

AIER Research Reports

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Research Reports

AIER publishes over 100 articles per month that are distributed in digital form. Research Reports contains Business Conditions Monthly plus 8 of the most representative, chosen here for popularity, variety, and relevance. These articles are often reprinted in venues around the web, including Seeking Alpha, Intellectual Takeout, Mises Brasil, and dozens of other outlets. To read all of them, go to www.aier.org

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April 2026

From the Managing Editor

Peter C. Earle
Senior Research Fellow

Financial markets are fascinating social machines: ceaselessly taking in information, filtering it through uncertainty, and rendering judgment in the form of prices. At their best, they function as responsive aggregators of expectations, reconciling growth, inflation, policy effects, and risk into a coherent narrative about the future. But at times, that process breaks down. Prices still move, often violently, but the story they tell becomes increasingly difficult to interpret. That may be where we are today.

Recent market behavior has been marked less by clarity than by contradiction. Equities rally on hints of geopolitical de-escalation even as bond yields rise, suggesting renewed inflation concerns. Oil prices fall alongside a weakening dollar, while rate expectations swing sharply from one week to the next. An Iranian threat against US bases in the Middle East and the gold price...falls? These are not simply disagreements about the economic outlook. They are signals that markets are struggling to integrate information into a consistent framework.

Part of the explanation lies in the proliferation of competing macroeconomic narratives. The economy can plausibly be read in multiple ways. Growth has not collapsed, but neither has it accelerated decisively. Inflation has moderated in some measures while remaining persistent in others, particularly in services. The labor market shows signs of cooling but not of outright weakness. In this environment, market participants are left to choose between a “soft landing,” a renewed inflation cycle, a delayed slowdown, or an impending recession—each of which possibly supported by selective readings of the data.

When multiple narratives coexist without a clear hierarchy, markets do not smoothly converge on a consensus. Instead, they oscillate. A single data release or headline can shift attention from one interpretation to another, producing sharp repricing even when the underlying information has not fundamentally altered the outlook. Prices begin to reflect not just expectations about the economy, but expectations about which narrative other participants will adopt next.

Policy ambiguity compounds the problem. The Federal Reserve now faces a policy trap in which their dual mandate is increasingly difficult to balance. Inflation has not fully returned to target, yet the risks of overtightening are more visible than they were a year ago. As a result, policy communication has become necessarily conditional. Officials emphasize data dependence, but in doing so, they leave the reaction function open to

interpretation. Each new data point can therefore be read as either reinforcing or undermining the cases for easing or tightening, depending on the lens applied.

This ambiguity reduces the anchoring role that policy typically provides. In more stable periods, markets can orient themselves around a reasonably well-defined path for interest rates. Today, that path is less certain, and expectations adjust accordingly - usually abruptly.

Geopolitical developments add another layer of complexity. Headlines related to trade policy, energy supply, or regional conflicts now circulate rapidly and are often incomplete or contradictory. Markets respond in real time, repricing risk before information is fully verified. Subsequent clarifications can then reverse those moves just as quickly. The speed of information dissemination has increased, but its reliability has not kept pace.

Taken together, these forces produce a market environment in which prices are less informative than they appear. Signals that would normally be interpreted as meaningful—rising yields, falling commodities, equity rallies—no longer fit neatly into a discrete narrative. For investors and policymakers alike, this complicates decision-making. If prices reflect shifting interpretations rather than stable expectations, their value as guides diminishes.

This does not mean that markets have ceased to function, nor that volatility is inherently problematic. Periods of uncertainty are a natural feature of economic life. But there is a difference between volatility that reflects new information and volatility that arises from vacillating interpretations. The former is a sign of adaptation; the latter, of dislocation.

When markets lose the plot, the risk is not simply that prices will move more. It is that the consequent fluctuations carry less meaning. In such an environment, caution is warranted—not because outcomes are necessarily worse, but because the signals used to assess them are less reliable. And until a clearer narrative emerges, that may remain the defining feature of the current market landscape.

Peter C. Earle, Ph.D
Managing Editor, *AIER Research Reports*

April 2026

Business
Conditions Monthly
January 2026

Peter C. Earle
Senior Research Fellow

The Leading Indicator stands at **63**, indicating a modestly positive tilt in forward-looking measures, with pockets of resilience in expectations-sensitive components. The Roughly Coincident Indicator registers at **42**, suggesting somewhat subdued but not contracting real-time activity, consistent with a mixed and uneven current economic environment. Meanwhile, the Lagging Indicator comes in at **33**, pointing to relatively soft backward-looking conditions, particularly in areas tied to credit and price dynamics.

LEADING INDICATOR (63)

The Leading Indicator registered **63**, with seven of twelve components improving, one unchanged, and four declining.

Gains were led by market-sensitive and forward-looking components. The University of Michigan Consumer Expectations Index rose **7.1 percent**, while the Conference Board US Leading Index Stock Prices 500 Common Stocks increased **1.7 percent**. The Conference Board US Manufacturers New Orders Nondefense Capital Goods Ex Aircraft advanced **0.5 percent**, and US New Privately Owned Housing Units Started by Structure Total SAAR climbed **4.8 percent**. United States Heavy Truck Sales SAAR surged **16.7 percent**, and Debit Balances rose **0.9 percent**. Labor-market forward conditions improved as US Initial Jobless Claims SA declined **6.0 percent** (a positive after inversion). Offsetting these gains, the Inventory-to-Sales Ratio Total Business fell **0.7 percent**, US Average Weekly Hours All Employees Manufacturing SA declined **0.2 percent**, and the Conference Board US Leading Index Manufacturers' New Orders Consumer Goods and Materials slipped **0.3 percent**. The 1-to-10 Year Treasury Yield Spread widened sharply by **70.2 percent** but was scored negatively given its inversion. Adjusted Retail and Food Services Sales Total SA was effectively unchanged. Overall, the leading profile reflects strength in expectations, housing, and financial conditions, partially offset by softness in production-related metrics and the yield curve signal.

ROUGHLY COINCIDENT INDICATOR (42)

The Roughly Coincident Indicator came in at **42**, with two components improving, one unchanged, and three declining.

On the positive side, Conference Board Coincident Manufacturing and Trade Sales increased **0.8 percent**, and US Industrial Production rose **0.3 percent**. However, Conference Board Coincident Personal Income Less Transfer Payments declined **0.2 percent**, and Conference

Board Consumer Confidence Present Situation SA fell **2.1 percent**. US Labor Force Participation Rate edged down **0.2 percent**, while US Employees on Nonfarm Payrolls Total SA was essentially flat. The balance of evidence suggests modest activity in production and sales, but weakening income growth, participation, and sentiment are weighing on current conditions.

LAGGING INDICATOR (33)

The Lagging Indicator stood at **33**, with two components improving and four declining.

US CPI Urban Consumers Less Food and Energy Year over Year NSA rose **0.2 percent**, and US Manufacturing and Trade Inventories Total SA increased **0.1 percent**. In contrast, US Commercial Paper Placed Top 30 Day Yield declined **5.3 percent**, Conference Board US Lagging Commercial and Industrial Loans fell **0.7 percent**, and Census Bureau US Private Construction Spending Nonresidential NSA dropped **0.7 percent**. The Conference Board US Lagging Average Duration of Unemployment rose **5.6 percent** and was scored negatively after inversion. Taken together, the lagging profile points to persistent inflation alongside softening credit conditions, declining construction activity, and lengthening unemployment duration — signals consistent with a cooling economic backdrop.

The January 2026 BCM readings suggest an economy with a modestly positive forward tilt, uneven current activity, and still-soft trailing conditions, but with an important caveat given the break in the data. The Leading Indicator (**63**) points to resilience in expectations, housing, and market-sensitive components, indicating some forward momentum despite lingering weaknesses in production metrics and an adverse yield curve signal. In contrast, the Roughly Coincident Indicator (**42**) reflects a mixed present, where gains in production and sales are offset by declining income growth, sliding labor force participation, and soft consumer sentiment, leaving real-time activity subdued. The Lagging Indicator (**33**) reinforces a softer backdrop, with tightening credit conditions, weakening construction, and longer unemployment durations outweighing persistent inflation pressures. Taken as a whole, the configuration is consistent with tentative forward strength layered over fragile current conditions and weakening underlying fundamentals. But because these figures follow a several-month gap in complete data, they should be interpreted cautiously as a snapshot of current conditions rather than as evidence of a sustained trend or turning point.

DISCUSSION, FEBRUARY — MARCH 2026

The latest inflation data present a conflicted but still informative picture, with early signs of disinflation at the consumer level offset by mounting upstream price pressures and a firmer underlying trend in services. February's Consumer Price Index (CPI) came in softer than typical seasonal patterns would suggest, with headline inflation rising **0.27 percent** month-over-month and holding at **2.4 percent** year-over-year, while core CPI moderated to **0.22 percent**. Much of the cooling reflects easing in heavily weighted categories such as rents and vehicles, and a broad decline in the share of items experiencing rapid price increases. Pockets of firmness remain, however, including apparel, discretionary services, and select goods categories influenced by rising input costs — particularly metals and memory chips — hinting at emerging supply-side pressures. At the same time, January's Personal Consumption Expenditures (PCE) data showed a hotter underlying inflation trend, with core PCE rising **0.36 percent** on the month and **3.1 percent** year-over-year, driven largely by health care and other service categories. Consumer spending continues to rotate away from goods and toward services, even as income growth remains modest and the saving rate rises to **4.5 percent**, suggesting cautious but still resilient household behavior.

Upstream, February's Producer Price Index (PPI) reinforces the notion that cost pressures are building beneath the surface. Headline PPI rose a stronger-than-expected **0.7 percent** on the month and accelerated to **3.4 percent** year-over-year, reflecting higher transportation, warehousing, and especially metals costs — now up more than **15 percent** since tariff measures took effect last year. While some components feeding into core PCE, such as health care and airfares, may exert less upward pressure in the near term, the broader trend in input costs points to continued pipeline inflation. Overlaying this dynamic is the emerging energy shock tied to the Iran conflict, which is likely to push headline CPI higher in the near term, potentially toward **3 percent**, complicating the Federal Reserve's policy path. Taken together, the data suggest that while consumer-level inflation has shown tentative signs of cooling, underlying service-sector strength and rising input costs — combined with geopolitical risks — leave the inflation outlook uncertain and increasingly sensitive to both supply shocks and policy responses.

Recent US labor market data point to a clear cooling in hiring, though the signal is muddled by temporary disruptions and measurement issues. February nonfarm

payrolls fell by 92,000 — well below expectations — and the three-month average slowed to just 5,700 jobs, indicating that hiring momentum has nearly stalled and is likely running below breakeven. Some of the weakness reflects one-off factors, including a major health-care strike, adverse winter weather, and payback from unusually strong January conditions, while revisions to business formation estimates may have further amplified the decline. Even so, broader indicators suggest genuine softening: the unemployment rate rose to **4.44 percent**, driven by job losers, while rising inflows into unemployment and declining outflows point to a less dynamic labor market. Wage growth remains relatively firm at **0.4 percent**, but appears uneven and partly distorted by sector-specific effects, and aggregate income growth has softened as declining payrolls offset earnings gains.

At the same time, complementary data suggest the labor market is not collapsing but instead settling into a looser equilibrium. Job openings rose unexpectedly to 6.95 million in January, and private payroll data showed a modest gain of 63,000 jobs in February, with hiring concentrated in health care, education, and smaller firms. However, the ratio of vacancies to unemployed workers remains below one, indicating that slack persists and that labor demand is no longer outpacing supply. The quits rate has stabilized and layoffs have edged lower, reinforcing the view of reduced churn rather than renewed strength. Taken together, the data describe a labor market that is cooling and stabilizing at a lower level of activity — no longer a clear source of inflationary pressure, but not yet signaling a sharp deterioration — leaving policymakers inclined toward caution but still biased toward eventual easing.

The February ISM surveys paint a picture of continued expansion across both manufacturing and services, though with important differences in momentum and inflation signals. The ISM Manufacturing PMI edged down slightly to 52.4 but came in above expectations, indicating ongoing — if somewhat moderating — growth in the industrial sector. Demand remains solid, with new orders still firmly in expansion territory and supported by low customer inventories and improving backlogs, suggesting continued production ahead. The headline was bolstered by gains in employment, inventories, and slower supplier deliveries, the latter signaling capacity strain. However, a sharp rise in the prices-paid index — driven in part by higher metals costs and tariff-related pressures — points to renewed input cost inflation that may concern policymakers even as output stabilizes.

In contrast, the ISM Services PMI delivered a stronger and more broadly positive signal, jumping to 56.1, its highest level since mid-2022. The increase was driven by a surge in new orders, accelerating production, and improving employment, indicating robust demand across the dominant services sector. Backlogs and export orders also strengthened, while supply chains showed modest improvement. Importantly, price pressures became less pervasive, with the services prices index declining, offering some relief on the inflation front. Taken together, the two reports suggest a US economy entering the year with improving activity and sentiment, led by services strength and supported by steady manufacturing demand, but with a divergence in inflation dynamics – easing in services while intensifying in goods – that complicates the broader outlook.

Recent sentiment data across consumers and small businesses point to a cautiously stable but increasingly fragile outlook, with geopolitical and energy developments emerging as key risks. The University of Michigan's preliminary consumer sentiment index slipped modestly to 55.5 in March, as a decline in expectations more than offset a slight improvement in current conditions, with the drop largely concentrated after the onset of military action in Iran. Inflation expectations remained relatively anchored – unchanged at **3.4 percent** for one year and easing slightly to **3.2 percent** over five years – but rising gasoline prices, up roughly **27 percent** this month to their highest levels since late 2023, pose a growing threat to real incomes and future confidence. Small-business sentiment remains just above its long-run average, with the NFIB index at 98.8, supported by improved recent sales and profit trends, but forward-looking indicators have softened, including a notable drop in expected sales and only modest plans for capital spending. While fewer firms are currently raising prices, a significant share still intends to do so, reflecting persistent cost pressures. Across businesses, taxes remain the top concern, followed by labor quality, inflation, and weakening sales, with rising competition and financing concerns also in the mix. Taken together, the data suggest that while sentiment has not yet deteriorated sharply, it is increasingly vulnerable to energy-driven cost shocks and geopolitical uncertainty, which could weigh on both consumer demand and business confidence in the months ahead.

Retail sales data and the latest consumer surveys together suggest a consumption picture that is shifting from temporary softness toward more structural

pressure. Retail sales dipped **0.2 percent** in January, largely due to winter weather disruptions that curtailed in-person activity, especially dining out, while boosting online purchases, which helped cushion the decline. Core measures excluding autos and gasoline remained modestly positive, indicating that underlying demand had not collapsed and could rebound as weather effects fade. However, that near-term stabilization is now being challenged by a sharp energy-driven shock tied to the Iran conflict, with gasoline prices jumping from about \$2.94 to \$3.63 per gallon and oil rising roughly **40 percent**. This surge has rapidly fed into consumer expectations, with anticipated gas price increases and broader inflation expectations moving higher, while perceptions of personal finances have deteriorated meaningfully.

More concerning for the consumption outlook is the breadth of this shift in sentiment. Higher-income households – previously a key driver of spending strength – have also pulled back sharply, raising the risk that aggregate consumption may weaken more broadly. At the same time, rising fuel costs are acting as a direct drag on discretionary spending, effectively reallocating household budgets toward necessities while amplifying price pressures in areas like transportation and travel. Coupled with growing concerns about job security and declining confidence in future income, these developments suggest that while early-year retail weakness may have been partly weather-related, the outlook for consumer spending is increasingly constrained by a combination of eroding purchasing power and heightened uncertainty.

Productivity and industrial output data together point to an economy that is still generating growth efficiently, even as sectoral performance remains uneven. Labor productivity rose at a solid **2.8 percent** annualized pace in the fourth quarter, with prior quarters revised higher due to lower measured hours worked, reinforcing a favorable underlying trend. While unit labor costs increased at a **2.8 percent** annualized rate in the quarter – driven by stronger compensation – the four-quarter trend remains subdued at just **1.3 percent**, indicating that labor costs are not exerting meaningful inflationary pressure. This combination – steady productivity gains alongside contained cost growth – suggests that output can continue to expand without forcing a policy response from the Federal Reserve on labor-driven inflation grounds.

Industrial production data echo this theme of modest but uneven expansion. Output rose **0.2 percent** in

February, supported by gains in manufacturing — particularly transportation equipment and business investment-related categories — while consumer goods production was flat, with durable gains offset by declines in nondurables. Utilities dragged on the headline amid weak natural gas output, while mining and energy extraction showed early signs of strengthening, likely to become more important given geopolitical supply disruptions. Taken together, the data suggest a production environment characterized by resilience in capital-intensive and strategic sectors, softer performance in consumer-facing goods, and an overall growth path that remains intact but far from broad-based.

The early March Beige Book points to an economy that is losing some momentum but largely maintaining its footing, with activity expanding at a slight to moderate pace in seven of twelve Federal Reserve districts, down from eight previously, and a growing share reporting flat or declining conditions. Consumer behavior remains uneven, with heightened price sensitivity among lower-income households weighing on discretionary spending, including weaker auto sales. At the same time, manufacturing conditions improved, supported in part by demand tied to data centers and energy infrastructure, highlighting a divergence between capital-intensive sectors and more consumer-facing areas. Employment was broadly stable, though firms cited softer demand, rising input costs, and uncertainty as constraints on hiring. Price pressures remained moderate, with tariffs contributing to elevated costs across most districts, but firms expressed expectations for some easing ahead — an encouraging signal that is now complicated by renewed geopolitical risks. While business sentiment has become more optimistic, the report largely predates the escalation of the Iran conflict and related policy uncertainty, suggesting that current conditions may understate the degree of volatility and downside risk facing the economy in the near term.

