LANTERN
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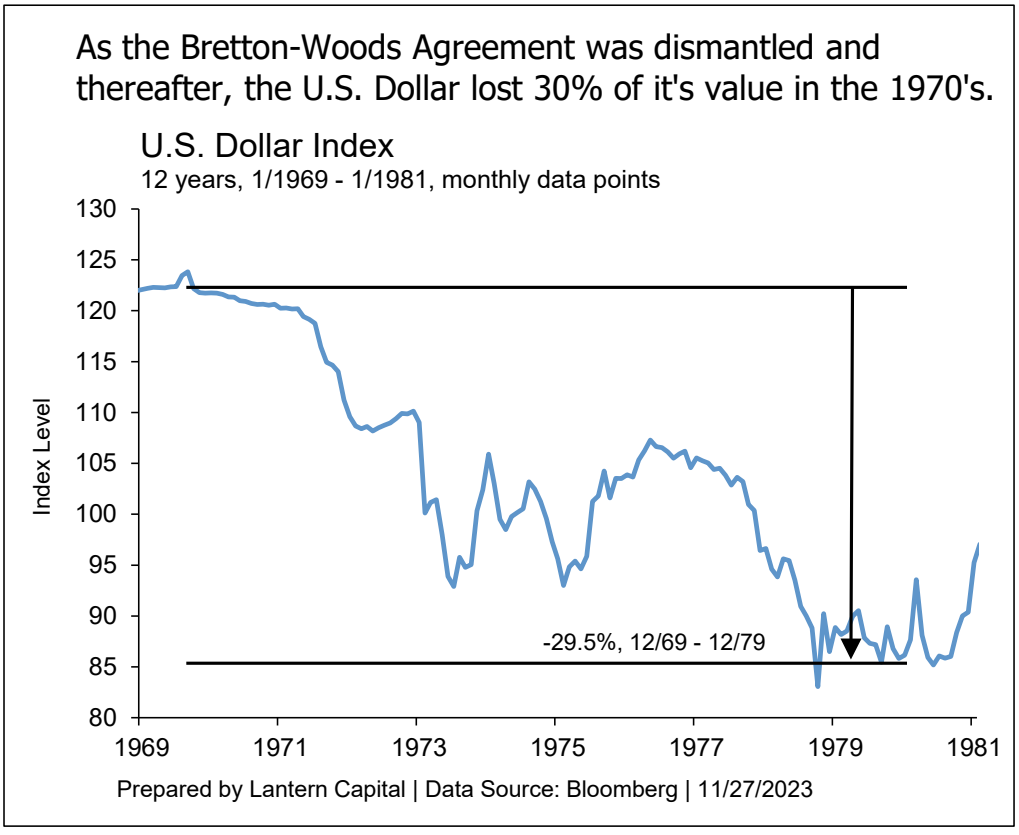
It Won't Be a Repeat of the 1970's

Economic conditions now are quite different from the 1970's and still disinflationary.

Eric Hickman, 11/28/2023

With inflation (headline CPI) reaching 9.1% last year (now 3.2%), union labor agreements being negotiated, and most recently, the Yom Kippur War-inspired Hamas attack on Israel, there are enough parallels with the 1970's to wonder if the future will bring high inflation and high interest rates. But the economic conditions which created that era are much different now and suggest a continuation of disinflation and lower rates. Below are seven contributing factors to 1970's inflation that aren't present now.

1. **Dollar depreciation** - The Bretton Woods agreement of 1944 which fixed global exchange rates to the dollar and the dollar to gold was slowly undone by the Nixon administration in the early 1970's. This started a broad decline in the dollar. Over the decade, the dollar declined about 30% (U.S. Dollar Index.) Weaker currencies are inflationary. Conversely, over the last 10-years, the U.S. Dollar Index has appreciated about 30% (+28.9%, 10/2013 – 10/2023.)



