Bitcoin from a Market Monetarist Perspective

Bitcoin seems on an unstoppable tear. Rising from about USD 700 in January 2017, to about USD 11,000 in early December and now to about USD 15,000 as of mid-December, the cryptocurrency has 'crushed its enemies, and seen them driven before it'. Many commentators claim Bitcoin is a bubble, after all, so the thinking goes, what do markets do but arbitrarily rise, and then randomly crash, causing havoc?

Of course, Market Monetarists see things differently. We respect markets, fear them too, and completely reject the concept of a "bubble". If the participants in the market decide Bitcoin is worth USD 11,000, arriving at this conclusion with their own Talebian "skin in the game", we take notice.

Bitcoin could certainly crash due to expected displacement by another cryptocurrency, or be undone by some unforeseeable complication, after all markets are not perfect. But at USD 15,000 per unit, and about USD 300 billion in total value of all Bitcoin, there is probably something to this given how many eyes are on it, and how many billions in mining hardware and electricity are currently dedicated to the network. Bitcoin may not work out, but there's a decent probability that it will, if you think otherwise, you should short it (which you can easily do).

The primary uses of bitcoin seem to be as medium of exchange and store of value. In countries with a weak rule of law, and a history of currency confiscations (think Argentina) or with rules preventing capital from leaving the country (China), bitcoin is a powerful tool for moving funds to more investment friendly jurisdictions, or for clandestinely storing savings. Bitcoin is unlikely however to become the medium of account, that is to say, it is unlikely that loans, employee salaries or prices in a store will be denominated and 'thought of' in Bitcoin terms.

If an advanced economy, such as the US or UK, with a high degree of financialization and lots of sticky prices, switched to Bitcoin as the yardstick by which the books were kept, disaster would ensue. Nation States would lose the ability to conduct monetary policy, and thus would be unable to offset domestic fluctuations in demand to hold currency, and would be buffeted by foreign demand for the

Bitcoin currency.

Due to the way that Bitcoin is configured and governed, the number of Bitcoin in existence would eventually asymptote to a fixed value, leading to deflation. Libertarian extremists might find this state of affairs ideal, but we in the real world see it as catastrophic. For this reason, governments are unlikely to endorse 'Bitcoinization' of prices or state budgets, and this in turn will keep big business from denominating in the unstable currency. The matter of Bitcoin being treated, for tax purposes, as a commodity, subject to capital gains taxes, also makes it unlikely to become a medium of account.

This role of medium of account isn't so important though. We'd propose that Bitcoin needn't be thought of as a currency, so much as a payments platform. Just as most consumer transactions are done with credit or debit cards, in the future these cards may run on a Bitcoin backbone. I buy a coffee for USD 5, swipe my card and my bank pays the merchant USD 5 in Bitcoin, using the spot price. It then debits USD 5 from my checking account to compensate for the Bitcoin it lost. This alone should create massive demand at any given point in time for Bitcoin, and support a high price.

There will also presumably be a big demand for Bitcoin in countries with highly corrupt and/or underdeveloped banking systems. In this way, the future of money *might* be a hybrid system wherein Bitcoin, or some successor crypto currency, plays a substantial role. But national currencies will continue to play the decisive role as unit of account. Think of the way the Euro is used in the Visegrad Group countries, a parallel currency, only on a global scale.

This is all speculative, and frankly, such a revolution in how money is managed that one can't help find it hard to jump in with both feet. If only Uncle Milton were alive to guide us!

Those who buy Bitcoin today may be massively rewarded, as those who bought Bitcoin in 2016 (or earlier) were rewarded. Markets are a two-way street though, there is no free lunch. Those who invest in Bitcoin are also investing in the downside, the risk that the dream of a low-friction decentralized global payments platform doesn't work out. The Bitcoin speculator has reaped rewards to-date, but those rewards are the compensation for the massive risks he took.

Note: *This post, as with everything at NGDP Advisers, should not be taken as investment advice. If we were able to give investment advice, we would just keep it to ourselves. This said the author has a modest, longstanding stake in Bitcoin.*

Stronger imports, a good sign for Q4 NGDP

You may have seen headlines on Tuesday, about how US imports for October jumped to "record highs". For the month of October, nominal US imports increased to $45.2 billion, seasonally adjusted, up 5.8% year-over-year.

The financial press are keen to write about trade reports, but almost without exception miss the implications of a widening or narrowing US trade deficit. The financial press, even prestigious outlets with expensive subscription fees, will claim that greater imports mean lower GDP. Witness, the Wall Street Journal on December 5th:

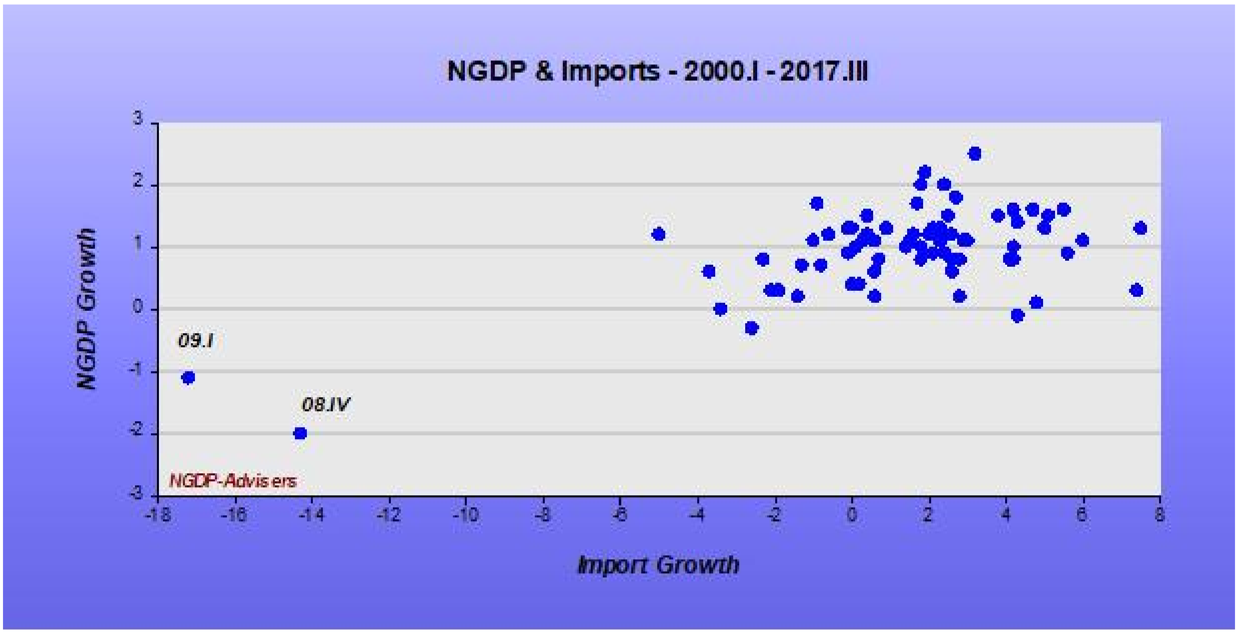
"The U.S. trade deficit widened in October largely because of a slowdown in exports and an increase in imports of oil and other foreign goods, which could ***drag down the country's growth at the end of 2017***." (emphasis added)

The facts are that a widening trade deficit, or more importantly, rising US imports, is associated with *greater* nominal GDP growth.

The chart below shows the association between imports and nominal GDP, comparing quarterly growth rates. The correlation is 0.58, which is quite high, and rises to 0.76 when we look at year-over-year growth rates (not plotted).

While it’s true that in an accounting sense, imports subtract from GDP, in an empirical sense, more imports, at least in the US, usually come along with more GDP. This makes sense when you think about it.

In a complicated, globalized economy, almost all spending stimulates be it on domestic goods or imports. If one buys a computer or a car, many parts will be sourced abroad, even if the unit itself was assembled in the US. The strong read for October imports, is thus an indication that the propensity to spend money was in some way accelerating.

