

War and Interest Rates

War is inflationary.

Wars come in many different shapes and forms. There are hot wars, cold wars, and what [Pippa Malmgren](#) calls hot wars in cold places – cyberspace, space, and deep underwater (see [here](#)). We would also add to the list of cold places “corridors of power” in Washington, Beijing, and Moscow, where great powers are waging hot wars involving the flow of technologies, goods, and commodities – [hot economic wars](#) – which have been major contributors to inflation recently.

Inflation did not start with the hot war in Ukraine...

...but the war did fan the inflationary currents that had been under way already: understanding today's inflation as the result of an escalating economic war and a lingering pandemic is important, for if war and zero-Covid policies stay, the view that inflation is mostly cyclical, driven by excessive stimulus, is wrong.

After visiting [over 150 clients](#) in eight European capitals over six weeks, my impression is that the expected path of Western policy rates rests on two hopes: first, that inflation is about to peak; second, that we are near peak hawkishness.

Obviously, if the first view is right, the second view is right too. But the risk with the first view is that it assumes a stable world with no geopolitical risk premia where demand management is more powerful than issues related to supply, when in fact we live in an unstable world where geopolitical risk premia are rising and where supply-side issues are more powerful than demand management.

It follows that if the first view is wrong (inflation is driven by the economic war, not stimulus), the second view is wrong too (we are not at peak hawkishness).

The aim of today's dispatch is to highlight risks to the peak hawkishness view. We won't be forecasting. We'll be observing. And you'll draw your conclusions.

Thus, with slight exaggeration, the low inflation world stood on three pillars:

first, cheap immigrant labor keeping service sector wages stagnant in the U.S.; second, cheap goods from China raising living standards amid stagnant wages; third, cheap Russian gas powering German industry and the EU more broadly.

U.S. consumers were soaking up all the cheap stuff the world had to offer: the asset rich, benefiting from decades of QE, bought high-end stuff from Europe produced using cheap Russian gas, and lower-income households bought all the cheap stuff coming from China. All this has worked for decades, until [nativism](#), [protectionism](#), and [geopolitics](#) destabilized the low inflation world...

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President Trump's immigration policies to appease nativists has cost the U.S. two million jobs, which is driving the current labor shortages and wage pressures. Covid-19 changed labor markets further: early retirements and other changes have exacerbated the labor shortages and increased wage pressures further.

President Trump's hardline approach to China became a bipartisan stance that drove the imposition of protectionist tariffs on China, and what started as a trade war became a technology war: the U.S. went from tariffs on cheap goods, to banning ASML from selling state-of-the-art lithography machines to China to ensure the balance of technological power remains in U.S. hands (see [here](#)).

President Xi's zero-Covid policy continues to frustrate the flow of cheap goods, causing occasional cardiac arrests in global supply chains and backlogs at ports; trade and economic relations between the U.S. and China became inflationary, in contrast to previous decades when U.S.-China relations were deflationary...

President Putin's efforts to make Europe dependent on cheap Russian gas – in order to tip the balance of economic power in Europe away from the U.S. – were frustrated by the U.S. sanctioning Nord Stream 2 last November, and President Putin's frustration with the shifting balance of military power in Europe (NATO) then spilled over into a hot war in Ukraine on February 24th, which supercharged the economic war. Both sides went “nuclear” quickly, economically: the U.S. weaponized the U.S. dollar, and then Russia weaponized commodities.

Welcome to the war economy...

...where heads of state matter more than heads of central banks.

Our jobs used to be simple. Central banks became the epitome of transparency, and with slight exaggeration, the only skill we needed to get by in markets was the ability to read and comprehend English: central bankers have been saying for over a decade that their aim was to fight deflation by inflating asset-prices, and all we had to do was borrow at low rates and buy assets irrespective of quality.

Now our jobs are becoming more difficult.

The policymakers to follow are no longer central bankers, but heads of state at the pinnacle of power who aren't known for the transparency of their thinking – especially not when at war. Translating speeches from Russian and Chinese and catching high-fives as opposed to fist bumps are becoming more important than parsing subtle grammatical nuances in central bankers' policy utterances.

Central banks' policy objectives are changing...

Central banks went from waging a war against deflationary impulses coming from the globalization of cheap resources (labor, goods, and commodities), to “cleaning up” the inflationary impulses coming from a complex economic war.

