



The Inflation Episode - What Will Happen & What Do We Do w Dr. Tom Lehman Lehman Transcript

Ryan Moran [00:00:04]

Dr. Lehman, welcome back to Capitalism.com. It's been a year since we've hung out here so thanks for coming back.

Dr. Tom Lehman [00:00:10]

Thank you for having me. Glad to be here.

Ryan Moran [00:00:15]

For anyone that didn't hear our first podcast episode together, Dr. Lehman is the economics professor at Indiana Wesleyan University that changed pretty much my viewpoint on the world. I think studying economics made me more of an educated person than any other field of study besides maybe 15 years as an entrepreneur. But Dr. Lehman, when we were here a year ago we were right in the middle of the government's response to the pandemic and my first question to you is are you surprised in any direction about how the markets and how the economy has responded to the government policy of the last year?

Dr. Tom Lehman [00:01:01]

Yes and no. I guess the surprising aspect is that as I look out over macroeconomic statistics and data today, on the surface the economy looks very strong and very good, and I guess over the past year, the surprise has been just how quickly the dip ... It was, of course, not a conventional recession. This was not a conventional ... From the perspective of most economists, me included, this would not be your typical business cycle kind of recession. This was a very much new [INAUDIBLE 00:01:41], a kind of land of exogenous shock outside the system just disrupting things, government policy responses disrupting on the supply side.

Dr. Tom Lehman [00:01:54]

But I'm pleasantly surprised at how things have responded very quickly. Now, you'll notice I said on the surface things look pretty strong, pretty good. So, that would be part of the surprising aspect of this I guess. More recently, what we talked about a little bit last year and what is maybe not as surprising is the rise in inflation that we're now seeing and for 2 reasons, 1 because of the ...



Dr. Tom Lehman [00:02:28]

Just the mathematical nature of how the price level is calculated, you're going to get some bump in month to month inflation rates, increases in the price level from last year to this year because of the reduction in the price level or the flatlining of the price level last year at this time. And so, with the robust bounceback that we've got, it's not surprising to see some inflation there. Then ...

Ryan Moran [00:03:03]

So, Dr. Lehman, I want to make sure I heard that correctly because what I think I just heard you say is that the inflation as it's being calculated is compared to last year when there was a dip. Am I hearing you correctly?

Dr. Tom Lehman [00:03:15]

That's correct, year.

Ryan Moran [00:03:16]

So, inflation as we talk about it usually means we kind of assume prices are either staying flat or going up, but I've actually never heard it compared to ... The inflation compared to the dip of last year which would actually make the inflation data less shocking to laymen like me who say 5% and 6% going up is kind of concerning.

Dr. Tom Lehman [00:03:39]

It is. Well, I don't mean to downplay that because there's another factor behind this, the supply constraints and the huge increase in demand on the demand side of the macroeconomy because of the major fiscal and especially monetary stimulus. So, you've got 2 factors playing a role here. One is just the math. Just the price level last year and this year going back to a more normal trajectory so that in the summer months this year we're seeing a bigger increase in year over year inflation as you've said. We're pushing 6% now and a CPI of 5%, roughly that, in the core stripping out food and energy.

Dr. Tom Lehman [00:04:29]

You're seeing the same thing in the GDP deflator. But the other aspect of this, it's not just the math. It's not just, this is what Powell is looking at the Fed and saying well, it's just transitory. This is just transitory inflation, we'll get out of this, it will go down. I don't necessarily believe that because the other piece of this is the major increase in the M2 supply of money over the last year, which we were talking about already, as you recall, a year ago when we were talking



at the onset of that when we had a really aggressive return from the Fed to quantitative easing and we had a major, kind of several, successions of fiscal stimulus ending the Trump administration and beginning the Biden administration. Which was financed, let's be honest, by Federal Reserve monetary policy, expansionary monetary policy.

Ryan Moran [00:05:22]

Dr. Lehman, for those of us who are headline readers, would you help us understand the idea of printing money or creating money, the increase in M2 which as I understand it is new money that is now in the economy that didn't exist before. Would you help us understand where that comes from and where it goes?

Dr. Tom Lehman [00:05:51]

Yeah. That's a pretty basic kind of macro econ 101 kind of thing. So, just to give you some numbers in the last year, the year over year rate of increase in the money supply has been on the upside, quite an aberration. There's been ... Back in March we hit our peak. Year over year from March of '20 to '21, we saw a 25% year over year increase in the M2 money supply which consists of currency and coin in circulation and banking deposits. And banking deposits, savings as well as checking account, deposits are the biggest component of that.

