Lead Left Interview – Tim Hopper

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This week we chat with Tim Hopper, managing director and chief economist for TIAA-CREF. Tim has over 20 years of experience writing and speaking about the global economy. Prior to joining TIAA-CREF, Mr. Hopper held various leadership positions in global banking and real estate. He also served as a senior economist with the Federal Reserve Bank of Dallas for over 10 years.

The Lead Left: Tim, I think a number of our readers would be interested in your perspective on the economy, but particularly your perspective on the Fed's rate strategy.

Tim Hopper: The problem has been the longer the Fed waits, the more they're held hostage to global events. In particular, I think the Fed has overstayed its usefulness on qualitative easing. So much liquidity is being trapped in banking instead of the economy. So much of the distortion we're seeing is being caused by this fact.

TLL: So the Fed is delaying the inevitable?

TH: We know there will be future business cycles. It's important to clean up the trapped liquidity issue now. But another reason to raise rates is the reflation argument. QE has been very stimulative for the financial economy, yet there's been little inflation or stimulus for the real economy. If the Fed raises rates, that will begin the process of re-inflating the economy by reinvigorating the banking sector to increase lending.

TLL: With interest rates near zero and all this excess liquidity trapped, that would allow the real monetary process to begin taking effect.

TH: Look, the Fed has inflated its balance sheet to over $4 trillion. You can't unwind that quickly. However, at the same time, you've got to restart the economic engine and let it behave like a more normal pattern.

TLL: What do you look at in terms of economic data?

TH: The Fed has been looking at employment of late. It's a more exact and current gauge on the economy than GDP, especially when the latest GDP statistics don't appear to reflect actual activity. But when labor markets get tight, wages go up, and you can see that pretty easily. It's not perfect, but it's better than many other metrics. So here's the rub. Wages aren't rising at the moment, but layoffs and unemployment are way down, and employment is rising. That means we're not far from seeing wages going up. And once it gets going, it's going.

TLL: But haven't economists poked a ton of holes in the validity of the employment numbers?

TH: Things have changed in this cycle, with the permanency of demographic shifts. That's put pressure on the Fed and makes it tougher to call when "full" employment has been reached. It's true, this is a fuzzy science. But there are things you can look to. For instance, when labor markets heat up across the country you'll begin to see stronger job growth. For an economy our size, once we start stringing together months of job growth in excess of 200k and it then starts to back off, it is a signal that labor shortages are accumulating, which means the economy is approaching full employment and that wages are about to start rising. And that dynamic happened this year.

TLL: You've mentioned in your weekly reports you believe capex spending is strong in the US.

TH: Capex spending isn't strong, but I would say the recovery of capex is being masked by the drop in energy spending which depresses the overall data. 30-40% of US capex is related to direct energy costs. That really impacts the numbers.

TLL: Tell me about core inflation, where does that stand?

TH: The headline measures say there's no inflation, and that's because the dollar is strengthening (import price deflation) and falling oil prices. But core measures are still running around 1.5%. However, even if you just looked at core, there hasn't been that much traditional inflation based on how much liquidity the Fed has pumped into the system. But that doesn't mean there hasn't been inflation, we've just seen it in other areas, like asset prices, high yield spreads, re-appreciating real estate prices and so on.

TLL: Does the winding down of QE point to a disinflation of these assets?

TH: If economic growth rates hold up, that will support asset prices at these levels, so no there is no particular reason for asset price deflation. However, it's important to maintain growth rates at or above potential and preferably with rising productivity. Doing so would also support a longer business cycle.

To be continued the week of Sept 28

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