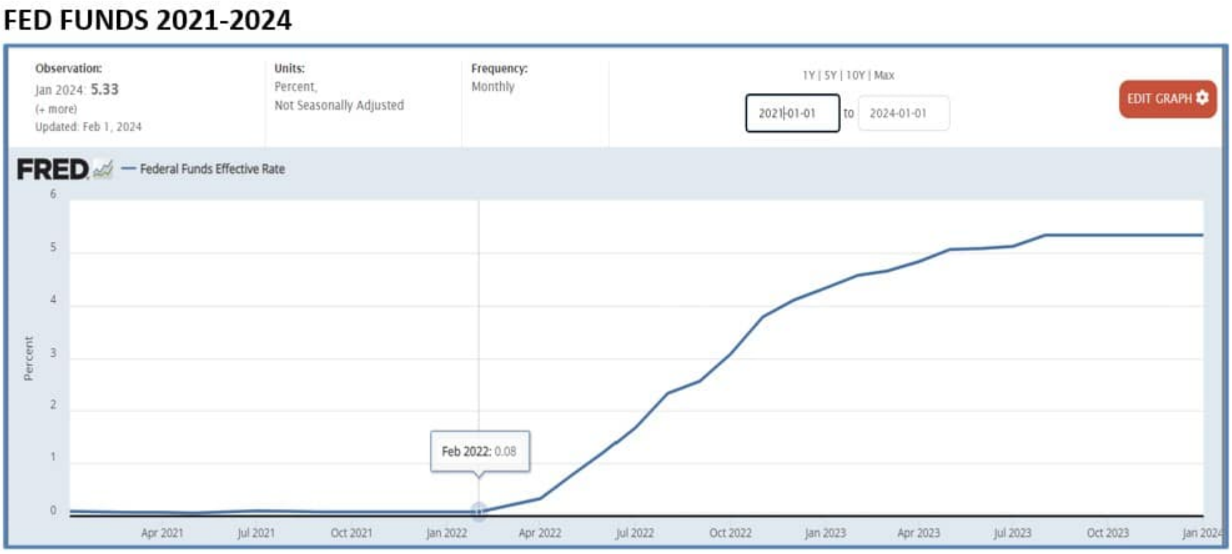
Is the focus on inflation justified? Or is it just the normal economic pattern?

Inflation is the reason the FED raised interest rates faster, in percentage terms, than at any time in the past 69 years. In this report, we examine if the economy really required such a drastic move or if the inflation rise was really just part of the normal economic cycle? We will also briefly ask the question, ?Does a 2% inflation target even make sense??

The backdrop

The FED Funds rate went from .08% to 5.33% since January 2022, which is an increase of 6500%.



In the 1977 to 1981 raise, the Fed Funds was pushed up 312% (4.61% to 19.08%) with harsh ramifications. So far, in this cycle, unemployment remains near a 50-year low and the overall economy is chugging along quite well.

FED FUNDS SINCE 1955

https://fred.stlouisfed.org/series/FEDFUNDS

Historical analysis

TPA examined economic cycles, based on Unemployment numbers, since 1960. We identified the low Unemployment number for each cycle and then measured inflation 1 year, 18 months and 2 years after that low Unemployment number was registered. The chart below illustrates the pattern we found. Normally, after each Unemployment low, inflation spiked. So far, for the next cycle, the Unemployment low is April 2023, when Unemployment hit 3.4%.

Cycle Unemployment Low (bottom) and CPI (top) – since 1960

Economic data – Federal Reserve St. Louis.
https://fred.stlouisfed.org/series/UNRATE
https://fred.stlouisfed.org/graph/?g=rocU

The table below shows the 7 Unemployment lows since 1960.

DATE	CPI	UNEMPLOYMENT
5/1/1969	5.833	3.400
10/1/1973	4.279	4.600
5/1/1979	9.428	5.600
3/1/1989	4.684	5.000
4/1/2000	2.269	3.800
5/1/2007	2.268	4.400
2/1/2020	2.380	3.500

The next table shows the percent rise in CPI 12, 18, and 24 months after the Unemployment lows. CPI rose an average of 24%, 42%, and 32%, 12, 18, and 24 months after the best Unemployment numbers of the cycle, respectively. In addition, CPI rose 85%, 85%, and 71% of the time, respectively.

CPI change measured from the low of the unemployment cycle.				
		12 months	18 months	24 months
	Average	24.31%	42.18%	32.74%
	High	147.31%	163.44%	171.12%
	Low	-46.40%	-11.11%	-18.59%
Percent of times CPI rose		85.71%	85.71%	71.43%
		CPI	Unemployment	
	Average since 1960 =	3.729	5.913	
	Current =	3.875	3.700	

Argument

It would appear that low Unemployment leads to inflation most of the time. Of course, the idea that a strong economy leads to inflation should not seem strange, but then why all the hand-wringing over inflation? It is, after all, just part of the economic cycle that accompanies strong employment.

Now, the second part of the question. *?Does a 2% inflation target even make sense??* The question is worth asking, because of the pain that a 6500% increase in Fed Funds causes consumers and, specifically, the housing market. The table above shows that the average CPI since 1960 is 3.729%. If the average CPI in the past 64 years is 3.729%, why is the target inflation rate 2% or almost half the historic rate?

Conclusion

The FED was justified in raising rates, but is no longer justified in keeping rates high because:

1. inflation spikes are a normal part of the Unemployment cycle and

2. the current inflation rate is right at the norm for the past 64 years.