Ryan Moran [00:06:35]

Now, when you say that, I think what you are saying is that government has debt, the Federal Reserve creates it in order to allow for what the government wants to do, like it or not, and that is new money that did not exist before that is flowing through bureaucracies. Is that the proper chain of command, that Congress passes a budget, Federal Reserve essentially sends it through? Would you help me clean this up a little bit?

Dr. Tom Lehman [00:07:10]

Yeah. So, theoretically the fiscal policy budgeting process of the executive and legislative branches is independent.

Ryan Moran [00:07:23]

Theoretically, yeah. Yeah. I call it the 4th branch of government. The Federal Reserve is just the 4th ...

Dr. Tom Lehman [00:07:28]

You're right, exactly. Exactly. So, what the Fed then does to accommodate a major fiscal stimulus, like the Trump and Biden administrations and the last 2 congressional sessions have done, to accommodate that is to, as you're saying, increase the supply of money. Now, the way



in which they do that is through what is called open market operations. The dominant means by which the Federal Reserve increases the money supply is to simply buy financial assets, the large bulk of which is going to be existing and newly issued treasury securities.

Dr. Tom Lehman [00:08:14]

Okay, so, banks, commercial banks, investment brokerage houses, they are the private market arbiters or brokers of treasury offerings. So, they will buy treasury bonds from the treasury issued at the behest of Congress for additional spending above and beyond tax revenues. Of course, that's become the majority of spending now is all ... Spending well above tax revenues. We're going to have \$3 trillion in tax revenues this year, give or take, and we're going to have \$6 trillion or more in spending.

Dr. Tom Lehman [00:08:52]

So, to get to make up that difference, the federal government has to borrow and add to the gross national debt. To facilitate that borrowing, the Federal Reserve will come into the private markets, as you recall I kind of refer to the Fed as the 800-lb gorilla. They are a market participant just like an investor would be, except they have an unlimited supply of money to buy treasury bonds, open market operations.

Dr. Tom Lehman [00:09:19]

And, by the way, in the last year they are not just buying treasury bonds. They are buying treasury bonds of different dated links. So anywhere from 3 months to 5 years. And they are also buying billions of dollars a month in mortgage-backed securities, which are essentially stocks that are based upon the financing, the private sector financing of the housing market.

Dr. Tom Lehman [00:09:46]

So, this is a way in which the Federal Reserve, through its open market operations and expanding to, what has been called for the last 10 years, quantitative easing, this is the way in which they increase bank reserves in the banking system and those reserves, of course, then, a certain share of those reserves, say 80%, 70-80% of those reserves are then loaned out to the private sector, people to borrow to buy homes or business firms to borrow to expand production capacity.

Dr. Tom Lehman [00:10:20]

And knowing that the Fed is always there to purchase treasury bonds gives the banking system an incentive to buy those treasury bonds on the open market from the treasury on the fiscal policy side because they will always be ... They know that they will always have a willing buyer



in the Fed to sell them, and that increases bank reserves and unleashes what we call a kind of deposit multiplier effect, which very kind of generally just means ...

Ryan Moran [00:10:58]

As you're explaining this, this all makes sense how it works now but it doesn't make sense in light of what you said at the top of our time which was that it kind of seems like ... I would expect inflation to be much higher than it is based on everything that you just described. But I also know that what is reported as inflation sure looks different than what I see happening in property values and Bitcoin and the stock market. So, I want to ... I'm trying to understand, why is there not more inflation based on what we have seen? Or, in your opinion, is it still coming or is it not measured yet because it's not factoring in the price of this paper boom that we see?

Dr. Tom Lehman [00:11:51]

Kind of a lot there to unpack. But let me start by saying that an increase in the money supply never affects the overall economy or all markets equally the same. So, a lot of the money that is flushed in can go to different sectors of the economy first and that's where you'll see the price pressures emerge first and then as it trickles through, it will become watered down as it moves into other areas.

Dr. Tom Lehman [00:12:21]

So, what we saw initially was a rebound in the stock market, so you get some asset appreciation there. That's not even included. Those are not ... Those assets are not included in your CPI, PPI, GDP deflator, any kind of measure the price index does not include those equities, asset values.

Dr. Tom Lehman [00:12:46]

Then there's home values and we've seen the huge increase in real estate, both commercial real estate prices going up and residential real estate prices really rising. Median price of a home in the United States is now higher than it ever has been. Had a huge jump in the last ... Earlier this year, last couple of months.

Dr. Tom Lehman [00:13:08]

So, you're seeing that money that's going into the banking sector either flowing into financial assets because the expectation is that the market will continue to appreciate there, or into housing as people are taking advantage of lower interest loans. The increase in the money supply of course is specifically designed to push interest rates down and make it less costly to borrow.



