# Economic Outlook and Risks to Inflation

## Federal Reserve Bank of New York, Economic Advisory Panel Meeting

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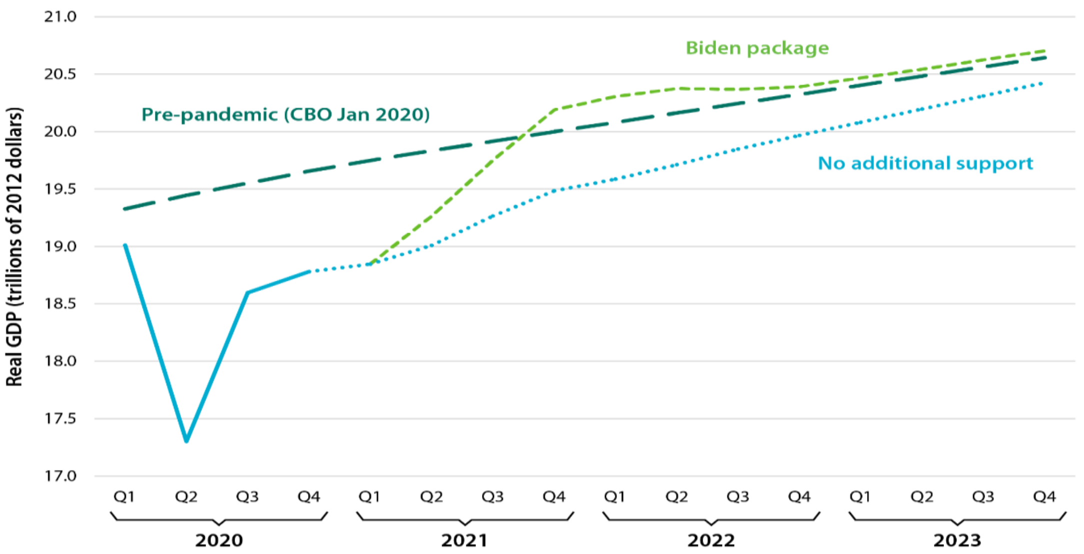
*April 9, 2021*

# Fiscal Tailwinds and a Return to Social Activity Underpin the Outlook for a Robust Recovery

| March Economic Outlook for 2021 | | | | |
|---|---|---|---|---|
| | ***MPP's Shadow Survey*** | ***Blue Chip*** | ***Bloomberg*** | ***FOMC*** |
| **Real GDP (% Q4/Q4)** | **6.3** | **5.7** | **6.0** | **6.5** |
| **Unemployment rate (% Q4 avg)** | **5.0** | **4.5** | **5.0** | **4.5** |
| **Core PCE inflation (% Q4/Q4)** | **1.9** | **2.0*** | **1.9** | **2.2** |
| * *headline* | | | | |

FIGURE 1.

Projections of Real GDP: Biden Package, Path with No Additional Support, and Pre-Pandemic Path (CBO Jan 2020)




Source: Congressional Budget Office January 2020; Bureau of Economic Analysis; authors' calculations.

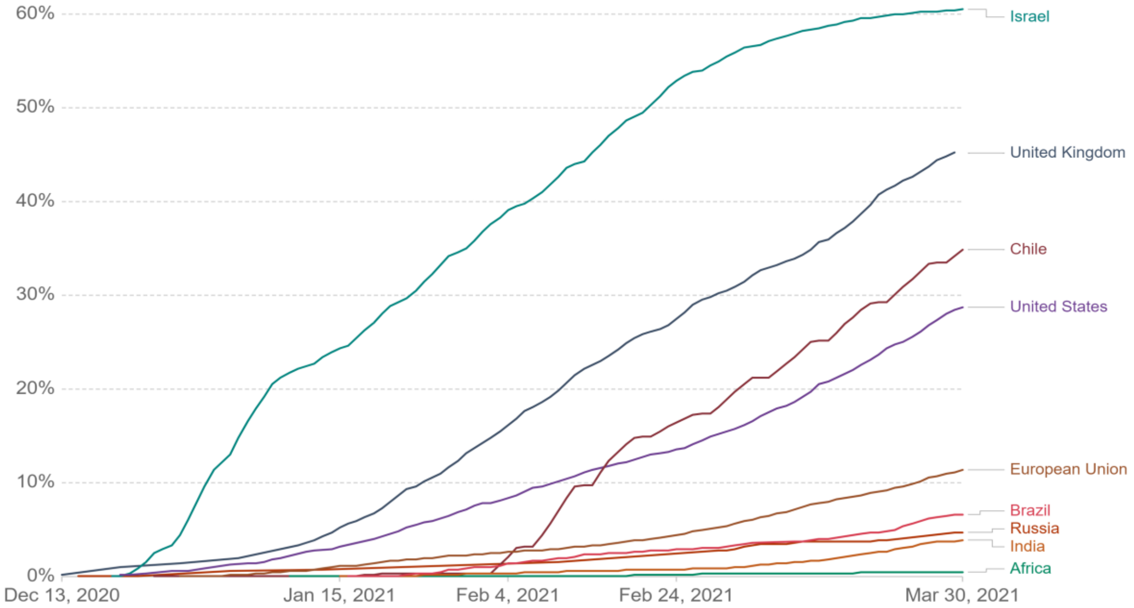
Hutchins Center on Fiscal & Monetary Policy at BROOKINGS