The current policy mix reflects a growing tension between a still-restrictive monetary stance and a fiscal impulse that is increasingly being offset by external shocks. At its March meeting, the Federal Reserve held rates steady at **3.50 percent** to **3.75 percent** but signaled a more hawkish underlying posture, raising its estimates of long-run growth and the neutral rate — partly on expectations of AI-driven productivity gains — while also revising inflation forecasts higher. Although the median projection still includes one rate cut this year, the upward shift in the dot plot and higher assumed policy baseline suggest a reduced willingness to ease quickly, especially amid lingering inflation risks and

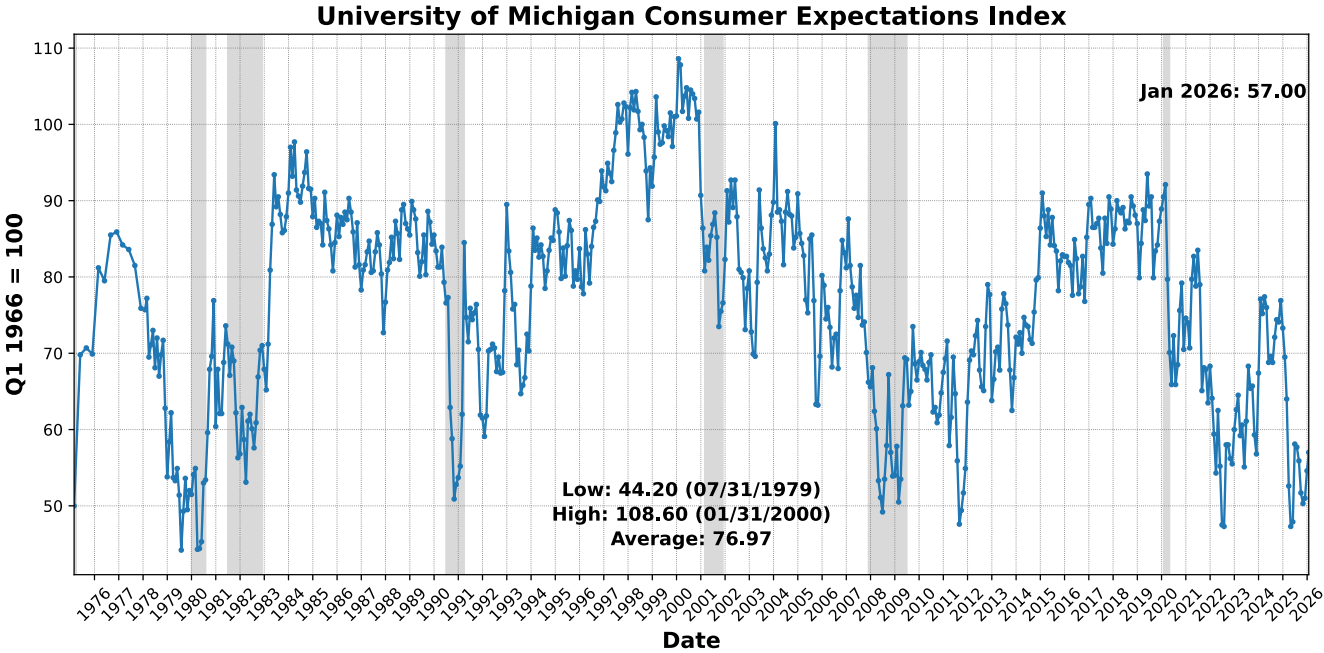
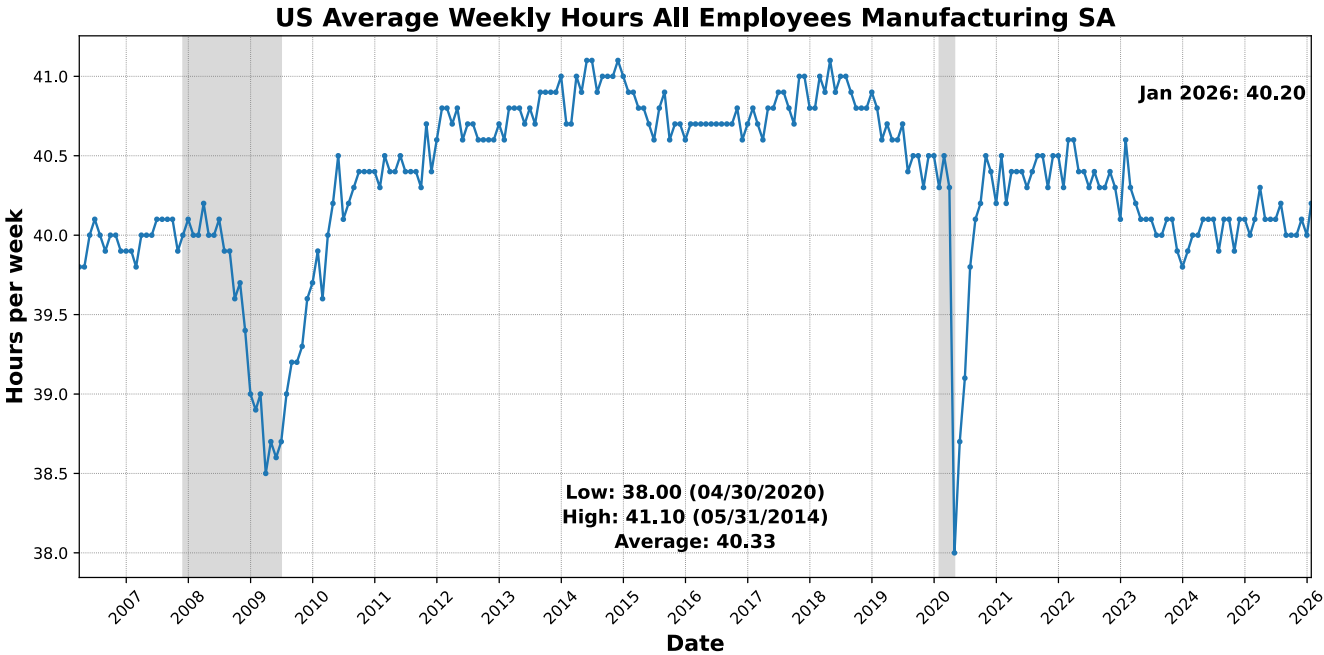
geopolitical uncertainty. This leaves policy effectively tighter than it may appear on the surface, particularly as the Fed balances stronger projected growth against rising inflation pressures and an unsettled global backdrop.

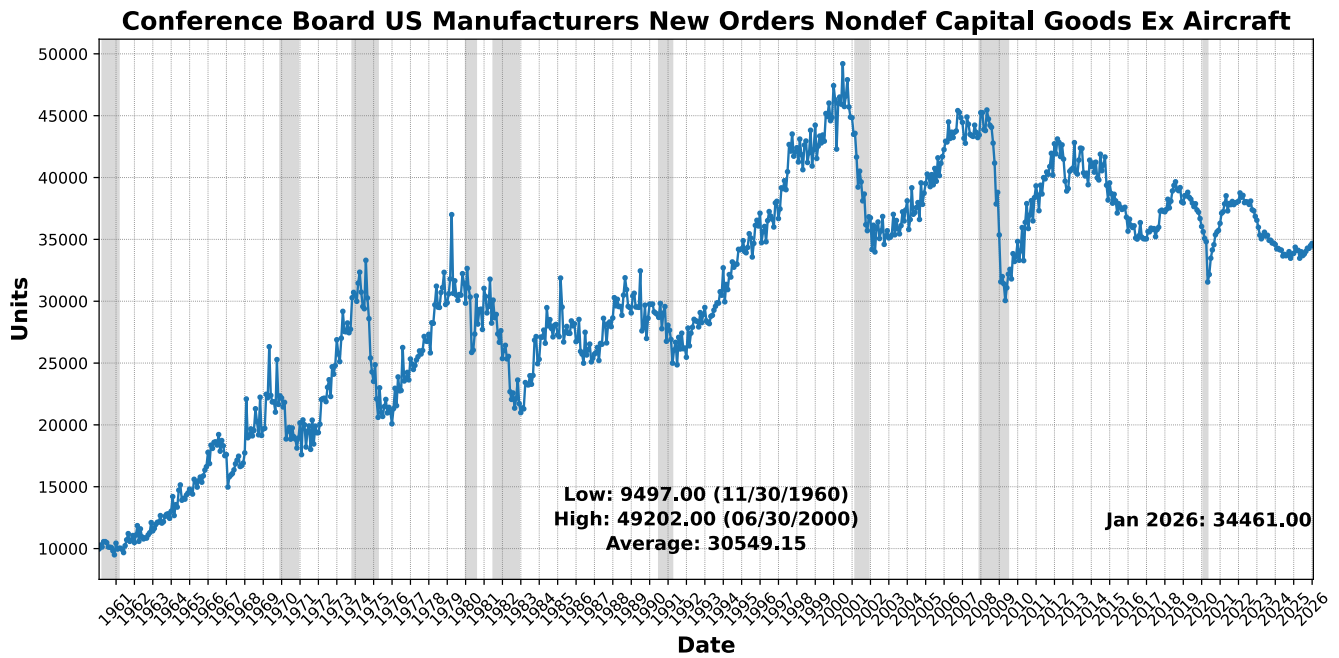
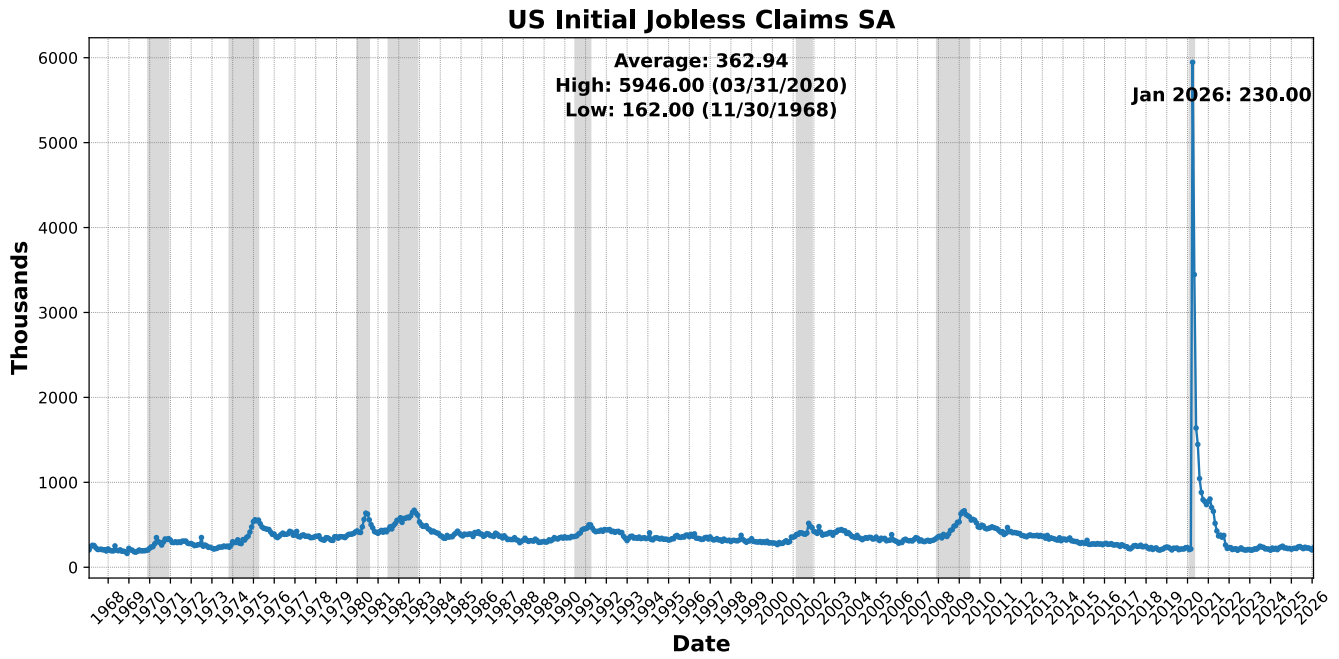
At the same time, the anticipated boost from fiscal policy is being eroded in real time. The One Big Beautiful Bill Act was expected to support consumption through increased tax refunds — roughly \$650 to \$800 per household, contributing about **0.4 percentage** points to GDP — but that impulse is now being offset by a sharp rise in energy prices tied to the Iran conflict. With oil prices already above the estimated breakeven level of roughly \$83 per barrel, higher gasoline costs are effectively neutralizing the benefit of those refunds, particularly for lower-income households that spend a larger share of income on fuel. In effect, the policy mix is shifting from one of modest support to one of partial offset, where fiscal stimulus is diluted by energy-driven real income losses and monetary policy remains cautious. Together, this creates a more constrained near-term outlook, in which growth depends increasingly on higher-income consumers and favorable financial conditions, both of which are vulnerable to ongoing geopolitical and market volatility.

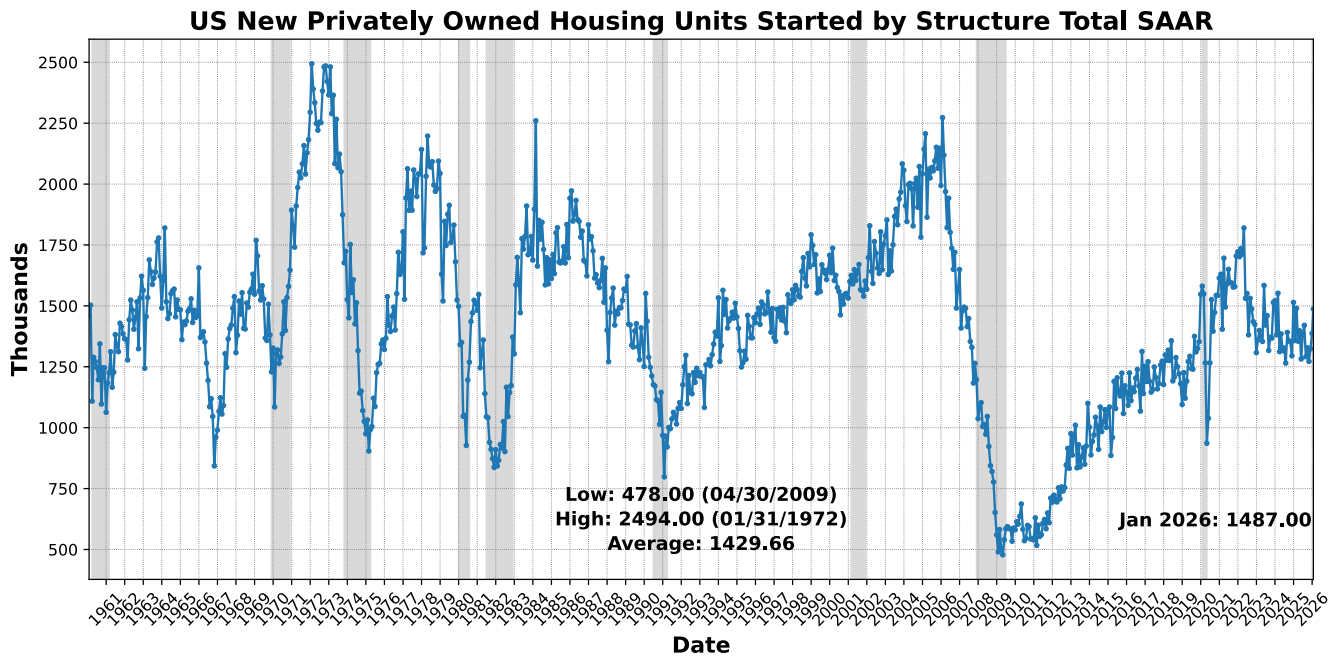
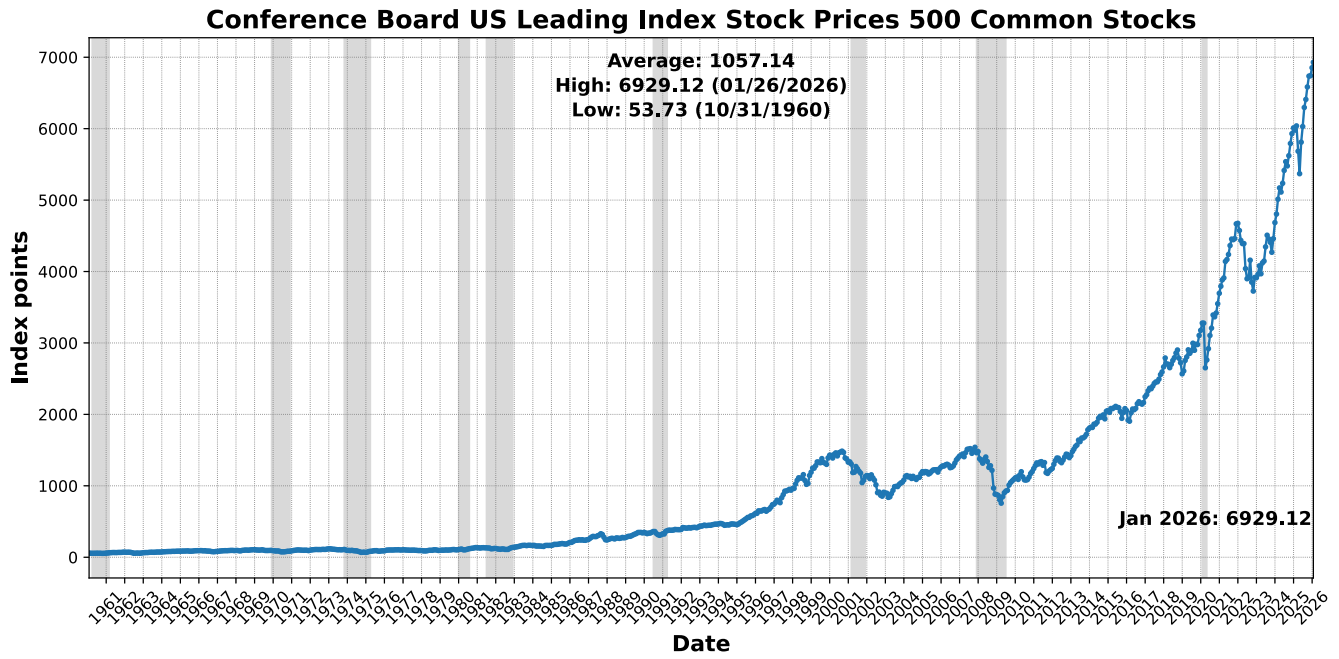
The US economy is showing modest but uneven growth, with services and productivity providing support while manufacturing, consumption, and hiring lose some momentum. Inflation appears to be cooling at the consumer level, but rising input costs and an energy shock tied to the Iran conflict are reintroducing upward pressure and complicating the outlook. The labor market is clearly softening, while consumer spending faces increasing strain from higher gasoline prices, weakening sentiment, and a potential pullback among higher-income households. Looking ahead, an increasingly cautious Federal Reserve (possibly facing a policy trap) and fiscal boost increasingly offset by energy costs leave the expansion intact but fragile, with growth more vulnerable to geopolitical risks and shifts in confidence.