2. **No Federal Reserve inflation target** – In January 2012, the Federal reserve announced an explicit inflation target of 2%. A well-defined and defended inflation target helps to anchor inflation expectations. Inflation expectation metrics aren't available from the 1970's, but they are low now; around 2% to 3%. Having a target helps markets believe that the Fed will return inflation back to 2% and prevents a continued ratcheting higher of inflation like the 1970's. A direction without a destination kept the public unsure of the Fed's resolve to lower inflation back then.

Inflation Expectations Now

Market and survey-based

Source	Level	From
2-years ahead (derived from TIPS)	2.1%	11/27/2023
5-years ahead (derived from TIPS)	2.2%	11/27/2023
10-years ahead (derived from TIPS)	2.2%	11/27/2023
5-year Inflation-5-years forward (swap index)	2.6%	11/27/2023
NY Fed SCE 5-year Inflation expectations	2.7%	Oct-23
University of Michigan 5-10 year Inflation expectations	3.2%	Nov-23
Survey of Professional Forecasters (SPF) 10-years	2.4%	Q4 2023 survey
Average	2.5%	

Market-based
Survey-based

Data Sources: Bloomberg, NY Fed, U.Mich, and Federal Reserve Bank of Philidelphia (SPF)
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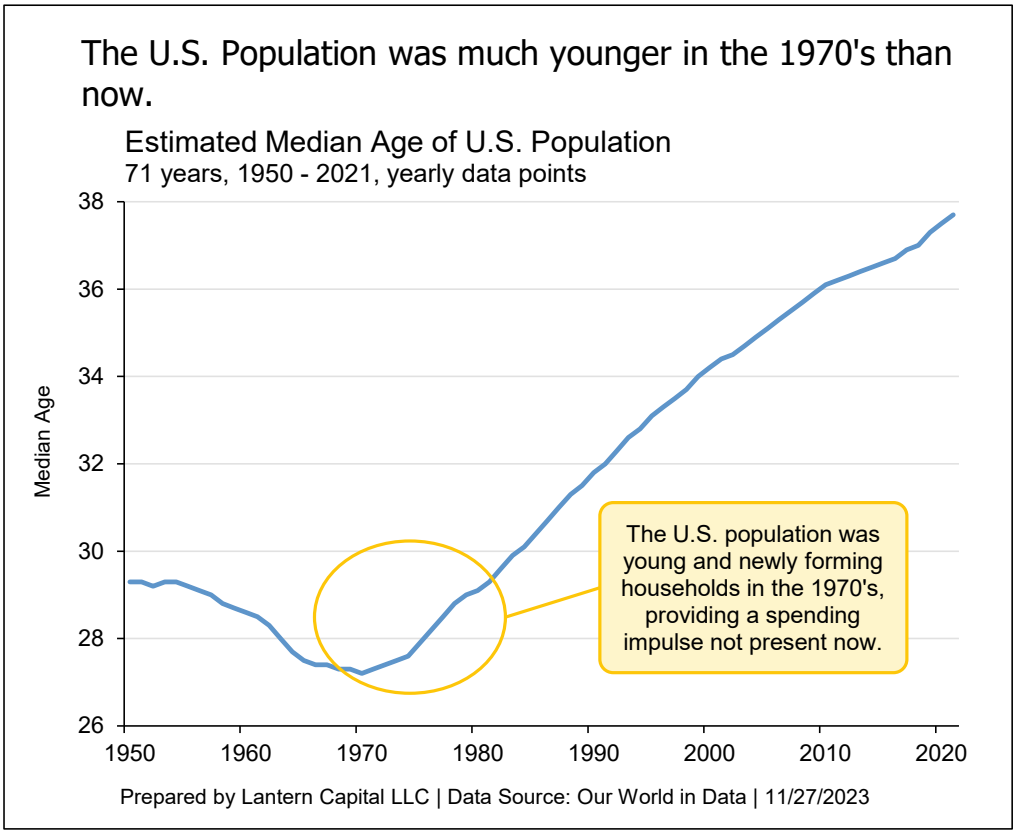
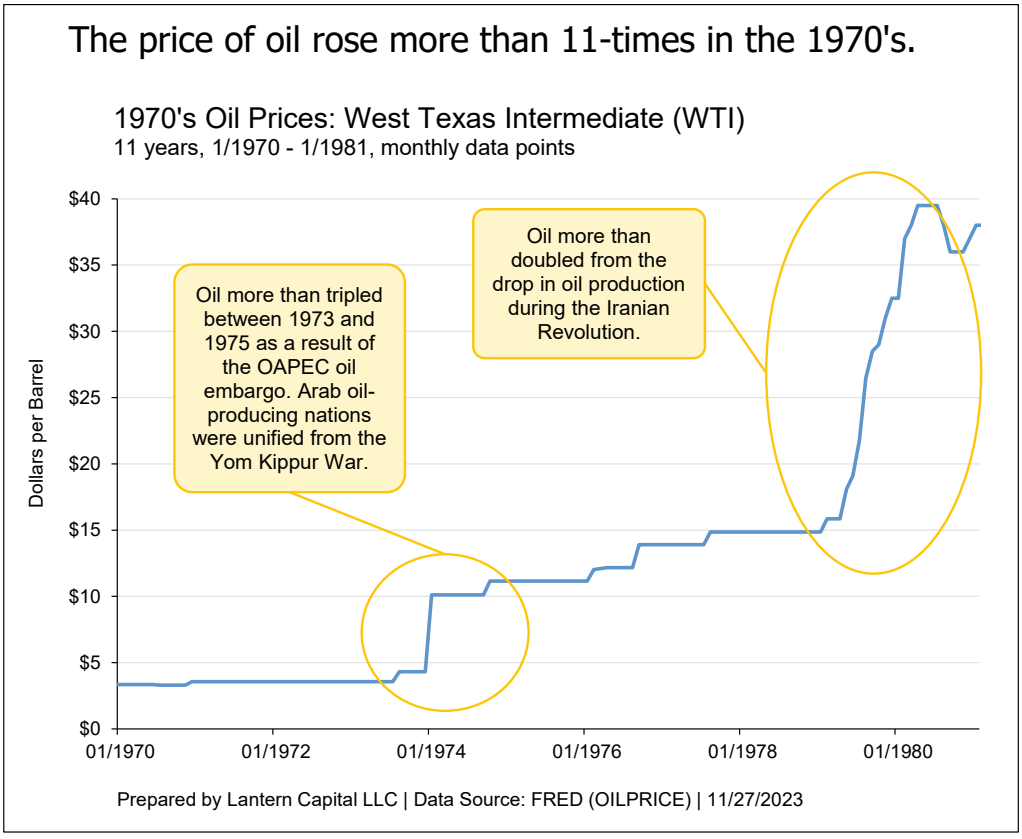
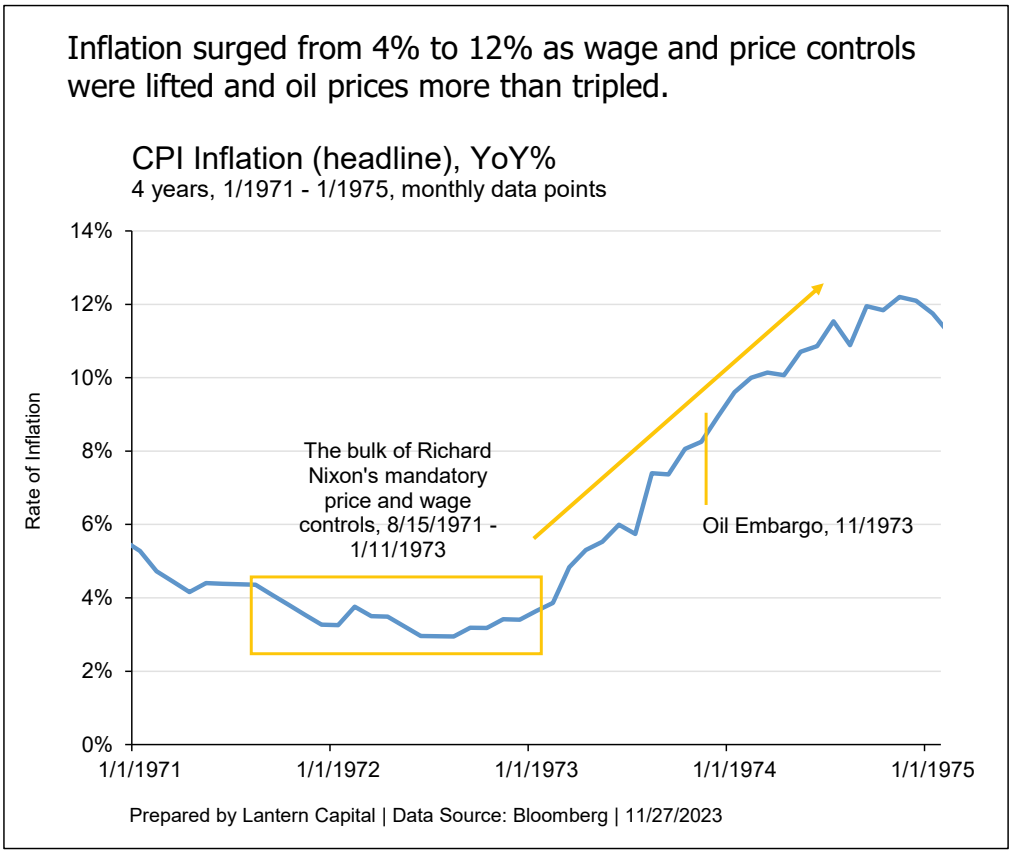
3. **Young population** – The median age of the U.S. population in 1975 was a young 27.9 years as baby boomers were just becoming adults and forming households. When households are being formed, debt accelerates spending. In 2021, the median age is about 10 years older at 37.7 years and only getting older. Older populations tend to save more and spend less which is disinflationary. Japan's median age has increased from 36.9 years in 1990 (similar to the U.S. now) to 48.4 years in 2021; a period characterized with a large crash in their equity market and a battle with deflation starting in 1998.