Dr. Tom Lehman [00:13:33]

So, homeowners or potential homeowners are scrambling, bidding competitively with one another over housing because of the lower rate of interest that they're offered. And there are supply constraints. So, when you have an increase in demand and constraints on supply, the price of housing will go up.

Dr. Tom Lehman [00:13:57]

But even in the CPI, housing is weighted as only about 1/3 of that. So, you see that going up, you see [INAUDIBLE 00:14:05] going up. In other markets, prices may not be rising as fast as when you have some 80,000 different goods and services, say, included in the overall CPI. That gets watered down a little bit. On the other hand I would say ...

Ryan Moran [00:14:22]

What I think I'm hearing you say by that point is that at least where it seems to be flowing is that there is definitely upward pressure on asset prices, but consumer prices haven't had the same effect. We don't know yet if it is first this then that, or if they're independent of each other but that the increase in the amount of money has affected asset prices more than consumer prices. Am I understanding clearly?

Dr. Tom Lehman [00:14:52]

Yeah. Yeah, that would be a good way to put it. But I would also caution that we are beginning to see those increases in consumer prices now in the last 3 months. As you have seen the CPI go very quickly since March from around a 2% annual rate of increase to now up to a 6% annual rate of increase in just a matter of 3 or 4 months. We saw it progress 3.5%, 4%, 5%, now 6%. The core rate is somewhat below that because the core rate strips out energy and food prices which are a little more volatile. But you're seeing this all across the board in all of the measures of the price level in the United States.

Dr. Tom Lehman [00:15:34]

You're seeing it in the CPI, you're seeing it in the personal consumption expenditures index which is what the Fed prefers to use as their preferred, the core PCE is what it's called, as their preferred measure. That's heading up to about 3.5-4% now. And you're seeing it in the GDP deflator numbers, in the 1st quarter and the 2nd quarter GDP deflator increasing at a 4% and then a 6% annual rate of increase. So, it's not that you're not seeing it, it's just that it's more pronounced in asset markets as you're saying. Somewhat less pronounced but still quite visible in consumer product markets. And this is the part that's not surprising to me from a year ago to go back to your original question.



Ryan Moran [00:16:15]

That consumer prices are starting to rise at an accelerated rate, that's the part that's not surprising to you.

Dr. Tom Lehman [00:16:21]

It's not surprising because you're seeing an increase in the supply of money and standard economic theory and the kind of laws of economics, the basic, what we call, quantity theory of exchange going all the way back to Irving Fisher and Milton Friedman, and even all the way back to Adam Smith, says that if you increase the supply of money faster than the output of goods and services, you're going to get inflationary pressures.

Dr. Tom Lehman [00:16:46]

The question before us now I think is is this going to be transitory as the Fed argues that this is going to go away in the fall? Or is this going to be a little bit more prolonged and going to continue? My bias is to say that it's going to continue.

Ryan Moran [00:17:03]

You think that the existing inflationary acceleration will continue, and you disagree that it's transitory like Powell suggests.

Dr. Tom Lehman [00:17:13]

Unless we define transitory to mean a number of years rather than a number of months. But when I hear the Fed speak, when I hear Powell speak and I hear him employ this idea of transitory inflation, he is referring to a kind of several months of inflation, and he's changed his tune a little bit and said well, now we think inflation is going to be around a few more months than we initially thought. But I'm saying this is likely to be more of a multiple years of potential inflationary pressures than just months. Now, here's the thing, I hope I'm wrong.

Ryan Moran [00:17:59]

I hope you're wrong too.

Dr. Tom Lehman [00:17:59]

I hope I'm wrong in the sense that I hope inflation is not as pronounced. But the logic of economic laws and the empirical evidence of the major increase in the supply of money that has taken place in the last year suggests to me that inflationary pressures are going to continue to build unless there is some major countervailing force, meaning maybe the Fed pursues a more contractionary monetary policy and throws us back into a recession.



Ryan Moran [00:18:33]

Yeah. I wanted to ask you exactly that question. Let's assume you're correct and let's say Powell's wrong, Dr. Lehman is correct, which I would put money on. But if that trend continues, it seems to me like the only option from a policy perspective is to increase interest rates, is for the Fed to somewhat aggressively raise interest rates, which I think would ... It would have a dramatic effect, we'll just say that. So, am I right to assume that that is the only response for the Fed to do and that it would impact the economy on a large scale?

Dr. Tom Lehman [00:19:27]

Yes. Under kind of traditional monetary theory, the Fed has a dual mandate. So, now I'm being evasive. I apologize. The Fed has a dual mandate, full employment and stable prices. When we break that down, what that means is the Fed has a kind of Catch 22. On the one hand, they must ensure that they're giving the duty of ensuring that the unemployment rate is as low as they can possibly get it without, at the same time, experiencing inflationary pressures that are persistently above 2% or more.