THE HAMILTON PROJECT

Share of people who received at least one dose of COVID-19 vaccine

Share of the total population that received at least one vaccine dose. This may not equal the share that are fully vaccinated if the vaccine requires two doses.

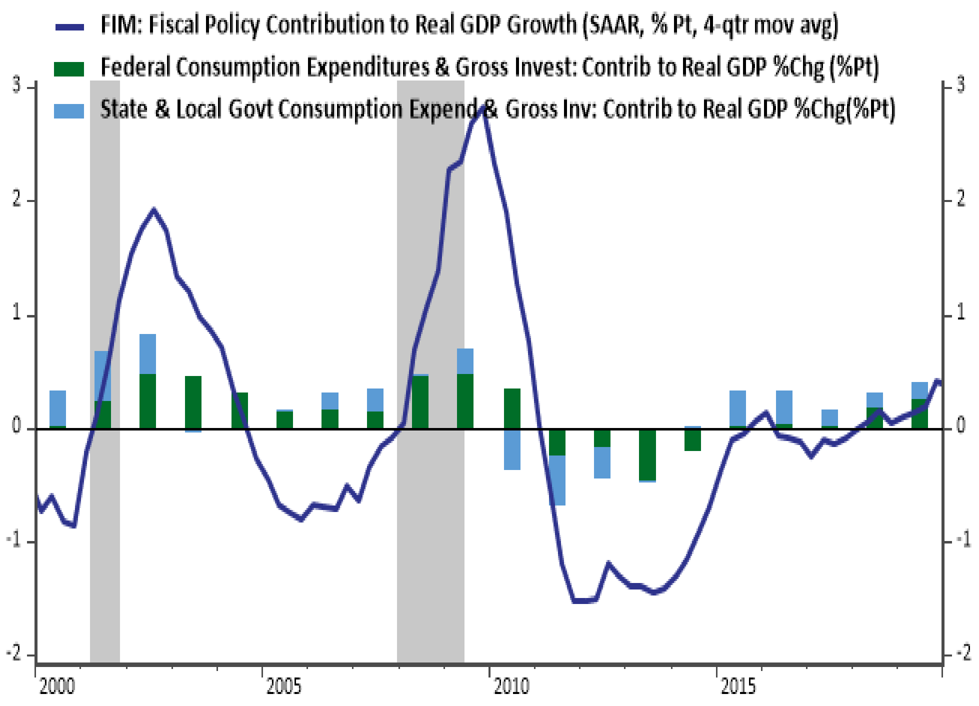
Our World in Data



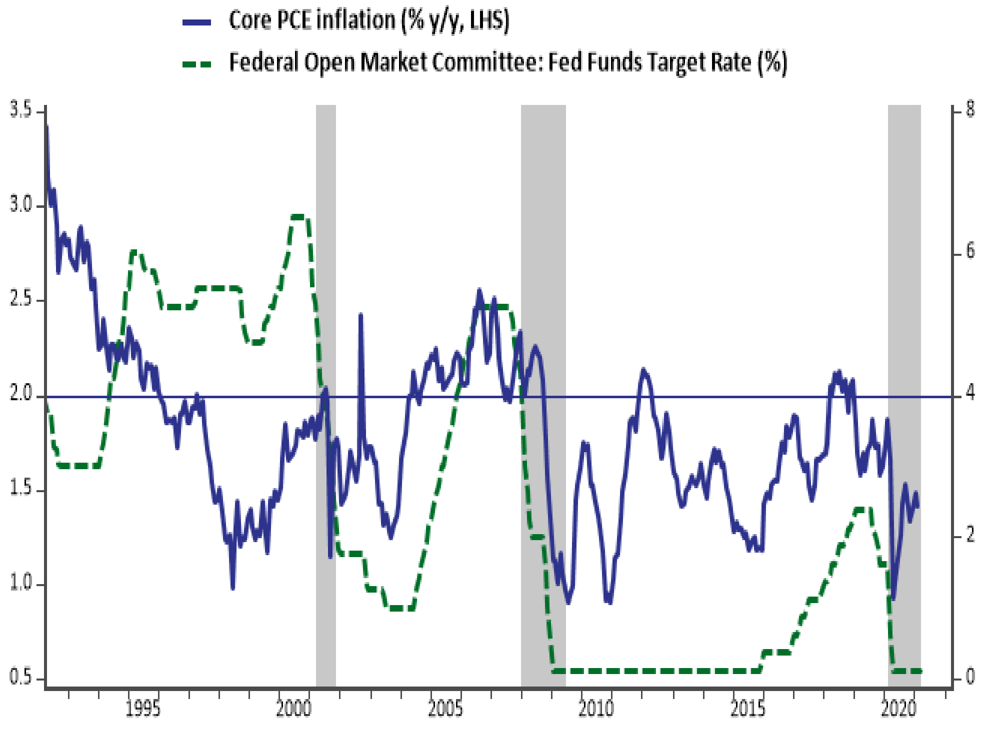

Source: Official data collated by Our World in Data

# What Did We Learn From Last Cycle? Policy Was Too Tight

- Federal fiscal policy was caught in partisan politics and an outdated understanding of deficit tradeoffs
- State and local governments were impacted by the housing bubble bursting
- Monetary policy misjudged slack and inflation dynamics