Think of the economic war between the U.S., China, and Russia as something that will weaken the pillars of the globalized, low inflation world described above – the process will be slow, not sudden, but it will be certain, where ongoing economic “tits” for “tats” will have the potential to drive more and more inflation.

Think of the economic war as a fight between the consumer-driven West, where the level of demand has been maximized, and the production-driven East, where the level of supply has been maximized to serve the needs of the West...

...until East-West relations soured, and supply snapped back.

If you see the “special relationship” between China and Russia in this context, you can see it as an “alliance of resources” that supplies the necessities the West needs to ensure social stability at lower ends of the income distribution:

think of Russia as a [“G-SIB of Commodities”](#) and China as a [“G-SIB of Factories”](#) that are the world’s biggest producers of commodities and consumer goods, respectively, providing two pillars of the low inflation world we described above.

By extension, [Russia and China have been the main “guarantors of macro peace” providing all the cheap stuff that was the source of deflation fears in the West, which, in turn, gave central banks the license for years of money printing \(QE\).](#)

But now that the pillars of the low inflation world are changing...

...central banks are done with fighting deflation with asset price inflation, and are now fighting inflation with asset price deflation. Central banks are adapting to a world that’s gone from having too much stuff and not enough demand, to a world that has not enough stuff and too much demand. Today’s inflation...

...is more about supply and less about demand, and...

...is more about geopolitics than (domestic) politics.

Maybe to understand the path of inflation from here, we should read less Friedman and Schwartz and much-much more [Brzezinski](#) and [Mackinder](#), for [the special relationship between China and Russia covers most of Eurasia, and Eurasia has most of the stuff needed to meet inflation targets in the West.](#)

To stress-test our thesis that we are indeed dealing with a war economy, and a major global conflict, consider that major wars involve “general mobilization”...

...and the world is indeed mobilizing to fight wars, shortages, and the pandemic: Russia has [passed](#) laws that require industries to step up their contribution to the war effort (a general mobilization of industry). In France, President Macron [called](#) for “general mobilization” as Europe tries to adjust to life without gas (a general mobilization to save resources). At the other end of the world, China is aiming to eliminate Covid (a general mobilization through lockdowns).

Only the U.S. does not engage in “general mobilization”...

Instead, it is using diplomacy to extract more for less: [more OPEC production](#); [Russian production for less](#); [Chinese goods without tariffs](#). Inflation is a problem (“*public enemy number one*” in the words of President Biden) and the Fed’s singular focus *du jour*. Chair Powell is trying hard to establish his credibility as an inflation fighter – a “general mobilization” of Paul Volcker’s legacy – and he will either succeed in doing that or cause long-term damage to the Fed’s credibility.

In fact, whether Jerome Powell will be remembered by economic historians as Paul Volcker or [Arthur Burns](#) depends on the course of the economic war. A war, where East and West are engaged in [unrestricted economic warfare](#) to tip and to maintain, respectively, the global balance of power in three domains: [the military domain; the technology domain; and, lastly, the production domain](#), which links commodity producers, production facilities, and shipping companies in the East to consumers in the West through a complex web of supply chains.

If we’re right that the economic war is the right context to understand inflation, then Western central banks will not have any good options to slay inflation. They can surely reduce demand by raising rates, but what if supply curves shift inward faster than demand curves? The market doesn’t think much about that...

Wars are hard to forecast...

...as are all the “tits” for “tats” in an unrestricted, geostrategic game of Go (or chess, depending on your perspective). As you focus on the contribution of used car prices, owners’ equivalent rent (OER), and Target’s inventory hangover to forecast the next CPI print and what the Fed will do next, please consider this:

the unfolding economic war between great powers is stochastic and not linear, and what inflation will do in the future does not only depend on the shocks that occurred in the recent past, but also on the many shocks that can happen still. These include more sanctions and the further weaponization of commodities, and more technology sanctions and further supply chain issues for cheap goods.

Getting right where inflation goes from here is basically a matter of perspective: do you see inflation as cyclical (a messy re-opening after Covid, exacerbated by excessive stimulus) or structural (a messy transition to a multipolar world order, where two great powers are challenging the might and hegemony of the U.S.). If the former, inflation has peaked. If the latter, inflation has barely started, and could actually be understood as an outright instrument of war, for as Lenin said, *“the best way to destabilize the capitalist system [is] to debauch the currency”*.

Finally, two more notes to close our opening essay about war and inflation...