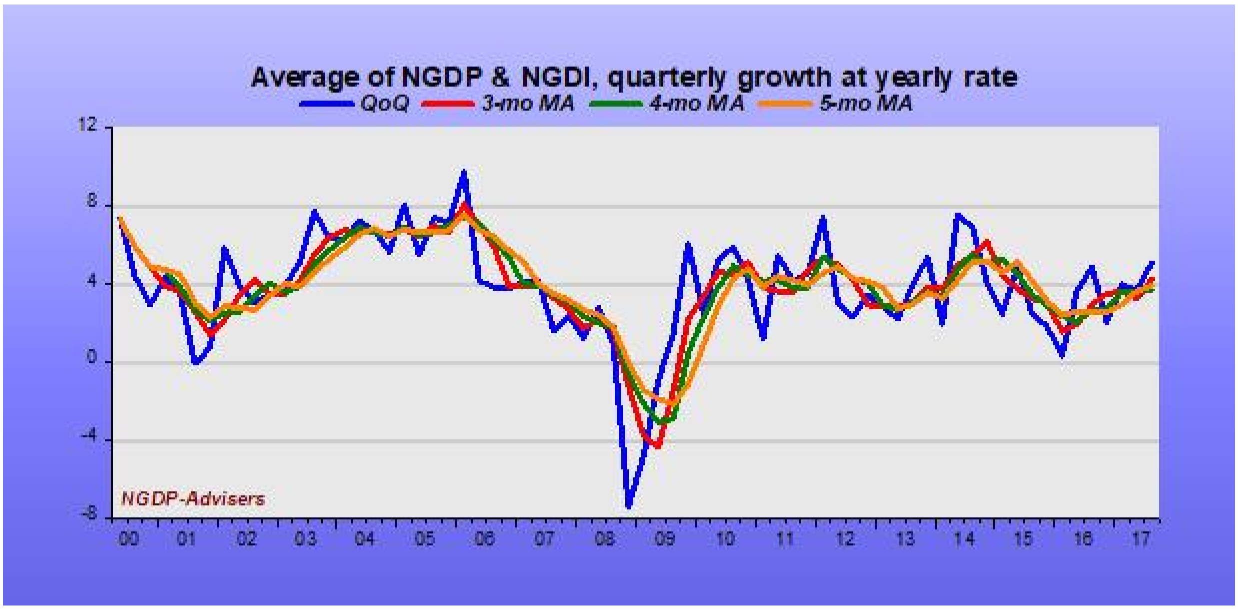


This is just one monthly report. A small indication that Q4 NGDP could be tracking to come in better than expected. The important point is to remember that when analyzing the US economy, stronger imports usually mean stronger NGDP. We should have a better sense of how the quarter is looking toward the end of December, when we get retail sales, industrial production and personal income numbers for November.

Faster NGDP Growth, what does it mean?

NGDP growth has accelerated in recent quarters. When we average NGDP and NGDI (Nominal Gross Domestic Income), we get, at a yearly pace, 5% for Q3, 3.7% for Q2 and 4% for Q1. Not jaw-dropping numbers, but the best run we've seen since 2014.

It's also worth looking at the figures in quarterly form, rather than just year-over-year, as inconvenient as it may be. It turns outs that the best way to predict NGDP growth, is to simply look at recent quarterly growth. In developing our forecast models, we found that sub-models that rely on only a single quarter of lagged NGDP growth can outperform models with more lags. At most, our sub-models use five lags, meaning you don't have to go too far back to fully capture the statistical signal as to the economy's 'momentum'.



This idea of NGDP momentum can be shown visually by looking at moving averages of the quarterly growth rate, shown in the plot above. Moving averages from three to five quarters have moved from just above 2% in 2015 to about 4% today. If the current quarter comes in at a yearly pace of 4.5%, as seems reasonable, then cumulative NGDP growth will be around the highest since 2014.

This time, things are different

Ordinarily, the Fed would use a rising NGDP growth trend as an excuse to unwind some of its balance sheet or to raise rates, as it did in 2015. There is good reason to think that this time they will not do this, however.

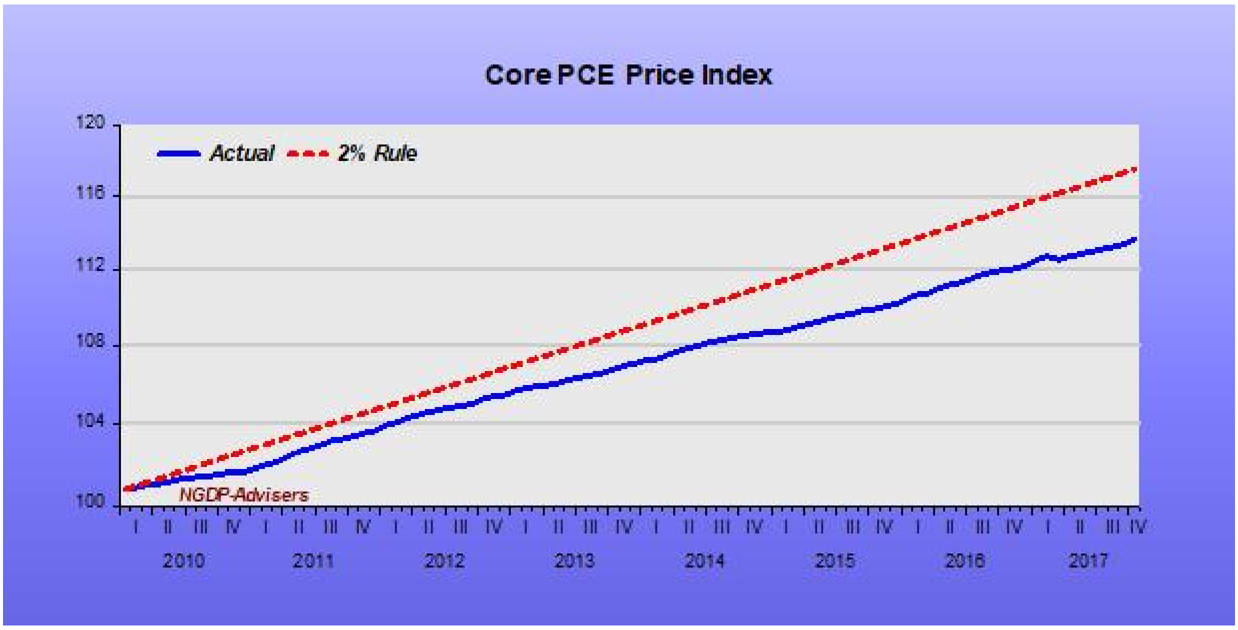
The biggest nod in favor of a more restrained response by the Fed in 2018 is the markets themselves. The rally in stocks is of course well covered, but other assets points to easier money too. Copper prices are back to 2014 levels, TIPS spreads have railed in late 2017, though are still below the “magic” 2% number, and the dollar has been slaughtered in 2017, with the broad, trade-weighted dollar index at a Trumpian low.

Some may object and say “yes, but markets were wrong about growth in 2014, they were too optimistic”. The response is simple “can you do any better?”. Markets are wrong all the time, but it’s hard to consistently anticipate them, anyone who could do it would be fantastically wealthy. Instead of trying to beat the market, especially deeply traded assets like bonds, currencies, commodities and stock indices, try to ***read*** the market.

Other factors—and these may be partly behind the market’s relatively bullish outlook—in favor of a continued runup in NGDP growth include the appointment of a new Fed chair. Given Trump’s peculiar nature, it is hard to imagine him not pushing for maximum concessions for giving Powell the big job.

Maybe prospective Chairman Powell will prove another timid ‘Fedling’ (to coin a diminutive), or maybe he will tack another half percentage point on to the NGDP growth path. We really can’t know, but the possibility of faster growth is enticing and plausible. This is aided by the low inflation record, in which case if the Fed did want to boost the economy; there is ample scope to do so.

The Fed likes to store up *low inflation record*. If there’s a supply shock, they can run the economy above their arbitrary 2% inflation threshold and their banked *low inflation record* will give them rhetorical ammunition when their colleges and the commentariat accuse them of being reckless. Regardless of the merits of this approach, it has become a tightfisted absurdity since, with the exception of four months in 2012, the Fed has not hit 2% year-over-year inflation since 2008. Every month that goes by causes the inflation gap (distance of actual prices from a theoretic 2% target line) to widen. Even on the ridiculous metrics the Fed has set up for itself, there is plenty of cover to let nominal growth accelerate to 5%, if the authorities want it to.



This is of course is mere speculation. Our forecast, more precisely our *expectation*, is for NGDP growth over the next year to be about 4.2%. This is what the models average out to, and a year ahead is about as far as there's any point in forecasting.

This said, growth has accelerated and 2018 is shaping up to be the most hopeful year for the economy in a long while—forecast risk is to the upside. Unlike in 2014, when a growth acceleration was thwarted by a Fed eager to start raising rates, all the pieces are in place to have a genuine boom, and believe it, if NGDP growth holds at (say) 4.7% for a few years, it will feel like a boom. Markets seem to sense this possibility, and have baked a *probability* for stronger growth into their implicit forecast.

When Will Martin Feldstein Be Right?

Macroeconomics is an eternally fruitful field for debate, as no one is ever wrong. There is always another calculus-strewn, opaque "serious" study to cite, or another country to praise or condemn, or an irrefutable theory to which to genuflect. When all else fails, there is resort to, "Just you wait. There will be consequences."

