



Five Critical Factors Why Prices Will Stay High For Years

Description

At approximately 9am local time on February 21, 1972, a Boeing 707 airplane dubbed *Spirit of '76* landed in Shanghai's Hongqiao airport.

The airplane's main door opened, and out walked US President Richard Nixon.

The trip shocked the world. There had been no formal communication or diplomatic ties between the US and China for 25 years. And Nixon's voyage not only normalized relations between the two countries, but it kickstarted decades of worldwide economic growth.

Back then, the US was the richest and most powerful economy in the world. But as a consequence of that prosperity, the US was also a very expensive place to produce.

US companies were on the lookout for inexpensive, foreign manufacturing hubs where they could cheaply produce their products and sell them back to the US market.

China became that cheap manufacturing hub.

Eventually China was producing just about everything from T-shirts to antibiotics. And because the cost of production was so low in China, consumers around the world benefited.

Combined with cheap oil, a functioning global supply chain, and relative peace and stability, cheap Chinese production helped keep prices low and constrain inflation for decades.

But these trends are rapidly coming to an end.

For starters, China is now an economic superpower; many of its largest cities, in fact, have a per-capita GDP that exceeds the United States and Western Europe.

Wages have increased dramatically in China over the years because of this increase in prosperity, which means that it's no longer cheap to manufacture most lower-end products there.

A lot of manufacturing has already shifted to cheaper places like Vietnam, Bangladesh, etc. But even

those countries are quickly becoming more expensive places to produce. And they don't have nearly enough capacity to keep up with global manufacturing demand.

Some large companies are starting to bring their manufacturing back home. This is becoming more popular now as global stability wanes.

Plus businesses learned during the COVID-19 lockdowns, and the resulting global supply chain dysfunction, that manufacturing at home is more reliable.

That may be true. But manufacturing in a 'rich' country is also a LOT more expensive.

So, regardless of whether a business chooses to manufacture at home or abroad, they're almost guaranteed to suffer higher production costs. And that means consumers will be paying more.

This trend is a massive reversal from decades of cheap foreign production that kept prices low. But it only scratches the surface of why inflation will likely persist for years to come.

(British economist Charles Goodhart, a former central bank official, describes this phenomenon in his new book *The Great Demographic Reversal*. It's definitely worth reading to understand this trend.)

Historic shifts in the labor market will also be a major contributor to inflation.

For example, there have never been more retirees in the history of the world than there are right now. And their numbers are growing.

According to Federal Reserve data, an additional 1.5 million people in the United States retired early during the first year of the pandemic. There will likely be more to come.

Plus US Labor Department statistics show that millions of other individuals, including young people, abandoned the idea of working altogether because of the pandemic.

Traditionally, there's a steady balance between the number of jobs in the economy, and the number of workers in the labor force. Sometimes there are shocks, like during the Great Recession in 2008, when millions of jobs vanished, practically overnight.

Now the converse has taken place: millions of workers have vanished, practically overnight.

The end result is that there are 11.3 million unfilled jobs in the United States – a record high – because so many people simply quit the labor force.

Of course, another key labor trend is that younger workers aren't interested in most traditional jobs.

Countless teenagers aspire to be Instagram starlets, or to live-stream themselves playing video games for a living. They have little interest in construction, transportation, or manufacturing jobs.

So, in summary, we have former 'low-cost' manufacturing hubs becoming a lot more expensive. Plus, a constrained work force back home that limits production and pushes costs higher.

This is all highly inflationary.

And there's absolutely nothing the government or central bank can do about it. Gen Z twenty-somethings aren't going to suddenly decide to start working traditional jobs just because the Federal Reserve raises interest rates by 0.25%.

Most likely the politicians will make it much worse— which is another key factor in future inflation.

Nancy Pelosi stated on Friday that inflation was solely Vladimir Putin's fault and insisted that their current multi-trillion dollar deficit spending is "reducing the national debt" and "not adding to inflation."

The President, meanwhile, has blamed inflation on "greed", while the Federal Reserve insists that higher prices are a result of supply chain dysfunction.

Not one of these institutions— Congress, the White House, or the Fed— seems capable of looking at their own actions.

The Fed refuses to consider that inflation is due to their dizzying expansion of the US money supply—the largest since 1943.

Congress refuses to consider that inflation is due to their insane deficit spending— the largest ever in US history.

And the White House refuses to consider that inflation is due to its fetish for anti-competitive regulations and constant attacks on capitalism.

So, when the three key institutions charged with keeping inflation in check refuse to understand why there's a problem, it's hard to imagine they're going to fix it.

There are plenty of other lingering inflation factors as well: Geopolitical conflict is obviously inflationary. COVID-19 continues to be very inflationary. Environmental fanaticism is inflationary.

And just like the challenge of increased manufacturing costs and labor market demographic trends, these issues cannot be magically fixed by politicians or central bankers.

In essence, policymakers are completely powerless to do anything about inflation.

There's an irrational hope that inflation will quickly reverse and prices will return to 2019 levels— just as soon as Putin leaves Ukraine... and the global supply chain dysfunction works itself out.

But this is wishful thinking.

First, both of those resolutions could take a very long time.

But, more importantly, the trends I outlined are much larger and could keep prices elevated for years to come.

By Simon Black

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