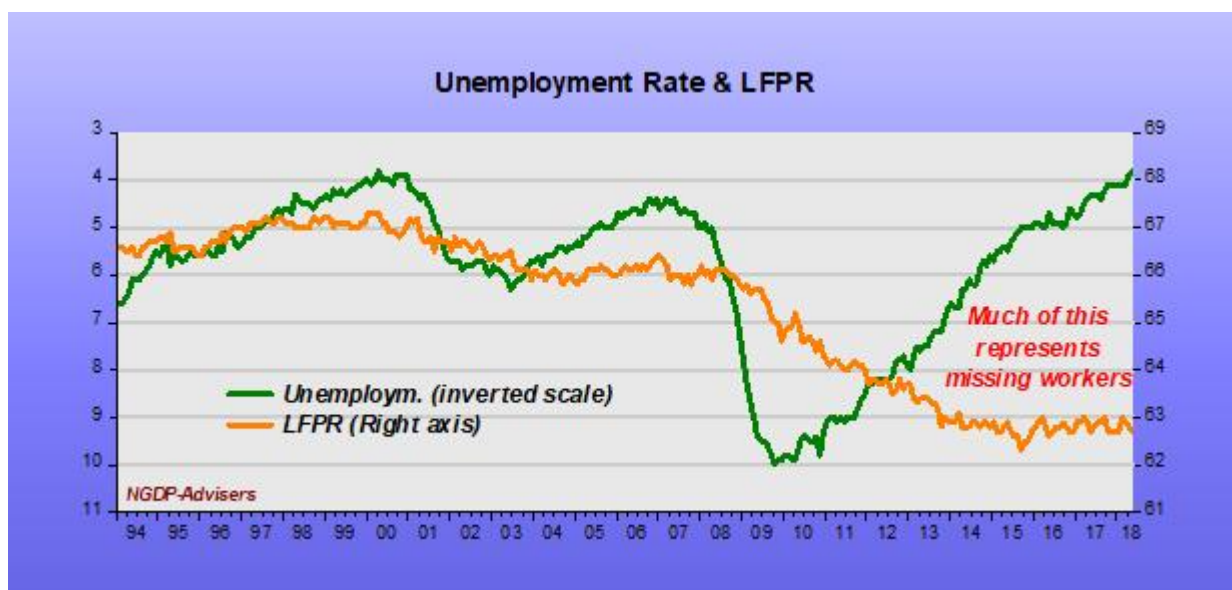


Houston, we have a (nominal) problem

Two instances of 3.8% unemployment and the corresponding wage, labor force participation and inflation.

	April 2000	May 2018
Unemployment	3.8%	3.8%
Wage growth	4.0%	2.8%
LFPR	67.3	62.7
Core PCE	1.7%	1.8%

It doesn't seem likely that the 3.8% unemployment today indicates anything close to full employment. The chart is illustrative.

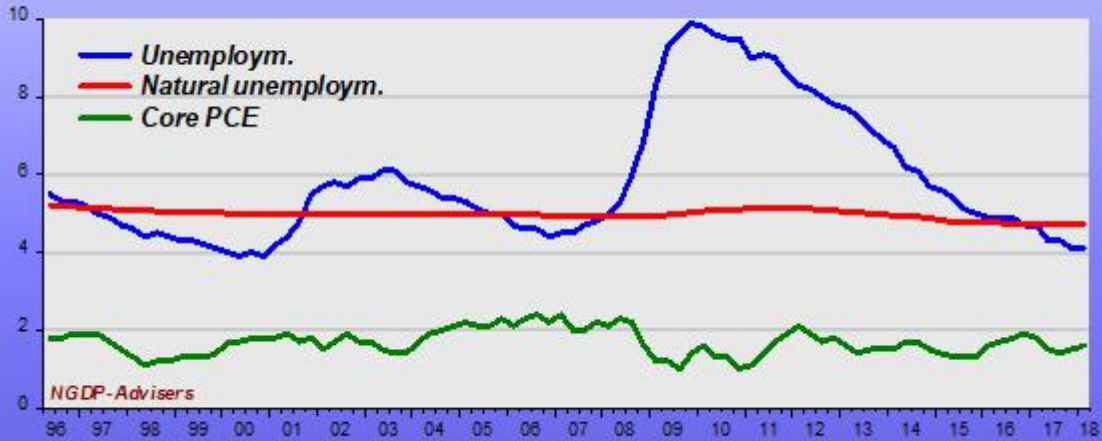


One implication is that Fed decisions shouldn't be informed by the unemployment rate (relative to estimates of "natural"). For example, statements like the [following](#):

"Indeed, in the Fed's forecast such tighter policy is necessary to edge up the unemployment rate and return the economy to a sustainable, non-inflationary path."

Are inexcusable, having no correspondence in reality.

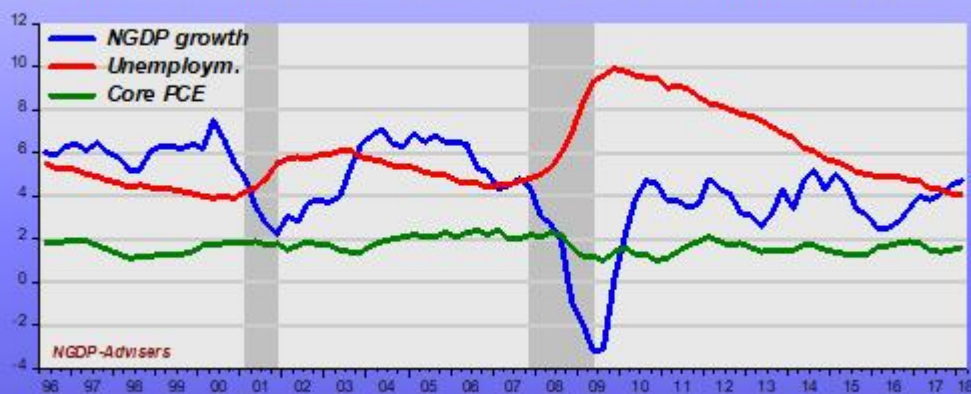
By being informed by "natural" rates, the Fed will botch the job



The Fed has direct influence over the nominal economy. In the chart below, we note that when the nominal economy is at an adequate **level** and evolving at an adequate stable rate, the unemployment rate is falling/low and the inflation rate remains low and stable.

When the **level** of the nominal economy becomes depressed and the nominal growth rate is low, unemployment slowly falls from the lofty level attained during the contraction of the nominal economy, with inflation remaining stable. However, the labor market becomes less attractive, leading to a low level of labor force participation.

When the nominal economy fumbles or tumbles, the real economy (unemployment) suffers



Therefore, if the Fed is informed, or guided, by the rate of unemployment, thinking, as evidenced by the quote above, that to control inflation it has to tweak the unemployment rate up, it will directly contribute to derail the economy.

The better policy is clear. (1) Find an adequate (non-depressed) level for the nominal economy and, (2) establish an adequate growth rate for nominal spending.

The resulting increased attractiveness of the economy will push the labor force participation rate up. As a result, initially the unemployment rate may even increase. With a stable nominal spending growth, inflation will remain low and stable.