And so we have prominent macroeconomist Martin Feldstein this mid-

November warning investors of a potential 38% plunge in equity values, when stock-market price-earnings ratio return to historic norms.

And that $9.5 trillion reduction in wealth will savage US spending, which will cut overall GDP growth by 2% —very close to snuffing out economic expansion.

But Why the P-E Plunge?

As Marketwatch put it, Feldstein explained the fearful financial outlook "is the result of the Fed's aggressive bond buying in the wake of the financial crisis. Speaking at the Cato Institute, he called on the Fed to tighten monetary policy swiftly, bringing the Fed funds rate up to 4% by the end of 2019 from just over 1% now."

Feldstein also declared the debt market is in dire straits, and that, "Bond prices are also out of line." The yield on 10-year US Treasuries should be near 4%, not the present 2.3% range, Feldstein posited.

With such a harrowing outlook, the Fed should push the Fed funds to 4% in the next year, Feldstein advocated. Otherwise eventually yields on 10-year Treasuries will rise and that "could have a substantial destabilizing effect."

Just you wait.

Conclusion

Martin Feldstein has a lengthy track record of predicting higher inflation and interest rates, extending back to at least April 19, 2009, with his missive "Inflation is Looming On America's Horizon".

Back then, Feldstein also warned that US Treasuries were, yes, overvalued. At the time of his prognosticating, 10-year U.S. Treasuries offered a 4.97% yield.

Of course, Feldstein has been wrong, and inflation is still below the Fed's 2% PCE target, and (as Kevin Erdmann points out) the CPI core sans shelter is rising at a 0.7% rate.

And 10-year Treasury yields have been cut in half, and then some, since Feldstein's long-faced warnings in 2009. Anybody buying US Treasuries using Feldstein as a negative indicator has made a lot of money.

So, is buying 10-year US Treasuries the right move now? Perhaps.

The Fed appears determined to raise short-term interest rates, even if in slow motion. The Fed also says they will sell off their balance sheet, and all this while they are still below their putative inflation target. A reasonable fear is that the Fed will trigger a recession, and then a flight to safety, and thus buying US Treasuries now is a good idea.

On the other hand, both Asia and Europe appear to growing again, which may forestall a Fed-induced economic contraction.

As usual, the large and fluid Treasuries market probably has matters pegged about right. It is difficult to out-forecast the market.

Feldstein's bravado in again declaring the bond market is wrong is…well, understandable. After all, in macroeconomics, no one is ever wrong,

Just you wait.

What does the Fed really want?

It wants to establish a new monetary policy framework. Recently, several presentations have hammered on this point. In a recent speech, Chicago's Charles Evans explains:

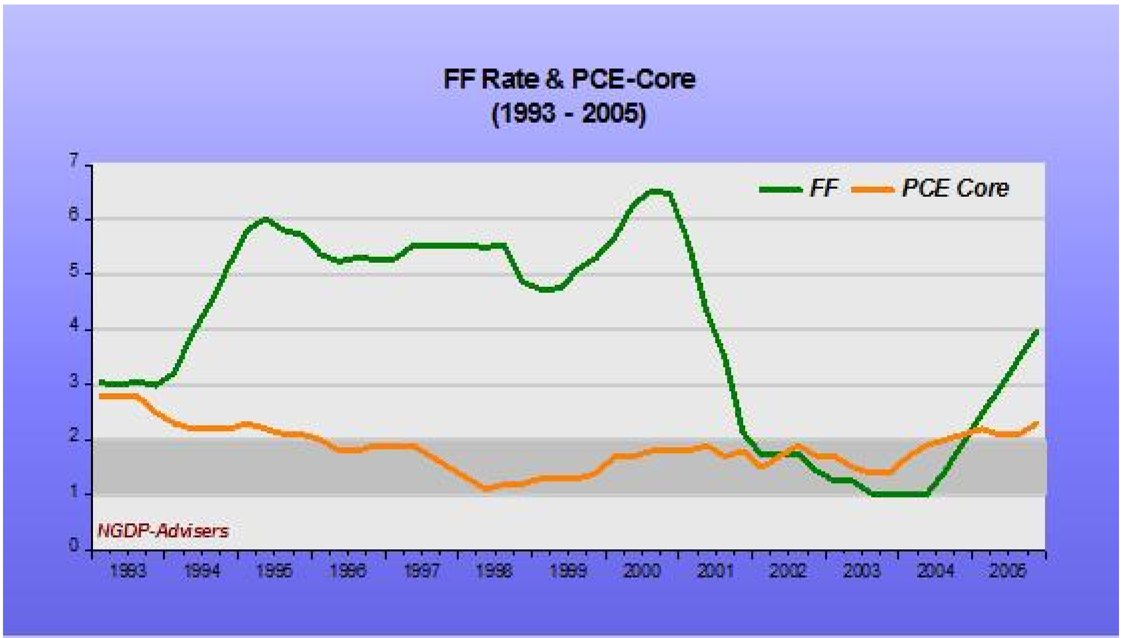
> Specifically, I will talk about ***Delphic communications as those associated with a well-functioning, well-understood monetary policy framework.*** A foundation for these communications is a variety of state-contingent responses to economic developments that are well understood and well expected by the public.
>
> ***I'll refer to Odyssean communications as those arising when unexpected events expose weaknesses and shortcomings in a Delphic framework.*** In such times, the need for outcome-based policies is paramount, and policymakers may be compelled to take less-well-understood actions to meet

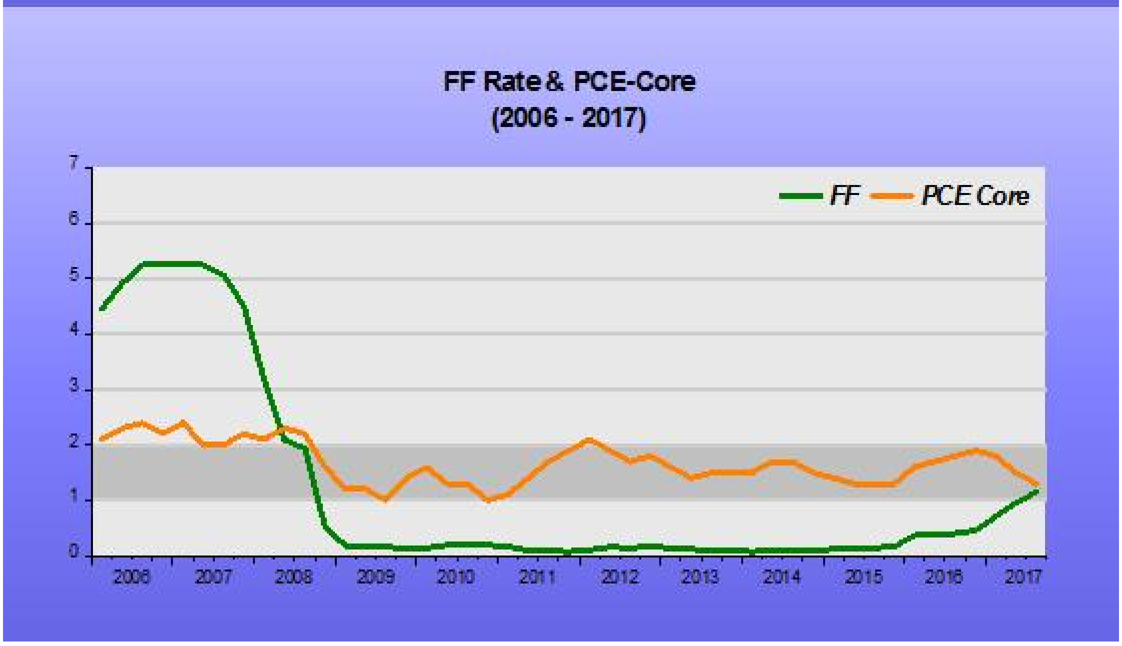
> their mandated goals. These actions may dispense with usual norms and could entail entirely new commitments about future central bank behavior. As such, these Odyssean policies might be difficult to communicate and might lack strong credibility. These shortcomings could dilute their effectiveness. So my question is this: ***How do you convert nonstandard Odyssean policies into a better-understood and more effective Delphic framework?***
>
> Well, you do so by ***strengthening*** your current monetary policy framework. Ben Bernanke's recent proposal at the Peterson Institute for International Economics regarding ***temporary*** price-level targeting (PLT) is one such example.[3]
>
> Furthermore, the journey from the Fed's 2010 policy debates about temporary price-level targeting at the zero lower bound (ZLB) to Bernanke's recent proposal ***illustrates the challenges in transforming Odyssean policies into Delphic ones.***

In addition to Bernanke and Evans, the "PLT" (Price Level Targeting) alternative has been put forth by others, including Francisco Fed John Williams.

