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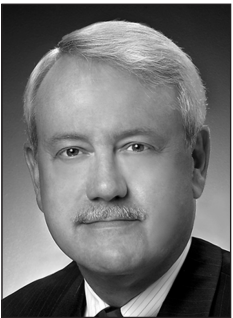
The Experts: Investing

2009 outlook - an inflationary whipsaw

Economists are busy quibbling about whether the bottom of this recession will be the second or third quarter of 2009.

However, it might be more useful to focus on inflation next year from two different schools of economics.

Monetarist perspective



The monetarists believe that inflation changes reflect changes in money supply. The Fed likes to see inflation around 2 percent and manages toward that goal by increasing or decreasing both interest rates and the supply of money.

One thing is clear going into 2009 - we are experiencing real, worldwide deflation in asset values, which causes a great many problems. It means falling income for producers. It means more charge-offs for banks.

Generally, economists are more worried about deflation than inflation. However, Fed chief Ben Bernanke is not one of them. He got the nickname "Helicopter Ben" when he off-handedly commented that deflation could be eliminated by throwing money out of helicopters and raining currency on consumers or rapidly increasing the money supply.

The money supply (M2) has been increasing at above a 10 percent rate for the latter part of this year, which is very high and very inflationary. This increase is primarily because the Fed has undertaken a huge 1,400

percent in bank reserves, which directly adds to the money supply and makes it easier for banks to also add to the money supply by making loans.

The effect of this increase in money supply will be apparent by the end of 2009, and it will be inflationary.

Keynesian perspective

Economists often joke that everybody is a Keynesian during a crisis. Sometimes called "demand-side economics," it teaches that GDP is the sum of consumer, business and government spending with some effect from international trade.

Holiday sales show consumers are not spending and business is smart enough to cut back spending going into a recession. With consumers and business demanding less goods and services, that leaves only government to support our GDP, which means they must increase spending, probably by a huge amount.

Keynesians also taught us that increases in the demand for some product, without a corresponding increase in the supply of that product, will cause the price to increase or inflate.

Apparently, the incoming Obama administration has determined to increase demand by government spending by as much as a trillion dollars, primarily for badly-needed infrastructure development.

One problem with that approach is the delay in implementing that strategy and spending the money. Just getting contract proposals in and negotiated for the "ready-to-go" projects will take most of the year, which means the spending will not begin until late in the year, creating

inflationary pressure when the monetarists are predicting the same.

What does all this mean? We can expect deflation for much of 2009, but quickly reverting to inflation before the year is over. This would hurt anybody living on a fixed income and raise long-term interest rates.

I just hope it is not such a sudden "whipsaw," or change in direction that it creates other "unintended consequences."

Economic versus financial cycle

Don't forget the economic cycle is different than the financial cycle. Traditionally, the stock market improves about five to nine months before the economy does.

If you think the economy will hit bottom in late year, you might want to get invested by the spring. Inflation is usually good for commodities, hard assets and those consumer staples with strong brand loyalty.

2009 is a good year to get agile and get ready for the next bull market!

Jim Flinchum, a CFP practitioner and a certified investment management analyst, is the managing principal of Bay Capital Advisors, an investment advisory firm in Virginia Beach. He can be reached at www.baycapitaladvice.com.