First, an observation from Pippa Malmgren: *“Peter Drucker delayed publishing his book, [The End of Economic Man: The Origins of Totalitarianism](#), until 1939 because he was frightened to say that WWII was about to begin. I feel his angst as I write of my belief that we have already entered WWII. But before you jump out of your skin, try to remember that war is changing: the confrontations and conflicts of our time may be different from what we experienced before. [...] New theaters of conflict are no longer exclusively about physical territory and humans on a front line, but about cyberspace, space and the high seas,”* as well as pipelines, interbank messaging systems (SWIFT), ASML machines, currencies, commodities, and inflation as described in our opening essay above.

Second, an observation about macro investing amidst a raging economic war: macro investing had its golden age in the post-Cold War era, and investors like George Soros, Stanley Druckenmiller, Paul Tudor Jones, and Louis Bacon traded in a peaceful world, punctuated only by relatively small military conflicts. The big conflicts these investors traded were all “nominal conflicts”, and involved markets and central banks, and the first three of the four prices of money: par, interest, and foreign exchange (see [here](#) and [here](#)). But today’s conflict, a complex economic war between “empires”, drives the fourth price of money: the price level and its derivative – inflation. Central banks aren’t fighting markets, but are “cleaning up” the inflationary consequences of the economic war; the besieged prices are not par, FX pegs, and bases between various rates, but the price level of goods and services – which is inflating faster than target...

John Maynard Keynes is one investor who comes to mind that we know practiced macro investing during the interwar period, and another investor is Nathan Meyer Rothschild who loaded up on gilts when he learned before everyone else of Wellington’s victory over Napoleon at the Battle of Waterloo. Neither of these figures approached their investments using a bottom-up, micro understanding of central banks’ inflation targets and reaction functions – that’s a peacetime game. Instead, they applied political and geopolitical lenses to understand *“[The Economic Consequences of the Peace](#)”* and victory, respectively, to place wagers on interest rates. Today, it’s time to think more about the risk of inflation staying higher for longer due to economic warfare, and less about inflation being driven by a messy re-opening process and stimulus.

In the context of “War and Interest Rates”, the focus of today’s dispatch is inflation and the Fed. In subsequent dispatches, we’ll talk about what it will take to fix the supply-side issues of the West; why Bretton Woods III is the East’s “natural” response to the West’s supply-side fixes; and why central banks won’t be able to get out of QE (no QT), even as inflation is likely to remain high.

Thus, let's start with some observations about the nature of today's inflation...

Today's inflation is mostly a story about the "revenge" of headline inflation, combined with an extremely tight labor market in the service sector in the U.S. (and the developed West more generally). The tightness of the labor market is the result of protectionist immigration policies in the U.S. (or Brexit in the U.K.) and early retirements and much less global labor mobility due to the pandemic, and the "revenge" of food and energy prices is the result of the war in Ukraine.

After decades of neglect, food and energy prices can't be stripped out to focus only on core inflation. Food and energy prices – basic, everyday necessities – are especially dangerous in a structurally tight labor market, as workers demand higher wages not when discretionary items like TV screens and cars cost more, but when necessities cost more. Wages are under pressure already, globally:

because of cost-of-living issues, government workers in Australia recently got a 5% increase in their salaries, which will set the tone for wage adjustments in its private sector; oil rig workers in Norway went on a strike recently after they were offered a 5% increase in wages, but wanted 10%; at the port of L.A., longshoremen secured a 10% increase in wages and also a clause that limits automation at the port and, by extension, the substitution of labor with machines; finally, in the U.S. and in Germany, pilots that retired early during the pandemic are being offered 50% over the salary of active pilots if they come back to fly to ease the shortage of pilots during the summer. All these examples involve wage increases that are at least in-line with the 5% growth of wages in the U.S. or multiples of that: double or ten times as fast. Wage pressures are an issue; three years of above-target inflation are starting to affect wage-price dynamics.

Comments from corporate CEOs during the second quarter earnings season also suggest that price pressures will continue for the foreseeable future, globally, and that means that other than food, energy, and core services inflation (driven by wages, see above), core goods inflation will remain a problem too, driven mostly by supply chain issues due to President Xi's zero-Covid policies.

We have purposefully omitted the contribution of stimulus measures from our discussion about the nature of today's inflation: while generous stimulus checks in the U.S. have no doubt contributed to elevated rates of inflation, inflation is elevated everywhere, including in countries where stimulus was less generous.

