

Paul Krugman - New York Times Blog

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This Time Was Predictable

Bruce Bartlett continues his interesting series on inflation panic, this time focusing on the economists and politicians who keep predicting runaway inflation year after year after year, and never seem to acknowledge having been wrong. I thought his analogy between Shadowstats and the “unskewed” polls predicting a Romney victory was especially apt.

But I do have a slight quarrel with Bartlett, who despite everything, I think, gives the inflationistas too much credit. First, he writes:

When the most recent recession began in December 2007, there was no reason at first to believe that it was any different from those that have taken place about every six years in the postwar era.

Actually, there was. Long before Reinhart and Rogoff circulated their piece on the aftermath of financial crises — an excellent piece of work, not to be confused with their unfortunately influential debt paper — it was already obvious to many people that we were looking at a “postmodern” recession like 1990-91 or 2001, which was likely to be followed by an extended jobless recovery. That is, this was not going to be a Fed-generated slump like 1981-82, which would be followed by a quick rebound once the Fed relented; it was a case of private-sector overreach, and was likely to go on for a long time.

Bartlett then goes on to say

During the inflation of the 1970s, most economists became convinced that if the Fed adds too much money and credit to the financial system it will inevitably cause prices to rise. Since the increase in the money supply in 2008 and 2009 was unprecedented, many economists reacted fearfully to the Fed’s actions.

Given the order of magnitude of the increase in bank reserves, from virtually nothing to more than \$1 trillion almost overnight and now to more than \$2 trillion, it was not unreasonable to be concerned about the potential for Zimbabwe-style hyperinflation.

Yes, it was unreasonable. If you had paid any attention to Japan, or to the revived theory of the zero lower bound (starting here) inspired by Japan’s experience, you knew full well that the Fed’s expanded balance sheet was mainly going to just sit there.

And that, in turn, gets at the true sin of the inflationphobes. They were wrong; well, that happens to everyone now and then. But the question is what you do when events prove your doctrine wrong — especially when they unfold almost exactly the way people with a different doctrine predicted. Do you admit that maybe your premises were misguided? Do you admit that maybe those other guys were on to something? Or do you just keep predicting the same thing, never admitting your past mistakes?

Guess what the answer turned out to be.

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