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DOUGLAS HOLTZ-EAKIN | MAY 4, 2015

Nearly half of the 17 Obamacare exchanges set up by individual states are having financial troubles just five years after the passage of the law. According to the Washington Post, the state-run websites are "wrestling with surging costs, especially for balky technology and expensive customer call centers…" Just running the call center in Colorado is expected to cost over $21 million this year. Pair those costs with lukewarm enrollment numbers and money troubles quickly appear.

Warren Buffet's Berkshire Hathaway has come under scrutiny as an institution that may be hit with the "Too Big to Fail" tag. According to Buffet, "There is no reason, in logic or in terms of what we've heard, to think that Berkshire would be designated as a SIFI." The reason that the *Oracle of Omaha* is fighting the idea is that the Systemically Important Financial Institution (SIFI) designation comes with numerous regulations that can hinder company growth. Last summer Douglas Holtz-Eakin commented on the failed assessment process when FSOC went after MetLife for the SIFI tag.

Eakinomics: Inflation and the Fed

The Fed has been engaged in extraordinary monetary policy, including a near-zero policy ("federal funds") interest rate, for eight years. It has openly signaled its desire to normalize monetary policy and to begin raising rates in 2015. Unemployment continues to fall toward levels considered consistent with full employment, but so far no rate increase has been announced. Why not?

One explanation focuses on weak readings in recent economic data and the need for the Fed to stay accommodative to support growth. This presumes that loose monetary policy has produced growth, and there isn't much support for that in the data. Reversing an ineffective policy will not change the growth trajectory significantly.

The other explanation one hears focuses on inflation and the concern that low inflation will transform into damaging deflation. In particular, proponents of this view point out that food and, especially, energy prices have produced downward pressure on top-line inflation recently, requiring the Fed to stay on hold. This observation has been true over the past year. The chart below shows inflation (measured by the price index for Personal Consumption Expenditures (PCE)) from the 1st quarter of 2014 to the 1st quarter of 2015. Overall inflation is quite low (first bar, 0.3 percent) and well below "core" inflation (last bar, 1.3 percent), demonstrating the impact of excluding food and energy prices.

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A bigger contrast, however, is between goods prices overall (second bar, -3.0 percent) and durable goods prices (third bar, -2.5 percent) and services (fourth bar, 1.9 percent).

As it turns out, this contrast is a key characteristic of the recovery. The second chart (below) shows that over the course of the entire recovery the rate of top-line inflation and core inflation are essentially identical. Instead, the key contrast is between goods prices, especially durable goods prices, and services prices. Service price inflation is essentially at the Fed's 2 percent target. Goods price inflation, however, is only at 0.5 percent because of the substantial durable goods price deflation over the course of the recovery. From the Fed's perspective, durable goods are globally traded and their prices are influenced far less by U.S. domestic policies and economic conditions. Those are better reflected in services inflation.

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It is time for the Fed to start normalizing. Growth won't suffer and inflation is right where the Fed wants it. Waiting too long risks missing the inflation target.

From the Forum

Week in Regulation by Sam Batkins, AAF Director of Regulatory Policy

Six Differences between the NDAA and the President's Budget by Rachel Hoff, AAF Director of Defense Analysis