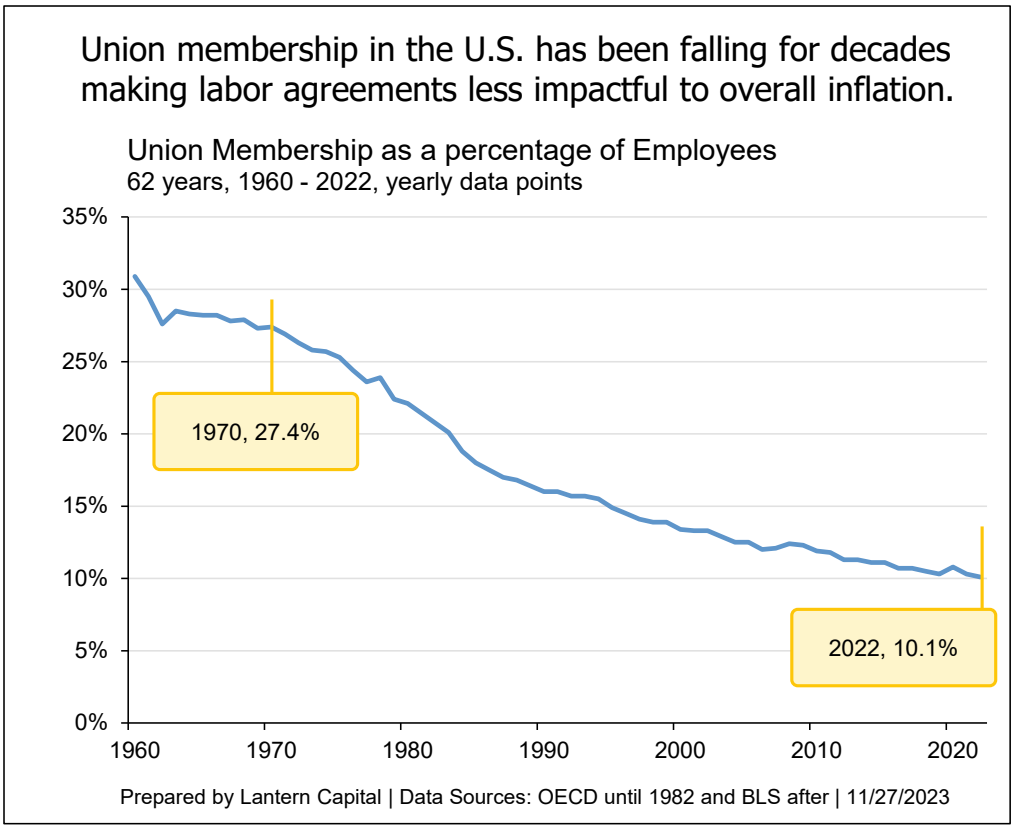
4. **Oil price explosions** – Oil prices rose more than 11-times (11.1) in the 1970's from two events. First, oil prices tripled between 1973 and 1975 from an oil embargo on the U.S. by Arab oil producing nations in response to the Yom Kippur War. As this represented lost business for the participating countries, it required a shared ideology worth more than economics that doesn't exist today. In today's globalized and more competitive world, it is hard to imagine Saudi Arabia, Qatar, and the UAE (for instance) not selling oil to the United States. Second, oil more than doubled in 1979 and 1980 from a large decrease in Iranian production during the Iranian Revolution. Iran went from producing 5.3mn barrels of oil per day in 1978 to just 1.5mn barrels of oil per day in 1980. This represented a drop of 6% of global oil production (source: 2023 Statistical Review of World Energy from the Energy Institute.)



