NWAnews.com
Northwest Arkansas' News Source

Welcome **Angela Peacock**
Edit | Help | Logout

Thursday, November 12, 2009 | **Current Weather for NWA: Fair 63 F** (more conditions and forecast)

Classifieds | Jobs | Obituaries | Business Directory | Blogs | TV Listings | Search

Search Enter search terms Search Date range: YYYY-MM-DD to YYYY-MM-DD

Tools & Information
Contact Us
Place a Classified Ad
Subscribe to the Print Edition
Print and Web Advertising Rates
Newspapers in Education (NiE)
Carrier Opportunities
Blogs
Special Sections
Saluting American Valor
Northwest Arkansas Now
WHS presents 3 Points of Pressure
Community Guide 2009
Best of the Best 2009
Ozark Living
NWA Area Church Guide
Real Estate

SALUTING AMERICAN VALOR
Selfless courage at the moment of truth

CLICK HERE for this week's SALES!
MARVIN'S FOOD STORES

Stephens execs say inflation looms

3 contradict and blame Fed, cite doubled monetary base

By David Smith

Sunday, October 25, 2009

Print item

LITTLE ROCK — A team of Stephens Inc. executives believes that inflation will begin to rise early next year, a view that contrasts with opinions expressed by most economists.

Brian Bush (left), Alan Tedford (standing) and Bill Tedford, all vice presidents with Stephens Capital Management, say the Federal Reserve's increase in the monetary base will spur inflation.

Bill Tedford, Alan Tedford and Brian Bush, all vice presidents with Stephens Capital Management, believe the Federal Reserve is wrong in its projection of low inflation in the next few years. The majority of economists also agree with the Fed.

"The general expectation of inflation we read from the [Federal Reserve] and Wall Street is generally years down the road and we're saying it's much closer than that," said Bill Tedford, who's the executive vice president and director of fixed income strategy at Stephens Capital Management, Stephens' money management division.

Stephens projects that inflation will begin to rise early next year and possibly increase to 5 percent or 6 percent in another year to 18 months. Currently the Consumer Price Index is slightly deflationary at about minus 1.5 percent.

The reason Tedford, his son Alan and Bush believe inflation will skyrocket in the coming months is because of the Federal Reserve's massive increase in the monetary base, which is the total currency in circulation plus bank reserves at the Fed.

In the 95-year history of theFederal Reserve, it created a monetary base of a little less than $1 trillion, Bill Tedford said. Then in a 12-month period beginning last fall, the Fed doubled that.

ADVERTISEMENT

"Nothing like this has occurred in the history of monetary policy in this country," Tedford said during an interview on the 21st floor of the 25-story Stephens Building in downtown Little Rock.

Only about 11 percent of that additional $1 trillion has been utilized by banks so far, he said. But all of the excess money is available for banks to draw on.

The Fed is not expecting a rush of inflation because of Chairman Ben Bernanke's theory on the output gap, or the slack in the economy. Bernanke says businesses have an excess capacity that allows them to make more goods and services without inflation accelerating as they use up the slack, Tedford said.

He said Bernanke's theory was tested in 2003 and the result backs the Stephens analysts' belief.

Bernanke was on the Fed board under Chairman Alan Greenspan in December that year. The Fed funds rate was 1.9 percent. Bernanke argued there was no need to raise the interest rate because the slack in the economy would hold inflation down. The Federal Reserve heeded Bernanke's advice and did not raise rates.

"By the following summer,inflation had compounded at 5.9 percent," Tedford said. "Inflation, in other words, surged and the Fed was behind the curve."

In a statement last month, the Federal Reserve's Federal Open Market Committee said the substantial slack in the economy is likely to "dampen cost pressures" and "inflation will remain subdued for some time."

Most economists agree that what will keep inflation from taking off is "the overwhelming degree of slack in this economy," said Kathy Deck, director of the Center for Business and Economic Research at the University of Arkansas at Fayetteville.

Michael Pakko, state economic forecaster and chief economist at the Institute for Economic Advancement at the University of Arkansas at Little Rock, said the increase in the monetary base is dramatic.

"The question is whether the existing slack in the economy is sufficient to keep that liquidity from becoming an inflationary factor," Pakko said.

