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The Return of Stagflation?

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CORNHUSKER ECONOMICS

University of Nebraska–Lincoln Extension

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Department of Agricultural Economics
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The Return of Stagflation?

Market Report	Yr Ago	4 Wks Ago	4/11/08
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight	98.33	89.78	88.31
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	127.02	121.81	115.28
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	110.33	102.26	99.01
Choice Boxed Beef, 600-750 lb. Carcass	168.89	145.69	140.91
Western Corn Belt Base Hog Price Carcass, Negotiated	65.29	50.41	58.05
Feeder Pigs, National Direct 50 lbs, FOB	70.88	50.44	38.52
Pork Carcass Cutout, 185 lb. Carcass, 51-52% Lean	66.98	57.73	60.95
Slaughter Lambs, Ch. & Pr., Heavy, Wooled, South Dakota, Direct	88.50	95.38	91.87
National Carcass Lamb Cutout, FOB	244.27	262.09	253.37
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	4.61	11.90	8.84
Corn, No. 2, Yellow Omaha, bu.	3.42	5.25	5.51
Soybeans, No. 1, Yellow Omaha, bu.	6.78	12.53	12.71
Grain Sorghum, No. 2, Yellow Dorchester, cwt.	5.50	9.09	9.45
Oats, No. 2, Heavy Minneapolis, MN , bu.	2.82	3.81	3.79
Hay			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	135.00	135.00	135.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	92.50	85.00	85.00
Grass Hay, Large Rounds, Premium Nebraska, ton.	90.00	*	**82.50

* No Market

**Market was changed from NE Nebraska, Good Large Rounds to Nebraska, Premium Large Rounds

Within the past few months, there has been a substantial increase in the news media's use of the term "stagflation" in reference to the future of the U.S. economy. Economists use stagflation to refer to a prolonged period characterized by both stagnation, represented by slow economic growth and high unemployment, and inflation, which is an increase in the general price level.

Stagflation was an important economic problem for many countries during the 1970s. In the United States, stagflation is associated with the 1973 oil embargo, which brought skyrocketing energy prices. Although the embargo was lifted in 1974, its effects persisted well into the 1980s. During that period of stagflation, unemployment ranged from 4.9 percent to 9.7 percent and inflation ranged from 5.8 percent to 13.5 percent. The so-called "misery index," the simple sum of the unemployment and inflation rates used to gauge the economic and social costs to the nation, ran in double digits, reaching as high as 20.8 in 1980.

According to economists, there are two possible causes of stagflation. It can be caused by an adverse supply shock, such as a substantial increase in the price of imported oil. The increase in the price of such an important input raises the general price level while simultaneously slowing economic growth by making the production of goods and services less profitable. Stagflation can also be caused by government policies. For example, a government can slow economic growth by overregulating markets. Then, in an attempt to stimulate the economy, the central bank can allow too much expansion of the money supply, resulting in inflation. The stagflation of the 1970s is usually attributed to both these causes. It began, in large part, because of a substantial increase in oil prices but continued as central banks overstimulated the economy in an effort to avoid recession, leading to a continuing upward spiral of wages and prices.

IANR

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The current economic downturn in the United States began with the "subprime mortgage crisis." While housing prices were rising, higher-risk borrowers were given incentives and encouraged to take out mortgages with the expectation they could refinance later at more favorable terms. However, once housing prices began a moderate decline in 2006, refinancing became more difficult and many borrowers with subprime or other adjustable rate mortgages started to default on their loans. Because of a growing number of defaults and the absorption of credit losses, financial institutions began to reduce lending and charge higher interest rates, making refinancing even harder and exacerbating the problem. The surplus inventory of homes that has resulted has exerted downward pressure on the economy by suppressing new home construction. The attendant credit crunch has had a wider effect on the economy by decreasing consumer spending and business investment.

Slower economic growth was apparent by the fourth quarter of 2007. The increase in real gross domestic product (the total value of goods and services produced by labor and property located in the United States) for that quarter was only 0.6 percent, compared to 4.9 percent for the third quarter. More recently, the unemployment rate increased from 4.8 percent to 5.1 percent in March 2008, compared to an average of 4.6 percent for 2006 and 2007. Many economists believe the country could soon be headed toward a recession, usually defined as a decline in real GDP over two or more successive quarters, a possibility Federal Reserve chairman Ben Bernanke recently acknowledged.

Speculation about the recurrence of stagflation increased earlier this year when the government released its inflation figures for January. The producer price index, a measure of prices at the wholesale level, had risen 7.4 percent since January 2007, the largest 12-month increase since 1981. The consumer price index increased 4.3 percent over the same period and had advanced at a 6.8 percent annual pace during the last three months of the period. February inflation figures were lower, but during March the PPI rose at a faster rate than in January. With the price of oil reaching a record $113 per barrel this week, economists expect inflation to continue in the coming months.

Much of recent inflation can be attributed to increased food and energy prices, which combined make up about 24 percent of the CPI. In March, the prices for food, household energy, and motor fuel were respectively 4.5 percent, 6.8 percent, and 26.4 percent higher than a year earlier. Economists find solace in the fact that the inflation rate for all other items, the "core" inflation rate, was only 2.4 percent, suggesting the inflation associated with higher food and energy prices had not yet worked its way into the prices of other goods and services. The difference between inflation at the wholesale and retail levels indicates competitive pressures may have restricted the ability of manufacturers and other businesses to pass increased costs onto consumers.

The current economic situation presents a dilemma for the Federal Reserve System. The principal tool used by the Federal Reserve to implement monetary policy is the federal funds rate, the interest rate banks charge each other for overnight loans used to meet statutory reserve requirements. By lowering the targeted federal funds rate, to which commercial interest rates are tied, the Federal Reserve can stimulate economic activity by making it easier for banks to loan money to consumers and businesses. However, lower interest rates expand the money supply and risk fueling inflation. Of course, by increasing interest rates and contracting the money supply, the Federal Reserve can attempt to reduce inflation, but it loses its ability to stimulate the economy.

During the past several months, the Federal Reserve has been under pressure to ease credit in an attempt to prevent a recession and soften the effects of the mortgage crisis. It has responded by lowering the federal funds rate six times since September, from 5.25 percent to its present level of 2.25 percent. Many observers believe the Federal Reserve has been correct to focus on the immediate threat of recession and the reduced demand resulting from the slowdown will eliminate inflationary pressures until the economy is back on its feet. Others point to rising energy prices as the underlying cause of current inflation, similar to the supply shock stemming from the 1973 oil embargo. At least one media commentator has criticized the Federal Reserve as overreacting to the current situation and repeating the mistakes that led to stagflation in the years following the embargo.

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