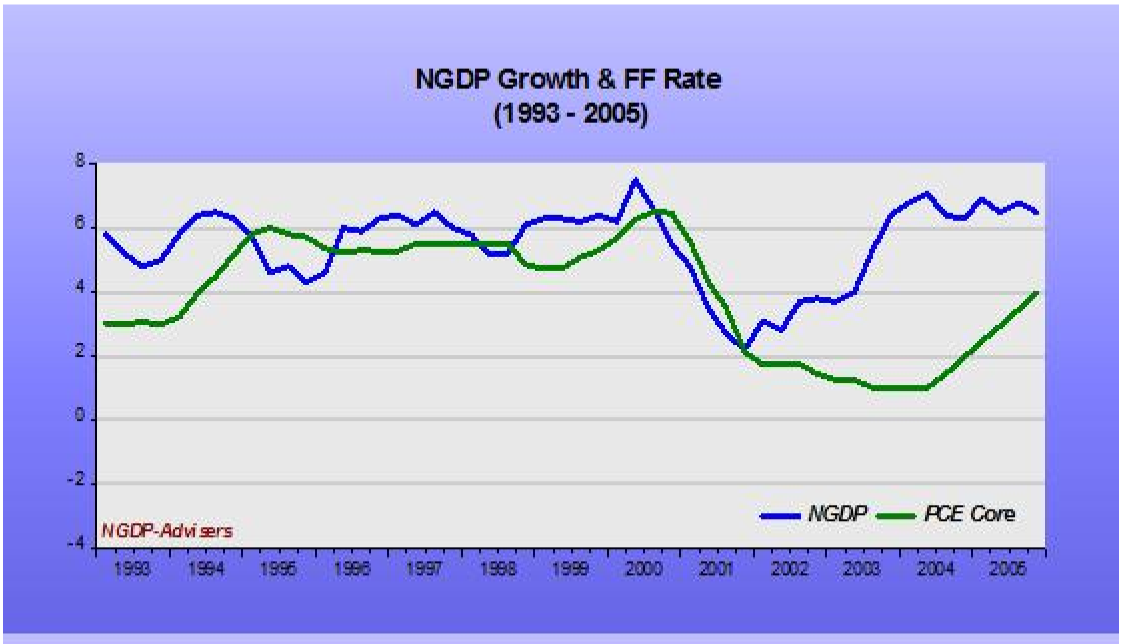
For almost two decades monetary policy makers have discussed, published and debated on the topic of "Monetary Policy in a Low Inflation Environment". One early readable essay on the subject is this one.

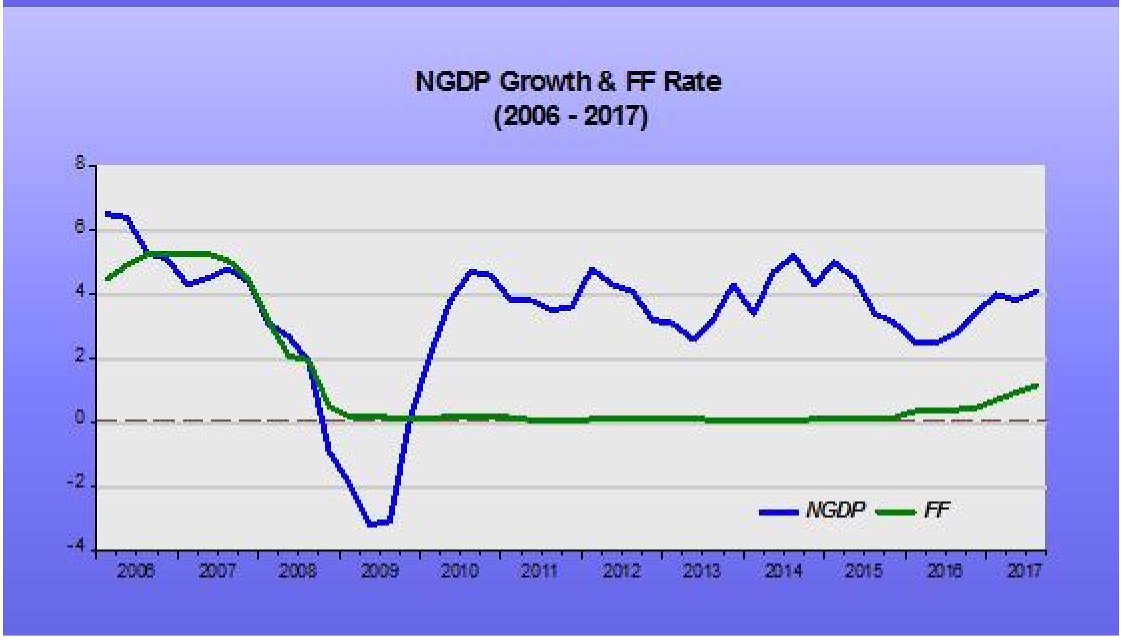
The focus has been on the "dangers" of reaching the ZLB ***due to low inflation***. However, as the charts indicate, it appears ***that low inflation has no implication for the risk of reaching the ZLB***.





The thing that poses that risk, for sure, is the Fed making a gargantuan monetary policy mistake letting NGDP growth turn significantly negative as happened in 2008. The big drop in the ***level*** of NGDP was never made up, and the rate of NGDP growth has remained low and stable, consistent with low and stable inflation and very low FF rate.





If too low NGDP growth (additionally at a low trend level) is the major reason for interest rates having difficulty moving up and away from the ZLB, the “best” monetary policy framework is NGDP Level Targeting, not inflation or price level targeting.

Faulty, but dangerous, reasoning

From “Fed-watcher” Tim Duy:

> The Federal Reserve believes the economy currently operates close to if not a little beyond full employment. The unemployment rate fell to 4.1% in October, well below the

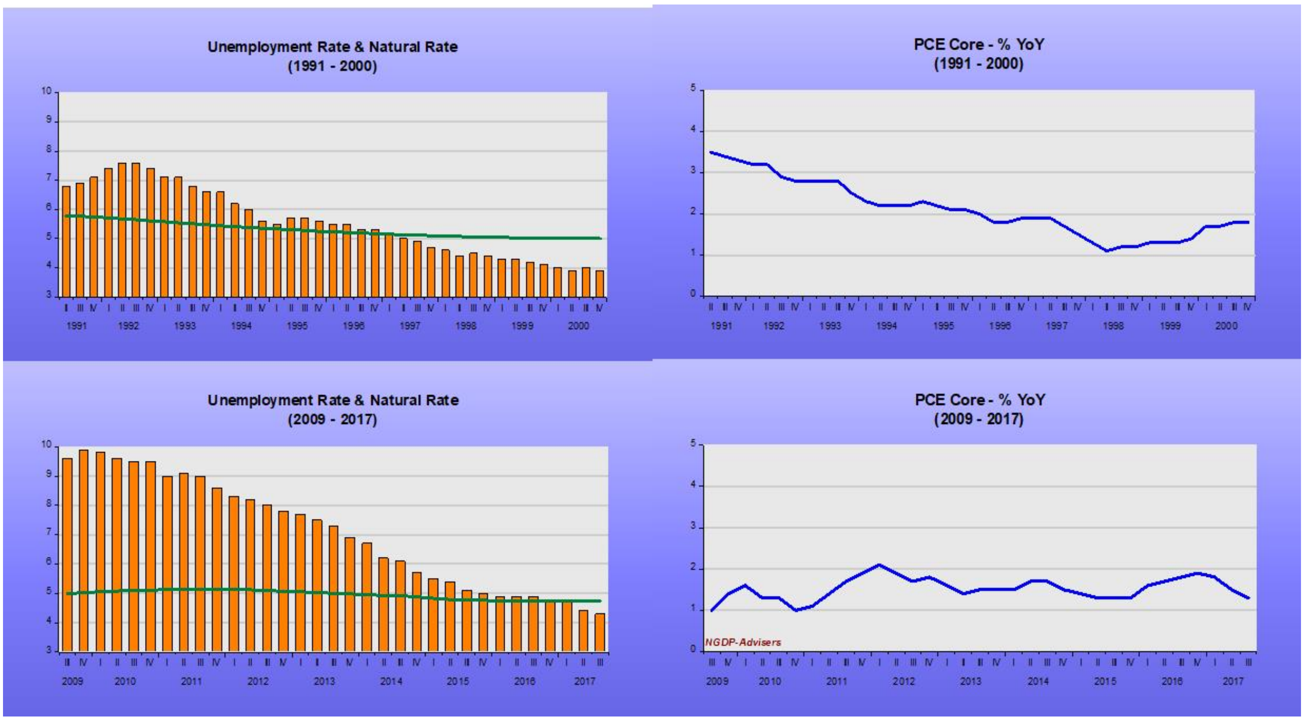
Fed’s longer run estimate and the 4.4% low of the last cycle. And note the broader U-6 unemployment rate, which includes measures of underemployment, fell to 7.9%, the low of the last cycle.