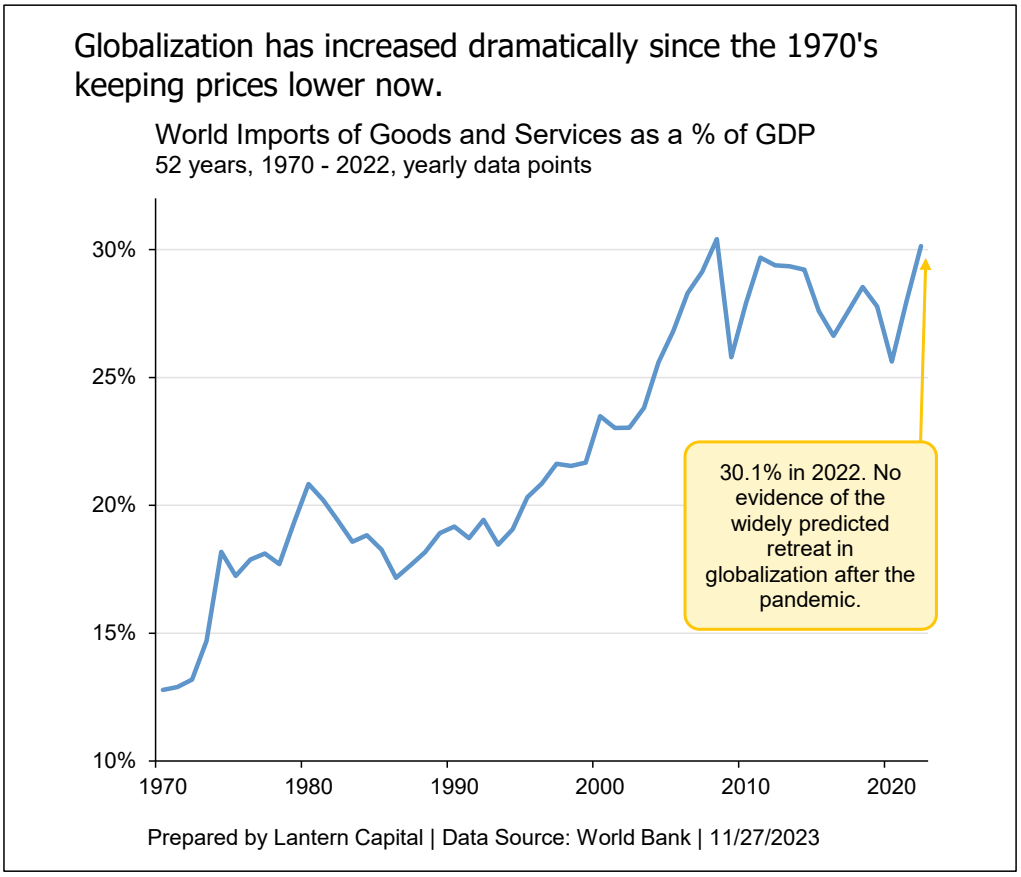
5. **The End of Wage and Price Controls** – In an attempt to stop inflation, the Nixon administration instituted a freeze on wages and prices in August of 1971 which parts-of lasted until late 1973. During this policy's existence, inflation was held down, but as it was lifted and after, inflation surged from 3.6% in 1/1973 to 12.3% in 11/1974; rising from pent-up inflation and the 1973 oil embargo. There is no evidence to suggest this policy exacerbated inflation more than the sum of the period of suppression and after, but it created a surge which undoubtedly negatively affected the public's inflation expectations and was a factor in the Fed raising rates into the middle of the recession of 1973 - 1975.