Dr. Tom Lehman [00:20:09]

And the conventional monetary theory is that if unemployment is fairly low, that is if the economy is at full employment, say 4% unemployment rate or less, and we are getting accelerating inflation as we've been talking about, you and I here, but then the Fed would slowly ratchet back its buying of treasury securities and other financial assets, and that would then influence interest rates in an upward direction. And that would then constrain demand hopefully without disturbing the labor market and without throwing the economy back into a recession. This is what is referred to by many pundits as bringing the economy in for a soft landing.

Dr. Tom Lehman [00:21:05]

Okay, we've got full employment, we've got inflationary pressure, now the Fed should draw down its buying of assets, pursue what we would call, not a contractionary monetary policy, I don't see the Fed doing a true contraction like bulk or bid in the late 70s and early 80s. But instead, a less accommodative policy which would then, as you're saying, put upward pressure on interest rates.

Dr. Tom Lehman [00:21:29]

Now, here's the interesting thing. Even if inflation continues, as I think it probably will, we'll see, I don't think the Fed is going to really do that. I don't think Powell is actually going to pursue a less accommodative or more contractionary policy to really deal with inflation and here's why. Now, this is not a forecast, okay. I hate to even call it a speculation. I'm just going to call it a



hunch. But my hunch is that even if inflation becomes the number 1 problem in the macro economy, the Fed has its back against the wall because of fiscal policy.

Dr. Tom Lehman [00:22:22]

The federal government is very quickly ... The gross national debt is very quickly approaching \$29 and eventually \$30 trillion dollars when and if they raise the debt limit, which they're starting to debate now. That is about 50% more than real GDP right now. Real GDP is around \$20 trillion. We've got a gross national debt outstanding of about \$30 trillion. When you've got that much debt, even one small little ... One basis point increase in interest rates increases the government's borrowing costs significantly.

Dr. Tom Lehman [00:23:02]

And I don't think the Fed wants to force the legislative branch, the executive branch, to pursue a contractionary fiscal policy to pay higher interest rates. So, I think that what we'll end up with is more inflation than what most people anticipate and that the Fed will not react to that, not to say that they won't taper because they're already talking about this tapering, of reducing the amount of quantitative easing. They're talking about it well in advance so that they don't spook the markets once they start doing it. They might taper a little bit, but I don't see a big increase in interest rates unless the bond market forces their hand.

Ryan Moran [00:23:48]

So, Dr. Lehman, as a layman that sounds scary. What I interpret from that means that there would be sustained inflation for quite some time and that this kind of, in my opinion, exhausting bubble where numbers just keep going up and there's a lot of ... We've got to keep up with this. It seems like your hunch is that that may continue for quite some time. Is that correct?

Dr. Tom Lehman [00:24:24]

Yeah. I think so. I mean, I think there will be great resistance at the Fed and the Federal Open Market Committee to significantly increase interest rates in the face of rising inflation. The only thing that would force them to do so is if the bond market ... The 10 year bond market is the benchmark here. If that yield starts to rise on its own because inflationary pressures are sustained and increasing, you don't want to hold a depreciating asset. You don't want to earn 1.5 percentage points on a financial asset in nominal terms that is depreciating in real terms because of high inflation of 4%, 5%, 6%, 7%, maybe higher percent.



Dr. Tom Lehman [00:25:26]

So, private investors in the bond market may very well sell bonds and that will put downward pressure on the price of a bond, the current yield will go up. But the Fed can counteract that by simply buying up those bonds and increasing the money supply to keep those interest rates low. Or to present what, in technical jargon, we'd call to prevent the crowding out effect of government borrowing.

Dr. Tom Lehman [00:25:54]

And so, I think to some extent they will try to do that. The only thing that would really force their hand is an extreme high-end rising rate of inflation like we experienced in the late 70s and a big increase in current yields in the bond market that would kind of force them to reverse course. And in that case, I think they throw the economy back into recession. I mean, I think the recession would be kind of inevitable at that point, very much like we experienced in the early 80s.

Ryan Moran [00:26:28]

So, Dr. Lehman, my reaction to this is you'd better buy assets and hold on tight because that means there is ... It's like, this only reasonable strategy. And I have publicly admitted that I now believe I was wrong about Bitcoin. Actually, I would say Jerome Powell convinced me that I'm wrong about ... Jerome Powell increased the demand for a Bitcoin-like alternative, let's say that.