By these metrics, conditions are fast approaching those the late-90’s. I believe the economy will sustain enough momentum to hit that point within the next six months.

We do not have much experience with an economy operating near full employment. This sounds odd, but generally the Fed kills the economy soon after reaching that point. Moreover, we do not have much recent experience with a ***full employment, low inflation economy***. The tops of the last two cycles were fairly short-lived. Beyond that, I think you need to look at the late 60’s for a similar dynamic.

The tricky part for the Fed will be managing the slowdown of activity. Policymakers have had limited success at holding the economy near full employment for a sustained period of time. The risk is that the Fed forgets about policy lags and believing that the economy is not slowing quickly enough, tightens too much. ***This sets the stage for recession in late 2019 or 2020. That would still leave this as a record-breaking expansion.***

Conditions in the late 1990s and now

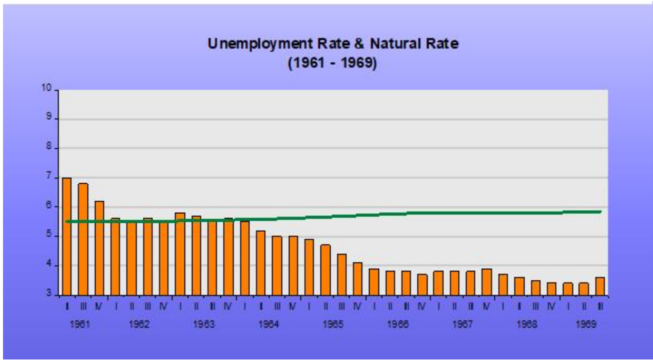


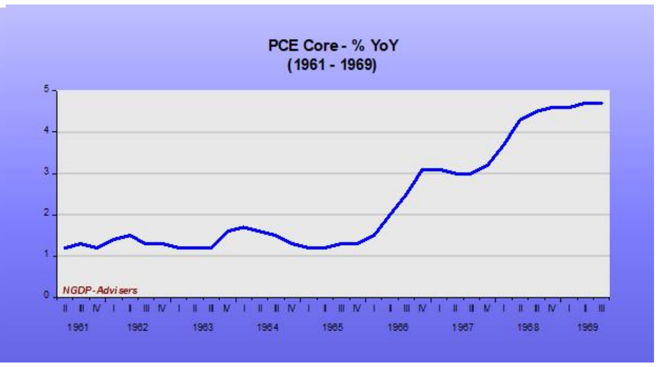
In the 1990s, unemployment and inflation went down together. Despite unemployment being below the natural rate in the last four years of the 1990s cycle, inflation fell further and remained low.

At present, despite a long period of falling unemployment, inflation remained low and stable. Only recently, unemployment fell below the natural rate but inflation remains dormant. If inflation didn´t rise even a little while unemployment was falling dramatically, why should it rise now that the unemployment rate has more or less stabilized?

Therefore, Duy´s statement that “***We do not have much experience with an economy operating near full employment…. Moreover, we do not have much recent experience with a full employment, low inflation economy***”, is clearly false.

He asks us to “look at the late 60’s for a similar dynamic”. His “drink must have been spiked” because there´s no “similar dynamic”. What we get is a falling rate of unemployment that goes below the natural rate, just as in the 1990s, but inflation “soars”.





More than anything, this last chart explains why Yellen, Fischer & friends, who "came of age" in the late 1960s (Yellen PhD 1971, Fischer, PhD 1969) are firm believers in the Phillips Curve. Therefore, to them, falling/low inflation in the face of low unemployment is a "mystery".

If inflation is not rising, it must be because temporary or transitory factors are at play.

From Yellen:

> "A pricing war among mobile phone service providers has led to falling prices for cellphone plans, and prescription drug prices have made what appears to be a one-time drop".

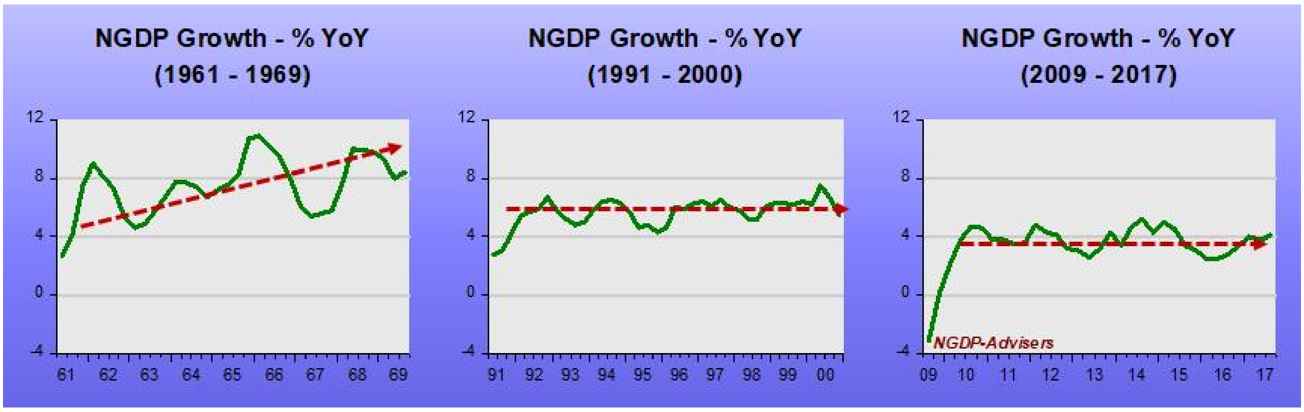
Bank of Canada Stephen Poloz "agrees":

> "One-off factors such as electricity rebates in Ontario, as well as the combination of abundant crop supplies and increased retail competition that have held down food prices, account for about two-thirds of this year´s shortfall."

Interestingly, when inflation was on the rise in the 1970s, Fed Chairman Arthur Burns blamed it on oil prices, worker unions and oligopolistic firms!

To central bankers, monetary policy is synonymous with interest rate policy.

If instead you gauge monetary policy by what´s happening to nominal spending (NGDP) growth, there´s no more "mystery". Either for the rising/high inflation of the second half of the 1960s (which was "delayed" due to the time it took for inflation expectations to “adapt”) for the falling/stable inflation of the 1990s or the low/stable inflation in the present cycle.

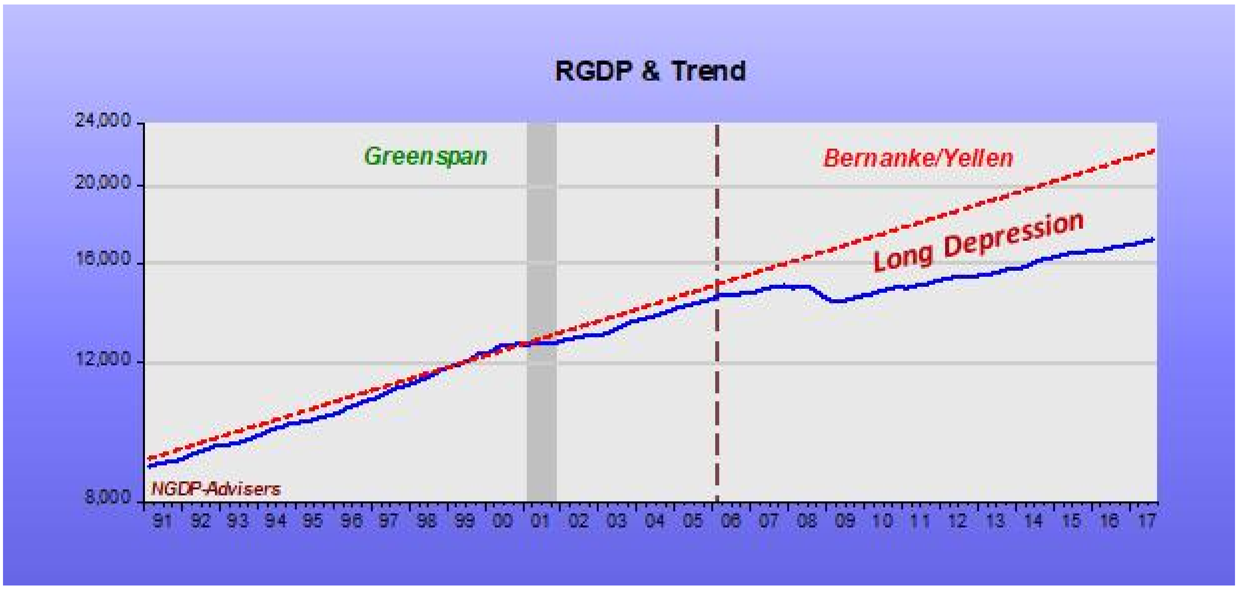


Tim Duy is right when he says, “believing that the economy is not slowing quickly enough, [the Fed] tightens too much. ***This sets the stage for recession in late 2019 or 2020.”***

To us, “tightening too much,” means allowing NGDP growth to fall from the already low level. This is a clear possibility because they are looking at the wrong metric: the unemployment rate.

