Mitchell's Musings 6-17-13: The New Keynesians

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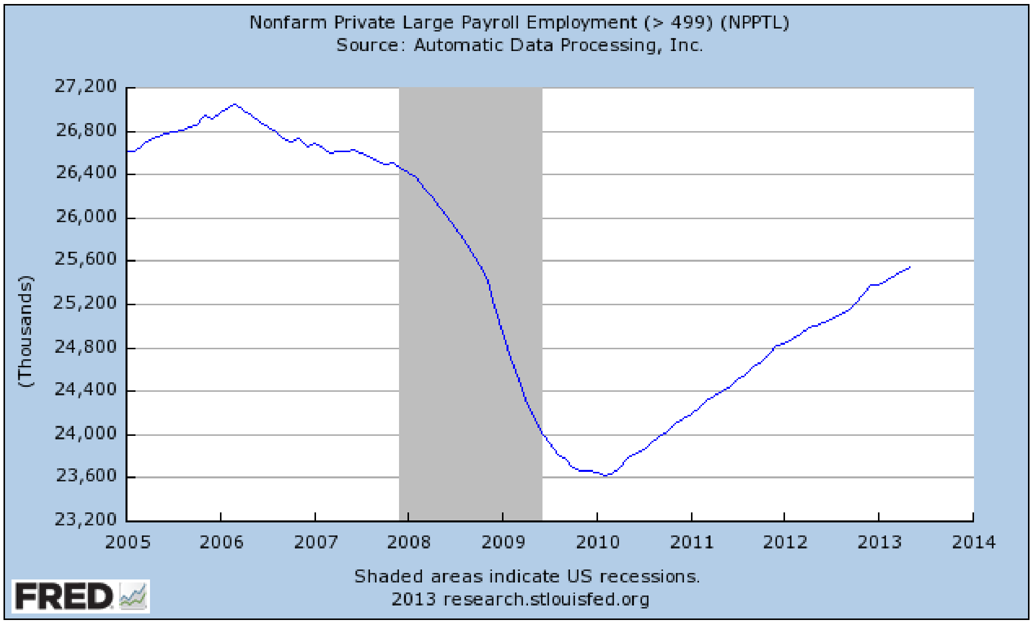
From time to time, various surprising folks have said they were "Keynesians" including Milton Friedman and Richard Nixon.[1] The National Federation of Independent Business (NFIB) seems to be the latest of the converts – although it did so without mentioning Keynes overtly. Still, what else could you make of the quote below for NFIB – an organization representing small business – that appeared recently in the Washington Post? The article generally reported a lament by the organization about lackluster job creation by small business.

> *"The group blamed the consistently low readings on 'increased taxes and the budget cuts.'"*[2]

If poor job creation performance is due to *increased* taxes and budget *cuts*, then presumably that performance would benefit from tax *cuts* and spending *increases* – which sure sounds like pop Keynesianism. The theme of the article is that according to a survey by NFIB, small business has not done well – particularly last month. However, the Post piece goes on to refer to the Automatic Data Processing (ADP) survey that suggests a somewhat different story – one on which we mused some time ago. Employment growth overall has been lackluster – no doubt about it – but it seems to be large business that has had the worst performance in job creation, not small.