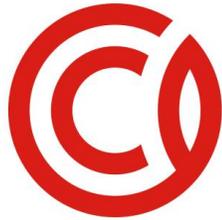
Dr. Tom Lehman [00:27:01]

And just today, it's kind of gone up ... Just today as we talked here on August 13th, it's taken a big jump just today and over the last several days. Now, that's not what you would call a hard asset because it's a digital currency but it's still ... I think you're onto something. The big increase in that asset is a result of the expectation that inflation will continue, will persist. Gold is kind of similar in that respect.

Ryan Moran [00:27:33]

Gold hasn't reacted the same way which has kind of surprised me. But I'm curious from your perspective, if you're right that inflation does continue to go up for longer than we expect and there is continued more desire for deflationary assets, things that hold their value, the way I see that playing out is for private individuals and private institutions to transact in cryptocurrencies or private currencies because the US dollar is going down in value. Is that too catastrophic of a viewpoint or is that actually a logical fear, or logical [INAUDIBLE 00:28:18].

Dr. Tom Lehman [00:28:18]



I would say don't sell all of your dollar denominated assets. That's something I would definitely say. But hedge against the depreciation of the dollar as you're talking about. When we start talking about the dollar depreciating, we have to be careful here. It is depreciating in terms of the prices of goods and services that we buy. Right now at least for this summer and on into the fall, we're seeing this increase in inflation, price inflation. And so, that means the currency buys less, purchasing power of the dollar is less.

Dr. Tom Lehman [00:28:58]

But because on your national markets in a global sense, the dollar is the reserve currency, you don't see it depreciating quite as much against other currencies. It's a reserve currency and other central banks are mimicking the quantitative easing and accommodating policies of the Fed. So, you have the same thing going on in the Eurozone. You have the same thing going on, Bank of England. You have the same thing going on with Bank of Japan and all around the world. Banks are, or central banks, are highly accommodative.

Dr. Tom Lehman [00:29:37]

And so, you don't see as much depreciation between the dollar and, say, the British pound or the Euro or the Yen because all of those currencies are increasing in supply in kind of lockstep. Not necessarily by the same magnitude, but in lockstep.

Ryan Moran [00:29:58]

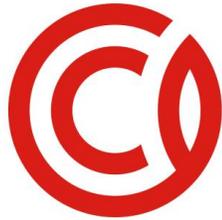
And what do you make of some smaller countries' decision to legalize Bitcoin as tender? And once again, I want to be very specific in how I say this, I believe that government policy increased the desire and the need for a Bitcoin-like alternative, which is why I was wrong. But what I'm asking in that is do you see private currencies, Bitcoin or something else, possibly emerging as a solution to government policy?

Dr. Tom Lehman [00:30:40]

It's possible. I've debated this with myself for a long time. And like you, I've kind of been ... Well, at least for me, I speak for myself, I've been a little lukewarm. There are days when I think man, I should have stocked up on a lot more digital currency or cryptocurrency. And then other days I think man, the volatility of that and the acceptance of that, the universality of that, is not such that it can at least yet be used as a common medium of exchange, as a true form of money. I think potentially, it has that potential. There are other ... When you talk about Bitcoin, there are now other competitors with that.

Ryan Moran [00:31:29]

There's a few.



Dr. Tom Lehman [00:31:29]

And you mentioned gold earlier. Gold has not responded as much to the inflationary pressures. I think that's because cryptocurrency has taken the pressure off of gold. People who would have otherwise bought gold bought Bitcoin instead because they're substitutes as an inflation hedge. And so gold may not have gone up as much as it otherwise would have had cryptocurrency not been available.

Dr. Tom Lehman [00:31:56]

So, I think definitely it's a hedge against inflation. I think that's the way people are seeing it. I don't think I'm out on a limb to say that. Whether or not it's going to become a useful currency in the future or whether it would be too heavily regulated or constrained by governments, by the federal government, or whether ... I mean, there's some talk about central banks issuing their own form of cryptocurrency or their own form of digital currency now, and so ...

Ryan Moran [00:32:26]

So they can ruin that sector as well as government always does.

Dr. Tom Lehman [00:32:31]

They could compete in that sector. I'm not sure what would keep them from debasing it further, but ...

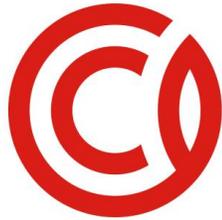
Ryan Moran [00:32:37]

I agree. Dr. Lehman, I would like for you to respond to a statement I made in a recent Youtube video in which I argued that Bitcoin itself is not a hedge against inflation, our story about Bitcoin is a hedge against inflation. It's psychologically-driven rather than economically-driven, and that our story about it being adopted and being a hedge is what actually drives the value of that. And I'd also make the case that all assets are hedges against inflation. Do you agree? From an economics perspective, would you agree with that or disagree with that?