Maybe because he´s a Bernanke/Yellen fan, Tim Duy ends with a spin ***“…That would still leave this as a record-breaking expansion.”***

When the truth lies more in calling it “the longest depression”!



The Fed´s "doom machine"

Tim Duy "terrorizes" in his "Fed will keep rate hikes coming":

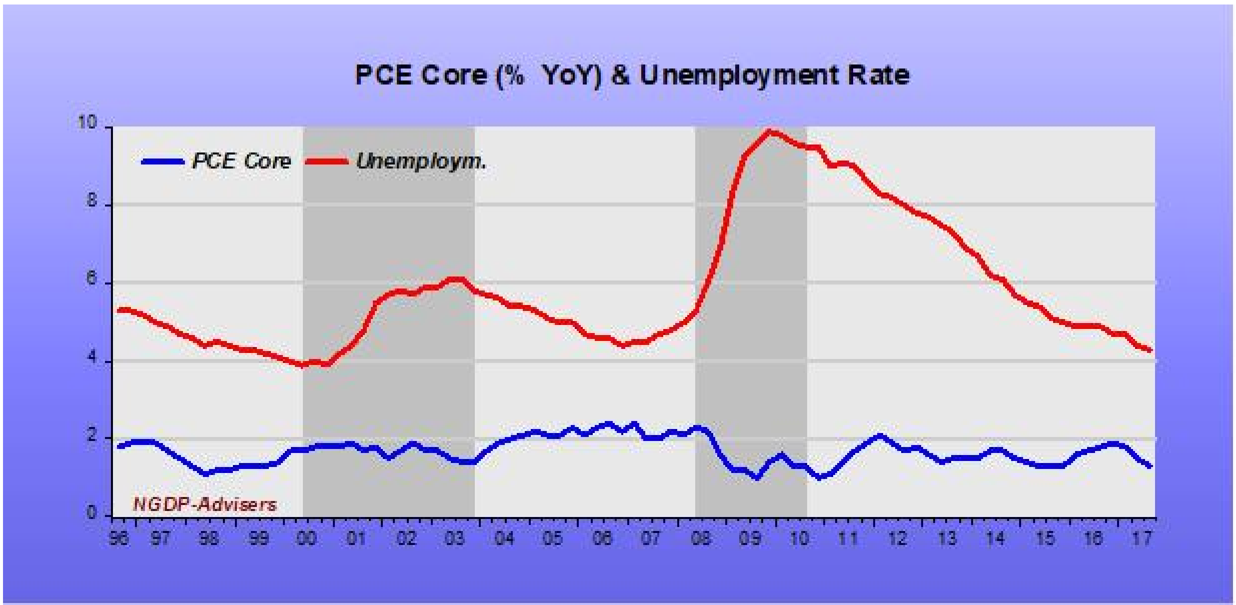
> Lots of news from last week, most of which supported the Fed's current anticipated rate path of one 25bp hike in December followed by three more in 2018.
>
> The only potential obstacle on that path is the persistent weakness of inflation. But the ***ongoing decline in the unemployment rate, along with the promise of further declines in the months ahead, will dominate lingering concerns at the Fed regarding the inflation numbers***.

That´s exactly Yellen´s thinking:

> It's important to try to estimate the unemployment rate that is equivalent to maximum employment because ***persistently operating below it pushes inflation higher, which brings me to our price stability mandate***.
>
> —Janet Yellen, January 18, 2017

When monetary policy is synonymous with interest rate policy, and when the rate of unemployment is the "guiding light" to interest rate decisions, what you get is very bad monetary policy.

Look at the charts below



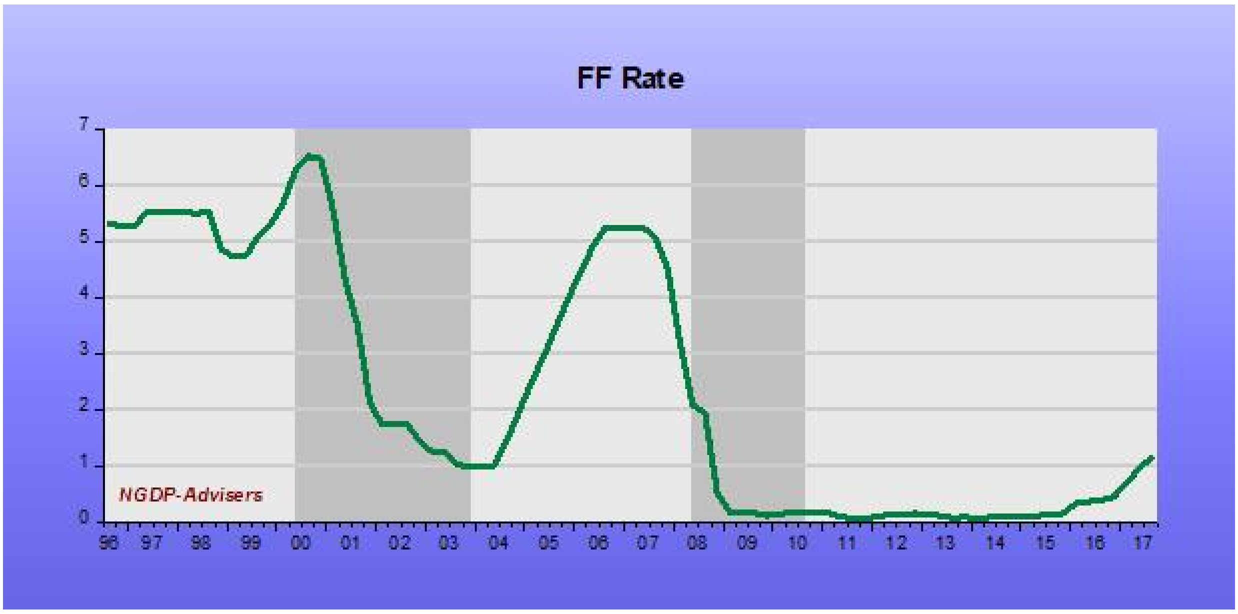
While you do not see any obvious relation of unemployment and inflation, you see a clear relation between unemployment and nominal spending (NGDP) growth.

When spending growth falls off its path, unemployment increases and the magnitude of the unemployment increase depends on the magnitude of the spending fall.

A stable level of spending growth is consistent with unemployment falling, while inflation remains low and stable.

With inflation expectations anchored, drops in spending growth have little effect on inflation. The deep drop in spending in 2008-09 had some impact on inflation, but that was temporary because inflation expectations remained stable.

Meanwhile, the Federal Funds rate, set by the Fed has “travelled widely”.



In the shaded areas, the FF rate falls significantly. By that metric, monetary policy was “easy”. How can that be with spending growth falling and unemployment rising? Friedman´s dictum solves the puzzle. According to Friedman, “low interest rates are a sign that monetary policy has been tight”.

Bottom line: if the Fed is afraid of low unemployment, it should decrease the rate of spending growth. If it pursues that objective, it will end up with rising unemployment but inflation expectations (and inflation) would fall. The result would be a recession within a depression and the loss of Fed credibility!

