American Abundance

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Is There A Liquidity Shortage?

(NAPSA)—Bad Consumer Price Index (CPI) and Producer Price Index (PPI) reports for the month of January sent a stagflationary shiver through the financial markets.

The stagnant economy is best illustrated by the continued drop of industrial production, which has fallen four consecutive months.

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Production is the single best coincident economic indicator. Two more monthly declines might well spell recession. Or, to use Vice President Cheney's phrase, "the front-end of recession."

Lower tax rates to put more cash in consumer pockets and improve rewards for investment spirits and producer incentives will solve the "stag" problem. The more I think about tax policy right now, the more I believe that a return to our four percent growth potential will not occur until a good tax-cut bill is signed.

As far as the inflation threat, every commodity price on the planet is falling. Including the mother of all inflation indicators, gold, which has dropped into the $250's—a five and a quarter percent decline, year-to-date.

It would be a great mistake if the Federal Reserve holds back on its easing strategy just because of flukey, one-month, energy-driven PPI and CPI reports. If the Fed looked forward at the implied forecasts of market price indicators, instead of backward at flawed statistical reports, it would see declining future inflation and recognize the need to inject considerably more liquidity into the economy.

Take a look at the commodity charts. Gold, silver, platinum, copper, cotton, lumber, steel, all down. Crude oil down. Natural gas down. All this shows deflation—not inflation—in the air.

Gold and commodity prices are declining even while money supply growth is recovering. Monetarists are actually worried about overexuberant money growth. They shouldn't be.

MZM or the supply of money of zero maturity—the sum of currency, demand deposits (checking accounts) and institutional money funds—has spurted to 15.2 percent annualized growth over the past three months, while the broader money stock—M2—has increased by ten percent.

These measures are influenced by Fed policy, but mostly they are demand driven by private sector transaction and investment preferences. Lately, the biggest push to these money aggregates has come from mortgage refinancing activities, as households rebalance and reliquefy their financial statements in the wake of lower interest rates. Also, turbulent stock markets may be inducing people to hold more cash.

There is no excess money problem that would foreshadow rising future inflation. That is why gold, commodities and interest rates are falling.

Greenspan and company are moving in the right direction by lowering the fed funds policy rate and expanding its creation of bank reserves, but the demand for cash is rising faster than the supply.

Commodity and financial market prices are smarter than government inflation indexes. When money supply data confirm market price indicators, the case is even stronger. There is still a liquidity shortage.

Mr. Greenspan in his most recent Senate hearing on monetary policy never spoke about inflation-sensitive market price indicators or money supply measures. Too bad. They're sending him an important message: more high-powered cash and a lower fed funds rate are necessary. The sooner the better.

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