Dr. Tom Lehman [00:33:18]

Well, there's certainly a psychological element to it, and it's ... I would say that in that respect that Bitcoin and other cryptocurrencies are not any different than other hard assets like gold. There's a psychological aspect of that, that the expectation of higher prices in the future drives demand for those assets now. Gold has a particular unique position in our history because it literally was money in our past.

Dr. Tom Lehman [00:33:50]



And so, it's seen as that hedge against the debasement of fiat currencies which are just legal tender currencies issues by central banks. But the same thing that drives that is the psychology that you're talking about and the expectation that these assets will be worth more in the future than they are now relative to other potential investment vehicles or instruments. Now, I'm not sure I answered your question fully there. Maybe you need to just flesh out what you mean by the difference between Bitcoin being an asset to hedge against inflation versus a psychological.

Ryan Moran [00:34:32]

Well, at its core, aren't all assets hedges against inflation?

Dr. Tom Lehman [00:34:45]

Not necessarily. Well, let me use an extreme example. I mean, I could purchase a used automobile. That's an asset. I don't think it would make a very good hedge against inflation.

Ryan Moran [00:34:56]

Well, in the last year, used cars have gone up quite a bit [INAUDIBLE 00:34:59]. I suppose I'm biased of what I mean by an asset.

Dr. Tom Lehman [00:35:06]

Yeah. There's a narrower class of assets that could be considered a hedge against inflation.

Ryan Moran [00:35:11]

Interesting.

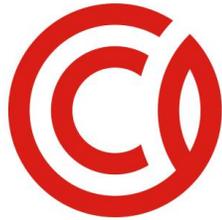
Dr. Tom Lehman [00:35:13]

But there's a psychological element to that as you're saying.

Ryan Moran [00:35:17]

I would like for you to take off your professor hat for a moment and I really just want to ask you, Dr. Lehman, what's going to happen and what should I do about this? I really want you to be wrong. And I really want things to kind of settle a bit because I don't just ... As a consumer and as an entrepreneur, it's kind of exhausting trying to keep up with the pace of change and the pace of mostly price changes, I mean. The pace of change in the world is accelerating and there's no getting around that.

Ryan Moran [00:35:54]



But the price adjustments are giving me a little bit of whiplash and I would like to know from your perspective if there is, besides just buying assets and holding on, is there any logical response for business owners and consumers to have at this point in order to, well, shield themselves against the event in which prices continue to climb?

Dr. Tom Lehman [00:36:30]

Well, let me keep my professor hat on for one second and follow up on what you mentioned. It's a very good point, and we make this point over and over again in principles classes. The main reason why inflation, especially rising and somewhat unpredictable inflation, is damaging to an economy is precisely for the reason that you mentioned. As you yourself are saying, as an entrepreneur, making investment decisions, deciding whether to spend retained earnings of millions of dollars or take out a loan for millions of dollars and invest in a certain business enterprise, becomes that much more uncertain. It's already uncertain.

Dr. Tom Lehman [00:37:16]

There's already a risk of a failure or a risk element to it but it becomes ... The fact that the monetary regime in which you're operating is in flux, and you don't know what's happening with your input costs, you don't know what's happening with your output prices, you can't as easily forecast profitability or loss. That causes a kind of shilling of investment and that's the very ... The investment in capital and technological innovation and research and development is all what drives economic growth in the long run.

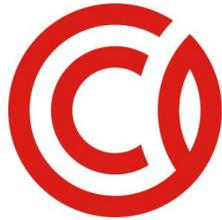
Dr. Tom Lehman [00:37:54]

And so, that's why inflation is damaging especially when it's unexpected, unanticipated, or volatile. It just reminds me, your comment reminds me, we haven't really talked about the PPI, the purchasing of producer goods, the producer price index. That is up now at around 6% year over year.

Dr. Tom Lehman [00:38:25]

And it creates a dilemma especially for firms that sell consumer goods. Well, how are we going to pass this onto consumers? Are they going to absorb this? Are they going to stop buying the product? Some producers now are saying well, we're just going to pass it on and we'll either pass it on in the form of higher prices or we'll pass it on in the form of repackaging, what's called shrinkflation, so you get smaller packages. This is another reason why you don't necessarily see all of the inflation effects in the CPI because some of the packages are smaller that are tracked, so that's a kind of shrinkflation.

Dr. Tom Lehman [00:39:06]



Others are saying, well, let's wait it out, maybe the inflationary pressures will subside and we won't ... And others are just saying, well, it's not the right time to invest. So, I just want to make the point that this is why we call unexpected or unanticipated inflation potentially damaging to long term economic growth because it creates more uncertainty and greater risk than what already exists for the typical entrepreneur.