PS: A new “Leading Indicator” of inflation – restaurants – has been suggested:

> Menu Prices Will Tell the Future of Inflation – When wages rise, these businesses must raise prices or go bust.
>
> If these price hikes materialize, they could be an ***early indication of inflation getting back on track***: Restaurants are more sensitive to labor conditions to most, but all industries are eventually affected.
>
> But, restaurants can also foretell recession:
>
> If the margin pressures on restaurants leave them too cautious to raise prices, ***we’ll see a wave of restaurant closures and laid-off employees – another sign that the***

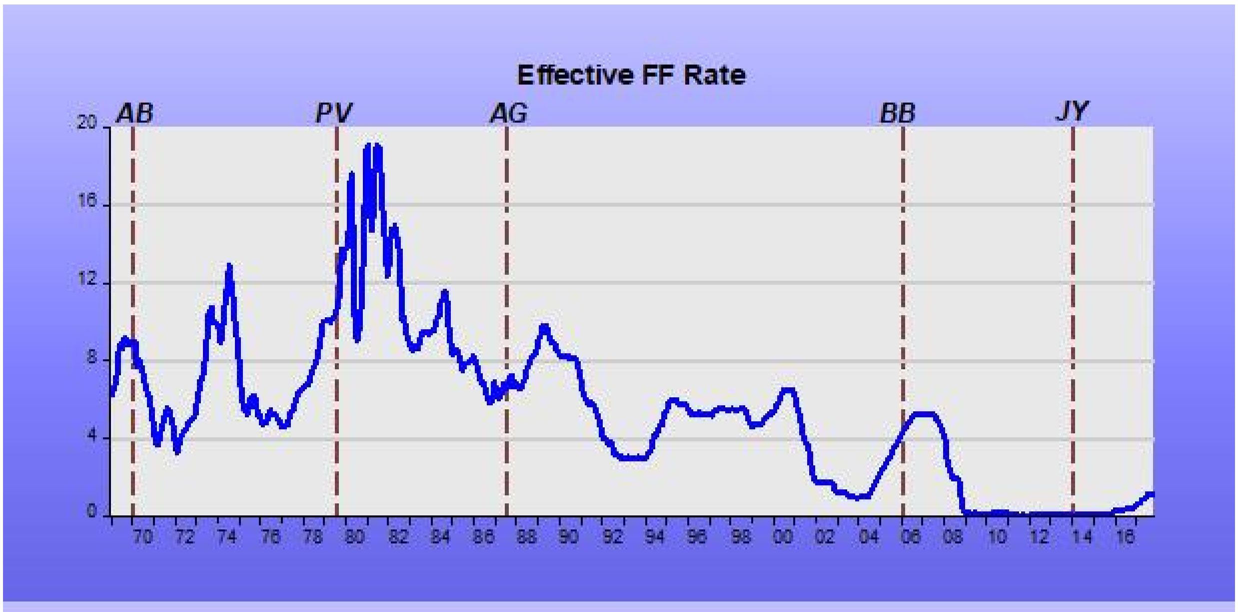
> ***economy is stuck in a post-recession rut***.

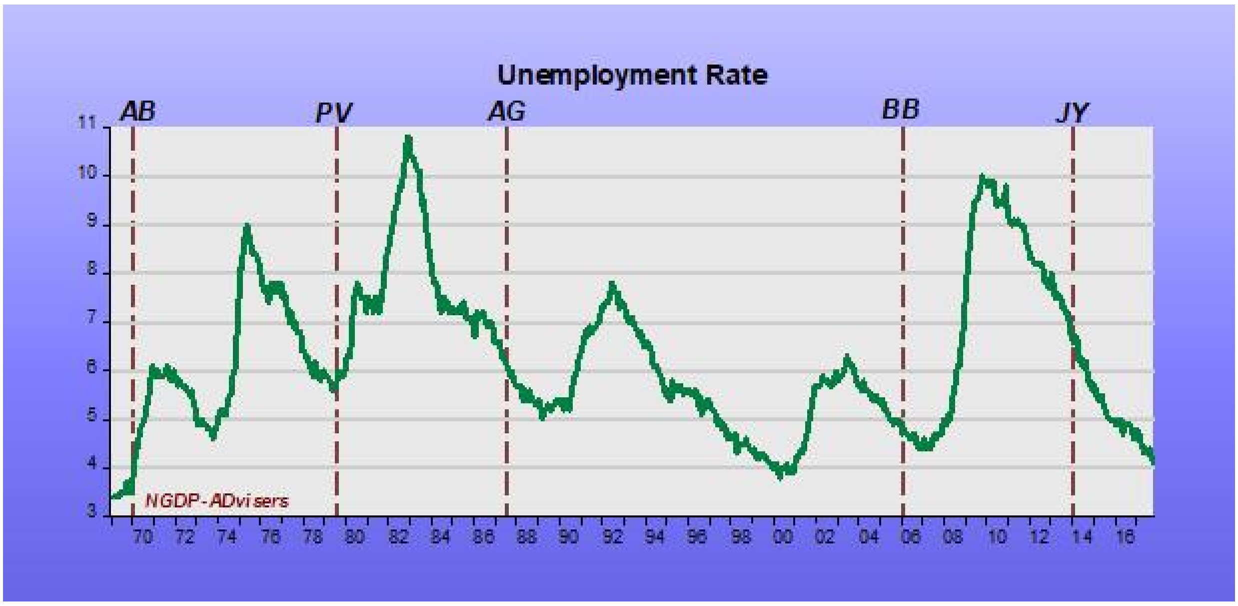
Anticipating disaster

A new Fed Chair is always required to show his anti-inflation credentials: Booming Labor Market Could Pose Challenge for Powell and the **Fed** **–** Janet Yellen's prospective successor may find himself needing to ***restrain an economy that is too vibrant***:

> The hardest job in central banking is to take the punch bowl away from the party just when people are starting to have fun. Jerome Powell, the Federal Reserve's prospective chairman, ***could soon have to assume the role of sober killjoy as he is confronted with an economy and markets that are heating up***.
>
> That could put Mr. Powell in a tricky position. On one hand, an economy at risk of overheating should prompt the Fed to steadily raise interest rates to cool it down.
>
> … some Fed officials worry that such a strong labor market could ***cause inflation to rise too rapidly as pent-up pressure releases, forcing the Fed to raise rates more than planned.***
>
> In a June speech, ***Mr. Powell said the continued strength of the labor market "might warrant a faster pace of tightening***."
>
> For now, weak inflation has been holding the Fed back, he said. But he added that "there are good reasons to expect that inflation will resume its gradual rise***" in an environment of tighter labor markets and increased consumer spending***.

In the panel below, the vertical bars mark the moment each of the last five Fed Chair took power and what happened to the FF rate, inflation and unemployment in the follow-up.





The only one that decreased rates immediately after taking power was Arthur Burns. The others raised rates while Yellen´s first rate hike took place 22 months after starting on the job.

In Arthur Burns case, Nixon´s price controls took effect 6 months down the road, but things went haywire when the first oil shock hit two years later…

To better gauge how the different Chairs performed relative to their dual mandate of “maximum employment” and “low/stable inflation” (which since January 2012 means 2%), it is more useful to observe the behavior of aggregate nominal spending (NGDP) growth, over which the Fed has close control.

The correspondence of nominal spending growth to inflation is almost exact! The rising spending growth during Arthur Burns’ tenure explains the rising inflation. Falling inflation during the Volcker years goes hand in hand with the fall in spending growth.

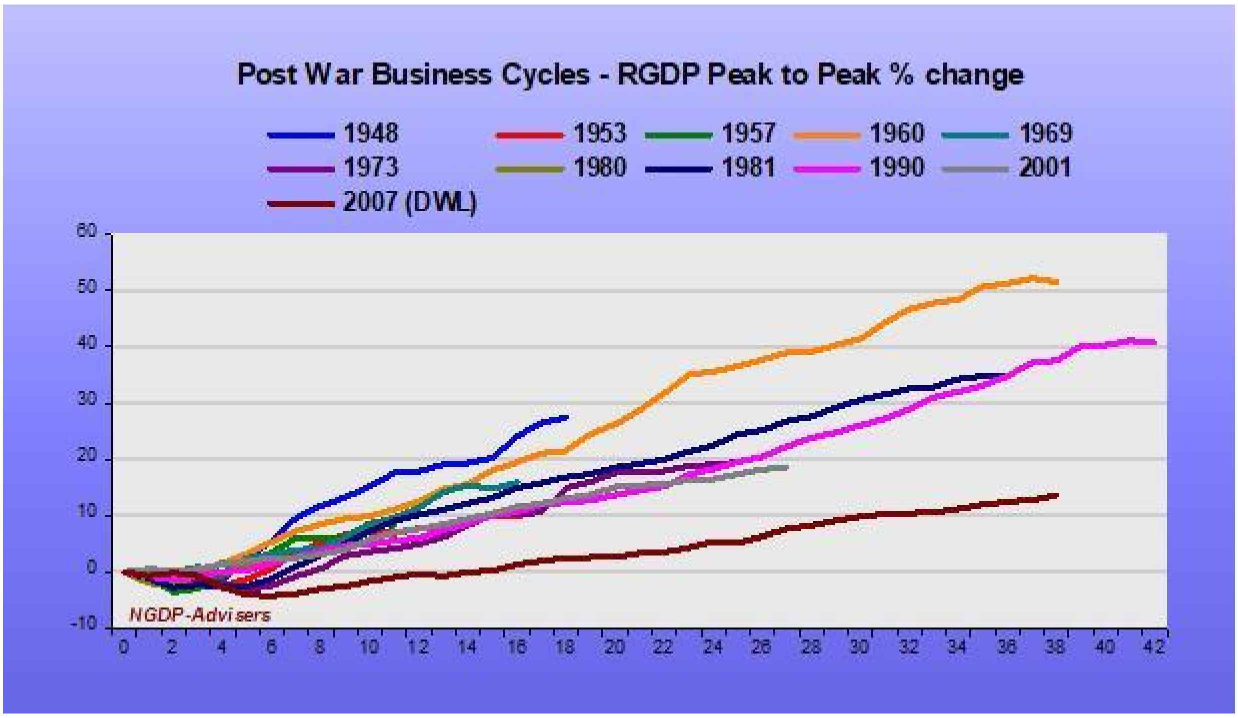
Falling and then stable inflation during Greenspan´s command is reflected in the relatively stable spending growth.