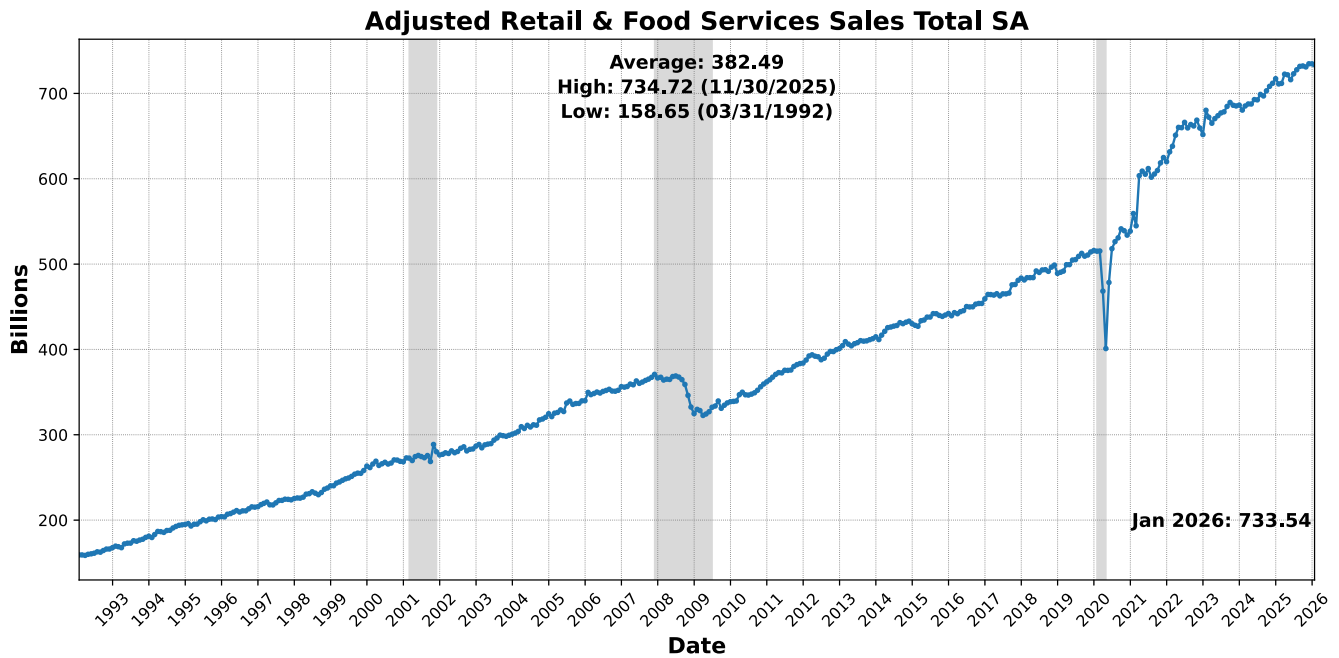
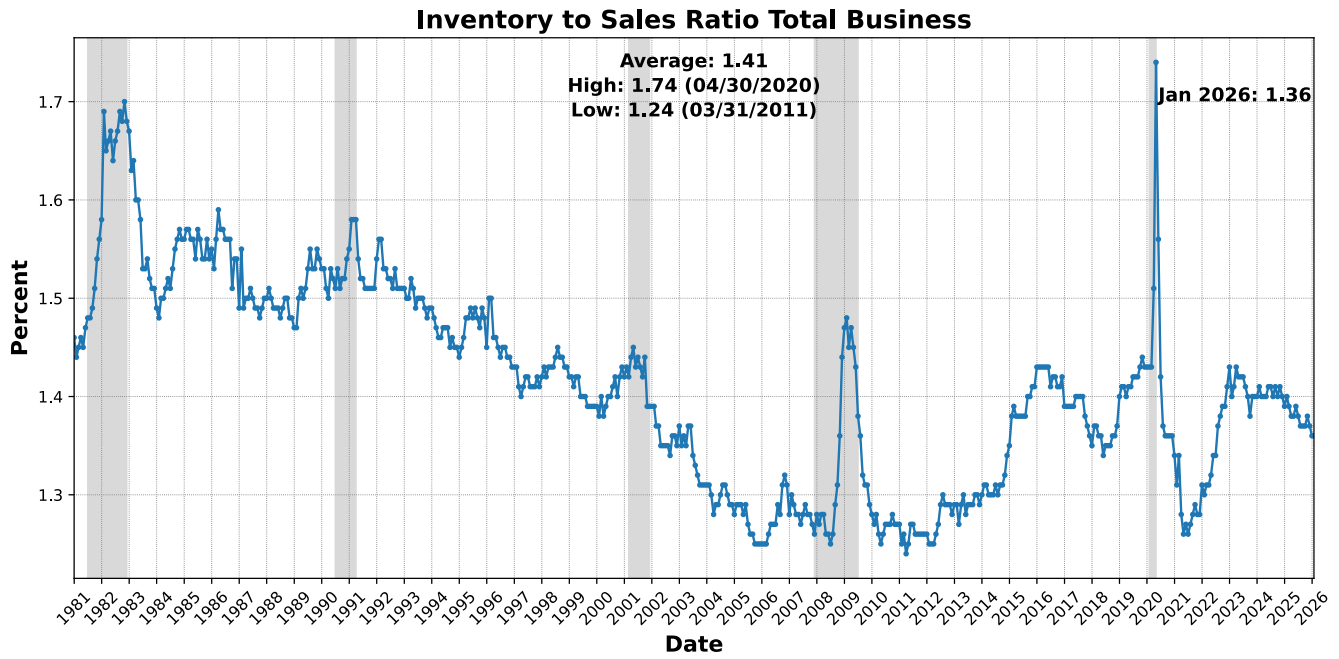
Note: As of the January 2026 Business Conditions Monthly (BCM) calculation, sufficient data have become available to resume publication of the three BCM diffusion indices. However, because the most recent fully complete run of constituent data dates back to July 2025, there is a discontinuity in the series. As a result, the current readings should be interpreted on a standalone basis — reflecting present conditions — rather than as the latest observation in a continuous trend. Until several additional months of consistent data are released and any revisions are incorporated, caution is warranted in drawing conclusions about momentum or directional changes in underlying economic conditions.

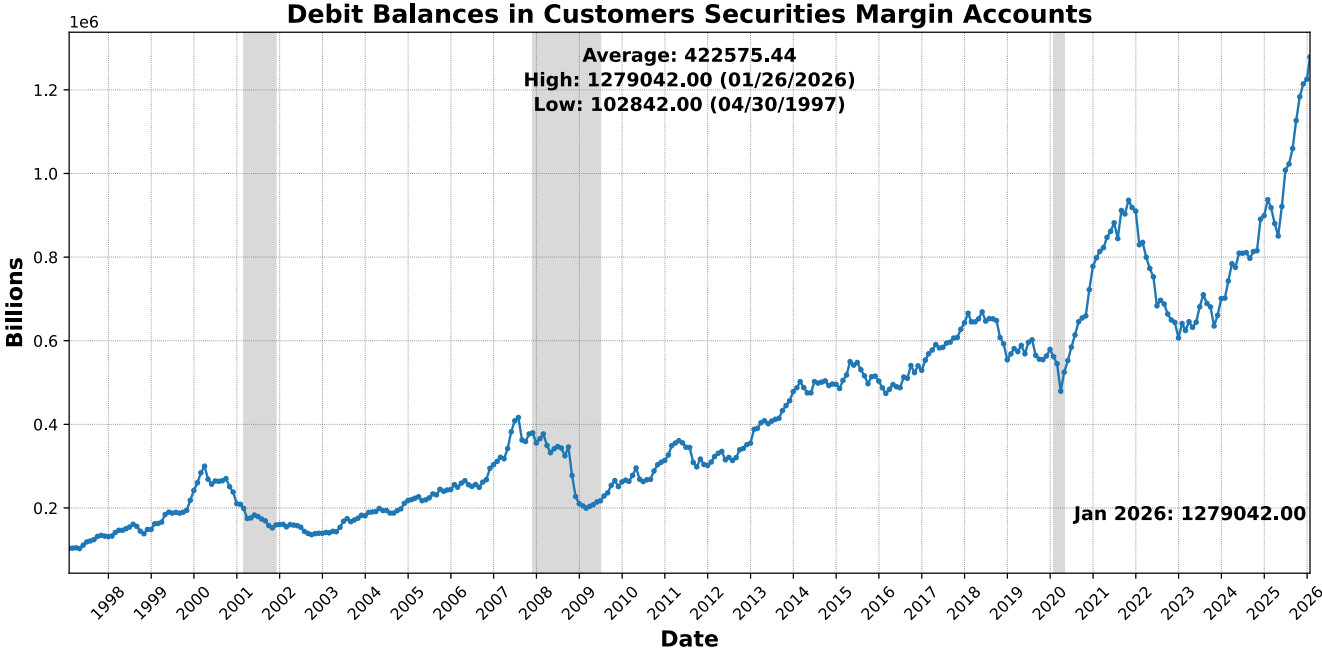
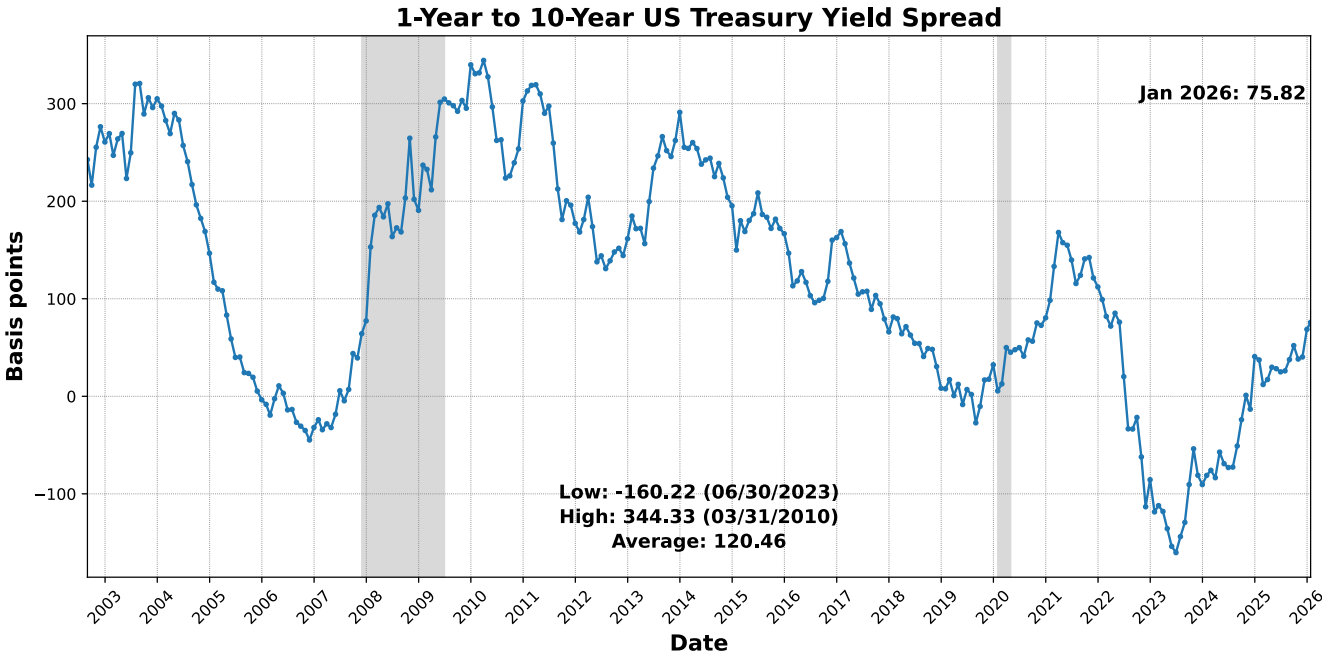
LEADING INDICATORS

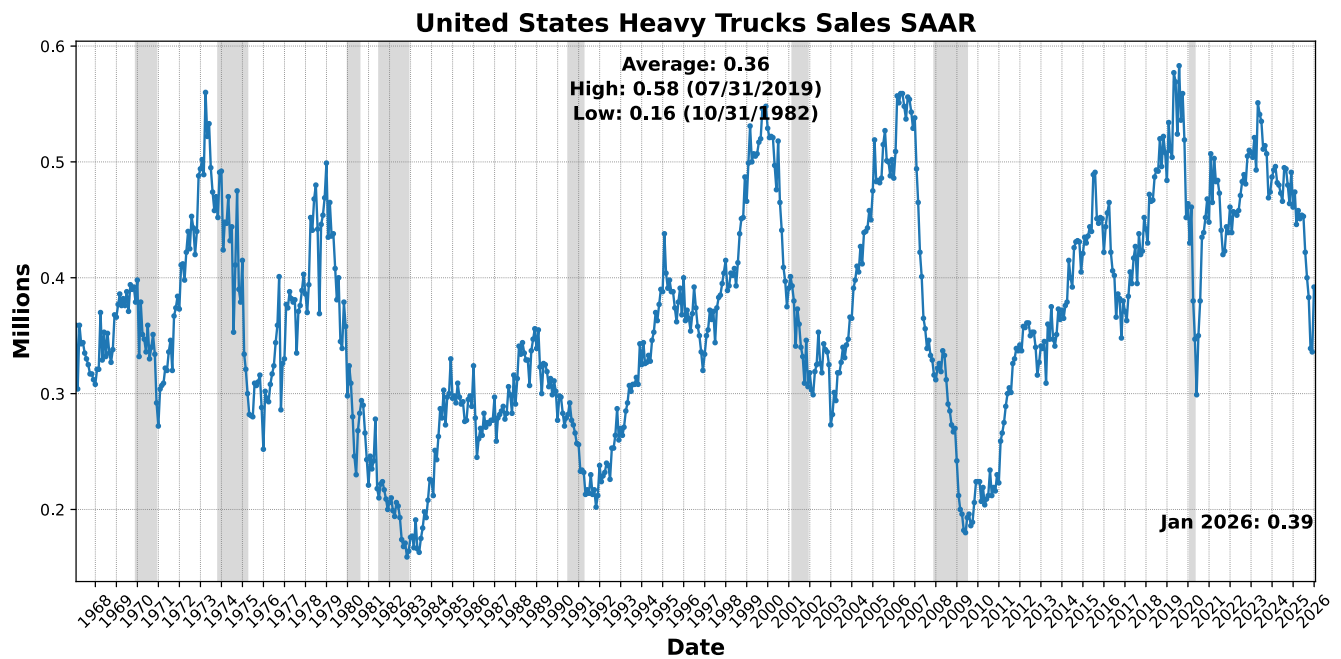
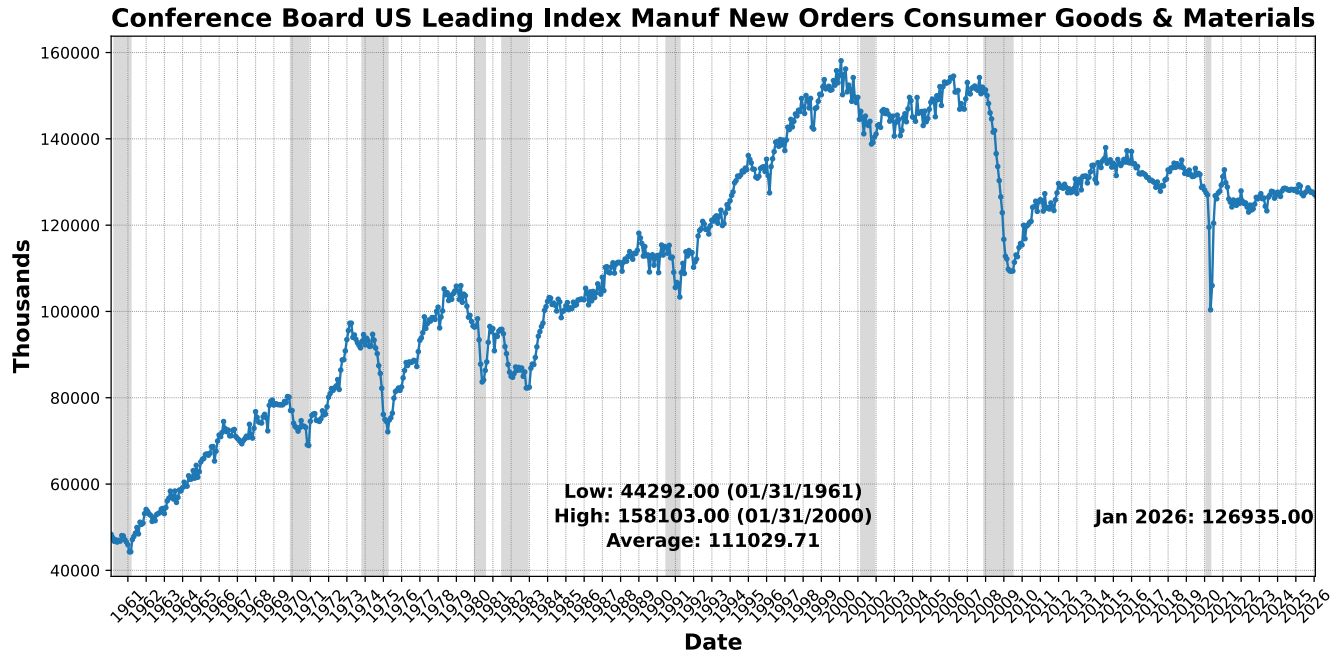




