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First Trust

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Monday Morning Outlook

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Ben Bernanke: The Real Pay Czar

Wall Street has been on the defensive as populist political winds support the decision by the Obama Administration's "pay czar," Kenneth Feinberg, to limit bonuses at banks that accepted government support during the financial panic. But when it comes to controlling the value of what we earn, Feinberg is a piker relative to Fed Chairman Ben Bernanke and the Federal Open Market Committee (FOMC) – the monetary policy arm of the Fed.

Ultimately, if someone gets paid in dollars – no matter how rich or how poor – the Fed has massive influence over the amount of goods and services they can buy with what they've earned.

Lately, the US dollar has fallen sharply on world foreign exchange markets. Since early March, the dollar has lost 15% of its value versus the euro and 8% versus the yen. What this means is that relative to other countries (and currencies) US citizens have taken a pay cut. Our standard of living, when measured by purchasing power, has declined – we now have to work harder and export more in order to afford the same imports.

To some extent, this is nothing new. The dollar has been trending down versus other major currencies since early 2002. The Federal Reserve was way too tight in 1999/2000, leading to the recession (and fears of deflation). Then the Fed cut rates too much and held them too low for too long in 2001-2004. The dollar tanked. Then it stabilized when the Fed raised rates in 2005-2006, only to fall again as the Fed cut rates to near zero during the financial panic of recent years.

Now, the dollar is consistently hitting new lows against foreign currencies, and gold is near an all-time high in dollar terms. And while all of this is important, what we are really seeing is the early signs (the canary in a coal mine) of what we expect to be a significant increase in inflation.

In the short run, looser monetary policy can generate faster real economic growth. While some growth is still real (due to productivity), some is not. It's this latter part that gets us nowhere.

One way to think of loose money and dollar depreciation is that it's like recovering from a hurricane. After a hurricane is over, the community that is hit often goes through a burst of positive GDP. People are as busy as beavers: putting roofs back on houses, replacing broken windows, and generally cleaning up the mess. All this activity gets scored as production, which shows up in GDP. But all it really does is get the community back to where it was before the storm hit. They would be better off if the storm never hit at all.

Lasting prosperity cannot be built on loose money and dollar depreciation. It can temporarily make us busier, but by reducing the value of the dollars we earn and the dollar-denominated assets we have already accumulated, it's a recipe for stagnation in our standard of living. It's a pay cut that some economists in Washington think will make the country more competitive.

The worst part of the pay cut is that the people who get hit the hardest by higher inflation will be low-income workers who spend a larger share of their income on the commodities that will go up the most in price. Getting a pay cut is never good, but when it doesn't help the economy grow over the long run, it's bound to generate more worker frustration, potentially leading to a vicious cycle of economic populism, where frustration leads to more government action, leading to more frustration even later on.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-2 / 9:00 am	ISM Index - Oct	53.0	**53.5**	55.7	52.6
9:00 am	Construction Spending - Sep	-0.2%	**+0.1%**	+0.8	+0.8%
11-3 / 9:00 am	Factory Orders - Sep	+0.8%	**+0.6%**		-0.8%
sometime	Domestic Auto Sales - Oct	3.4 Mil	**3.5 Mil**		3.3 Mil
during the day	Domestic Truck Sales - Oct	3.6 Mil	**3.8 Mil**		3.5 Mil
11-4 / 9:00 am	ISM Non-Man. - Oct	51.5	**51.6**		50.9
11-5 / 7:30 am	Q3 Non-Farm Productivity	+6.5%	**+7.4%**		+6.6%
7:30 am	Q3 Unit Labor Costs	-4.0%	**-5.9%**		-5.9%
7:30 am	Initial Claims - Oct 31	523K	**523K**		530K
11-6 / 7:30 am	Non-Farm Payrolls - Oct	-175K	**-55K**		-263K
7:30 am	Manufacturing Payrolls - Oct	-45K	**-50K**		-51K
7:30 am	Unemployment Rate - Oct	9.9%	**9.9%**		9.8%
7:30 am	Average Hourly Earnings - Oct	+0.1%	**+0.2%**		+0.1%
7:30 am	Average Weekly Hours - Oct	33.1	**33.1**		33.0
10-7 / 2:00 pm	Consumer Credit - Oct	-$10.0 Bil	**-$12.1 Bil**		-$12.0 Bil