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I Wonder What Milton Friedman and Karl Brunner Would Say About Allan Meltzer

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While in Toronto Tuesday evening, I just happened to see on a Canadian television program Allan Meltzer, a professor of political economy at Carnegie Mellon University and co-founder, along with the late Professor Karl Brunner, of the monetarist-oriented Shadow Open Market Committee. An issue being discussed on this Canadian television program was the Federal Reserve's second round of quantitative easing, QE2. Professor Meltzer was expressing views critical of the QE2 policy. For some reason, the topic of quantitative easing in the U.S. during the 1930s came up. I cannot remember exactly what Professor Meltzer said, but it was something along the lines that the unemployment rate never fell below 10% in the 1930s. Although this is true, it seems disingenuous to me.

Back on November 9, I wrote a commentary entitled "[Quantitative Easing in the mid 1930s Appeared to be Successful](#)". In this commentary I explained how the upward revaluation of the Treasury's gold stock by President Roosevelt was "monetized." The upshot of the monetization of the increased dollar value of the Treasury's gold stock was that the federal government was able to finance some of its expenditures by figuratively printing money. QE2 is now being described, more or less accurately, in a current animation, which has gone viral, as printing money. In my commentary, I noted that coinciding with an increased rate of growth in the nominal M2 money supply in the mid 1930s there was an increased rate of growth in nominal GNP.

In my commentary, I did not mention what happened to the U.S. unemployment rate as a variation on quantitative easing was taking place. So, let's do this now. Plotted in Chart 1 is the year-over-year percent change in the nominal M2 money supply along with the level of the unemployment rate from January 1930 through December 1939. If Professor Meltzer said on the above-mentioned Canadian television program that the U.S. unemployment rate did not fall below 10% during the 1930s, he was quite correct. But, what Professor Meltzer failed to mention is that as the U.S. M2 money supply transitioned from year-over-year contraction to year-over-year growth in early 1934, the U.S. unemployment rate did trend *lower*. The unemployment rate peaked at 25.6% in April 1933. By March 1934, when the year-over-year change in the M2 money supply turned positive, the unemployment rate had fallen to 16.8%, a decline of 880 basis points. The unemployment rate hit a low of 11.0% in July 1937, a further net decline of 680 basis points from its March 1934 level.

Chart 1

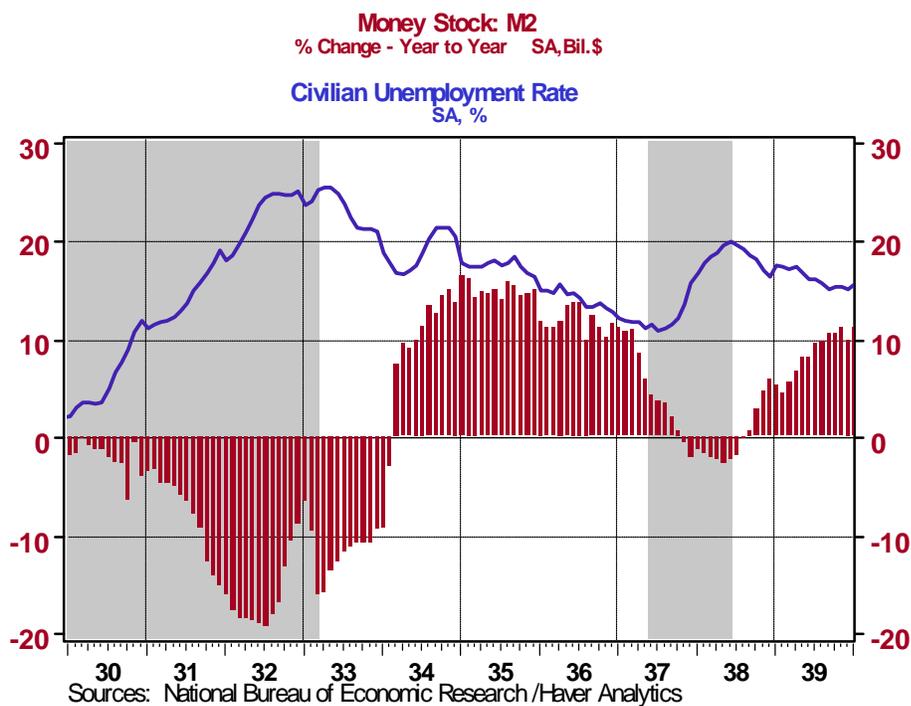
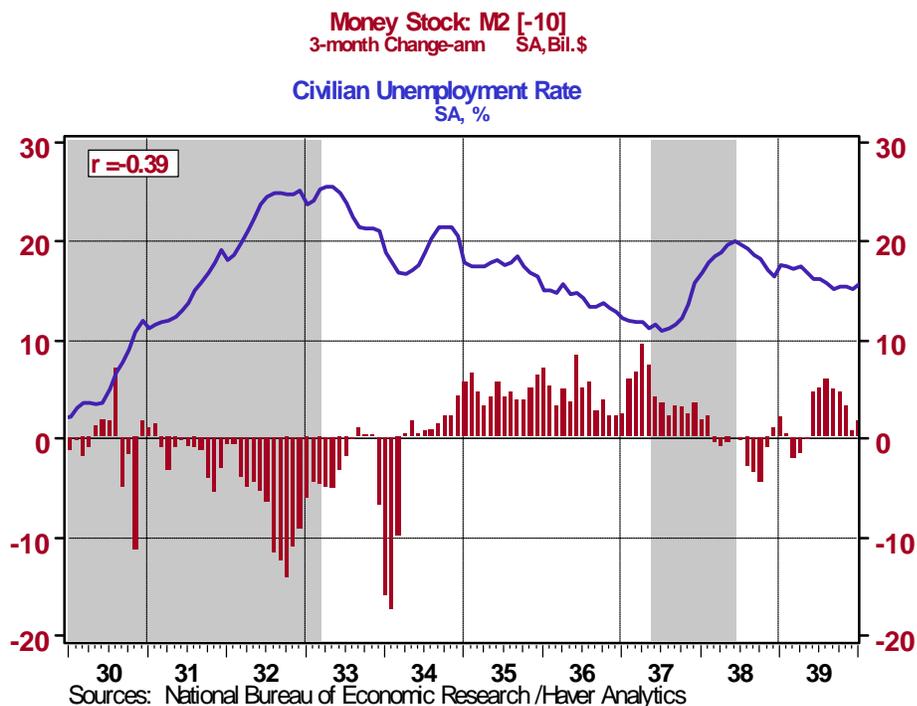