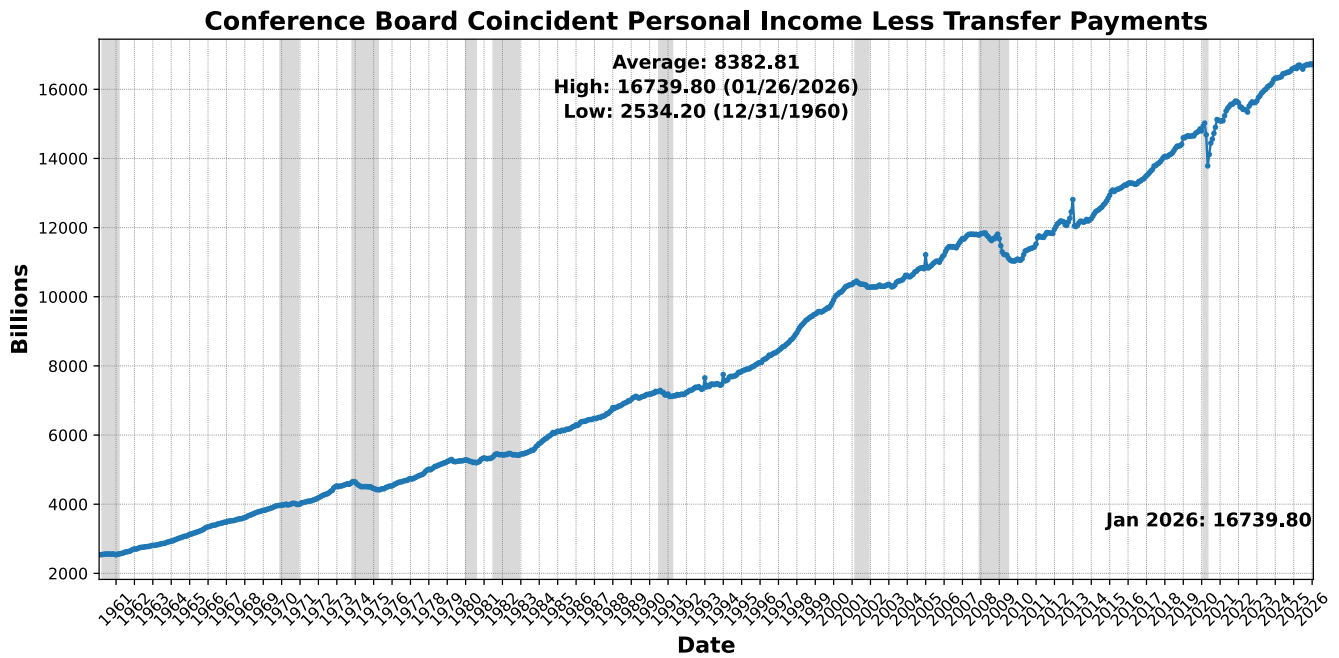
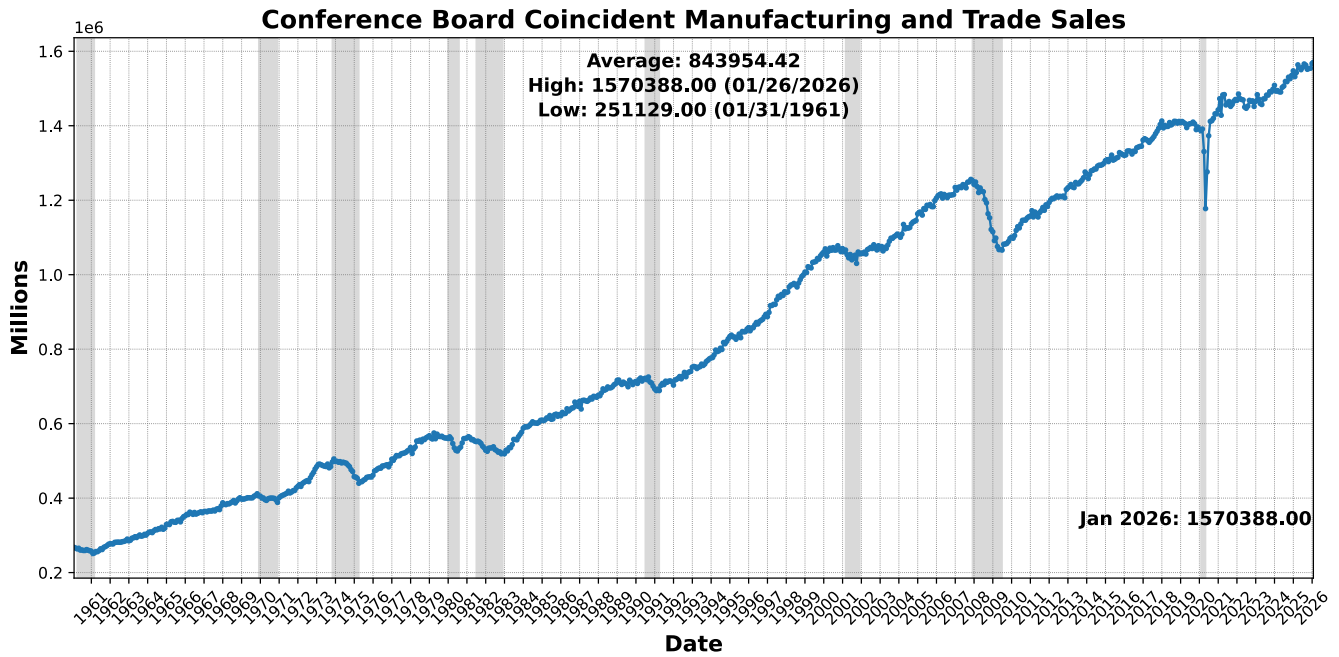




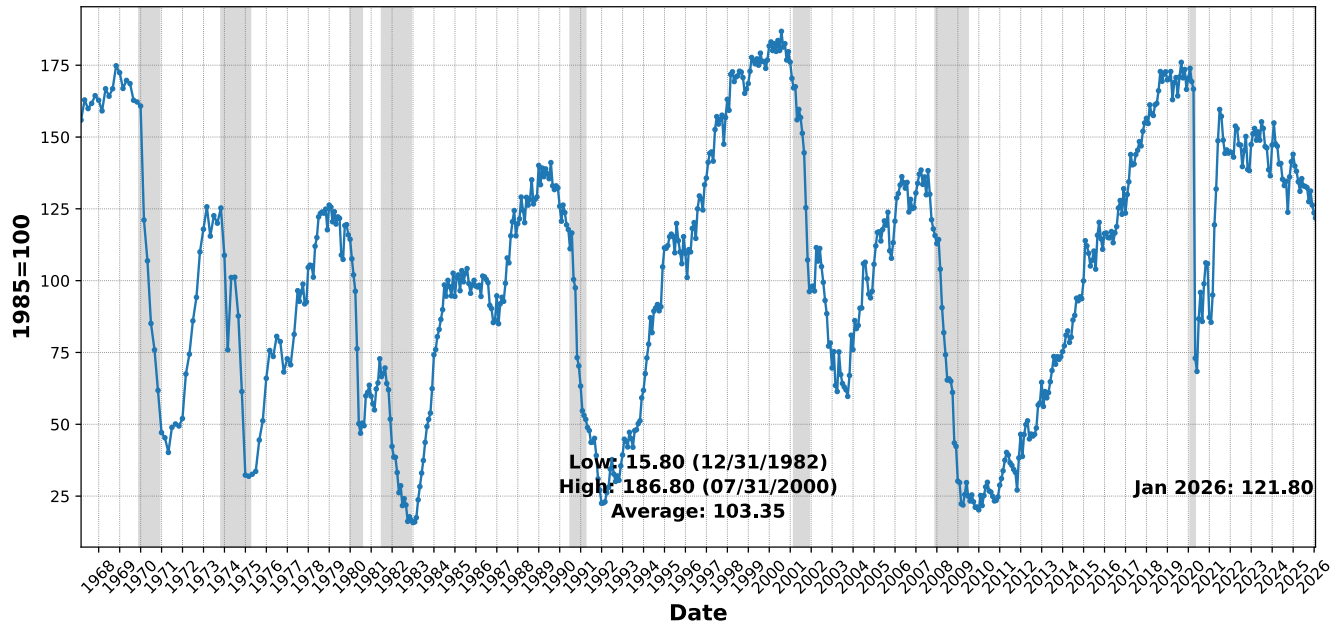




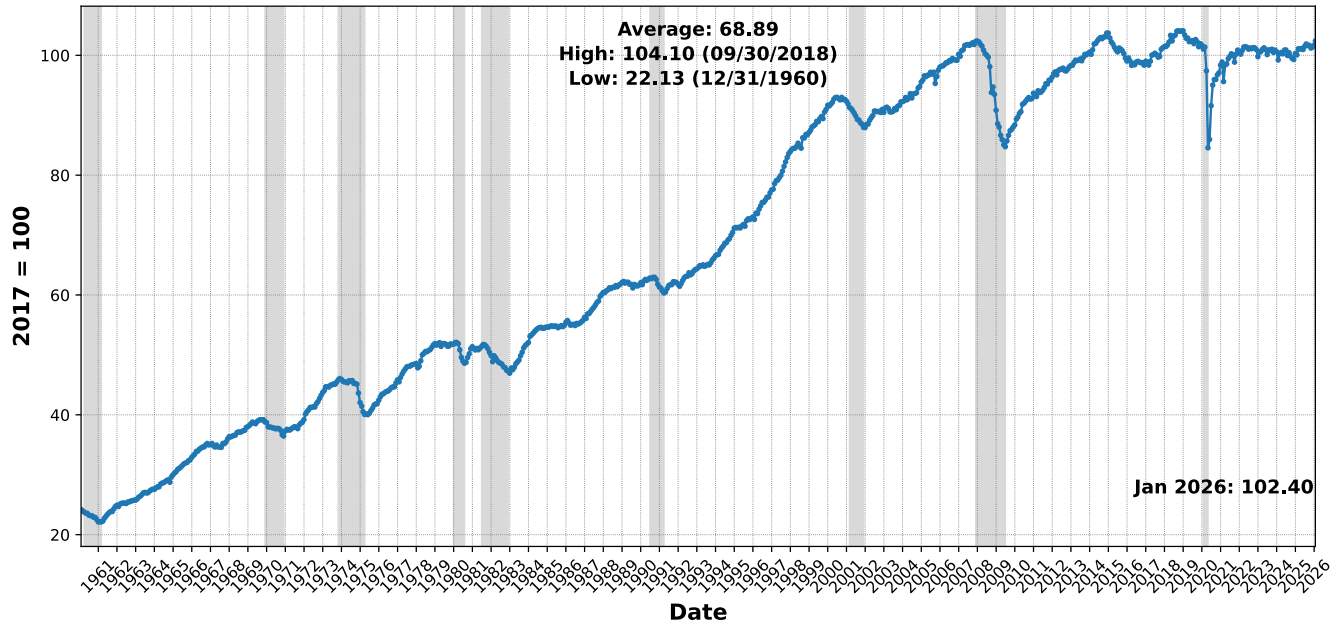
ROUGHLY COINCIDENT INDICATORS

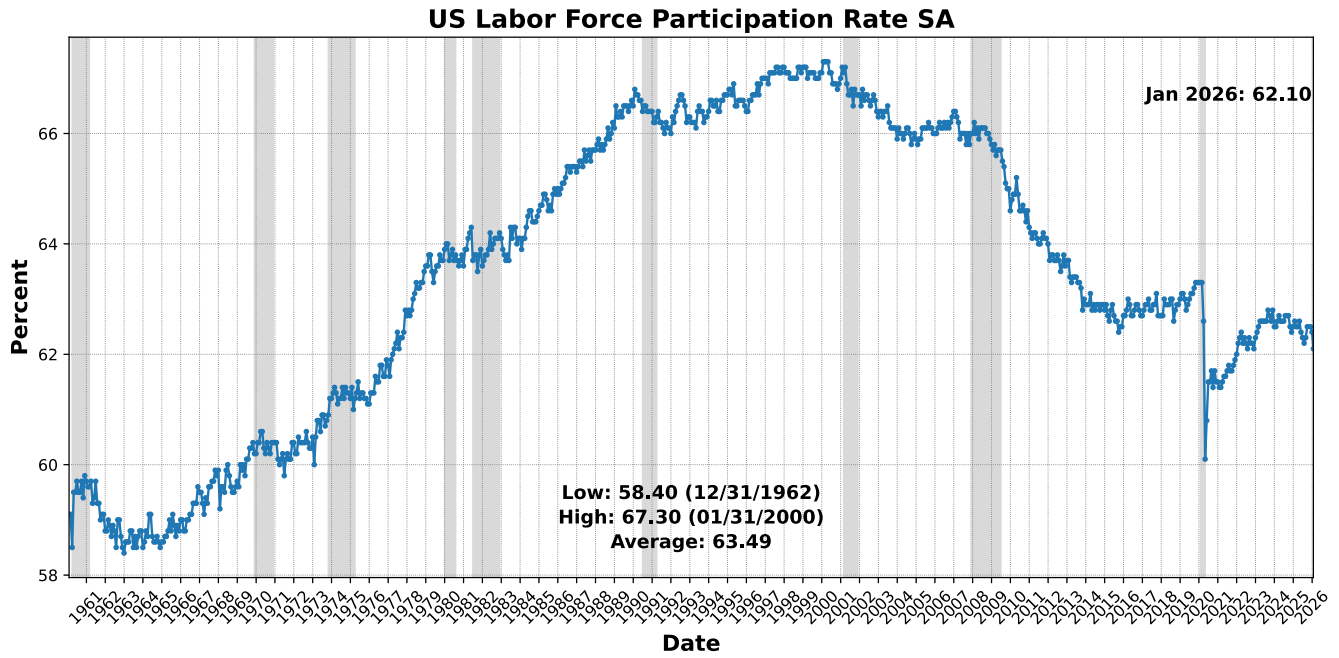
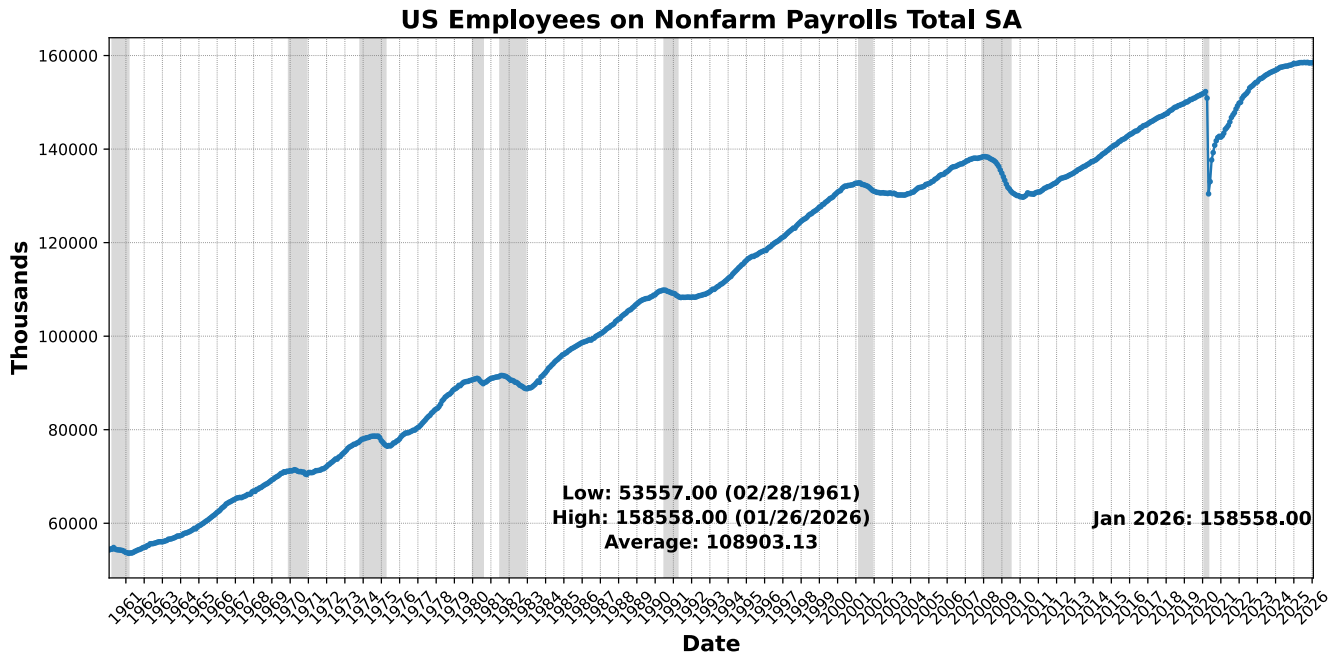