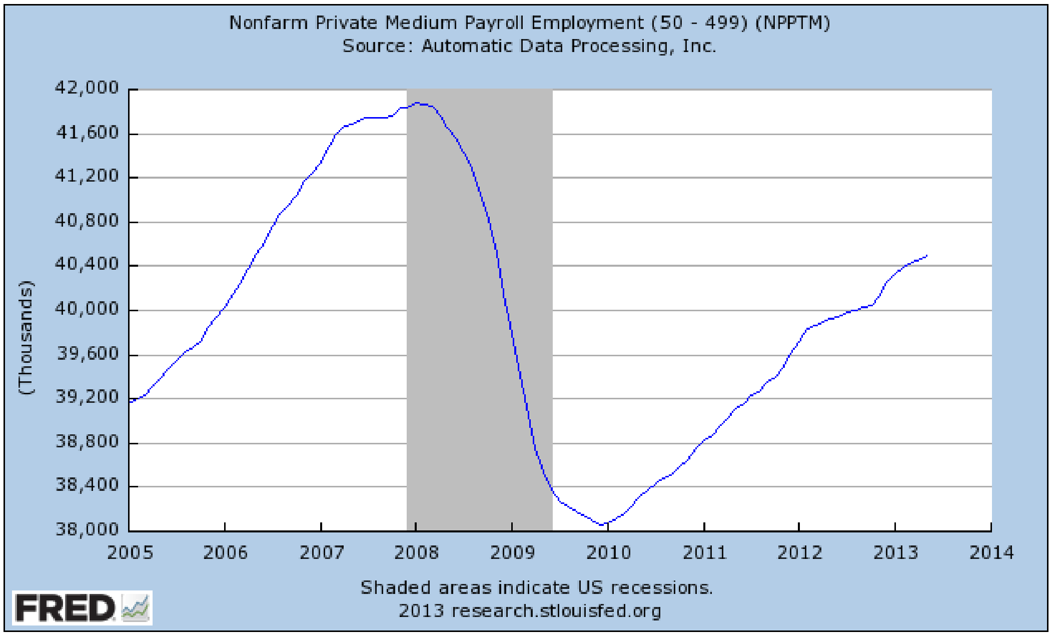


As the graphic above indicates, larger employers have still got a ways to go even to return to their previous peak in employment. And their previous peak came well before the official start of the Great

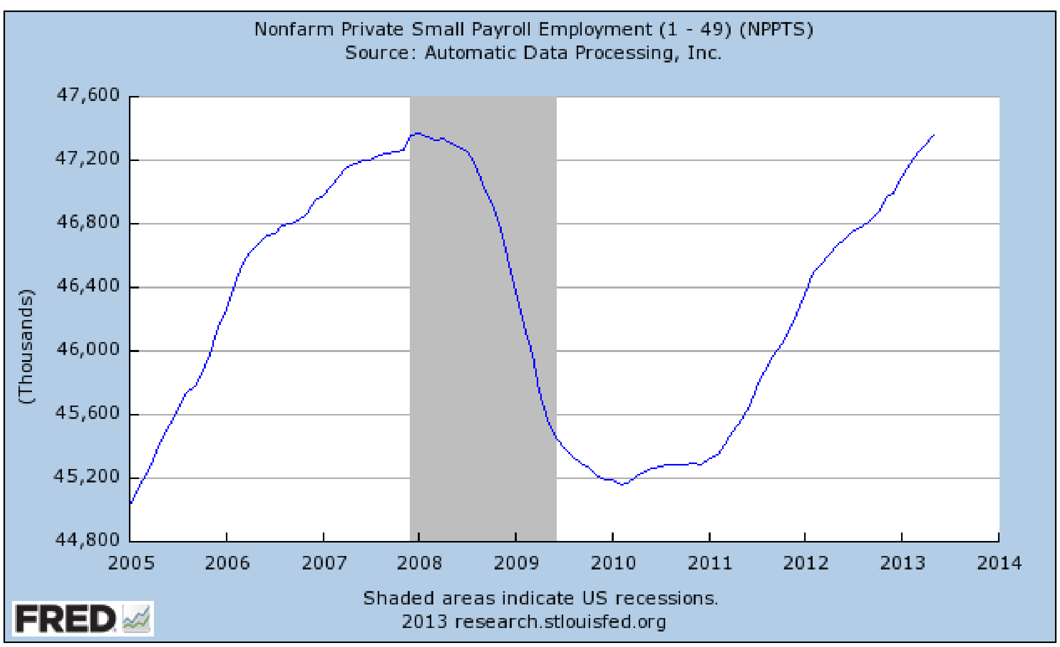
[1] http://www.ontheissues.org/celeb/Richard_Nixon_Budget_+_Economy.htm
[2] http://www.washingtonpost.com/business/on-small-business/a-step-backwards-small-business-firings-outpace-hirings-for-the-first-time-this-year/2013/06/05/e4ac05e0-ce03-11e2-8845-d970ccb04497_story.html

Recession at the end of 2007, the shaded area. Some of these large employers are in manufacturing, a sector that was in decline - due in part to international pressures - before the recession.

When we look at intermediate size businesses – see below - we find a similar failure to return to pre-recession levels, although the peak for those firms came just prior to the Great Recession.