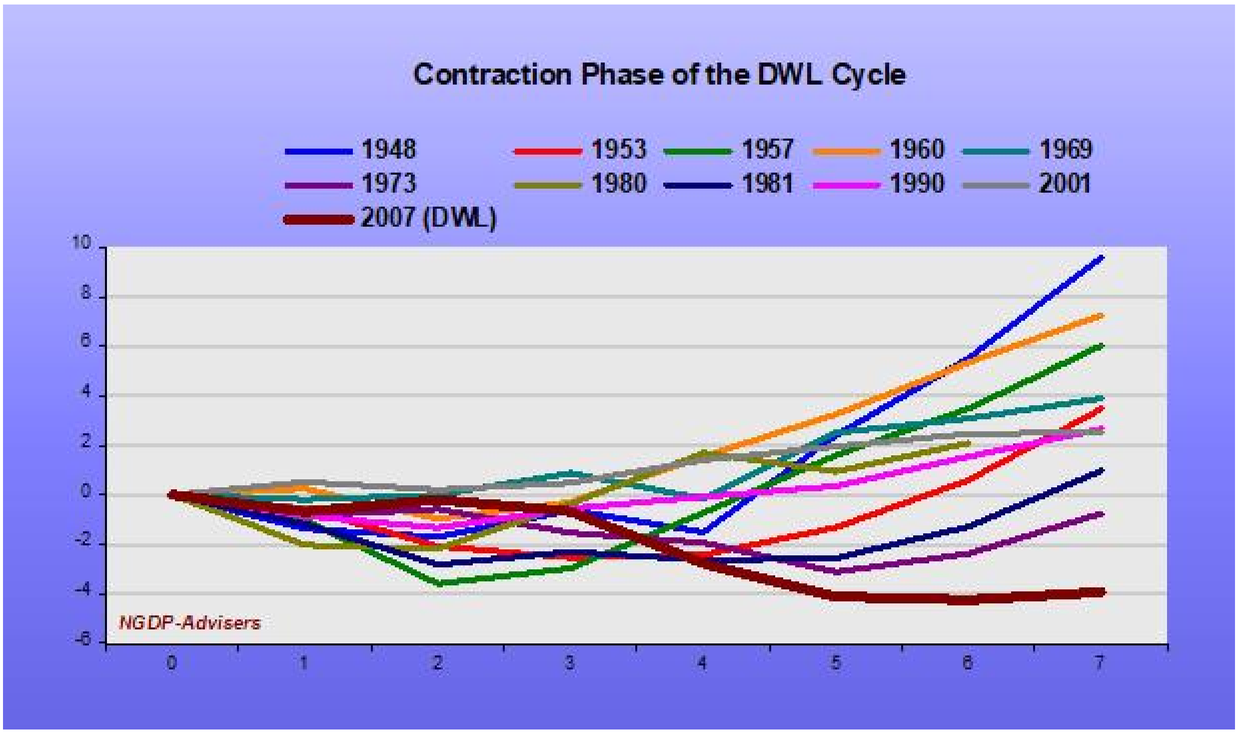
Bernanke´s “spending plunge” illustrates the biggest monetary policy mistake since the 1930s. There was no inflation worries (apart from the oil shock of 2007-08, which according to his own writings the Fed should ignore, but did not). Yellen just kept the economy on the same “depressed road”. The lower but stable spending growth was sufficient to keep inflation “too low” (because under 2%) and unemployment falling.

The pick-up of spending in the aftermath is timid and insufficient to generate anything that could be called “recovery”.

The two charts below illustrate what I call the DWL cycle, for

Deepest recession, **W**eakest recovery and (shortly) **L**ongest expansion.





In the second chart you note that for the first few quarters into the recession, the economy´s performance was "better" than average, despite the tumble in house prices and the financial crisis. However, while in many other occasions the economy had started to recover, in this cycle it plunged deeper. That was the outcome of the massive monetary (Aggregate Demand) shock generated by the Bernanke Fed.

The present and clear danger is that if Powell is “sold” on the idea that he has to restrain an economy that is “too vibrant”, the outcome will be “disaster”.

U.S. Federal Reserve Eyes Rate Hikes, Citing Tight Labor Markets; Q3 Unit Labor Costs Down YOY

As I reported in this space recently, the U.S. Federal Reserve has been in sustained catatonic hysterics about “spreading labor shortages” in the United States, going back several years, as evidenced by Beige Book passages nearly too numerous to catalogue.

This week, the U.S. Labor Department reported third-quarter unit labor costs were down 0.1% year-over-year.

As noted by many, the Fed long ago ossified and since at least 2008 has chronically projected inflation, interest rates and economic growth higher than is obtained.

Perhaps underlying this petrified bias has been an acute squeamishness about labor markets, especially as advanced by regional Fed presidents. The Fed Beige Books are detailed compendiums of worsening shortages of “skilled” and “unskilled” workers.

The labor shortages are so dire…as to result in falling unit labor costs?

But is the third quarter decline in labor costs a one-off? Well, actually since the fourth quarter of 2015, unit labor costs are up, as in 0.20%. Not annually, that is in total.

Making matters more curious, the Fed recently and abruptly ceased publication of its once ballyhooed Labor Market Conditions Index, which appeared on course to reveal labor markets were easing, not tightening.

Conclusion

The Fed has been grasping at straws for years to justify monetary tightening, even as it chronically undershoots a putative 2% average inflation target on the PCE, and even as labor costs flatten or decline.

The new Fed Chair, Jerome Powell is said to be "dovish," but what that means in the current context is debatable. Let us hope that under Powell the Fed suffocates the economy a bit less.

While some will praise Chair Janet Yellen upon her departure, in truth trillions of dollars of real output, wages and profits have been foregone to fight an inflation bogeyman.

For investors, Powell appears to be the best option for now. The S&P 500 is richly priced, but interest rates are low, and will likely stay low.

Slow growth ahead? Probably, but not if Powell gives in to the tight-money crowd. Watch carefully.

BoE rate rise – the MPC minority loses but wins

The UK central bank raised interest rates by 25bps today. Big deal. Because GBP fell and stock markets rose, we have just witnessed a ***dovish rate rise***. In achieving this feat, the BoE has had the same success as Draghi on the expected tapering of the ECB's QE announced late last month. Hats off to both the ECB and the BoE

How is a dovish rate rise or QE taper achieved? By convincing markets that their expectations of ***further*** rate rises or ***faster*** tapering of QE or ***reductions*** in central bank balance sheets were too hawkish.

The key to this particular dovish rise was not Carney, He is largely history now given the limited time left on his tenure. The next Governor is now looming into view. Who will it be? The appointment is in the hands of the Chancellor of the Exchequer at the UK Treasury.

And here the minority voting against the rate rise was fascinating.

The two heroes who voted against the rate rise were the two Deputy Governors most closely connected to the Treasury, Jon Cunliffe and Dave Ramsden. They are both now well positioned to be the next Governor. I favor and expect it to be Ramsden. He will clearly reverse this rate rise very quickly if necessary. For Americans, these two dissents are rather like both Stanley Fischer and Bob Dudley voting against Janet Yellen.

The market just ignored Carney's nonsense about "the economy growing above its speed limit" – if only – or Carney's foolish micro-estimates of the amount of "slack" left in the economy.

When Carney et al cut rates in 2016 from 0.5% to 0.25% in the aftermath of the Brexit vote turmoil, it signified little except that the BoE was following through on its guidance that it would ease substantially in the event of a Leave win. GBP collapsed on the night as markets had already taken Carney at his word. Monetary policy was already significantly eased by the time the BoE cut rates and restarted its bond-buying program.

Likewise, this rate rise was signaled months ago as evidenced by the worrying rally in GBP over the 2nd quarter. This rally has slowed nominal GDP growth that had nicely recovered following the 2016 monetary easing. What was not signaled was the authority of the twosome who voted against the rate rise.

One of the benefits of raising rates a little is that the BoE can easily switch back to signaling they can cut them again. If a "No Deal" Brexit looks more likely over the next few months then the BoE will most certainly have to start signaling an easing again.