Conference Board Consumer Confidence Present Situation SA

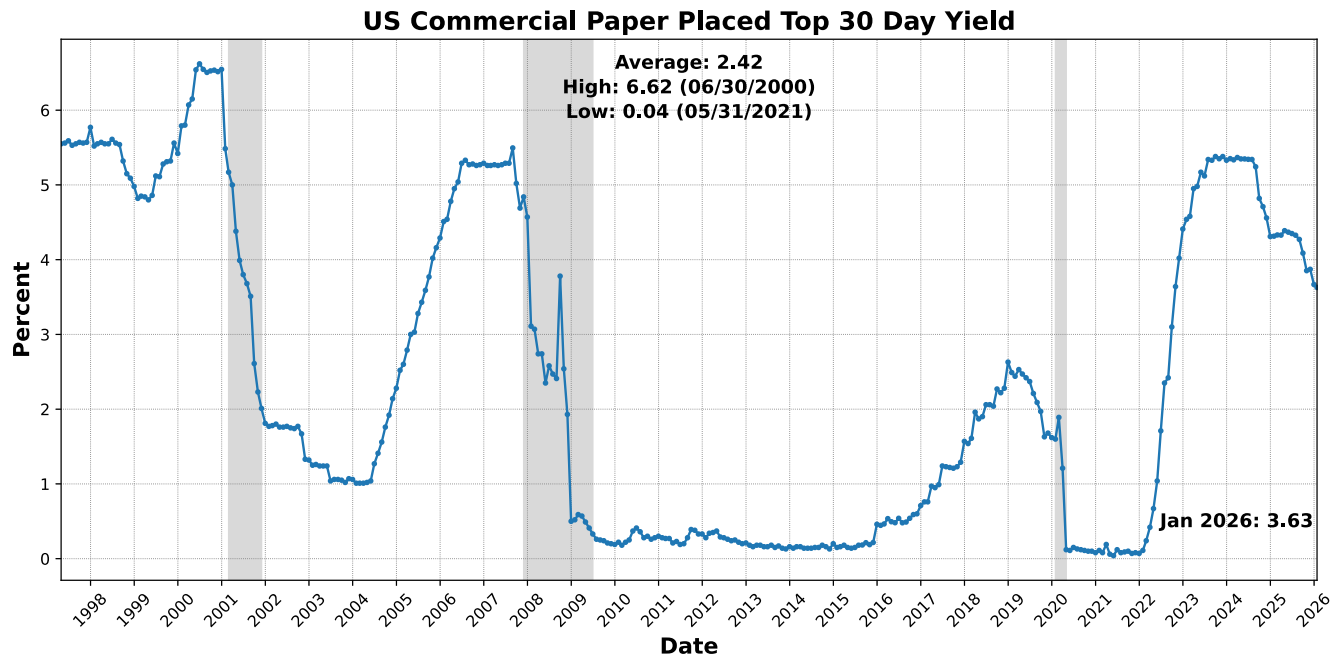
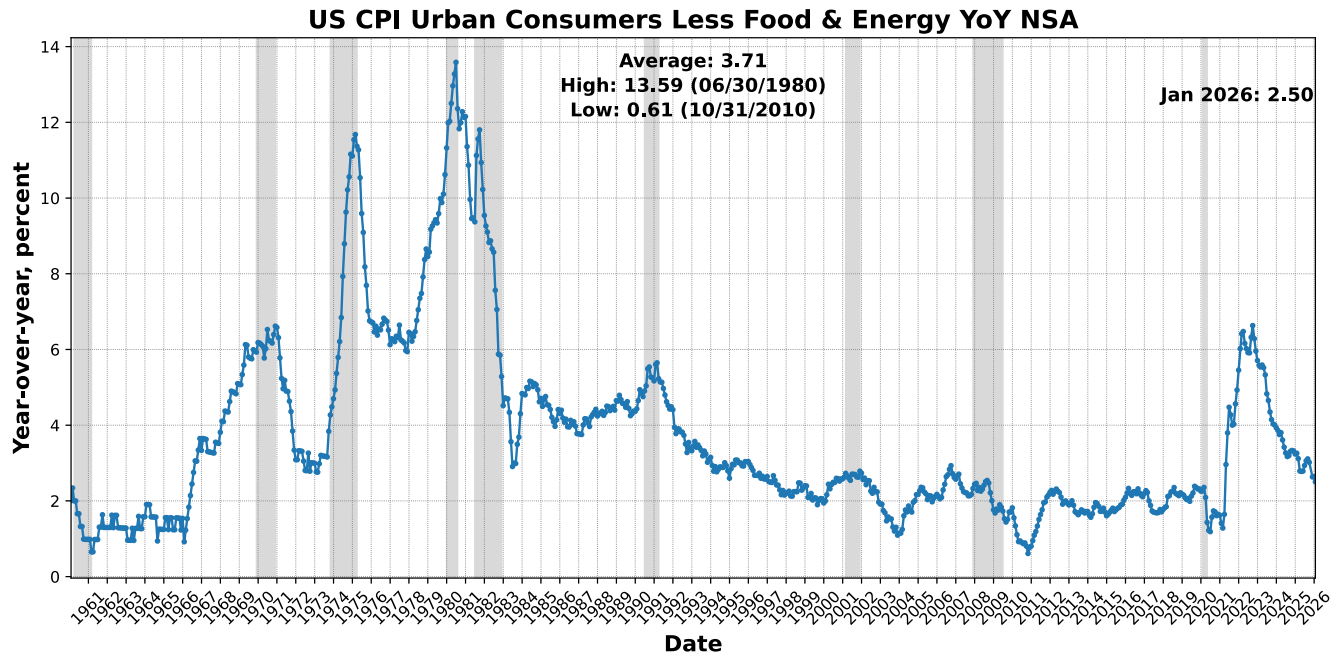


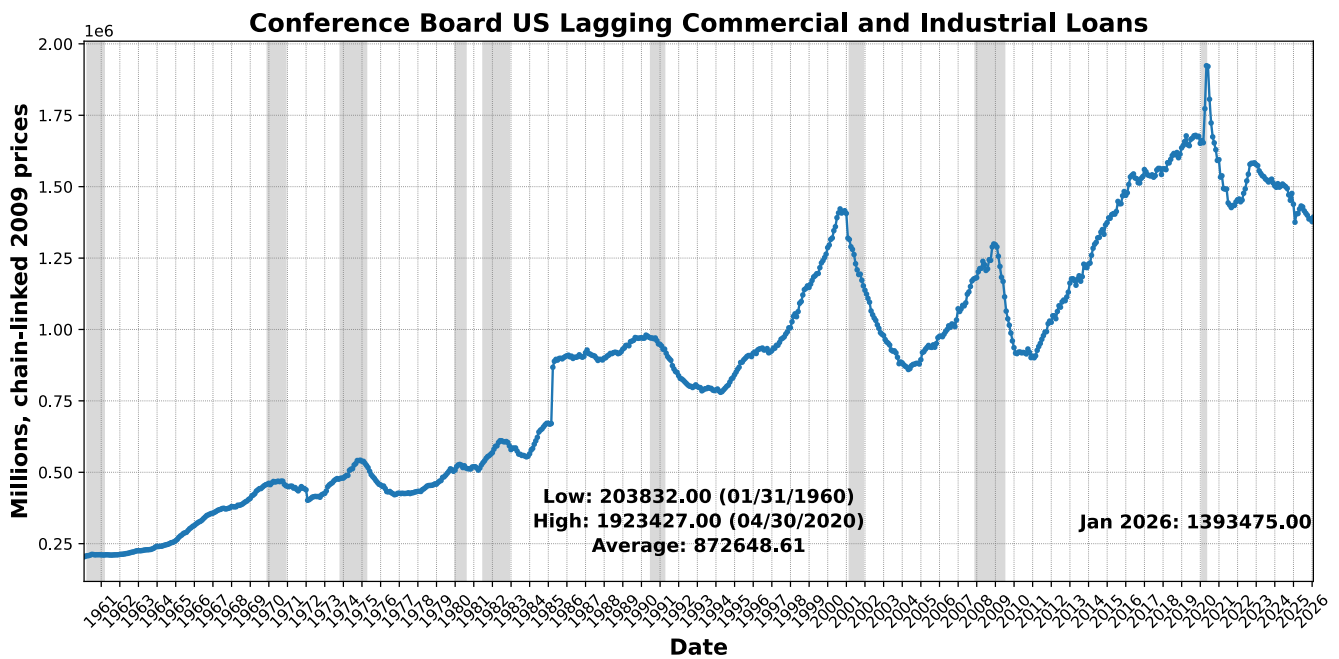
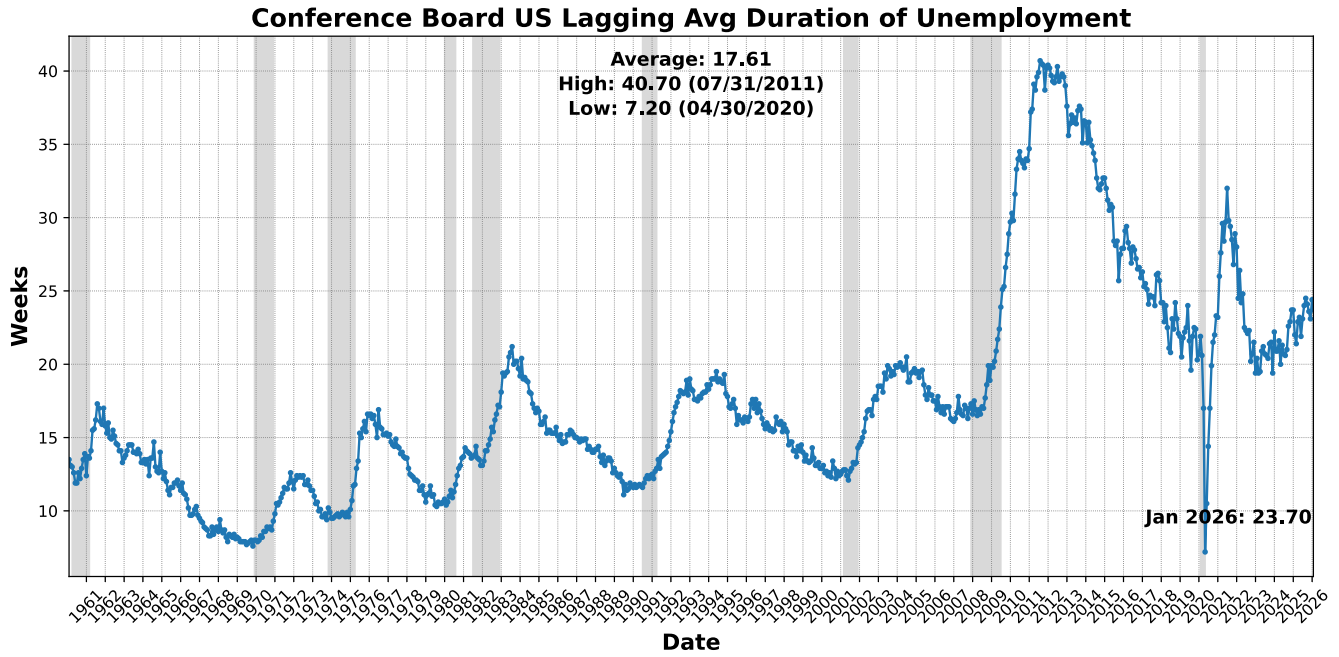
US Industrial Production SA

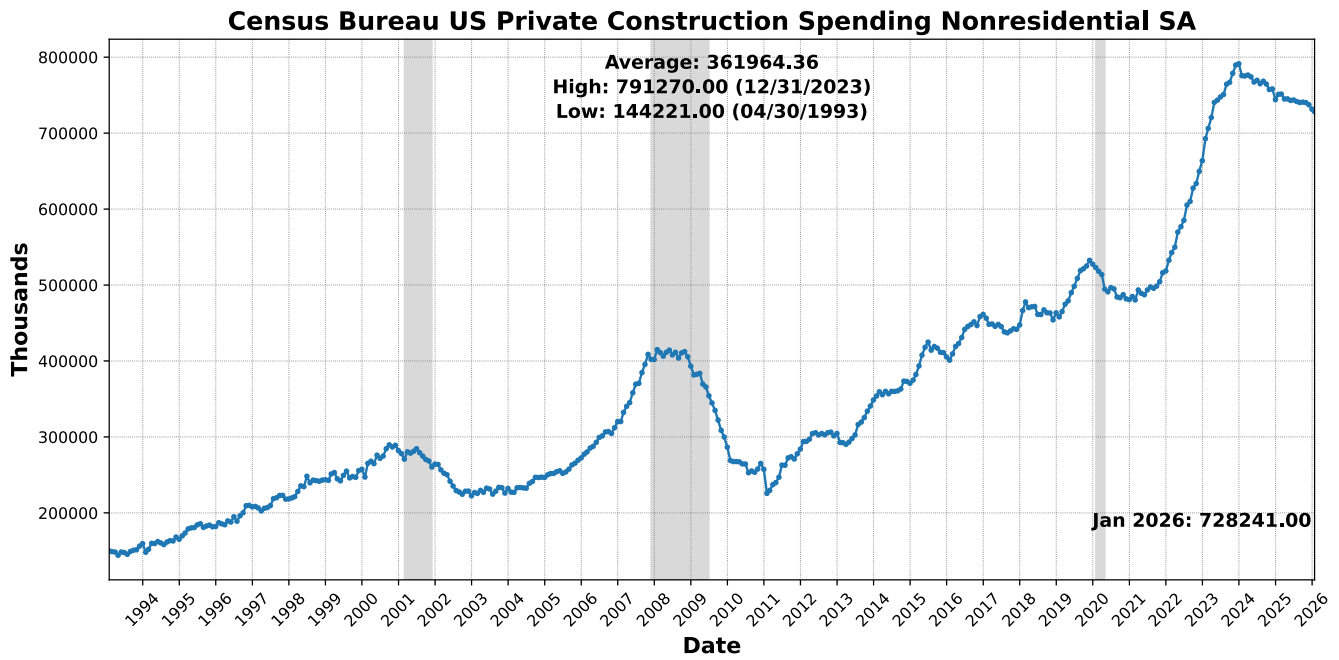
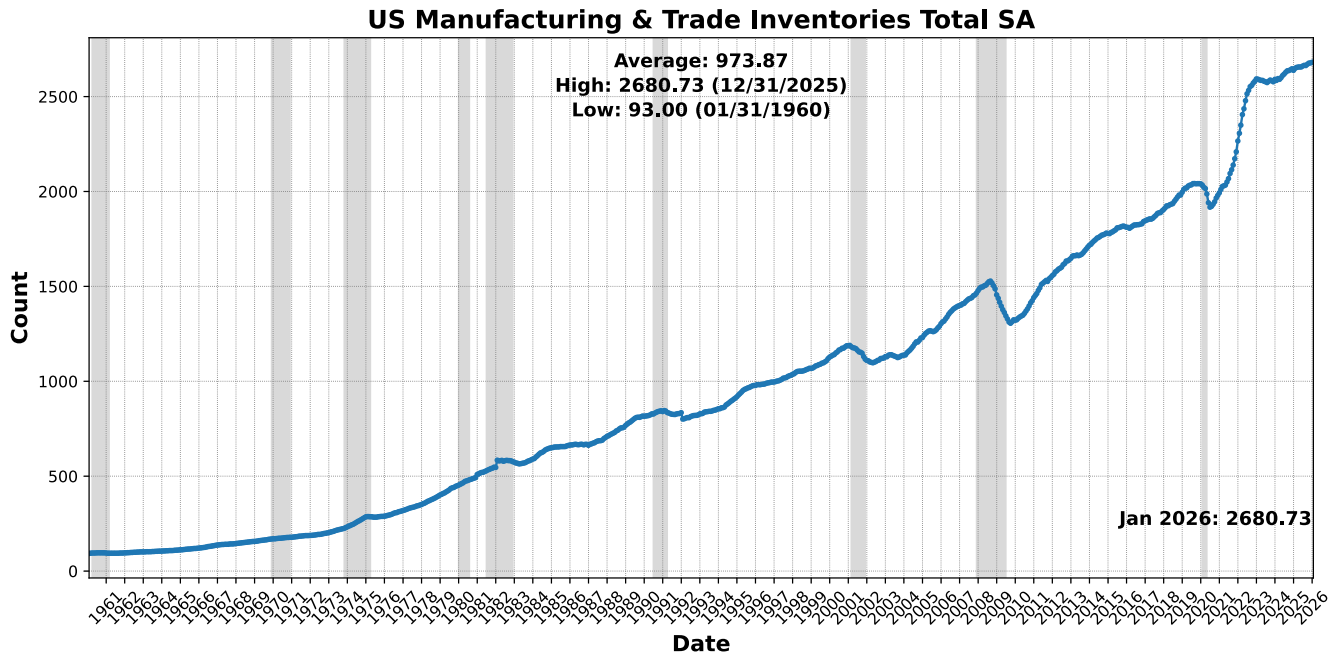




LAGGING INDICATORS







Capital Market Performance

| Ticker | Short Name | %1M | %3M | %1YR | 3 Year Annualized Total | 5 Year Annualized Total | 10 Year Annualized Total |
|-----------|--------------------------------|---------|---------|----------|-------------------------|-------------------------|--------------------------|
| ▶ SPR | S&P 1500 Composite Index | -5.01% | -5.56% | +14.63% | 19.0695 | 11.7131 | 15.0728 |
| ▶ SPXT | d S&P 500 Total Return | -4.74% | -5.55% | +16.25% | 19.7238 | 12.3156 | 15.3886 |
| ▶ SPX | d S&P 500 INDEX | -4.84% | -5.84% | +14.80% | 19.6985 | 12.2933 | 15.3723 |
| ▶ MID | d S&P 400 MIDCAP INDEX | -6.97% | -2.11% | +11.90% | 12.6376 | 6.3173 | 12.0168 |
| ▶ RTY | d RUSSELL 2000 INDEX | -6.96% | -4.04% | +18.55% | 13.3668 | 2.6451 | 11.2282 |
| ▶ SXXP | d STXE 600 (EUR) Pr | -8.67% | -2.62% | +4.30% | 12.8903 | 9.7650 | 10.3051 |
| ▶ TLT US | d ISHARES 20+YR TR | -4.00% | -1.75% | -5.37% | -2.9587 | -5.6284 | -.8942 |
| ▶ QLTA US | d ISHARES AAA - A | -2.86% | -1.81% | -.80% | 4.1060 | .3065 | 2.5409 |
| ▶ CRY | d TR/CC CRB ER Index | +18.37% | +21.70% | +20.06% | 12.8782 | 14.2098 | 6.8106 |
| XAU | Gold Spot \$/Oz | -14.74% | -.61% | +48.02% | | | |
| XAG | Silver Spot \$/Oz | -23.08% | -5.02% | +105.49% | | | |
| ILM3NAVG | Bankrate 30Y Mortgage Rates Na | +2.93% | +.48% | -6.64% | | | |
| ILM1NAVG | Bankrate 15Y Mortgage Rates Na | +3.06% | +.70% | -4.98% | | | |
| MB301ARM | 5 Year ARM | +6.81% | +.36% | -3.25% | | | |
| ILA3NAVG | Bankrate 30Y Fixe Mtg Refis Na | -.43% | +.29% | -9.19% | | | |

(Source: Bloomberg Finance, LP. Data subject to shutdown limitations.)

April 2026

What a Children's Book Taught Me About Core Economic Principles

Thomas Savidge
Research Fellow

Communicating economics to a general audience isn't just about accuracy. It's also about keeping people interested. In *Useful Economics*, AIER Founder Colonel EC Harwood aimed to engage "both student beginners and general readers" by grounding economics in "an area of the field where they at least have some familiarity with the principal matters discussed."

Making economics accessible often means finding relatable situations. Colonel Harwood used the example of making decisions in a supermarket. One such moment caught me by surprise while reading to my children. In the pages of Richard Scarry's *What Do People Do All Day?* I found an illustration of Say's Law of Markets.