Chart 2 is a variation on Chart 1. Instead of plotting the year-over-year percent change in M2, I have plotted the 3-month annualized percent change in M2 and have advanced this percentage change in M2 by 10 months. The rationale for advancing the percentage change in M2 relative to the level of the unemployment rate is the hypothesis that quantitative easing works with a lag. The reason for choosing to advance the percentage change in M2 by 10 months is empirical – it results in the highest absolute value of the correlation coefficient, 0.39.

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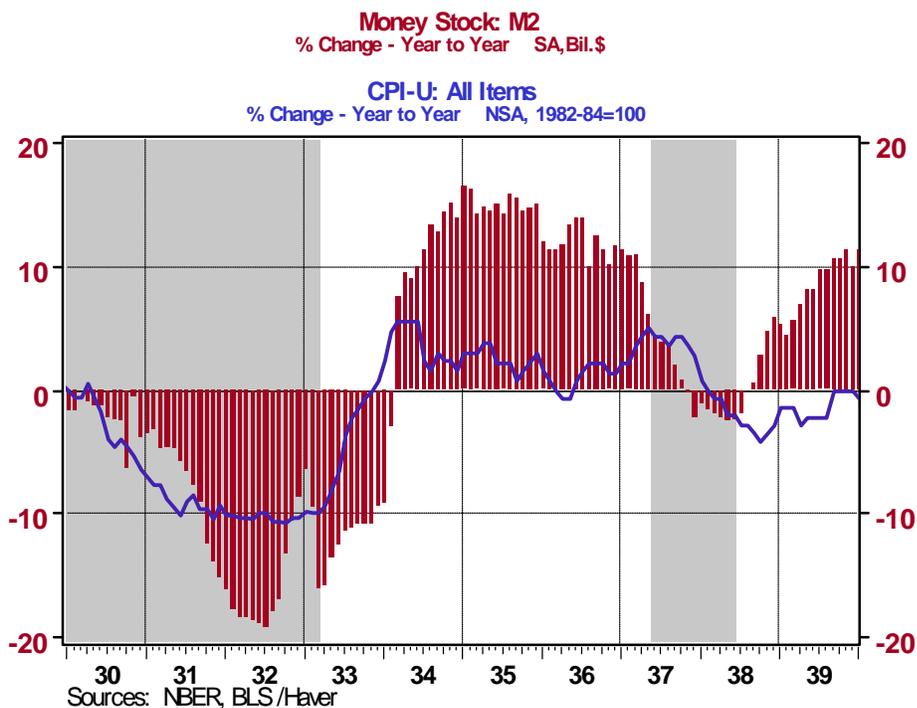
Chart 2



After hearing Professor Meltzer state accurate, but, in my opinion, disingenuous information about the unemployment rate during the 1930s, I turned off the television program and began writing this commentary. So, I do not know if he mentioned what happened to the CPI inflation rate as the money supply grew and the unemployment rate came down. Some critics of QE2 argue that U.S. inflation will rise in response to the “printing of money.” I expect that they are correct in the sense that inflation will be higher *than it otherwise would have been*. U.S. inflation rose in the 1930s after the increased dollar value of the Treasury’s gold stock was monetized, as shown in Chart 3. Between January 1934 and December 1937, the average value of the year-over-year percent change in the monthly CPI was 2.6%. The maximum year-over-year increase was 5.6%. In contrast, from January 1930 through December 1933, the average value of the year-over-year percent change in the monthly CPI was *minus* 6.4%.

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Chart 3



I “renounced” monetarism back on September 1 [[I renounce Monetarism \(with apologies to Mr. Lippman of Pendant Publishing\)](#)]. But by renouncing one aggregate related to the liability side of the banking system, I embraced another aggregate related to the asset side of the banking system, bank credit. I wonder if Professor Meltzer, too, has renounced monetarism. If so, I wonder if he has replaced it with another “model.” I wonder what Professors Milton Friedman and Karl Brunner, may they rest in peace, would say about Professor’s Meltzer’s criticism of QE2. I wonder who the real driving intellectual force was behind all of those academic journal articles in the 1960s and 1970s co-authored by Karl Brunner and Allan Meltzer.

Paul Kasriel is the recipient of the 2006 Lawrence R. Klein Award for Blue Chip Forecasting Accuracy

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