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Stephen Moore Has a Risky View on Commodity Prices

Ramesh Ponnuru

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Stephen Moore may be setting a new standard for engagement on the issues as a nominee to the Federal Reserve Board.

Since his name was floated for the position, Moore, a co-founder of the free-market Club for Growth, has done interviews with several media outlets candidly setting forth his views on economic issues. He has been particularly concerned to get across two ideas about monetary policy: that the Federal Reserve should be accommodative when presidents pursue pro-growth policies and that it should aim to hold commodity prices steady.

Moore has shown flexibility on these topics, saying he would not be "doctrinaire" about commodity prices and that he erred in predicting high inflation during the Barack Obama administration. His view on commodity prices seems to be of recent vintage: He didn't call for a looser monetary policy to help boost them during their long slide from 2011 through 2016.

I hope that Moore, with whom I have been having friendly discussions and occasional arguments for more than two decades, will reconsider both of the views that he has been expressing -- especially if he gets confirmed to the Fed.

These ideas, that the Fed should accommodate growth and stabilize commodity prices, don't fit together very well. Commodity prices can rise at the same time that tax rates are being cut, as happened during President George W. Bush's first term. In such cases, Moore's idea about commodities would have the Federal Reserve raise interest rates.

But his second aim, to make room for the pro-growth effects of conservative policies, would have it cut them. More important than the fact that these ideas can point in different directions, though, is that neither of them on its own offers a useful guide for monetary policy.

Start with Moore's view about economic growth and the Fed. On Bloomberg TV, he has argued that central banks should not fear growth as a warning sign of high inflation – and he is right about that. But on other occasions, he has gone further, asking, "Why would you want to raise interest rates at a time when the economy is clicking on all cylinders?"

If you're ever going to raise rates, an economic boom is exactly when you would usually want to do it. The alternative would be for the Fed to raise rates when the economy is weak and thus make the business cycle more severe. That's the opposite of what a central bank should do.

If President Donald Trump's policies have had the strongly positive effects on current and future economic growth that Moore believes, then interest rates should go up. The neutral interest rate -- the one that has neither a contractionary nor expansionary effect on the economy – should rise when expected growth does.

As for commodity prices, Fed officials have often looked at them among many other indicators of the state of the economy. One might think that because of their rapid movements, they can serve as advance signs of whether the economy is weakening or overheating. Reviewing studies on the subject, though, monetary economist George Selgin does not findevidence that commodity prices do well at predicting trends in the level of prices or spending in the overall economy.

Central bankers generally place more weight on "core inflation" -- that is, the inflation rate for everything but energy and food, and thus excluding a lot of commodities -- than on overall inflation. That's because taking those items out makes the measure less volatile and a better gauge of continuing trends.

What Moore is advocating is very nearly the reverse approach: keeping commodities in the price index and dropping everything else. Critics have pointed out that commodities prices were rising from 2009 through 2011, and therefore counseling monetary tightness during the end of a severe recession and the very start of a recovery.

Moore has replied to that argument by saying that if the Fed had paid attention to rising commodity prices during the preceding boom and tightened money then, there wouldn't have been a crash, and thus a need to reflate, in the first place.

This response sidesteps the key point. If commodity prices can point in the opposite direction from what the economy badly needs, why tie policy to them?

If consumers in China and India increase their purchases of gold jewelry, it will raise the price of gold. Under a commodity-price rule, their shift in buying habits would require deflation in the U.S. That can't make sense.

The rule would also, perhaps more importantly, put monetary policy at the mercy of supply shifts. Widespread strikes by copper miners in Latin America would raise commodity prices and militate in favor of tightening.

Even in the absence of a commodity-price rule, monetary policy has sometimes been too responsive to changes in supply. Productivity gains exert downward pressure on prices. In the mid-2000s the Fed was arguably too loose because it wanted to offset that downward pressure. In 2008, it tightened money at the worst possible time because it feared oil prices were rising.

A central bank driven by commodity prices will make supply-induced errors more than one driven by inflation, which will in turn make more than one driven by core inflation. A central bank that used total dollar spending as its guide would be the least prone to such errors.

Moore should drop his focus on commodities, which would make the flaws of current monetary policy worse. By the same token, though, his numerous critics should realize that what's wrong with his commodities idea is what's wrong, on a smaller scale, with what the Fed already does.