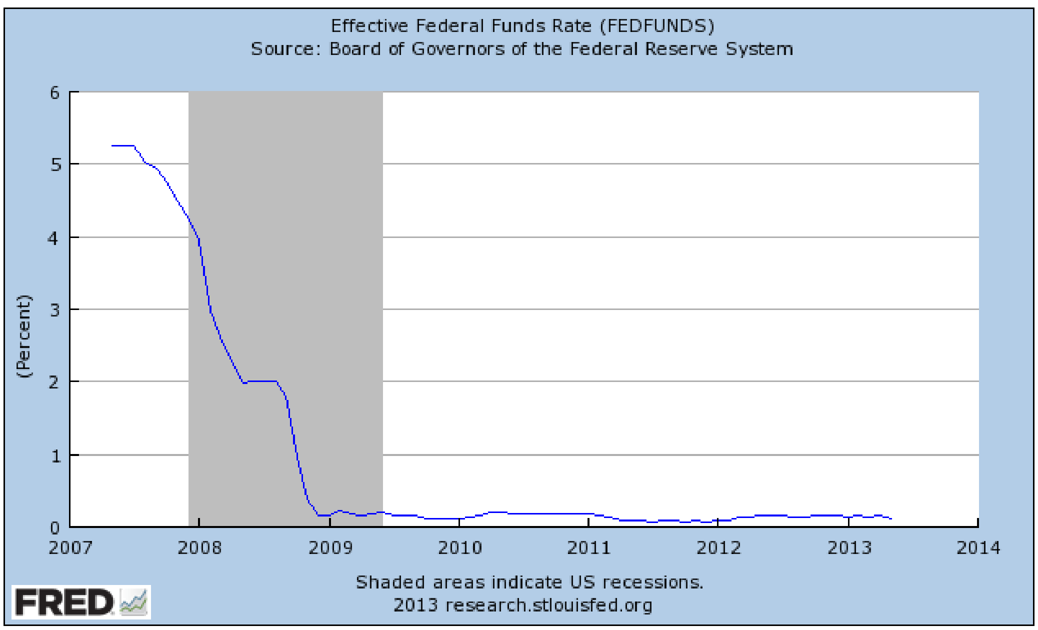
On the other hand, small businesses seem to have done the best as the graphic below illustrates. They have at least (barely) surpassed their pre-recession peak. Of course, just getting back to prior peak levels five years after that peak occurred is not a good result. Such performance doesn't account for the population and labor force growth in the interim.



Nonetheless, Congress might take note of the seeming conversion of small business – or at least their representative - to Keynesianism. On January 1, 2013, payroll taxes that had been temporarily cut were allowed to revert (rise) to their earlier rates. And the "sequester" is resulting in spending cuts that would not otherwise occur. At the moment, no one in authority in Congress is acting very Keynesian.

That legislative failure leaves monetary policy as the sole macroeconomic tool. It is probably somewhat of an historic precedent that the main public official who continues to voice concern about poor performance in the labor market is the chair of the Federal Reserve. Traditionally, the heads of central banks worry about inflation and talk about the labor market only when they feel public pressure to do so. Fed Chair Ben Bernanke has been (refreshingly) different.

The Fed has remained activist, holding short-term interest rates close to zero, as the graphic below illustrates. And even while some observers have now converted to Keynesianism, there also appears to be a gradual realization that old-style monetarism is dead. Monetarists of the old school have continued to warn that the Fed's action in holding down interest rates – essentially through large purchases of financial assets and therefore monetary creation – will produce a rapid inflation any day now. It has been an article of faith among monetarists that creation of money (somehow defined) will soon thereafter pull up prices. But faith-based economics has its limits.



There has indeed been much monetary creation by the Fed. (See the upper chart on the next page.) However, the transactors in financial markets apparently are not old-school monetarists. The yield spreads between long-term inflation-adjusted Treasuries and corresponding conventional Treasuries – basically a consensus forecast of future increases in the Consumer Price Index - simply have not predicted the inflation that monetarists fear. (Lower chart, next page.) Actors in financial markets are evidently not expecting high inflation.

In summary, it appears of late that Keynesianism is winning converts – except in Congress where it counts. But if there were once monetarists in the financial markets, apparently their faith has lapsed.