Ryan Moran [00:39:34]

So, what do we do?

Dr. Tom Lehman [00:39:35]

Keeping in mind that I'm not a financial advisor ...

Ryan Moran [00:39:42]

This is for entertainment purposes only, Dr. Lehman.

Dr. Tom Lehman [00:39:44]

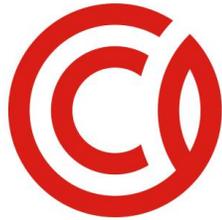
Yeah, yeah, there's your disclaimer. Okay, so, I do think 2 things are going to typically be advantageous during a higher inflation environment. Holding hard assets, real estate and commodities or anything related to real estate and commodities, and as long as the inflation is unanticipated and nominal interest rates do not start to rise to offset it like they did in the late 70s, as long as we are still before that part of the process unfolds, borrow because unexpected inflation will always benefit the debtor more than the creditor.

Dr. Tom Lehman [00:40:40]

And of course, the leading example of this is our federal government. In an inflationary environment, it's better to be a borrower than a saver or a lender. This is not good for the economy in the long run. But if you're asking me what you want to do to kind of protect yourself, borrow in dearer dollars now and pay back at fixed interest rates, hopefully in cheaper dollars, in the future.

Dr. Tom Lehman [00:41:12]

Now, if you borrow at an adjustable rate and the inflationary pressures in the economy build, then those nominal rates are going to go up and that won't work. But you see what I'm getting at, that if you're a debtor in an inflationary environment, you gain. You get windfall gains because that inflation as yet, not expected. Perhaps not as expected. Inflationary expectations are not where actual inflation is. We'll see what happens here going into the fall. But yeah, borrow and hold hard assets that are in some sense fixed in supply relative to the amount of money circulating in the economy.



Ryan Moran [00:41:56]

That was the entire thesis of what Michael Saylor did where he borrowed billions of dollars in what he called basically worthless currencies and put them into Bitcoin, which has so far worked out for him. But that was his entire thesis behind that was to get trashy dollars now and buy appreciating assets. I would like for you to respond and tell me if you agree or disagree to something that Cathie Wood said recently, and she's been saying it often, which is her argument is that we're actually in a deflationary environment.

Ryan Moran [00:42:38]

Cathie Wood has the same economics background as you have, comes from the same school of thought if I remember correctly and she's arguing that there's such a technological boom happening that it is increasing productivity so much that she expects a deflationary environment in terms of standard of living and purchasing power. Would you agree with her assessment or not?

Dr. Tom Lehman [00:43:02]

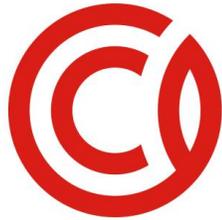
I think in general, overall, I would probably disagree, but having said that there are definitely some deflationary forces pushing back against the inflationary ones. I just happen to be of the view that probably in the long run or over the next medium run, the inflationary forces are probably going to out. But there are ... And I wanted ... I'm glad you asked this question and posed this because I wanted to get back to this. There are a number of forces in the economy that are pushing back against the rise in prices, which again goes back to your earlier question, why aren't we seeing more inflation?

Dr. Tom Lehman [00:43:50]

We're seeing a rise in inflation, but it's maybe not as much as we would have anticipated. Why aren't we seeing more of that? Well, you've got what's called the China effect. You've got a very globalized economy to the extent that we don't further constrain trade. The development in manufacturing in developing middle-income, developing economies like China and India, have the effect of putting downward pressure on consumer prices at least. And then you have the technological advances that are probably best manifest by the Amazon effect.

Dr. Tom Lehman [00:44:27]

Online retailing and delivery, any time you've got the richest man in the world that says to his competitors your profit margins are my opportunity, you're going to have some deflationary forces there. I mean, there's going to be elements brought about by technological advances



and globalization, those are the 2 big ones, that will constrain the otherwise inflationary pressures.

Dr. Tom Lehman [00:44:58]

To say that we're in a deflationary environment I think ignores the big increase in the supply of money and the very much expansionary fiscal and monetary policies that we've had, so I don't think I would maybe go that far, but definitely agree that there are countervailing forces pushing back against inflation. Yeah, no question.

Ryan Moran [00:45:19]

I want to end this conversation with a debate with you, Dr. Lehman. I believe when we recorded last year, you made the argument that people will likely flock toward cities. If we go in the direction that we have, there would be a flock toward cities. And I am of the opinion that if we continue down this road, that we will have a flock out of cities and there will be a boom in Arkansas, Missouri, places where there is land that is cheap, readily available, and warm.