Scarry's story offers a case that can help general readers – especially children – grasp the basic intuitions of economics.

THE BUSY WORLD OF MARKETS

What Do People Do All Day? Is a collection of illustrated short stories set in fictional Busytown, a community populated by animal characters who go about their daily jobs, aiming to teach children about different occupations and how they contribute to the wider community.

The story "Everyone is a worker" follows Farmer Alfalfa and his interactions with five other workers in Busytown. He grows food, keeps some for his family, and then sells the rest to Grocer Cat in exchange for money. With the money, Farmer Alfalfa buys a new suit from Stitches the tailor, a new tractor to boost his productivity, and presents for his wife and son from Blacksmith Fox. He then puts the remainder of his earnings into the bank.

The story doesn't end there. Grocer Cat sells the food to other people in Busytown, using the proceeds to buy a dress for his wife and a present for his son. Stitches and Blacksmith Fox first use the money to buy food, then new clothes, and then other goods. Stitches buys an eggbeater to make fudge while Blacksmith Fox buys more iron for his shop, reinvesting in his business. Any money left over, Scarry notes, is saved in the bank.

Those familiar with Say's Law may already see the connection. While Scarry does not include equations or a specific discussion of economic terms, he includes the core aspects of Say's Law: exchange, money, and a division of labor.

WHAT IS SAY'S LAW

Say's Law (named after nineteenth-century French political economist Jean-Baptiste Say) is often reduced to the phrase "supply creates its own demand."

Taken literally, that would mean any good or service automatically generates buyers. If that were true, I could get rich selling surfboards at the Continental Point of Inaccessibility in South Dakota (the farthest spot from any ocean in the continental US).

Say himself wrote in *A Treatise on Political Economy*: "[I]t is production which opens a demand for products... Thus the mere circumstance of the creation of one product immediately opens a vent for other products." Essentially, one's ability to produce is the source of demand.

Say's Law means that one's ability to do his or her job enables that person to demand all the goods and services he or she cannot personally produce (also known as "noncompeting" goods and services). Recall Farmer Alfalfa. Because he can grow his own food, he does not demand additional food. Instead, he trades his output for money and then uses the money to purchase goods that do not compete with his own labor.

A more influential criticism comes from John Maynard Keynes. He argued that Say's Law implies market economies cannot experience economy-wide gluts or shortages, because income from production should always be sufficient to purchase what is produced – in other words, that aggregate supply must equal aggregate demand. Critics then point to recessions and depressions as evidence that Say's Law fails.

Economist Steven Horwitz explained why this critique misses the point. Say's Law, he noted, "has nothing to do with an equilibrium between aggregate supply and aggregate demand." Instead, it describes how production generates income, which then becomes demand. As each worker becomes employed, Horwitz explained, he or she can purchase goods and services from other noncompeting producers, creating opportunities for their employment as well.

Farmer Alfalfa's ability to grow and sell food allows him to demand the goods produced by others. Those workers, in turn, can demand food and other noncompeting goods and services. Production, not consumption, drives the process.

Horwitz also noted that larger, wealthier communities support greater product variety, specialization, and competition, while smaller, poorer areas face fewer

choices because they produce less. As Busytown becomes more productive – shown by workers reinvesting in their businesses – residents can offer one another a wider range of goods and services.

Money also plays a crucial role in connecting production and demand. The Busytown workers receive money in exchange for their productive actions, and the money serves as an intermediary good facilitating exchange. In a barter economy, if Stitches does not want Farmer Alfalfa's vegetables, no trade can be made. Money makes exchange possible even when preferences do not align.

Savings matter too. When Busytown's workers deposit money in the bank, those funds become available for loans. When people delay consumption, spending power shifts to borrowers, whose purchases replace what savers set aside. So long as savings flow through the banking system, overall spending need not fall.

ECONOMICS IN ORDINARY LIFE

From the little I was able to read about Richard Scarry, he did not appear to have any economic training or particular interest in economics. Yet, intentional or not, Say's Law shines through the ordinary interactions of Busytown residents.

That's the beauty of economics. Its core principles reveal themselves in everyday life. While young children may not grasp the great debates in economics, they can still see through a simple picture book that honest work, currency, and exchange help make communities prosper.

But What About China? A Response to Tariff Advocates

David Hebert
Senior Research Fellow

In a recent *Wall Street Journal* piece, I argued that erratic tariff policy has alienated our allies and that the world is increasingly building trade relationships that don't require American participation. Days later, a Letter to the Editor was published responding to it.

I'll confess that finding so much common ground with someone of Max Meizlish's caliber is both flattering and, given the state of trade policy discourse, genuinely refreshing. We agree on the core argument, we agree on the facts, and we want the same thing: a more secure and prosperous United States. That said, there are differences worth spelling out. I'll go through the letter paragraph by paragraph, which I recognize can look combative, but isn't meant to be.

David Hebert writes that the world is growing tired of the US and "reglobalizing around partners who commit to rules rather than those who wield tariffs like a club" ("Everyone Else Is Trading Without Us," op-ed, Feb. 27). It's a fair observation, but his piece avoids addressing the threat from China.

"Avoid" is a strong word. I didn't "avoid" addressing China because "addressing China" wasn't relevant to the thesis of my piece: that inconsistent, erratic tariff policy and the sudden renegeing on past agreements have alienated our friends.

Meizlish continued, noting the collapse in imports from China — with a crucial caveat.

Recent Commerce Department data adds crucial context. American imports from China collapsed by nearly 30 percent in 2025 while European flows into the US grew. Notwithstanding the real potential of Chinese goods making their way into the US by way of Europe, that looks less like American isolation than the beginnings of a reorientation Washington has been trying to engineer.

It's on the issue of transshipment where I part ways with Meizlish. He acknowledges that transshipment — for example, China routing goods to the United States through Europe — is a real possibility, then quickly moves past it. But this is a serious and well-documented problem, serious enough that the Department of Justice has created a Trade Fraud Task Force.

Transshipment is *incredibly hard* to protect against and enforce. It will almost certainly be fraught with minutiae and judgment calls. If China creates the steel that goes into engine components machined in Germany before ultimately finding their way into a Ford F-150, are those parts subject to Chinese tariff rates or German tariff rates? The answer, like beauty, "lies in the eye of the beholder."

And therein lies the problem: in a world where tariff rates are determined by rules and long-standing relationships, the answer to this question is basically inconsequential for business-minded people. When tariffs are imposed whenever "the White House finds a new grievance," they matter.

My suspicion is that Meizlish agrees with me on the transshipment front and that, if he had a larger word count, he could have elaborated on this. But the printed words give the impression that this is *possible* but *not that big of a deal*. But insofar as transshipment is happening, that's an argument against the efficacy of tariffs to accomplish their stated goals and it should be counted as such.

Moving on, Meizlish points out some of the effects of the tariffs that have actually been implemented. On this, we are in total agreement. But when it comes to what to do moving forward, we differ.

Broad tariffs moved imports away from China without meaningfully closing the overall trade deficit or generating the export growth the administration needs. Finishing the job will require smarter tools — targeted tariffs, trade agreements and investment incentives — not a retreat from economic pressure.

The call for "smart policy" is a classic and technocratic move. The problem is that this argument is completely unfalsifiable. No matter what happens, proponents will always be able to say, "it would have worked if only we had used *smart* policy, instead."

Targeted tariffs and other smart policies, however, aren't some newfangled policy. They've been tried. President Obama did it in 2009 on Chinese tires, and President George W. Bush did it in 2002 on Chinese steel. The results weren't great. Prices rose for American consumers and producers, retaliatory measures from countries around the world followed, and China didn't meaningfully alter their behavior. But you don't have to take my word for it: here's a copy of the 2019 Economic Report of the President, signed by President Trump. From the report itself, "Rather than changing its practices, China announced retaliatory tariffs on US goods." Targeted tariffs, on their own evidence, haven't moved Beijing. If they had, we wouldn't be having this conversation.

"Trade agreements and investment incentives" are genuinely good tools. But for them to be a viable strategy, the US must be seen as a reliable, predictable partner. And unfortunately, the US just is not as trustworthy as we once were, so our ability to make those trade deals or to provide investment incentives has been diminished and other countries are increasingly looking elsewhere.

Hebert also notes that so-called middle powers are expanding trade among themselves. That may be true, but whether it represents a problem depends entirely on if those relations are pulling countries toward Beijing or away from it.

First: it's absolutely true. And Meizlish is correct that the key question is whether these relationships pull countries toward or away from Beijing. The answer depends crucially on what kind of trading partner the rest of the world can expect out of Beijing (as compared to the United States). On this, we don't need to speculate. China ended 2025 with a record \$1.2 trillion trade surplus precisely because, as Canadian Prime Minister Mark Carney pointed out, China is "more predictable" than the US.

Now consider the broader pattern. The Greenland episode, where the US openly discussed annexing the territory of a NATO ally and threatened tariffs against anyone who stood in our way, drew global condemnation. Then, consider what happened with Switzerland just a few weeks ago: in his own words, President Trump "didn't really like the way [Swiss Finance Minister Karin Keller-Sutter] talked to us and so instead of giving her a reduction, I raised [Swiss tariffs] to 39 percent." Finally, remember all the humiliations that Trump launched toward Canada in early 2025. None of this bodes well for the US in terms of generating the stability and predictability that other countries are looking for when signing new trade deals.

The Supreme Court may have struck down the ability of the President to use IEEPA, which is a meaningful check on the President's power going forward. However, it does nothing to erase what the world now knows the US is willing to attempt. Businesses deciding where to locate and who to work with aren't just assessing today's legal situation but its broader views on trade and property. Checks and balances are important, but there are limits to how much comfort they offer to a business underwriting a decades-long capital investment.

Finally, Meizlish argues something must be done about China.

A trading world organized around rules rather than coercion has an obvious antagonist – one whose industrial subsidies and currency manipulation destabilized the system Mr. Hebert wants to restore. Getting the rules-based order right requires naming who the rules are designed to constrain. That shouldn't be too hard.

He's right, it isn't hard: China is a bad actor on the world stage. On this, we are in total agreement.

But the solution to China's nefarious ways does not lie in tariffing Canada, the European Union, Japan, -Mexico, and South Korea. Those countries have been our friends and allies for generations at this point. And they could have easily been the coalition partners we needed to build an effective multilateral response to Beijing. Instead, what we've done over the past year is pick trade fights with every potential ally simultaneously.

The simple fact is that, relative to Beijing, the US looks unpredictable and chaotic. That's a very big problem. The US cannot go it alone against China and get them to change their tune. This isn't because we're "too weak" or anything of the sort, it's because that's not how Chinese diplomacy works. It will take a coalition of willing and enthusiastic partners to accomplish the goals *vis-à-vis* Chinese trade policy that Meizlish and I recognize and share.

It isn't too late to start rebuilding the relationships that have been damaged by the past year of US trade policy, but time is running out. Tariffs have been a rotten deal for the American people. If we don't reverse course now, they'll only make it more difficult for us to accomplish other, important goals.

April 2026

The Year of Adam Smith: Why the Savvy Scotsman Remains So Important

Paul Mueller

Senior Research Fellow

2026 commemorates the 250th anniversary of Adam Smith's great work *An Inquiry into the Nature and Causes of the Wealth of Nations* (often shortened to *The Wealth of Nations*). This book has probably been read more than any other economics book. It has been foundational for the discipline of political economy, and then later the evolving field of economics. Adam Smith was one of the most profound modern thinkers not only because of his contribution to economics, but also because of his contributions in moral theory.

I'll be taking a deep dive into *The Wealth of Nations* this year with twelve monthly essays overviewing the book. I'll supplement that with twelve review essays of papers written about Smith by Nobel Prize-winning economists. This month that will include Smith's three-step plan for prosperity and a review of Ronald Coase's "Adam Smith's View of Man."

In this essay, I want to explain why *The Wealth of Nations* was so important, why it matters today, and what we can glean both from it and from Smith's legacy as moral philosopher, political economist, and one of the more important thinkers in the last 300 years.

Although many consider Adam Smith the "father of economics," there are some detractors. Joseph Schumpeter, for example, once said that "The fact is that the *Wealth of Nations* does not contain a single analytic idea, principle, or method that was entirely new in 1776." And "His very limitations made for success. Had he been more brilliant, he would not have been taken so seriously. Had he dug more deeply... he would not have been understood."

Not particularly charitable words.

Rothbard had an even more scathing assessment: "The problem is that [Smith] originated nothing that was true, and that whatever he originated was wrong." That's just a less clever way of saying: "Your book is both good and original; but the part that is good is not original and the part that is original is not good."

I happen to think Schumpeter and Rothbard stretch credulity in their criticisms of Smith. Sure, he had some mistaken views about the labor theory of value, among other things. Smith drew on a legacy of existing ideas and material for *The Wealth of Nations*. He read many different thinkers. In his day, there was plenty of conversation about just-price theory, specialization of labor, trade and markets, tax policy, and the like.

Smith collated and organized all of this information in a coherent system of political economy. While that might

sound like a simple clerical job, there was a great deal of intellectual work and imagination required to bring all these different elements together. And Smith did have original contributions of his own - most especially the idea of spontaneous order or what he described as an "invisible hand."

The Wealth of Nations explains how economies form organically to serve people's needs. They consist of a huge network of decentralized contributors pursuing their self-interest, yet serving others. This whole system is, to use Adam Ferguson's phrase, "the result of human action but not of human design." Smith points out that: "In civilized society [man] stands at all times in need of the cooperation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." And that "without the assistance and cooperation of many thousands, even the very meanest person in a civilized country could not be provided" for.

What's more, the "division of labour...is not originally the effect of any human wisdom....It is the necessary, though very slow and gradual consequence of a certain propensity in human nature which has in view no such extensive utility."

Smith's political economy created a powerful and novel framework. His work has similarities to the periodic table. Many elements had been discovered over the centuries, but it wasn't until Dmitri Mendeleev noticed similarities and patterns among these elements, and then organized them in the periodic table, that modern chemistry took off.

The power of the periodic table, and what I think is similarly powerful about *The Wealth of Nations*, is that it related already known elements in a new way; in a way that both countered some existing beliefs about the world while also predicting or suggesting future discoveries.

Mendeleev's original periodic table was very incomplete. Yet it allowed him to predict where new elements would fit; elements that hadn't been discovered. He also suggested that some of the current beliefs about existing elements in terms of their atomic weight were actually wrong based on his table. Subsequent research validated the periodic table on both counts - revealing the power of Mendeleev's theory.

Scientists discovered new elements that fit into his table where he said they would. And there were adjustments to the elements that he said were incorrect in their weights. Later measurements and experiments showed

that he was largely right. This meant that the periodic table, as a theoretical organization of reality, had incredible power to describe and explain the world and to relate all of its different elements (pun intended).

Smith does something similar in *The Wealth of Nations*. He relates the division of labor, the size of the market, tax policy, trade policy, competition, how the capital stock grows over time, the way labor is compensated, and the different kinds of incentives and innovations that come about in a commercial society. He talks about the role of money and banking in promoting trade and commerce, as well as what the effects of increasing commerce will be for the average person.

While not exactly creating a grand unifying theory, Smith remains one of the most important economists of all time for his work. Smith had profound insight into where the world was going. His theoretical framing of the economy predicted how the modern world would develop, how industrial economies would grow, and which kinds of countries would be successful, as well as the kinds of policies that would make them successful.

All of this is there in *The Wealth of Nations*. I would be remiss, however, if I didn't mention that not everything Smith talked about was correct. Mendeleev, too, had a few errors in his work. Smith famously subscribed to the labor theory of value, though not exactly in the way Marx would later describe the labor theory of value. Smith describes labor as a *measure* of value rather than as the sole *source* of value.

Yet the labor theory of value turns out to be quite incorrect. The marginal revolution in the 1870s demonstrated that utility was subjective and that economic phenomena should be assessed *on the margin*. One does not simply "value" pizza or water or diamonds. We value an additional piece of pizza, an additional cup of water, and an additional diamond relative to what we already have. Prices are determined *on the margin* through the forces of supply and demand.

An important part of Smith's legacy has been contested recently. Smith famously criticized the mercantilist systems of his time. Mercantilists thought wealth consisted of large stocks of precious metals gained through running a trade surplus with other countries. That mercantilist thinking has been resurgent in the United States in recent years. Advocates of American protectionism argue that Smith, and later David Ricardo, and economists in general, have gotten the issue of trade completely wrong.

Part of the significance of this 250th anniversary of *The Wealth of Nations* will be thinking through whether Smith's theory – his periodic table of political economy, if you will – was wrong or right. Will we see the implications of his theory continue to describe or predict what we see manifest in the economy? Will we find that the advocates of protectionism turn out to be wrong because they contradict the organizing principles of *The Wealth of Nations*?

I think the answers are "yes," but subsequent work and analysis at AIER and elsewhere will show this to be the case (or not) over the coming months and years.

I'm not the first or the best to comment on Adam Smith's ideas and his legacy. Here is a list of famous economists and articles they wrote about Adam Smith:

Ronald Coase - "Adam Smith's View of Man" (1976)

Friedrich Hayek: "Adam Smith's Message in Today's Language" (1976)

James M. Buchanan - "The Justice of Natural Liberty" (1976)

Jacob Viner - "Adam Smith and Laissez Faire" (1927)

Milton Friedman - "Adam Smith's Relevance for 1976" (1976)

George Stigler - "The Successes and Failures of Professor Smith" (1976)

George Stigler - "Smith's Travels on the Ship of State" (1971)

Ronald Coase - "The Wealth of Nations" (1977)

Paul Samuelson - "A Modern Theorist's Vindication of Adam Smith" (1977)

Joseph Stiglitz - "The Invisible Hand and Modern Welfare Economics" (1991)

Vernon L. Smith - "The Two Faces of Adam Smith" (1998)

Amartya Sen - "Adam Smith and the Contemporary World" (2010)

Angus Deaton - "Insights from Adam Smith" (2023)

Daron Acemoglu - "The Wealth and Poverty of Nations" (2024 Nobel Lecture)

April 2026

Interest Rate Caps Keep Coming Back – Bastiat Explained Why They Fail

Nikolai G. Wenzel
Associate Research Fellow

Compare this argument from President Trump on Truth Social, in January 2026, to another (perhaps the same?) made by Pierre Joseph Proudhon in 1849.



