Rodney's Take

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Tony Robbins, Lumber, and Inflation

Self-improvement guru Tony Robbins created an international brand by talking people through ways to break bad habits and reinforce positive steps. Among other things, Robbins uses neuro linguistic programming (NLP) to help people change the way they think, feel, and behave by changing their focus. As his website puts it, "…[W]here our focus goes, energy flows."

The same can be said about inflation.

John Maynard Keynes described the paradox of thrift, where consumers put off purchases because they believed prices would be lower in the future. Falling demand leads retailers to lower prices to attract customers, which confirms the view that prices will fall and leads more potential buyers to put off purchases. While consumers might pay less for goods in such a situation, it also leads to retailers paying lower wages, buying less inventory, and demanding lower prices from wholesalers, which drives down GDP and reduces the overall standard of living. It all starts with visualizing lower prices.

Today, consumers are visualizing *higher* prices.

The New York Federal Reserve Survey of Consumer Expectations in June showed that consumers expect prices to rise by 4.8% over the next 12 months. As the opposite of the paradox of thrift, this could lead consumers to pull forward purchases so as to take advantage of today's prices and thus avoid higher prices in the future. The surge in demand could lead retailers and service providers to raise prices in the face of higher demand to pay for more inventory and the increased labor necessary to operate at the higher level as well as to boost profits.

Complicating matters a bit more, the NY Fed survey also showed that consumers expect wages to increase by 2.6% over the next year and household income to increase by 3%. Those are good numbers, but they're short of inflation expectations, which shows that consumers expect their incomes to buy a lower standard of living in a year's time. This also might motivate consumers to buy things before prices march higher.

Of course, the reason Tony Robbins and others like him remain in business is that so many of us are bad at visualization and change. Let's hope that when it comes to inflation and consumption, consumers are slow to adapt and we don't end up with a self-fulfilling prophecy of higher prices driving prices higher. But even if we fall into this spiraling cycle, we might be in for a bit of inflation for a much simpler reason: we've shown that we will pay for it.

In 2016, a famous Japanese frozen treat company increased the price of its main product from 60 to 70 yen ($0.60 to $0.70). It was the first price increase on the product in 25 years, and the price remains at 70 yen today. Deflation and flat prices are so ingrained in the culture that on the day the price increase was announced, the company ran an ad featuring all of its management apologizing for the price hike. That's not where we are in the U.S.

With the federal government showering money on consumers and supply dislocations leading to price hikes, we're getting comfortable paying more for everything, including food, cars, and retail goods, which is a big step up the inflation ladder. Housing (and more specifically, lumber) shows the way.

The price of lumber shot up more than 400% from the start of 2020, as homebuilders and renovators bought all of the two-by-fours and pressure treated wood they could find. The higher costs drove up the price of lumber at the local Home Depot and, according to the National Association of Home Builders, added $36,000 to the price of a new home. After reaching $1,711 per thousand board feet, the price of lumber fell more than 70% and now sits at just over $600. Lumber prices are falling at Home Depot in concert with the drop in lumber futures, but don't expect new home prices to ease by $20,000 or so.

The housing market remains out of whack, and supply is outstripping demand. Sales slowed down in recent months, as prices set new records and some buyers were priced out, but we're still short millions of homes because builders held back during the 2010s while the adult population increased as the Millennials and, recently, Gen Z came of age. As more buyers sign on the dotted line at current prices, those numbers become the starting point for future buyers.

All of this presumes that we won't have a major economic setback in the months ahead which, as Harry often notes, is a growing concern. If we have a big economic setback, then we can expect things like new home sales and prices to come crashing down. But unfortunately, there's another possibility. The equity markets could get clobbered because we're at such extended levels and GDP could drop back to the long-run average near 2%, and we'd still get higher prices based on changing psychology and some inputs, such as rising labor costs and regulation. This would be the worst sort of visualization, the reinforcement of bad habits and the scourge of the 1970s: stagflation.

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