

Market Sense – Warsh is Taking the Greenspan Challenge on Price Stability

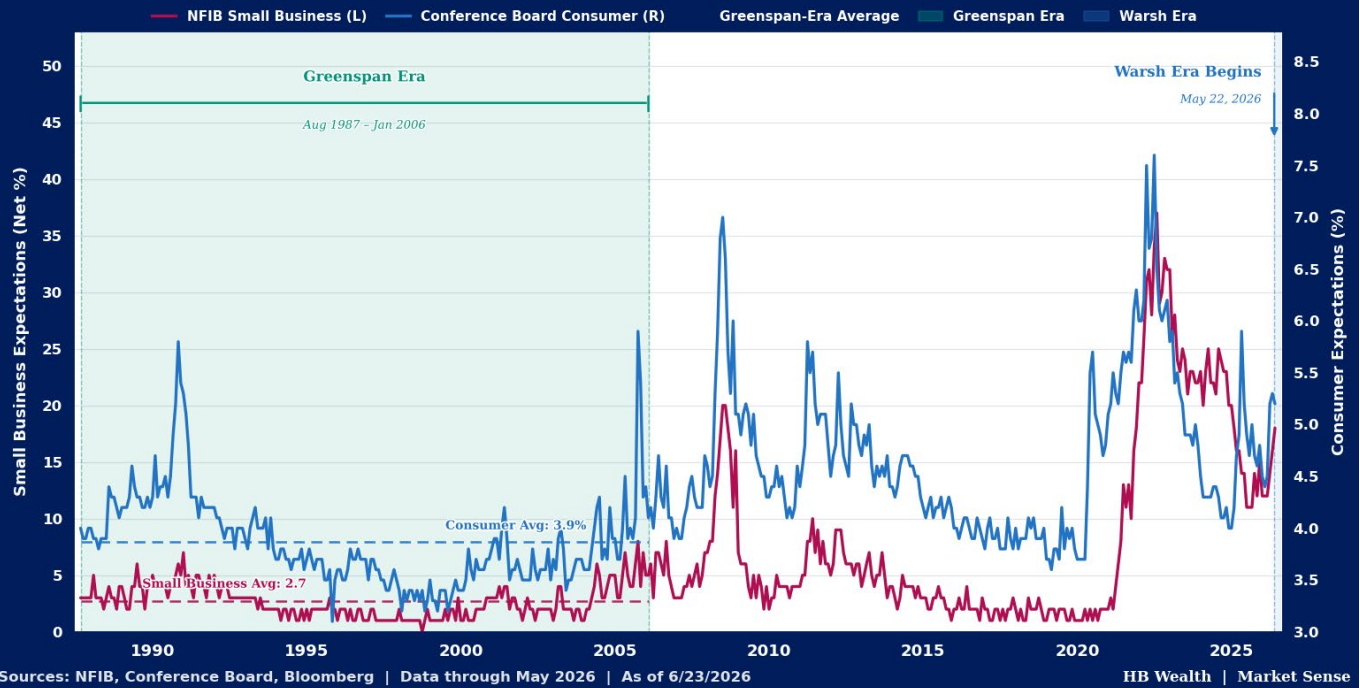
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Financial markets' inflation expectations have stabilized with peace talks in the Middle East, but it may be up to the Fed to help tame the inflation beast in the real economy. After years of above average inflation, consumer inflation expectations and small business inflation concerns both appear somewhat entrenched. Consumer year-ahead inflation expectations sit at 5.2%, in the 89th percentile of historical observations since 1987. Meanwhile, small businesses continue to claim inflation is one of their biggest problems (second only to taxes). Large businesses are also sour, with ISM's manufacturing prices-paid index at 82.1 – roughly 1.7 standard deviations above its long run norm – and services prices-paid at 71.3, about 1.3 standard deviations above average.

Kevin Warsh made it clear in the press conference following the FOMC policy meeting last week that the Fed is committed to achieving “price stability”. He mentioned the phrase no less than 14 times in the press conference just after the meeting, in a tip of his hat to Alan Greenspan, who stressed the price stability imperative during his nearly 20-year tenure as Fed Chair. Greenspan once suggested that price stability is achieved when households and businesses no longer have to think about it. Households and businesses are thinking about inflation now more than they were during the Greenspan era at the Fed, suggesting Warsh faces an even greater inflation challenge than his role model did.

Inflation Expectations: Consumer & Small Business

NFIB small business net % expecting higher prices (left) vs. Conference Board consumer 12-month expectations (right)



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