Please be informed that we will no longer let the American Public be "ripped off" by Credit Card Companies that are charging Interest Rates of 20 to 30%, and even more, which festered unimpeded during the Sleepy Joe Biden Administration. AFFORDABILITY! Effective January 20, 2026, I, as President of the United States, am calling for a one year cap on Credit Card Interest Rates of 10%. Coincidentally, the January 20th date will coincide with the one year anniversary of the historic and very successful Trump Administration. Thank you for your attention to this matter. MAKE AMERICA GREAT AGAIN! PRESIDENT DONALD J. TRUMP

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Jan 09, 2026, 8:10 PM

I protest against your credit at five per cent, because society is able and ought to give it to me at zero per cent; and, if it refuses to do so, I accuse it, as well as you, of robbery...

- Pierre Joseph Proudhon, Bastiat-Proudhon Letter #5, 1849.

Some arguments, we think, have been won decisively. Logic has forever buried their adversaries. And yet, friends of freedom find themselves defending free speech and the Enlightenment itself (in an age of old socialism and new post-liberalism). I never thought I would have to rediscover the nineteenth-century arguments of Frédéric Bastiat in favor of free trade. But here we are, in an age of tariff wars.

I thought Bastiat would remain a wise portrait looking down on interns and scholars in AIER's library, or perhaps a gem to be shared with my undergraduates as a witty illustration of basic economics. But the politicians are back to their economic sophistry, so I find myself re-reading Bastiat.

On January 10 of this year, President Trump posted a call for credit card interest rate caps of **10 percent**, effective January 20. His announcement was not followed by an executive order, so the cap hasn't been implemented (it would have been interesting to see what presidential authority he claimed, but that's a different story).

Last year, Representative Ocasio-Cortez and Senator Bernie Sanders introduced bills proposing 10-percent caps on credit card interest rates. The bills are stalled in their respective chambers, but President Trump's announcement has revived lobbyist interest in moving the bills forward.

This year, there's another twist. Instead of a national **10 percent** interest rate cap, the Empowering States' Rights to Protect Consumers Act would allow each state to cap interest rates within its borders.

Interest rate caps are a bad idea (as are any price controls). My purpose here is not to explain why (John Phelan does so nicely in his recent column in these pages). Nor is it to explain the difficulties, economic and constitutional, with a hodgepodge of conflicting state-level regulations. Nor is my intention to worry about the effects of such short-sighted interventionism on the most vulnerable Americans.

Instead, I propose to take a walk down memory lane, by returning to the Bastiat-Proudhon debate on interest of 1849-1850.

THE BASTIAT-PROUDHON DEBATE ON INTEREST

The debate took place in the pages of *La Voix du Peuple* ("The People's Voice") between October 1849 and March 1850. It comprises a total of 14 letters.

Pierre Joseph Proudhon (1809-1865) was a French journalist, philosopher, and socialist. Proudhon favored peaceful social revolution, and called for a national bank to extend "free" credit. He is most remembered for coining the phrase "property is theft".

Frédéric Bastiat (1801-1850) was a French lawyer, journalist, and economist. He is most remembered for his series of essays on "what is seen and what is not seen," and his defense of free trade and limited government. A clever writer, Bastiat often used humor, as well as *reductio ad absurdum*, such as when he proposed banning sunlight (through mandatory curtains) to protect the candlemakers, and reducing the trade deficit by sinking ships returning with gold from export sales. He is most remembered for the broken window fallacy. Along with John Locke and FA Hayek, he presides over the learning in AIER's library.

Bastiat argues that interest is compensation - both just and economically sound - for the forgone use of capital, but also for the service rendered by the loan of capital. Proudhon disagrees: capital is returned after the loan period, so any interest is mere exploitation. What is more, interest might once have been necessary to attract capital, but the economy is now sufficiently advanced that it can pool funds in a national bank and provide interest-free loans.

THE ARGUMENT

Bastiat explains that a loan involves two parts (Letter 2): “1. the restoration, intact, at the expiration of the loan, of the object lent; 2. a service to be rendered the lender by the borrower as compensation for the service which the latter has received.”

Capital increases productivity, thus benefiting both the borrower and the economy as a whole. Bastiat argues that tools and capital can't exploit workers, because by the borrowing of tools, the worker can produce much more than he could alone. So even if the lender of the tools claims some share of the greatly increased production, the worker is left better off than he would've been working only with his hands. “And because he surrenders to me, freely and voluntarily, one-twentieth of this *surplus*, you represent me as a tyrant and a robber,” Bastiat asks. “The workingman shall see his labor increase in productivity, humanity shall see the sphere of its opportunities enlarge, and I alone, the producer of these results, must be prohibited from participating in them, even by universal consent!”

Capital, writes Bastiat, “in the form of wheel, gear, rail, waterfall, weight, sail, oar, plough, performs so large a part of the work,” that it should be considered “the friend and benefactor of all, and especially of the suffering classes.” Laborers should celebrate capital, “desire its accumulation, its multiplication, its unlimited diffusion,” because it multiplies the efforts of “nerves and muscles” and increases the value of workers' productive contributions.

Proudhon disagrees. He starts by claiming that the owner of capital wouldn't lend it if he were using it, “does not *deprive* himself,” but “he lends it because he has no use for it himself.” Capital, by this argument, requires labor, and otherwise “this capital, sterile by nature, would remain sterile, whereas, by its loan and the resulting interest, it yields a profit which enables the Capitalist to live without working... a contradictory proposition.”

Bastiat counters that there is, in fact, an opportunity cost to lending, so the lender can command “a compensation for delay,” where the lender has forgone consumption. Interest on capital lent is, he says, “the price of time.” Real-world lending must also be priced to account for the risk of lost principal.

Proudhon then calls for a national bank, which could lend at zero interest. He proposes to finance this bank through a wealth tax. He continues:

a single tax should be established, not on production, circulation, consumption, habitation, etc., but, in accordance with the demands of Justice and the dictates of Economic Science, on the net capital falling to each individual. The Capitalist, losing by taxation as much as or more than he gains by Rent and Interest, would be obliged either to use his property himself or to sell it; economic equilibrium again would be established by this simple and moreover inevitable intervention of the treasury department.

To Proudhon, *any* interest is usury, because society owes him access to capital: “I protest against your credit at five percent, because society is able and ought to give it to me at zero percent; and, if it refuses to do so, I accuse it, as well as you, of robbery; I say that it is an accomplice, an abettor, an organizer of robbery.”

Bastiat counters with simple economic logic. Incentives matter. Without interest, there will be no capital to be lent: “in order that it may exist, it must have an incentive to birth in the prospect of reward offered to the virtues which create it.” Unless, he writes, “the time has come when houses, tools, and provisions spring into existence spontaneously,” then the capitalist is indeed laboring, and to continue to lend, will have to be compensated. If no one lends capital, productivity goes down, and prices go up. Indeed, by forgoing interest, we risk a “return to barbarism, to the time when a thousand days' labor would not have procured a pair of stockings.”

Pretending that lending isn't a necessary and productive activity is “to say that capital ought to vanish from the face of the earth, is to say that Peter, John, and James ought to procure their transportation, their wheat, and their books by the performance of as much labor as would be necessary to produce these things directly, and with no other resource than their hands.” Our escape from subsistence living owes much to what we might today call the Austrian structure of production: “All Capital... is the result of prior Labor, and increases the power of subsequent Labor. Inasmuch as it is the result of prior Labor, he who lends it receives a reward. Inasmuch as it increases the power of subsequent Labor, he who borrows it owes a reward.”

April 2026

INTEREST RATE CAPS FAIL EVERY TIME

Proudhon, in his debate with Bastiat, committed all the sins shared by socialists, from Marx to Zucman. His “economic theory” relies on wishful thinking, attempting to replace laws of economics with lofty sentiments and shoddy logic that falls apart under the simplest scrutiny.

Proudhon hoped his national bank would erase class conflict, despite its being funded by a tax on capital. Markets create spontaneous connections — economic harmonies — while nationalized capital lending would replace those natural balances of capital and labor with political agendas backed by force.

Bastiat’s theoretical foreshadowing is astonishing, but we also have concrete examples of his prescience. The Durbin Amendment to the Dodd-Frank Act of 2010 capped debit card fees. Banks responded by ending free checking account programs and raising account minimums and maintenance fees. The effect, far from increasing affordability, was to push a whopping one million Americans out of the banking system.

Almost two centuries after Bastiat made his case, the principle (and the principal!) remain the same. Interest rate caps were a bad idea then, and they’re a bad idea now, because they ignore the value that lenders contribute economically and make it less attractive to lend. That punishes those who need to borrow, and whose labor would be made wildly more valuable through alliance with capital.

The Student Loan Reckoning Has Arrived

Jeffrey L. Degner
Research Fellow

Millions of Americans are channeling the classic Eagles’ tune “Hotel California” in their experience with student loan debt: “you can check out any time you like, but you can never leave.”

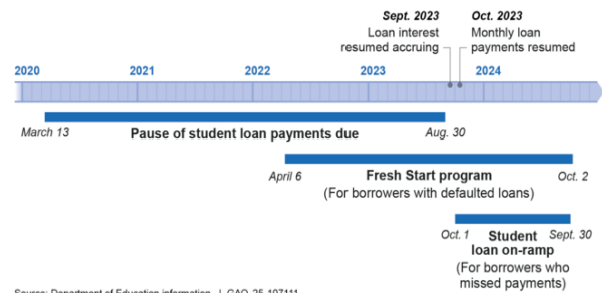
Two emergent trends encapsulate the inescapable trap of student debt repayment. First, the rate of serious delinquencies on student loans is approaching an all-time high. Second, student loan debts are intentionally made nearly impossible to discharge, even in bankruptcy. Despite recent news that some 200,000 borrowers may be seeing significant relief due to misconduct on the part of a handful of schools and lenders, they make up a very slim minority of just **0.4 percent** of all borrowers.

The Federal Reserve’s Quarterly Report on Household Debt and Credit has recently been released, and it’s not a pretty picture. Alongside debt on student loans spiking, seriously delinquent (90+ days late) credit cards have reached levels not seen since the financial crisis. About one in eight credit card accounts is now three months behind. This trend has been rising since 2022, and seems to indicate that households were already beginning to fall behind on their debts, setting the stage for serious delinquencies.

Combine all those factors, higher home and rent prices, greater reliance on credit cards, and increased reliance on longer term car loans (over **20 percent** are now of the 84-month variety), and you wind up with a perfect storm to place additional pressure on student loan repayments. The backlash was waiting to be unleashed after a long period of genuine forbearance, along with an administrative shell-game that hid the seriousness of the fragility of the student loan market.

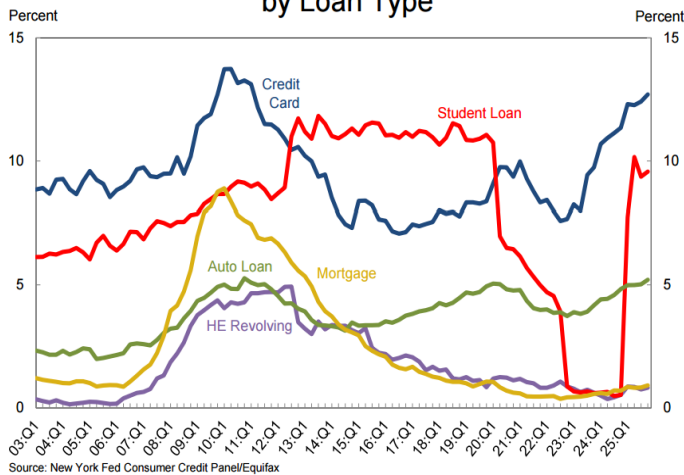
With the passage of the CARES Act in March of 2020, most federal student loan repayment was suspended, with no additional interest paid. Further, collections on defaulted loans were halted. These were supposed to have been temporary measures. Instead, they lasted until October of 2023. And even then, policymakers created a so-called “on-ramp”.

Timeline of Education’s Student Loan Payment Pause and Temporary Relief Options, 2020-2024



Source: Department of Education information. | GAO-25-107111

Percent of Balance 90+ Days Delinquent by Loan Type



Not to be outdone, auto loan serious delinquencies have also been on the rise since the beginning of 2023. Put these factors together, and it seems that the temporary COVID-era relief on student loan repayment didn’t make it any easier for borrowers to pay down their credit cards or car loans. In the meantime, serious delinquencies for mortgages are very low, but this is easily explained. With the ultra-low interest rates that many homeowners have on their mortgages, they stay put longer, overall saleable inventory declines, and home prices remain high despite the relative increase in interest rates since their pandemic-era nadir.

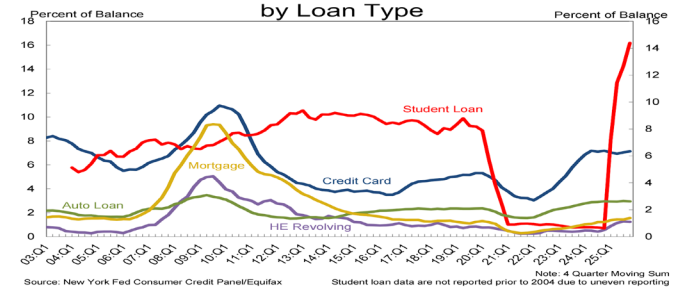
Amazingly, during that timeframe, missed payments were simply not reported. So, by the end of Q4 in 2024, only a paltry **0.7 percent** of student loans (both federal and private) were sliding into serious delinquency. A year later, the real state of affairs became evident. The share of student loan balances that moved into serious delinquency shot up to **16.19 percent**.

Flow into Serious Delinquency (90 days or more delinquent)

| CATEGORY ¹ | Q4 2024 | Q4 2025 |
|----------------------------|--------------|--------------|
| Mortgage Debt | 1.09% | 1.38% |
| Home Equity Line of Credit | 0.56% | 1.24% |
| Student Loan Debt | 0.70% | 16.19% |
| Auto Loan Debt | 2.96% | 2.95% |
| Credit Card Debt | 7.18% | 7.13% |
| Other | 5.63% | 5.13% |
| ALL | 1.70% | 3.26% |

Source: newyorkfed.org

Transition into Serious Delinquency (90+) by Loan Type



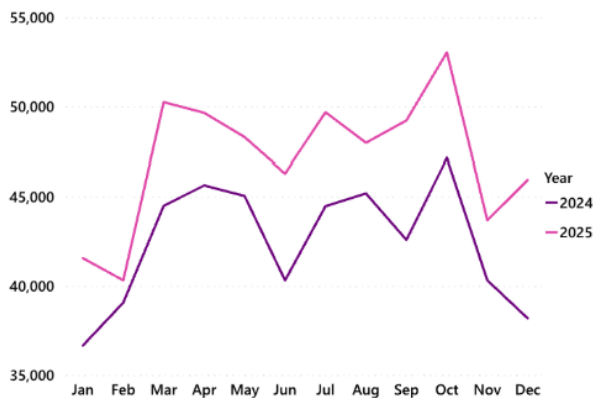
Source: New York Fed Consumer Credit Panel/Equifax. Note: 4 Quarter Moving Sum. Student loan data are not reported prior to 2004 due to uneven reporting.

Of course, no trend lasts forever nor maintains the same pace, but new serious delinquencies in student loans have surged to levels not seen since the Fed began tracking this category in the early 2000s. With both credit card and car loan serious delinquencies on the rise at the same time, increased bankruptcy filings might be anticipated in the months ahead.

In fact, we don't have to prognosticate on the future regarding bankruptcy filings. The American Bankruptcy Institute tracks all filing types, and every month of 2025 saw higher numbers of bankruptcies when compared with 2024. Last year saw a **12 percent** increase in individual filing, coming in at 533,949 compared to 478,752 in 2024. And even within that window, each month of 2025 saw more bankruptcies than the year before.

If the same trend unfolds for 2026, it's clear that the surging student loan crisis will have something to do with it. But here's the problem for these borrowers: unlike many other forms of debt, student loans are the financial equivalent of Hotel California. Once you're in, you can (almost) never get out.

Total Bankruptcy Filings by Month, 2024 vs. 2025



If the same trend unfolds for 2026, it's clear that the surging student loan crisis will have something to do with it. But here's the problem for these borrowers: unlike many other forms of debt, student loans are the financial equivalent of Hotel California. Once you're in, you can (almost) never get out.

Those inclined to look deeper can consult US Bankruptcy Code (Section 523(a)(8)) and the special privileges it gives to the student loan industry. In brief, this provision says that "student loans are not dischargeable unless it would impose 'Undue hardship' on the debtor." How does one prove that they're under undue hardship? In most US Circuit Courts, debtors have to prove to the court that their situation meets the infamous "Brunner Test".

According to this legal standard, the debtor has to prove that:

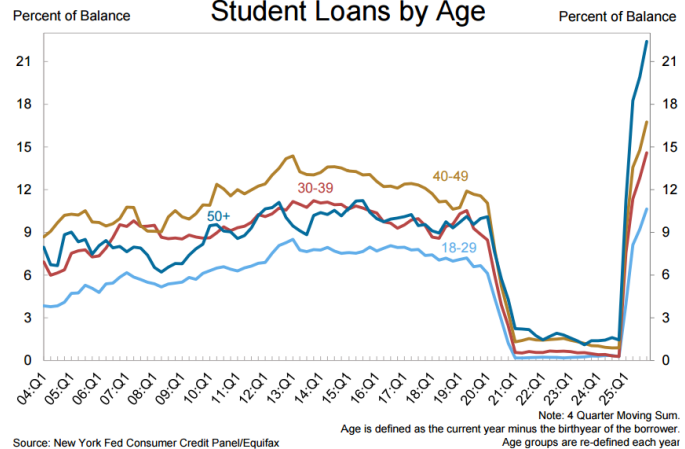
- Repayment creates a hardship that would prevent a minimal standard of living
- The hardship is likely to continue
- The borrower has acted in "good faith" to try to repay

It doesn't take a legal eagle to understand that each of these proof points relies on the subjective decision of a judge. Out of the 13 federal circuit courts, only two (the first and eighth) use what is called the "totality of the circumstances" standard, giving the court much greater latitude to discharge student loan debt. A year after those two courts adopted that standard, nearly every case went in favor of the borrower with some or all of their student loans being wiped away. But those wins were a tiny fraction of the nearly 43 million student loan debtors, who now owe a collective \$1.66 trillion.