Ryan Moran [00:45:55]

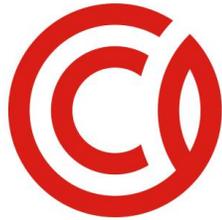
You can buy 100 acres in Arkansas for \$1 million bucks, it would be beautiful, and you can move your friends and family there. You've sent me articles backing up your claim, and anecdotal evidence suggests that I see lots of people flocking out of cities. So, who's right?

Dr. Tom Lehman [00:46:20]

Yeah, this is a very interesting question. I'm glad that you ask it. It gives me a chance to just throw a little urban economics in here along with the macro theory that we've been talking about. Let me just clarify, my hunch, again, or speculation at the beginning of the pandemic, a lot of people were saying ... Maybe you include yourself in this. This changes everything, the metropolitan area is no longer valued because the virus creates too much of a risk and people just want to get out and get away from that, there's congestion externalities, there's pollution, there's whatever, you name it. People don't like cities anymore and they want to ...

Dr. Tom Lehman [00:47:07]

Cost of living is too high, real estate, can't buy a home, can't afford to buy a home. All of those things, valid points. And for a while, during the early stages of the pandemic, we did see that. We saw people leaving cities. They were remotely working people who could remotely work, had the kind of job that would allow that. They were saying why would I stay here in the city? Let's go out to that farm in Arkansas, or let's buy that property in the middle of Montana or some place, or let's go where there's nice environmental amenities and telecommute.



Dr. Tom Lehman [00:47:49]

To get back to your kind of argument here, my view is that once we have the biological elements of this kind of licked, if that ... We're going to end up living with this ... COVID is never going to go away, we're going to live with it, but to the extent that enough people become vaccinated and we have something approaching herd immunity, whatever that is, I think the attraction of cities, to most people, is so great on the social and consumer side that those cities will continue to grow.

Dr. Tom Lehman [00:48:37]

Maybe not as rapid a pace, but I think they will and that's because I think people are lured back by the presence of other people. The technical term for this is just what urban economists call an agglomeration economy. But really, it just boils down to the fact that people like to be around other people. And unless you're really kind of a hermit, sort of kind of like I am ... I don't mind living in rural Indiana, it doesn't bother me. For most people, they want to be around other people.

Dr. Tom Lehman [00:49:12]

And I think the wage opportunities, the income salary opportunities will be greater in urban areas and the social aspects, the economies of scale in socializing if you will. Being around other like minded people, being around other people of a certain age or a certain demographic, is very appealing. And so, I think that will eventually overcome any kind of the congestion externalities or other negative aspects of metropolitan or urban living.

Dr. Tom Lehman [00:49:53]

It was in the 1990s when the internet really kind of exploded on the scene, the world wide web, and I remember this very well. People were saying, well, this is the end of the city, this is the end of the urban era, this is ... We will now see cities become depleted of population and people will move out. There will be this massive sprawling into the rural areas, ex-urban. That actually didn't happen. The opposite happened.

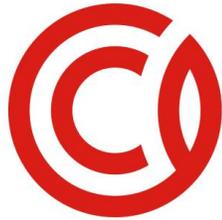
Ryan Moran [00:50:24]

The opposite happened, yeah.

Dr. Tom Lehman [00:50:25]

And I'm thinking based upon that history that the forces in favor of large urban areas are still on balance greater than the forces working against them.

Ryan Moran [00:50:36]



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— B E T H E C H A N G E —

Well, I'm going to stand by my prediction and I'm going to take it one step further and say that poor people will live in urban areas and rich people will move out of the cities and build their own mini cities with like minded people. That's where I think this is going to go. Dr. Lehman, I always enjoy hanging out with you. It's great to see you. Thanks for spending some time with us at Capitalism.com.

Dr. Tom Lehman [00:51:02]

Well, thank you. It was good to see you again Ryan as well and thanks so much for having me. Always enjoy it.

Ryan Moran [00:51:09]

If you found value in this podcast and you're ready to go deeper, here are 3 resources where we can help you. 1, you can grab my book 12 Months to \$1 Million on Audible or Amazon. It has over 1000 reviews and it's the playbook to building a 7 figure business. 2nd, you can join our community of entrepreneurs who are following a plan to build a 1% net worth by building businesses and investing the profits. You can get plugged in at Capitalism.com/1.

Ryan Moran [00:51:37]

And 3rd, if you're looking to go deeper and build a 7-figure business that you can sell, you can work closely with us inside the Capitalism Incubator and you can get on the waiting list and find out what we do over at Capitalism.com/inc. That's Capitalism.com/inc.