increase the labor force participation rate. If printing money actually created wealth, then we should allow every citizen to counterfeit their own currency. Of course, this would not work. Counterfeiting is illegal because you get something for nothing.

No monetary policy expert has argued that the US experienced the crisis of 2008 because the Fed was too tight. And no one, with credentials, argues now that the US economy is growing slowly because money is scarce.

In other words, monetary liquidity was not, and has not been, a problem for the economy. As a result, any findings by the Fed that the labor market is not performing at its full potential can be seen as proof that monetary policy is not the tool for the job.

As the US learned in the 1980s, over the long-term, a single policy lever cannot accomplish more than one policy objective. Monetary policy controls inflation in the long run. Fiscal policy impacts the real economy (GDP and unemployment).

The Fed has now been easy for over five years, so it is impossible to argue that monetary policy is being used as a short-term tool. If the labor market is still having problems it must be because fiscal policy is harming potential growth. With government spending, and especially redistribution, much higher than in the 1990s, regulation a huge and growing burden, Obamacare, and higher tax rates, it's no wonder employment and incomes are lagging.

Unfortunately, the Fed does not see it this way. It is willing to maintain abnormally, and artificially, low interest rates because the US hasn't reached so-called full employment. But those artificially low rates may cause other problems, like a bubble in some sector, which the Fed has now decided to deal with using "macro-prudential policy tools." It sounds really technical, but it's essentially playing "whack-a-mole" once excesses from easy money pop up. In effect, the Fed wants to use monetary policy as a long-term policy tool and deal with short-term monetary problems by using regulatory tools.

In reality, the existence of financial market excesses should prove that Fed policy is being mishandled. But the Fed will choose to view excesses as a mistake by financial institutions themselves. Blame the other guy, always.

This is a recipe for falling behind the curve. The Fed is already there and is likely to stay there for some time to come.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
8-19 / 7:30 am	CPI – Jul	+0.1%	**+0.1%**		+0.3%
7:30 am	"Core" CPI – Jul	+0.2%	**+0.2%**		+0.1%
7:30 am	Housing Starts – Jul	0.966 Mil	**0.980 Mil**		0.893 Mil
8-21 / 7:30 am	Initial Claims Aug 16	300K	**302K**		311K
9:00 am	Existing Home Sales – Jul	5.010 Mil	**5.080 Mil**		5.040 Mil
9:00 am	Philly Fed Survey – Aug	19.4	**25.6**		23.9
9:00 am	Leading Indicators – Jul	+0.6%	**+0.7%**		+0.3%