The 1970s May Not Be The Proper Inflation Parallel

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Not Wanting To Repeat The Mistake Of The 1970s

The Fed has been consistent in its strong desire to not repeat its mistakes of the 1970s when it cut rates too soon, too fast thus leading to a second surge in inflation that was even bigger than the first. This is understandable because the current inflation episode so far resembles that of the 1970s as shown in the chart below. A near-term Fed pivot could set in motion a similar inflation dynamic. That is the concern of monetary policymakers. But will it?

Source: BLS, Haver, SMBC Nikko
But What If the Better Parallel Is The 1940s?

The Second World War led to a temporary collapse in labor supply while at the same time government (military) spending soared. Mechanically, this resembles what happened during the pandemic. There was a shut-in of labor supply while at the same time government spending soared. Today’s inflation backdrop so far also resembles that of the 1940s as shown in the chart below. If this continues, inflation is poised to fall much further in which case the Fed should soon be considering a pivot.

Source: BLS, Haver, SMBC Nikko
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