McGarrity: Economic Uncertainty - Log Cabin Democrat (Conway, AR) - September 30, 2015 - page 1

September 30, 2015 | Log Cabin Democrat (Conway, AR)

When there is widespread belief that the economy is about to grow quickly, some businesses will build new factories while others will purchase new equipment. At the same time, many consumers will buy new cars and other durable goods. In contrast, when it is generally acknowledged that the economy will grow slowly or even shrink, firms will try to cut costs, for example, by not renewing a lease on office space, while consumers may buy used cars rather than new ones. If people are uncertain about what the economic future holds, they often postpone their decisions until they get better information. Today many decisions are being delayed because it is so unclear where the economy is heading. Even the most expert economists can give little guidance because they do not agree about whether we are destined for better times or for worse times in the near future.Movements in the exchange rate provide evidence of this uncertainty.

The fortunes of most countries move together. When the United States does well, usually countries like Germany, France and Italy also do well. While all of these countries will probably share similar economic fortunes, the Central Banks in the United States and in the European Union have very different ideas about where the global economy is heading. The European Union's Central Bank believes that Europe is heading for bad economic times. To combat this, it is expanding the money supply. With more money available, the bank hopes that Europeans will increase their spending, which will hopefully revive their economy.

This expansion of the money supply had a predictable effect on the exchange rate. When anything becomes more abundant, people will pay less for it. Money is no different. When there are more Euros, the value of a Euro should go down.

In the United States our Central Bank, the Federal Reserve, foresees favorable economic growth in the near future. The Federal Reserve worries that people with money will spend it to get what they want. If they are unable to make a purchase at the existing price, they will bid up prices to get what they want. If the prices of enough goods and services rise, the general price level will increase and give us inflation.

Inflation is an erosion in the purchasing power of money. It is something to be feared. When we have inflation, the $10,000 that you have in the bank can now buy fewer goods and services. With inflation, people will decide to save less since money does not hold its value as well any more. With less savings available, businesses will have less money to borrow in order to buy new equipment that can make their factories more efficient. Without the new more productive equipment, the economy will not grow very quickly for years to come.

In recent times in order to prevent inflation, the Federal Reserve has not increased the U.S. money supply as much as Europe has increased its money supply. By refusing to expand the money supply when Europe has done so, the Federal Reserve has allowed the dollar to keep its value. Also, the Federal Reserve has been signaling that it will soon decrease the U.S. money supply. This intention is enough to make people believe that the U.S. dollar will become increasingly scarce. As any item becomes less abundant, its value goes up. The dollar is no exception. The Federal Reserve's intention to decrease the money supply has made the dollar even more valuable.

The European Union's Central Bank and its fear of bad economic times has made the Euro less valuable, while the U.S. Central Bank, and its fear of fast economic growth and the inflation that might accompany it, has made the dollar more valuable. This has shown up in the exchange rate. Three years ago relative to the dollar, the Euro was more valuable than it is today. A Euro was worth $1.31 three summers ago, but now after the Central Bank's actions, the Euro is only worth about $1.12.

These uncertain times have caused the Central Bankers in Europe and in the U.S. to make very different guesses about what the future holds, which have informed their very different decisions on how to manipulate the money supply, making the dollar more valuable and the Euro less valuable. The large change in the exchange rate between the dollar and the Euro reflect different policies by the Central Banks. The changing exchange rates are evidence of the unsettling situation where the experts are divided about what the economic future holds. Look for firms and consumers to postpone many decisions until a better consensus is reached about the direction of the economy.

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