The Outlook: May 8, 2020

Two Big Questions, As We Look a Little Bit Ahead.

There have been 2 "Big Questions" from the beginning:

1. How fast will the U.S. and global economy recover from the Virus Shutdowns, and how fully will they recover?

2. How will the Virus Shutdowns change the economy and business world, after some kind of recovery has happened?

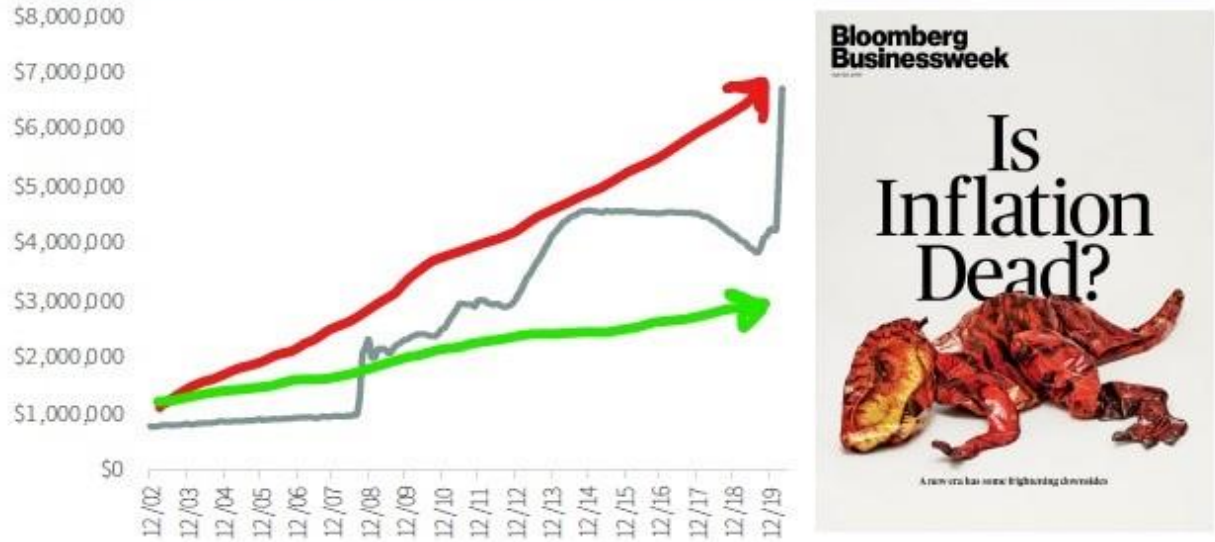
It would be nice to have better news on a Friday night—but we don't know the answer to either Question yet. On Question One, we can say this: "*There will be a recovery*. Plenty of early signs are showing that. Nobody knows how far and fast it will run . . . but some of those early signs hint that it might it might run faster and farther than we had any right to expect, given the horrendous economic damage from the Shutdowns."

Anything else about Question One would be guessing—and naturally there is an endless supply of guesses out there. But let's move to Question Two. "What longer-term changes look certain?"

As Outlook clients know, the "work from home" trend came out of the blocks like Usain Bolt, these past two months. Theresa's "Inside Microsoft" report, this morning, quoted CEO Nadella: "We've seen two years' worth of digital transformation in two months," as most of the world suddenly tried to work, play and learn from home. It's perfectly obvious that will strengthen the tailwinds behind plenty of Big Tech companies—which is why Outlook's clients own Microsoft. It's also perfectly obvious that what used to be merely serious concerns about the long-term health of business real estate has now become something closer to a galactic concerns. A great many investors who had gladly invested in all manner of Real Estate Investment Trusts, loving their high dividend payments, probably think the "galactic" label is no exaggeration, given what's already happened to those dividend payments.

Such long-term changes are serious enough, but kind of narrow; so they can be coped with. The picture below hints at something considerably broader, in its effect upon the entire economy.

FIGURE 4 Federal Reserve Balance Sheet



Data source: Federal Reserve; Image source: BloombergBusiness

The red arrow tracks 18 years of growth in what we might call America's "potential money supply." That vertical gray rocket at the right is the beginning of the Fed's jaw-dropping action since March: printing more than 2 trillion dollars to replace some of the "earned money" which vanished when the Shutdown arrived.

The green arrow is something different. It's only the picture of a concept, to get across the nature of the long-term problem. The green arrow is "the growth of the real economy: all the goods and services actually created, each year, on Main Street." For 18 years, it's grown about 2% to 3% per year. But the red arrow (the amount of money potentially circulating in the same Main Street economy) has now grown galactically beyond "real production." The fact that America now has way more money floating around—per car, cell phone or loaf of bread produced each year—is the worry.

It's an ancient saying, but "Too much money chasing too few goods" still gets to the heart of inflation. The heart of the Federal Reserve's job, year after year, is to make its best guess about how much additional money it should create, each year, to roughly match the increase in the amount of "goods" produced. In the 2008 – 2009 Financial Calamity, and now in the Virus Shutdown Calamity, that job went out the window. The Fed felt it had bigger fish to fry—namely saving the economy from collapse—and it was right. But after succeeding in that bigger job, the Fed and the whole country will face the consequence of printing "too much money," namely the near-certainty of higher inflation.

How high?

That brings us right back to the beginning: "We can't know, yet." When the Fed printed its first ocean of money in 2008 – 2009 and the next few years, inflation never showed up. That was a big surprise to many experts—though not to economist Brian Wesbury, who understood why. Having been frightened to death, almost, by the 2008 – 2009 Calamity, people and businesses were intent on one big goal: to build up cash reserves so that they wouldn't be wrecked by the next Calamity, whenever it showed up. Having been not just frightened by downright destroyed, pretty much, by the same Calamity, the U.S. banking

sector had no interest at all in pushing loans to put the extra printed money into circulation. So after 2009 there was "too much money" in spades . . . but it wasn't "chasing" goods and services or anything else. It was holed up in banks' digital vaults, so to speak; and in cash reserves against the next rainy day held by businesses and individuals.

The $64,000 Question is: "Will the newly-printed trillions do the same thing, this time? Will they hole up in bank vaults, again, because borrowers are alarmed about borrowing, and banks are alarmed about lending?" If so, the new trillions won't be "chasing too few goods," and inflation won't be a galactic problem.

At Outlook we suspect the new trillions will do the same thing, but not nearly as emphatically as 11 years ago. Once again, people and businesses are frightened through and through—which tends to keep the new money idle and inflation asleep. That would be good. But as that gray rocket line shows, up there, the sheer volume of the ocean of money printed this time is stunning. It is far beyond what happened 11 years ago. It is a sheer guess from "common sense," but we have to doubt that inflation will stay fast asleep, this time around.

There will be consequences to that . . . which aren't to be explored on a Friday night! But they won't be all bad, because U.S. inflation won't be Argentinian inflation. And they will certainly be good for the prices of commodities like copper and oil, which won't bother investors (like Outlook) in Conoco, Exxon, Shell and Freeport at all.

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