Inflation today is simply everywhere. It's plain impossible to talk to anyone who doesn't complain about rising prices, or to read the financial press without articles about inflation. It is also impossible to have a client meeting where inflation is not the center of discussion. As James Aitken recently noted, "inflation expectations are well anchored when nobody talks about inflation", and by that measure, inflation expectations are becoming clearly unanchored...

As a relatively junior member of the Credit Suisse economics team explained to me recently, *"the experience with forecasting inflation in the post-pandemic period has been humbling; everyone's forecasts have been way off, including the Fed's"*.

Now, if an economist straight out of university gets that in a stochastic world – where the price of everything is thrown around randomly by a pandemic and an unrestricted economic war – inflation is impossible to forecast, why is the market so confident that inflation is about to peak? Because the Fed says so?

Beware if yes, for the Fed's recent forecasting record has been very poor, and so if the market discounts the Fed's forecasts, you could be in for a surprise as to when the Fed's hiking cycle will end. Chair Jerome Powell's FOMC is data dependent, not forecast dependent, and the dot plots might be dotted...

Some market participants like to see the silver lining in today's environment, [arguing](#) that energy prices today aren't as big a deal as they were in the 1970s, because a service-intensive economy is less energy intensive. That's nonsense: what oil is to an industrial economy, people are to a service economy, and when Bill Dudley says that in his forty-year career in finance he hasn't seen a labor market this tight, I assume he means that the service economy is having its "OPEC moment". I can't have a client meeting without someone asking me where all the workers have gone. I have no idea, but they are apparently gone...
...and after a while, it becomes pointless to wait for Godot.

But perhaps the most unsettling parallel to the 1970s and early 1980s is the Fed's and the market's assumption that all it will take to break inflation is hiking interest rates with the resolve and determination of Chair Paul Volcker...

Paul Volcker is no doubt responsible for the deep recession of the early 1980s, but we shouldn't assume that rate hikes and a recession are all that are needed to weed inflation from the system. Recessions can help but may not be enough, especially if Ray Dalio and Larry Fink are right and we are headed for stagflation, i.e., an environment where inflation is persistent, whether there is growth or not.

Consider two developments that helped Chair Volcker's fight against inflation.

First, between the OPEC price shocks and Paul Volcker's arrival as Fed chair, major energy companies had poured USD billions into new energy projects – the oil fields of the North Sea as well as the Norwegian Sea were developed, and oil fields were developed in the U.S. as well. All this new supply of oil, combined with the recession of the early 1980s, led to a collapse of oil prices, which was doubtless one key ingredient of Paul Volcker's phenomenal success.

Second, 1981 was the year when President Reagan fired air traffic controllers that went on a strike, ushering in a period that saw the power of unions weaken: the institutional practice of linking wage increases to the rate of inflation ended, which is probably how Volcker "re-anchored" inflation expectations in practice (no Woodfordian voodoo-magic, just some heavy-handed, political meddling).

Today's environment couldn't be more different.

First, unlike the 1970s, when oil majors had invested for a decade to pump more, we just ended a decade of little investment in oil fields – a legacy of ESG policies. Yes, the price of crude is falling due to recession fears, but it is not collapsing. Supply in the oil market is tight, and releases from the SPR won't last forever: whereas in the 1970s we invested in oil, today we're depleting oil reserves, and it takes many years to develop new fields. The oil market will get tighter during the Fed's current tightening campaign, not easier like under Volcker: President Biden's recent visit to Riyadh didn't yield speedy production increases, only a commitment to increase Riyadh's production capacity to 13 million bpd, by 2027, up from its current oil production capacity of 12 million bpd, "after which [Riyadh] won't have any additional capacity to increase production" (see [here](#)). That's a maximum of 1 million bpd more from the largest oil producer in five years, when the U.S. is at present releasing 1 million bpd from the SPR.

Second, during the 1980s, short-circuiting wage-price pressures was relatively easy, as it only took political will to do it – see President Reagan's action above and weaker political support for unions. But today, we have a bigger problem: a shortage of labor, particularly in services, which is due to a mix of factors such as tougher immigration policies to appease nativists; early retirements and other labor market changes driven by the pandemic; and extreme wealth gains

sapping labor force participation on the one hand (“feel rich, work less”) and driving demand for services on the other (“feel rich, spend more”). It’s a mess: it’s easier to deal with the politics of wage setting than it is to “grow” people – even in The Matrix, that’s possible only over time. Until then, we are stuck with a labor shortage, and President Biden’s top labor lawyer is the anti-Reagan: she’s encouraging the unionization of workers from Amazon to Starbucks...

