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December 11, 2019

The Volcker Myth Is Unsupportable

Paul Volcker, a great man in central banking, has passed away. The New York Times headlined: ***"Fed Chairman Who Waged War on Inflation, Is Dead at 92"***. This is a legend that, sadly, is not supported by history. Firstly, Volcker in 1971 was instrumental in setting up today's aggressive central banking. Furthermore, Volcker happened to head the Fed when a great global boom in commodities blew out—naturally—and collapsed. They all do, but soaring prices and not-so-soaring wages have always been accompanied by rising social anxieties. Very stressful times and typically followed by a great bull market in financial assets. Which has been part of the post-inflation relief.

Paul Volcker just happened to be on duty during the natural transition from the stress of inflation to the wonders of financial speculation. Great bull markets have been fabulous, naturally making Volcker a popular hero. Practical and bereft of conventional economic reasoning, Mark Twain described the 1870s example as the "Gilded Age".

Market history tells the real story. As part of the global mania in commodities, the US rate of inflation soared to 14 percent in 1980, which compares to 23 percent reached on the previous example when global speculation in commodities completed in 1920. Which social distress was followed by the euphoria of the "Roaring Twenties". Now, without looking it up, who was the Fed chair that presided over that wondrous end to inflation? For the record, it was Roy A. Young, who was on shift during the same transition that made Volcker famous.

Indeed, during Volcker's watch inflation soared and as usual interest rates soared until the mania exhausted itself. But it was global and central banking has been a national enterprise. If one looks at the popular proxy for credit/money (M2) there was no decline in its growth rate during the 1980 transition. However, there was a harsh global recession that included America, followed by the fascinating shift to speculation in financial assets which continues to this very day.

Lately central bankers have been professionally worried about too little inflation.

In 2018, Volcker, published a book which title included *The Quest for Sound Money and Good Governance*. His fame rests entirely upon the world of economics and policymaking, which is mainly theoretical. And when the world of theory intersects with financial volatility, the results can be ironical. And Volcker's career in public affairs provides exquisite irony. The main thing is that neither he nor his policies "ended inflation". As in "No", "Nada" and "Unlikely". With ample evidence, global market forces ended intense speculation in inflation in 1980. It was yet another transition from run-away speculation in things to run-away inflation in financial assets.

Other than this writer's research publications, the linked phenomena have not been widely reviewed.

The world of modern finance had evolved in London by 1700, with enough publicly-traded companies, to be called a stock market. A central bank with the privilege of issue was chartered in 1694, presumptuously called the Bank of England. London's first financial advisory letter was published by John Houghton, beginning in 1692.

The first transition from soaring inflation to eventually soaring stock prices began with the commodity boom and collapse in 1711. The ultimately infamous South Sea Bubble completed in 1720, setting the pattern for the following five examples

The 1763 example was a reported in real time linking the transition with its commodity hit to the ultimate hit to the financial bubble. All of the great bubbles crashed in the fall and the Dutch publication *De Koopman* in December 1772 reported: ***"The dreadful year 1763 has returned – but the causes are different from those of 1763 and take root in England: the East India Company is the cause … our diseased credit is dead, discounting has gone wholly out of fashion, a loan cannot be had except on double security."***

It is an astute observation that this researcher has not seen with any of the other transitions. The Dutch understanding that "easy" credit is followed by "diseased" credit shows remarkable word usage.

By the time New York had become a big enough to join financial history a long run of inflation drove the US CPI up to 27 percent. That was in 1864 and the "Gilded Age" followed.

On the next example, inflation soared to 23 percent in 1920 and the natural run to financial ecstasy completed in 1929.

Of course, the most fascinating transition was set up by another great global speculation in commodities that drove the US CPI up to 14 percent in 1980. That one was riveting. Academics had a theory that artificial expansion of credit would drive economic expansion. Sadly, another example of a primitive syllogism. Beyond that it forced depreciation of the dollar, which drove the CPI up. Because such inflation has always been distressful, academics avoided blame by crafting the nonsense that the public's "inflation expectations" drove prices up. Tautology at its finest.

With this history, this writer's presentations to institutions in 1982 included a distinctive conclusion: ***"No matter how much the Fed prints, stocks and bonds will outperform commodities."*** It was controversial then and it is controversial now.

Paul Volcker was not in office at previous transitions from inflation to financial manias. At extremes, Mother Nature and Mister Market rule.

Nor was he in office in 2008, when international speculation drove commodity indexes to the most powerful rally since 1920. Crude oil soared to 147. And what happened? Another wonderful example of inflation in financial assets erupted and continues.

While Volcker was at the Fed in 1980, it was the public that forced the transition to the wonders of financial speculation. Moreover, he was instrumental in imposing policies that forced inflation. In 1971 he supported Nixon's decision to end gold convertibility.

Which was the fateful step that ended constraint, enabling reckless central banking and the world of unstable bubbles of speculation.

With remarkable irony, his book called for ***"Sound Money and Good Governance"***.

In 1864, the US did not have a central bank or banker to "end inflation," but it soared to 27 percent before collapsing. In June 1920, it peaked at 23.7 percent, before collapsing. But Volcker had only to contend with 14 percent. It is definitely time for some perspective.