The members of the Federal Reserve's Federal Open Market Committee are divided on that, Pakko said. Some are concerned that there may not be as much slack in the economy as people think and that inflation is a real possibility.

Pakko said he doesn't expect a sharp increase in inflation next year or even into 2011. He anticipates inflation will be in the range of 1.5 percent to 2 percent, "but nothing extreme."

"I think the long protracted recovery from the recession is going to keep price pressures down for the near term, but there is some concern as you look out to future years," he said.

PREDICTION NOT UNIQUE

The Stephens team is not alone in its prediction of booming inflation.

James Bullard, president of the Federal Reserve Bank of St. Louis, also is troubled about inflation. In a speech Oct. 11 to the National Association for Business Economics, Bullard said that inflation concerns in the medium term may be higher than most people believe.

Bullard also noted that there has been a large increase in the country's monetary base.

"This may lead to inflation in the medium term, depending on the markets' expectations of monetary policy going forward," Bullard said.

L. Jacobo Rodriguez, vice president with Dimensional Fund Advisors of Austin, Texas, said in a recent research report that there are valid reasons to be concerned that inflation is inevitable in the medium or long term.

Those include the fact that the Federal Reserve hasincreased the monetary base "on an unprecedented scale" and the Fed's "exit strategy may be more difficult to carry out successfully than the Fed anticipates."

"And, in the process of responding to the financial crisis, the Fed has seriously compromised its independence," Rodriguez said. "All these factors make it more difficult for the Federal Reserve to be able to fulfill its primary mission of creating an environment of low and stable inflation."

So what happens if inflation does begin to rise next year?

There are advantages and disadvantages to inflation, Tedford said.

One good change will be an increase in housing prices, and homeowners' equity will increase, Tedford said. That encourages them to spend money, which would help the economy, he said.

But when inflation becomes obvious, interest rates will start rising, he said.

Bush, who's the executive vice president at Stephens Capital, added that the buying power of the dollar will be eaten away by inflation.

FORECASTING STRATEGY

Stephens, which has been managing bonds for 30 years, has a long history of forecasting inflation.

"Our strategy has always been that if we could forecast inflation, we could forecast interest rates," Tedford said.

If inflation rises, interest rates generally will rise; if inflation falls, interest rates likely will fall, he said. And if the company expects that interest rates will rise, Stephens advises its clients to shorten their bond investments, he said.

The Tedfords and Bush developed a portfolio for Stephens' customers that will allow them to hedge against the expected increase in inflation.

But other investors can invest in inflation-protected bonds if they believe inflation will increase dramatically in the next few years, Bill Tedford said.

Stephens is suggesting that investors put about 10 percent of their portfolio in some sort of hedge against inflation.

The last time there was significant inflation in the country was in the late 1970s and early 1980s, Bush noted.

Tools & Information
Contact Us
Place a Classified Ad
Subscribe to the Print Edition
Print and Web Advertising Rates
Newspapers in Education (NiE)
Carrier Opportunities
Blogs
Special Sections
Saluting American Valor
Northwest Arkansas Now
WHS presents 3 Points of Pressure
Community Guide 2009
Best of the Best 2009
Ozark Living
NWA Area Church Guide
Real Estate

"Most investors have now gotten lulled into this low inflationary environment we've been in for 30 years," Bush said. "And 30 years ago investors did not have as many options to protect themselves as they do today. But if investors listen to most of the people out there, they are probably not investing in those categories. And they are going to wake up too late."

Despite the disagreements among economists about the future direction of inflation, there is ground for agreement.

Deck, the Center for Business and Economic Research director, acknowledged that the Federal Reserve's doubling of the monetary base is unprecedented.

"And I don't think anyone knows with certainty what the long-run implications of this are," Deck said.

Business, Pages 71 on 10/25/2009

Comments

To report abuse or misuse of this area please hit the "Suggest Removal" link in the comment to alert our online managers.

Use the comment form below to begin a discussion about this content.

Post a comment

Angela Peacock (screen name: cber_walton.uark.edu) Change your User information Change your avatar

Preview comment

Copyright © 2001-2009 Arkansas Democrat-Gazette, Inc. All rights reserved. Contact Us