...as opposed to firing them. Maybe it’s because I do not have a PhD degree, but I don’t see why inflation is about to peak. Why can’t it go higher from here?

Given today’s inflation backdrop, and the similarities and differences between now and then, let’s talk about the Fed’s tightening campaign to slow inflation.

I chose the word “campaign” carefully, as I think that it is fundamentally wrong to refer to what the Fed is currently doing as a “tightening cycle”. That’s because a “tightening cycle” is something that corresponds to a “business cycle”, and business cycles are about central banks managing short-term misalignments between supply and demand. But our opening essay was making the point that what we are living through now is structural, and so we are not dealing with a business cycle, but rather with something straight from the Book of Genesis...

...a “seven fat years. followed by seven lean years”-type of thing.

As we articulated above, the Fed went from generating demand structurally to soak up an excess supply of cheap stuff, to curbing demand structurally to adjust to shortages. That’s called right-sizing, or belt-tightening, which are structural, not cyclical affairs. It follows that what the Fed is currently engaged in isn’t a hiking cycle, but a structural tightening campaign. A tightening campaign that’s necessary because the supply of cheap labor, goods, and energy is over and the level of demand is too high and didn’t respond to lower supply fast enough (or by itself), which, in turn, are the fundamental sources of inflation. Remember nominal GDP targeting? We’re still doing it, but now in the opposite direction:

instead of playing “catch-up” with the pre-GFC trend of aggregate incomes, we’re now playing “catch-down” to the post-nativist, post-Covid, and post-Ukraine trend of aggregate supply. The level of economic activity needs to adjust down in an “L”-shaped manner. If it doesn’t, we will have more inflation problems...

In this context, the market’s recession/no-recession soul-searching is ridiculous: if the inward shift of supply curves across multiple fronts (labor, goods, and commodities) is the main driver of today’s inflation; if demand needs to be curbed significantly to slow inflation; and if a substantial reduction of aggregate demand means an “L”-shaped path for the economy, why is it so bloody hard to see that we need a recession to curb inflation? Instead of the question of “whether”, why don’t we think about the “depth” of the recession needed to curb inflation?

As Bill Dudley has articulated in a series of op-eds on *Bloomberg* recently, the Fed has some explaining to do about why it expects inflation to slow to target when it does not forecast either a recession or a material increase in the unemployment rate. Such forecast inconsistencies are hard to comprehend, especially in an environment where, beyond domestic wage pressures, other sources of inflation (food, energy, and goods) are out of the Fed’s control and where the labor market is so tight that inflation is starting to affect wages.

In a global economic war, it isn’t possible for every major country but the U.S. to be engaged in “general mobilization”, and if Jay Powell is engaged in the “general mobilization” of Paul Volcker’s legacy, he also needs to engage in a “general mobilization” of U.S. consumers to spend much-much less; that is, “general mobilization” in the U.S. means a recession. A big, long-lasting one...

...to purge the “Super Size Me” mentality and replace it with Jimmy Carter’s theme of living thriftily (a “cultural revolution”). And that involves not only slowing the interest-rate sensitive parts of the economy (housing and durables) but also reducing demand for labor in the service sector, which, as we have argued [here](#) and [here](#), is a function of the level of wealth across a range of assets (housing, stocks, as well as crypto) to weed the “feel rich, spend more” and “feel rich, work less” mentality from the system. And what the Fed is telling us when it flat-out dismisses two quarters of negative GDP growth is that it isn’t focusing as much on the rate-sensitive parts of the economy as it did in the past. Instead, it is focusing much more on the services economy and the labor market, which still remain strong. And therein lies the cautionary tale for the market...

...which expects the Fed to “chicken out” about growth in its fight against inflation. Basically, this is one reason why the market expects the Fed to ease in a year’s time. The other is the wishful thinking is that inflation has peaked...

We articulated the risks to the market’s inflation view above.

We will now articulate the risks to the market’s growth views.

The Fed has a dual mandate: inflation and full employment. Now consider that inflation today is way above target and employment is “way more than full” – there are more job openings than there are people to fill them, and “full-full” employment is a part of the inflation problem. Fulfilling both of the Fed’s mandates requires less growth: not in measurable goods but in immeasurable services, where we measure the health of the sector through wages and demand for labor. And today, demand for services and demand for labor still remain way too strong.