6. **Large union membership** – Union membership in the U.S. was more than a quarter of workers in 1970 (27.4%) but has fallen to just a tenth of workers in 2022 (10.1%.) Smaller union membership means that collective labor agreements are smaller as a percent of the economy and less impactful to overall inflation.



7. **Pre-globalization** – Globalization began in earnest during the 1990's as labor and factory capacity emerged in China facilitating cheaper labor, goods, and services. A metric of this, global imports to global GDP, has more than doubled since 1970; rising from 12.8% in 1970 to 30.1% in 2022. While the pandemic may cause globalization to retreat somewhat, as long as a growing and more connected global population is willing compete for lower prices, the base incentive for globalization remains, and keeps prices suppressed.



The high interest rates in the 1970's and early 1980's were an aberration of history. From Sidney Homer and Richard Sylla's *A History of Interest Rates*, 4th edition published in 2005 (my emphasis),

> "The spectacular rise in interest rates during the 1970's and early 1980's pushed many long-term market rates on prime credits up to levels **never before approached, much less reached, in modern history**. A long view, provided by this history, shows that recent peak yields were far above the highest prime long-term rates reported in the United States since 1800, in England since 1700, or in Holland since 1600. In other words, **since modern capital markets came into existence, there have never been such high long-term rates as we had all over the world a quarter century ago.**"

With inflation falling historically quickly (there will be more bumps in the road, however), some are beginning to wonder if fundamental global economic forces are largely unchanged from

before the pandemic despite ubiquitous calls to the contrary. As *The Telegraph* columnist Ambrose Evans-Pritchard wrote on 10/31/2023 in "Inflation is dying and bonds are a screaming buy" (my emphasis),

> "What has changed in the global economic system since COVID first erupted in Wuhan? **We may discover that the deep causes of the zero-rate era are still largely with us.**"
>
> and,
>
> "But as the International Monetary Fund (IMF) keeps telling us, **you can find the death of globalization everywhere except in the statistics.**"

The pandemic's supply-chain failure and panicked fiscal and monetary response that "over-filled the hole" undoubtedly created high inflation and called many economic dynamics into question—usually with an inflationary conclusion. But, the inflation surge of the last two years may be an isolated event. The two big factors that have kept inflation and rates low for decades remain: aging demographics and globalization. For these reasons and the others explained above, inflation is not set to rise like it did in the 1970's.