

POLITICAL PULSE

Defeat from the Jaws of Victory?

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Political posturing and unsound economics threatens the expansion.

We're not ready to say "man the lifeboats," but we are quite concerned that policy blunders at the **White House** and **the Fed** threaten the accelerating economic expansion just as it is getting good. The expansion really is accelerating -- signs of both higher expected returns and a greater willingness to bear risk to get those returns are abundant and clear. Correct policy decisions are largely responsible for this good news. But now policy-makers are getting impatient, and they risk making serious long-term mistakes because they are myopically focused on short-term jobs growth. They are on the verge of snatching defeat from the jaws of victory.

Treasury Secretary John Snow's attempts to persuade **Japan** and **China** to revalue their currencies -- to make their exports more expensive and our exports cheaper in world markets -- is misguided on so many levels it's hard to know where to begin (see ["Dangerous Game"](#) September 23, 2003). It is clear that the initiative is motivated by intense lobbying of the White House by manufacturers and politicians from several midwestern states, who rationalize their economic woes as a matter of jobs disappearing to Asia. A White House that sees the 2004 election as suddenly up for grabs needs all the friends it can get in "red states" -- so it's difficult to not be seen as "doing something." Our administration contacts try to assure us that the only real policy goal here is to *create the appearance* of giving it the old college try -- no actual result is desired or expected. That's a small price to pay, or so they rationalize, to forestall the risk of serious protectionist legislation getting spun up in **congress** in an election year. But we see this as dangerously naive. It's worse than "be careful what you wish for." It's "be careful what you *pretend* to wish for." So far China has stood firm, and we expect that it will continue to do so. But apparently Japan is giving Snow his pretend wish, whether or not he really wanted it. Did the administration really expect markets and our trading partners to not react to their public statements that can only be interpreted on their face as being calls for a reduction in the purchasing power of all savings and investments denominated in dollars?

The Fed is making a similar mistake. Repeated statements by Fed officials stress their intention to ignore the mounting market-based and statistical evidence of inflationary pressures, and focus only on jobs as the polestar for monetary policy. We have long warned of this risk, and it is very near now to being locked in as a reality. Markets sense that the Fed is on the brink. Gold -- our most sensitive inflation indicator -- is flirting with \$400 in highly volatile trading (see ["Gold At \\$380"](#) September 10, 2003).

The worst part is the interaction of these two policy errors. They both point in the same direction -- toward a cheapening of the dollar's value -- and give the impression that the White House and the Fed are allied in an effort to devalue and inflate **George Bush** into a second presidential term. The tragic irony is that these policies grant that a strong economy is what it will take to get the president re-elected -- but they are based on such naive and dangerous misconceptions about what creates economic growth that are likely to achieve exactly the opposite. There is still a chance for cooler heads to prevail. But we *are* worried. **TM**