What may come as a great surprise to some is the age of borrowers falling farthest behind. For student loans (unlike car or credit cards), older borrowers led the surge in new serious delinquencies. More than **21 percent** of borrowers over age 50 had their loans go 90+ days late at the end of 2025.

While this post certainly isn't a call for loan cancellation, which would represent a massive wealth transfer to those who are already relatively well off, it does represent the chaos that ensues from ongoing government intervention into higher education, and the special privilege granted to lenders that are absent in other debt markets. After all, it's mainly Gen Xers — who could sing every lyric of "Hotel California" by heart — now discovering that, despite their best efforts, this 'dark desert highway' of government intervention has made student loans nearly impossible to escape.

Transition into Serious Delinquency (90+) for Student Loans by Age



April 2026

Worry Spreads in Private Credit Markets

Peter C. Earle
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The near-collapse of London-based Market Financial Solutions (MFS) highlights structural vulnerabilities embedded in today’s private credit ecosystem. Founded in 2006, MFS specialized in complex, property-backed bridging loans — short-duration financing secured by transitional or hard-to-value real estate assets. At its reported peak, the firm’s loan book reached roughly \$3.2 billion. In 2024, it added about \$1.7 billion in new institutional funding and expanded or renegotiated roughly \$1.4 billion in additional credit lines.

On Monday, a Blackstone private credit fund had to raise its repurchase cap to meet nearly \$2 billion in redemptions, highlighting how quickly panic can spread. Major financial institutions were intertwined in the structure: Barclays reportedly had about \$800 million in exposure, Apollo’s Atlas SP Partners around \$500 million, and Jefferies roughly \$130 million.

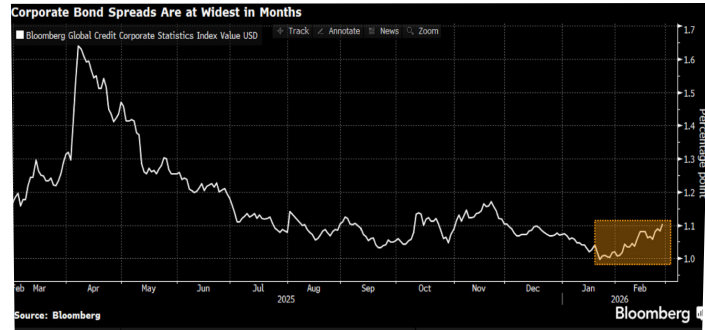
The firm also had ties to Santander and Wells Fargo. When stress emerged, and parts of MFS entered a UK insolvency process, confidence eroded quickly — underscoring the risks that arise when complex collateral, layered leverage, and short-term funding intersect.

This pattern is not accidental. Private credit expanded rapidly after 2008, when tighter capital rules and supervisory pressure pushed large banks away from asset-based lending, real estate bridge loans, and middle-market financing. Nonbank lenders stepped in to fill the void, often relying on funding lines from the very global banks that had reduced direct exposure to those risks.

When liquidity is abundant and asset values rising, the structure appears efficient and resilient. But when funding tightens or underwriting assumptions prove too optimistic, opacity, maturity mismatches, and embedded leverage can surface quickly. Risk may migrate outside the traditional banking perimeter, but it does not disappear.

When parts of MFS entered a UK insolvency process, court filings cited “serious irregularities,” a significant collateral shortfall, alleged diversion of income streams, and possible double pledging of assets. Authorities have not accused anyone of wrongdoing, and the firm maintained the issue stemmed from a procedural banking dispute. Markets — in particular, credit spreads — are reacting sharply, and lenders have moved to reassess exposures.

As early as October 2025, faint indications of duress were seen in funding markets. It is reminiscent of borrowing at the discount window several months before a handful of regional banks, most notably Silicon Valley Bank, became distressed.



The pattern is no longer theoretical. Thrasio’s bankruptcy (Feb 2024) exposed the fragility of acquisition-heavy, private-credit-funded roll-up models. Tricolor’s funding strains followed (Nov-Dec 2024), then First Brands’ alleged collateral double-pledging surfaced (late Jan 2025). More recently, Blue Owl gated withdrawals from a retail credit vehicle (early Feb 2026), and an Apollo-managed BDC (business development company) cut its payout and marked down assets (mid-Feb 2026). None were systemic events, but together they form a cadence.

The private credit markets are not large in relation to other financial markets — estimated at \$2 trillion globally — but contagion is the prevalent concern, especially with markets already spooked about the radically transformative possibilities of artificial intelligence. Credit spreads have widened toward levels seen during prior recession scares. Shares of business development companies — a liquid window into private credit — have been volatile amid redemption pressures and portfolio markdowns. Default rates remain contained. The tension lies not in realized losses but in fragility: when underwriting standards loosen during a boom, even a few surprises can alter perception quickly. As Jamie Dimon has warned, markets tend to rediscover risk in clusters. And while not conclusive, recent spikes in overnight repo usage and in discount window borrowing (primary credit) suggest that liquidity is being tapped more aggressively at the margin — not yet a crisis, but the kind of funding stress tremor that can signal trains beginning to move in the distance.

Overnight repo agreements accepted by the Federal Reserve USD, 2023 - present



In this environment, calls for tighter regulation are inevitable. History suggests that losses in nonbank finance will be followed by demands for expanded oversight, framed in the language of consumer protection and systemic stability. Yet regulation in finance has always had a dual character. It can restrain excess; it can also entrench incumbents. Large, highly regulated banks often benefit when compliance burdens rise, as smaller competitors and independent credit funds struggle to absorb new capital, reporting, and governance requirements. Consolidation can follow under the banner of safety.

From a public choice perspective, this dynamic is unsurprising. Regulators operate within political and bureaucratic incentives; rulemaking is shaped by concentrated interests more effectively than by dispersed borrowers. Regulation can as easily serve as a barrier to entry that protects established institutions as a safeguard for the public (consumers). Austrian economics adds a deeper analytical layer: cycles of credit expansion and malinvestment reflect distorted price signals — in particular, prolonged periods of artificially low interest rates and abundant liquidity — not merely supervisory gaps.

An alternative approach would focus less on expanding prescriptive rules and more on restoring the chastising force of market discipline. Funding structures that promise periodic liquidity while holding illiquid loans should carry explicit gating provisions and buffers that investors clearly understand. Collateral transparency could be improved through independent third-party registries — or tokenization — to reduce the scope for double pledging without micromanaging lending decisions.

Most importantly, losses must remain losses. When investors in private credit funds, BDCs, or warehouse facilities bear the consequences of underwriting errors, pricing adjusts and standards tighten organically. Attempts to soften or socialize those losses, whether through forbearance or implicit guarantees, delay adjustment and encourage the next cycle of excess. Market signals, though painful, are information-rich.

Private credit serves a legitimate economic role. It finances projects and borrowers traditional banks may not serve, which in turn supports development, expansion, and entrepreneurial risk-taking. It should be lost on no one that post-2008 regulatory shifts, including rescuing banks from their own mistakes, paved the way for the rise of private credit. The goal should not be suppression but transparency and aligned risk-sharing rather than regulatory arbitrage. If policymakers respond by expanding complex rulebooks that advantage the largest institutions, they will reduce competition while doing little to prevent future misallocations. A system grounded in transparency, capital at risk, and the discipline of profit and loss offers a more durable path than yet another gormless twist of the regulatory ratchet.

Federal Reserve Discount Window, primary credit activity (millions of USD, 2025 - present)



Inflation Edged Up in February, But Core Price Pressures Ease

Bryan P. Cutsinger
Fellow, Sound Money Project

Inflation ticked up slightly in February, the Bureau of Labor Statistics (BLS) reported in its March release. The Consumer Price Index (CPI) rose **0.3 percent** last month, up from **0.2 percent** in January. On a year-over-year basis, headline inflation was unchanged at **2.4 percent**.

Core inflation, which excludes volatile food and energy prices, rose **0.2 percent** in February, down from **0.3 percent** in January. On a year-over-year basis, core inflation was unchanged at **2.5 percent**.

The uptick in headline CPI reflected rising food and energy prices. Shelter, which accounts for about one-third of the index, rose **0.2 percent** and was, according to the BLS, “the largest factor in the all items monthly increase.” Food prices rose **0.4 percent**, with food at home increasing **0.4 percent** and food away from home rising **0.3 percent**. The index for energy also increased in February, rising **0.6 percent**, driven by a **0.8 percent** increase in gasoline prices. These figures reflect price data collected before the recent spike in oil from the conflict involving Iran and the disruption to shipping through the Strait of Hormuz.

The easing in core CPI reflected a mixed picture across categories. Medical care posted the largest increase among core components, rising **0.5 percent**, followed by apparel, which surged **1.3 percent**. Airline fares rose **1.4 percent**, and household furnishings and operations increased **0.5 percent**. Prices also rose for education.

Offsetting these gains were declining prices for communication, which fell **0.5 percent**, used cars and trucks, which declined **0.4 percent**, and motor vehicle insurance, which fell **0.3 percent**. Personal care also declined. In short, the categories that saw lower prices more than offset those where prices rose, pulling core inflation below its January pace.

While the year-over-year figures continue to show gradual disinflation, the recent three-month trend tells a somewhat different story. Inflation averaged **0.27 percent** per month across December (**0.3 percent**), January (**0.2 percent**), and February (**0.3 percent**), which is equivalent to a roughly **3.2 percent** annual rate. That is well above the year-over-year figure of **2.4 percent**, suggesting that the recent pace of price increases is running hotter than the trailing 12-month average. Part of that gap likely reflects missing housing data resulting from last year’s government shutdown that held down the year-over-year inflation rate.

Recent core CPI data tell a similar story. Core prices rose **0.2 percent** in December, **0.3 percent** in January, and **0.2 percent** in February — an average monthly rise of roughly **0.23 percent**, which is equivalent to a roughly **2.8 percent** annual rate. That’s higher than the year-over-year core figure of **2.5 percent**, meaning core inflation has also been

running somewhat hotter in recent months compared to its year-over-year pace.

Although the Federal Reserve officially targets the personal consumption expenditures price index (PCEPI), the steady February CPI report offers little reason to expect an imminent pivot toward easier policy. According to the CME Group’s FedWatch tool, markets are assigning a **99 percent** probability that the Fed will hold rates steady at its meeting next week. Markets’ expectations that the policy stance remains at least through July were modestly boosted as well.

Even with the real shock to the economy from higher oil prices, policymakers are likely to look past them as a temporary energy spike — especially if longer-run inflation expectations remain well anchored. More relevant for monetary policy is whether overall nominal spending — that is, the total amount of money households and businesses are spending across the economy — is growing at a pace consistent with stable prices. By that standard, the recent inflation data offer an ambiguous signal. While the year-over-year inflation numbers look reassuring, the three-month annualized pace above three percent suggests underlying demand is running somewhat stronger than the trailing 12-month figures imply.

Factoring in the latest labor market data, the picture is more mixed. February’s employment report showed a 92,000 decline in payrolls, a figure some observers have taken as evidence that the labor market is weakening. The unemployment rate held steady at **4.4 percent**, and both the labor force participation rate and the employment-to-population ratio were essentially unchanged. Wages are still rising at roughly a **3.8 percent** annual pace, pointing to continued growth in nominal spending.

Even with a dip in payrolls, those dynamics remain broadly consistent with nominal spending expanding faster than would be needed to keep inflation at the Fed’s two-percent target over time. In that environment, easing policy too quickly could risk reigniting price pressures. For now, patience remains the safer course.

April 2026

Fed Officials Face Diverging Mandates

William J. Luther
Director, Sound Money Project

Inflation ticked down in January, the latest data released Friday from the Bureau of Economic Analysis shows. But it still remains well above the Federal Reserve’s target. The Personal Consumption Expenditures Price Index (PCEPI), which is the Fed’s preferred measure of inflation, grew at an annualized rate of **3.4 percent** in January 2026, down from **4.4 percent** in the last month of 2025. The PCEPI grew at an annualized rate of **3.5 percent** over the prior three months and **2.8 percent** over the prior year.

Core inflation, which excludes volatile food and energy prices, remained elevated. Core PCEPI grew at an annualized rate of **4.5 percent** in January 2026. It grew at an annualized rate of **3.7 percent** over the prior three months and **3.1 percent** over the prior year.

BREAKING IT DOWN

The conventional view is that tariffs have pushed up prices over the last year. If that were the case, we would expect goods prices to grow much faster than services prices. It is easier to import a hat than a haircut, and tariffs will generally cause both foreign and domestic hat producers to raise their prices. Foreign hat producers raise their prices to cover some portion of the tariff. Domestic hat producers raise their prices because they know foreign hat producers will not be able to underbid them given the tariff.

Goods prices grew at an annualized rate of **0.5 percent** in January, and were up **1.3 percent** year-over-year. For comparison, goods prices grew at an average annualized rate of **-0.1 percent** per year over the five-year period just prior to the pandemic. That suggests goods prices have grown about **1.4 percentage points** faster than usual over the last year.

Services prices grew at an annualized rate of **4.6 percent** in January, and have grown **3.5 percent** over the last year. Over the five-year period just prior to the pandemic, services prices grew at an average annualized rate of **2.3 percent** per year. Hence, services prices have grown about **1.2 percentage points** faster than usual over the last year. Moreover, the excess growth of services prices can no longer be explained by the housing component, which tends to lag broader price movements. Housing prices grew **3.2 percent** over the last year, which is around 10 basis points *slower* than observed over the five-year period just prior to the pandemic.

Although goods prices have grown a bit faster than services prices, the difference — just 20 basis points — is relatively small. Recall that headline PCEPI inflation is around 80 basis points above the Fed’s two-percent goal. The available evidence suggests that inflation is relatively widespread. It is not primarily due to the tariffs.

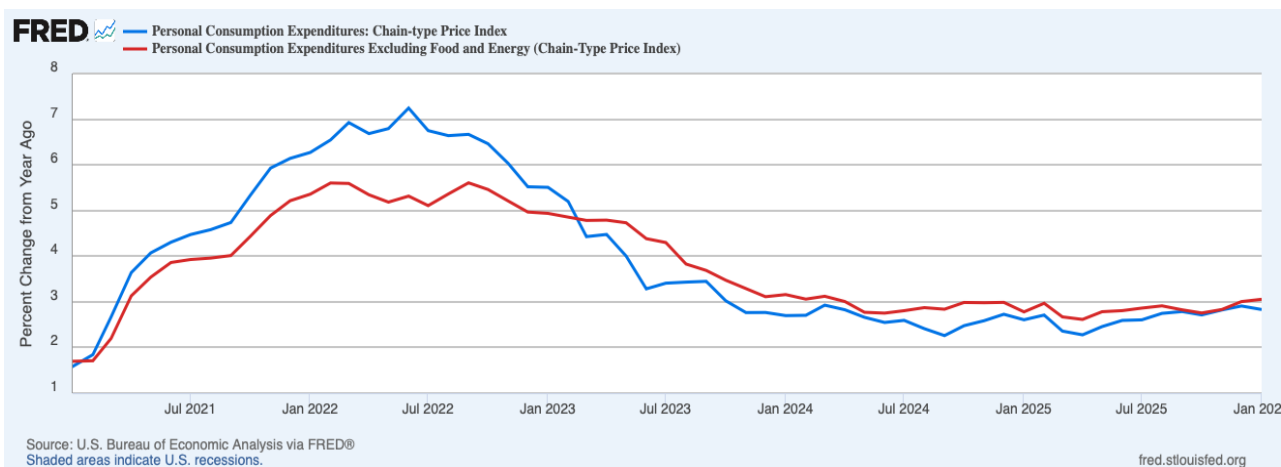
COMPETING OBJECTIVES

Elevated inflation is just one of the concerns Fed officials will be discussing at this week’s Federal Open Market Committee meeting. They are also concerned about the relatively slow job growth observed over the last year.

“There is no dismissing the weakness of job creation in 2025,” Fed Governor Christopher Waller said last month. Data released since then would seem to confirm his fears that the strong January “report may contain more noise than signal.” The economy lost 92,000 jobs in February, nearly wiping out the outsized gains in January.

Congress has tasked the Fed with delivering price stability and maximum employment. But it has largely left it to the Fed to determine what those terms mean and how to balance the two goals when they are in conflict.

Figure 1. Headline and Core Personal Consumption Expenditures Price Index Inflation, January 2021 – January 2026



The Fed explains how it will deal with diverging goals in its 2025 Statement on Longer-Run Goals and Monetary Policy Strategy:

The Committee's employment and inflation objectives are generally complementary. However, if the Committee judges that the objectives are not complementary, it follows a balanced approach in promoting them, taking into account the extent of departures from its goals and the potentially different time horizons over which employment and inflation are projected to return to levels judged consistent with its mandate. The Committee recognizes that employment may at times run above real-time assessments of maximum employment without necessarily creating risks to price stability.

The so-called "balanced approach" would seem to suggest it will place equal weight on the two goals. But the "extent of departures" and "different time horizons" affords a lot of flexibility. And the special attention given to employment in the last line suggests the Fed might put more weight on employment in practice.

WHAT SHOULD BE DONE?

My own view is that the economy is at or near full employment at the moment, with low job growth reflecting demographic changes and increased immigration enforcement. If I am correct, the Fed should not worry about the labor market. Instead, it should focus on getting inflation back down to target. The Iran conflict may complicate the Fed's job, by adding temporary supply-driven inflation (which it should ignore) to the permanent demand-driven inflation seen in the January release (which it should address). If supply-driven inflation emerges, and I suspect it will, the Fed will need to parse the data carefully in order to determine the extent of the inflation problem and, correspondingly, the extent to which it should respond to above-target inflation.

It is highly unlikely that Fed officials will adjust their policy rate on Wednesday. The CME Group currently puts the odds at just **0.9 percent**. But one should pay close attention to what Fed officials signal in their post-meeting statement and what Chair Powell tells the press. That may give us a better sense of how Fed officials are interpreting the incoming data — and what they intend to do about it.



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