The market can talk all it wants about a “soft landing,” but as explained above, we need an “L”-shaped adjustment in activity, and an “L”-shape has two parts: first an “|” which you can think of as a vertical drop (perhaps a deep recession); second, an “_” which you can think of as a flatline (stagnation, as in stagflation).

Regarding the first bit, there is nothing “soft” about a vertical drop.

Regarding the second bit, there is nothing that guarantees an interest rate cut after the vertical drop: stagnation, especially when paired with inflation (stagflation), means that interest rates may be kept high for a while to ensure that rate cuts won’t cause an economic rebound (an “L” and not a “V”), which might trigger a renewed bout of inflation. To date, I haven’t heard anything from the FOMC that would suggest that the Fed wants to avoid a recession (“*there will be pain*”), or that the Fed would rush to cut rates if we had a recession with high inflation (“*we’ll cut when we are confident that rate cuts won’t ramp inflation back up*”).

Don’t marry your views too much to the SEP and the dot plots...

...because the SEP is just a forecast in an increasingly stochastic world, and forecasts can change with incoming geopolitical events, and the next step after the Fed ending a running commentary of hikes (too much forward guidance) may be ending the practice of publishing the SEP and the dot plots. Were that to happen, how will the market price the “terminal rate” and the “neutral rate”?

Precisely...

It’s time to think outside the box and to appreciate the pattern: the Fed went from transitory to not transitory; no hikes to hikes; hikes to a string of rate hikes; a string of 25 bps to a string of 50 bps; a string of 50 bps to a string of 75 bps; a string of 75 bps with forward guidance to the same without any comments...

Bill Dudley and Larry Summers are having a Volcker moment in a “spot” sense, but they are not in charge, and they don’t have to navigate the political aspects

of interest rate hikes. Jay Powell has too, and that is why he is moving slower. But moving he is, and he is quietly having his Volcker moment in a rolling, “forward” sense: look at the pattern above; listen to him when he says that “there will be pain”; listen to him when he says “we’ll cut when inflation is dead” – we are paraphrasing Powell only on the last bit but are not exaggerating...

This is not the growth-sensitive Fed of the post-GFC era.

This is not the stocks-sensitive Fed of the post-Greenspan era.

This is not the unipolar world order the Fed’s been operating in since WWII.

This is a different ballgame...

...and if you think that the peak of tightening is 3.5% because inflation peaked, (maybe it hasn’t; see above) and that cuts are coming next year because a recession is nigh and stocks are now at the cusp of a bear market (maybe not, because we need a recession, and lower asset prices are the path to a recession), you might be terribly wrong. Bill Dudley and Larry Summers are right about the direction of travel (more from here, not less), but Jay Powell sets the pace...

...because he is accountable to Congress; Dudley and Summers are not. But make no mistake about it: the risk of the Fed hiking to 5% or 6% is very real, and ditto the risk of rates cresting there despite economic and asset price pain.

The market and the Fed’s SEP (perhaps the market, because of the Fed’s SEP) is telling us that we will curb the biggest outbreak of inflation in fifty years with a “hiking cycle”, where the peak of the “hiking cycle” next year corresponds to negative real interest rates... unless you think that inflation moderates to target, that is 2%, by next year. If that is true, I am going to re-take Economics 101.

What could I be missing?

Is Jay Powell a dark horse who is more political than serious about inflation? I do not think so. Once you go down the path of invoking Paul Volcker’s legacy, you can’t avoid making good on that promise: if you do, you damage the Fed’s reputation irreparably. The risks are such that Powell will try his very best to curb inflation, even at the cost of a “depression” and not getting reappointed...

Between a deep recession and damaging the Fed’s reputation as an institution, a deep recession is the lesser of two evils. The former is public service, and the latter is public disservice. The former is a central banker’s clear conscience, and the latter is a life-long burden. Whether Jay Powell will succeed in slaying inflation is not the question; in the context of economic war, we can doubt that. Rather, the question is whether he’ll try his best to slay it. There I have no doubts.

In our next dispatch, we’ll start thinking about “what’s next”:

if we are right about the nature of inflation and the need for an “L”-shaped path for the economy, how will we ever ramp up from the “_” part of the “L” without generating inflation? If the East holds the key to the supply side, and economic war means that the supply side is held back, the West will have to develop its own supply of things such that “L” becomes “L/”. And much like the current hiking cycle is not a cycle but a tightening campaign, that recovery won’t be a recovery driven by rate cuts but by fiscally funded industrial policy...

...which we will discuss in detail in our next dispatch.

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