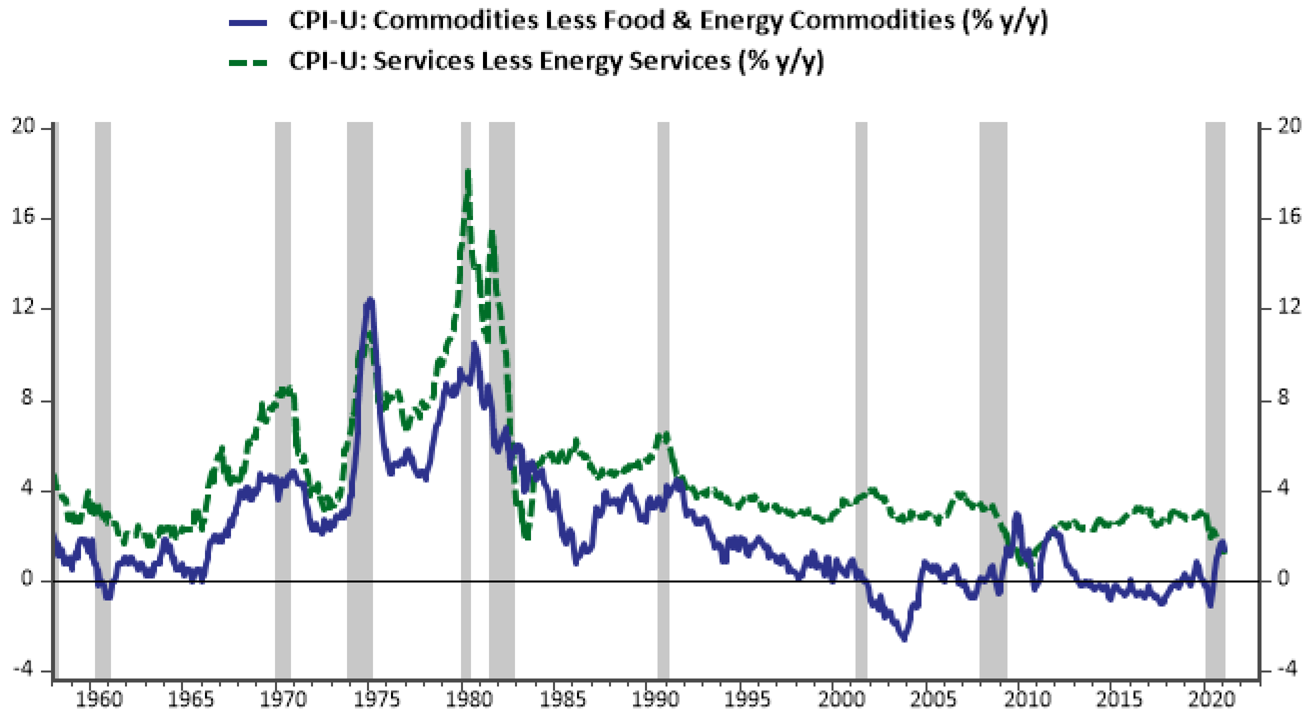

Sources: MacroPolicy Perspectives/HC/BEA, BEA/Haver




Sources: MacroPolicy Perspectives/BEA, FRB/Haver

# New Policy Approach in Action, Will Structural/Secular Forces Restraining Inflation Shift?

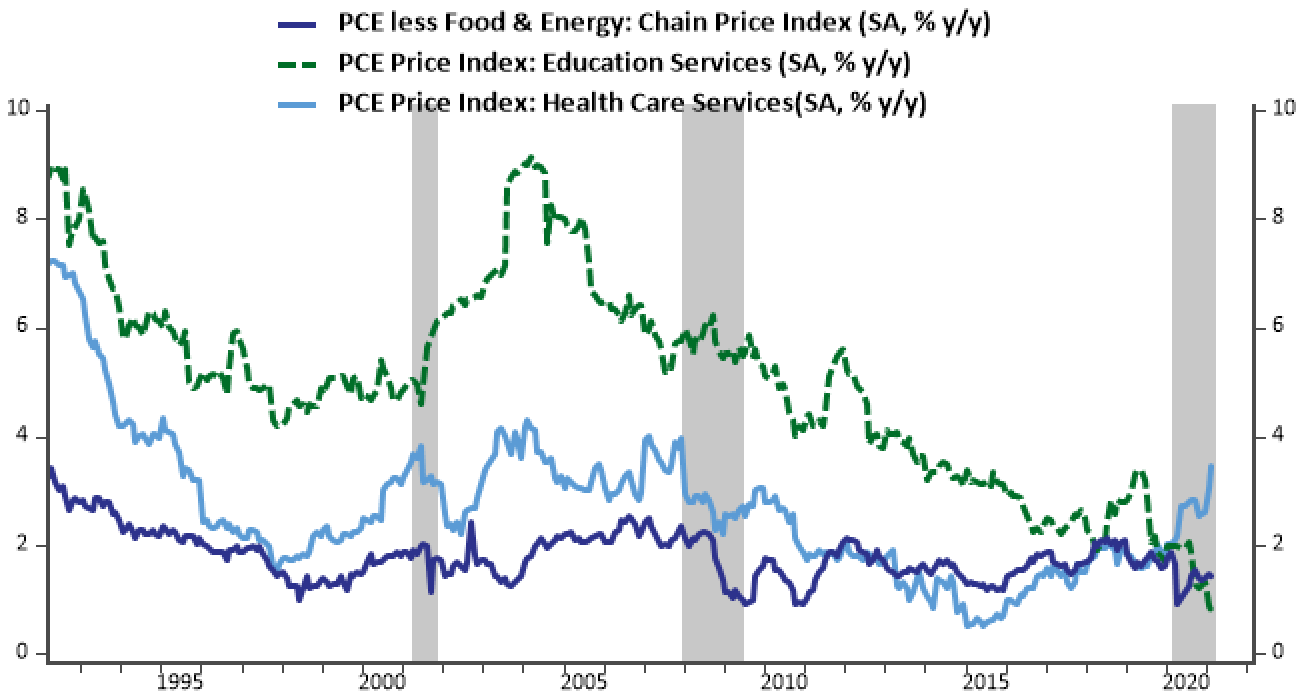
- New approach: go big early on both fiscal and monetary policy—structurally lower inflation and an elastic labor market mean risks from over stimulating in a recession are lower than previously thought
- The Fed moved back to data-based monetary policy from forecast based policy
- Is that enough to change inflation dynamics? Globalization and rapid technological change has depressed goods inflation—technology through quality adjustments + price transparency




Source: MacroPolicyPerspectives/BLS/Haver

# Demographic Forces Restraining Health Care and Education Inflation

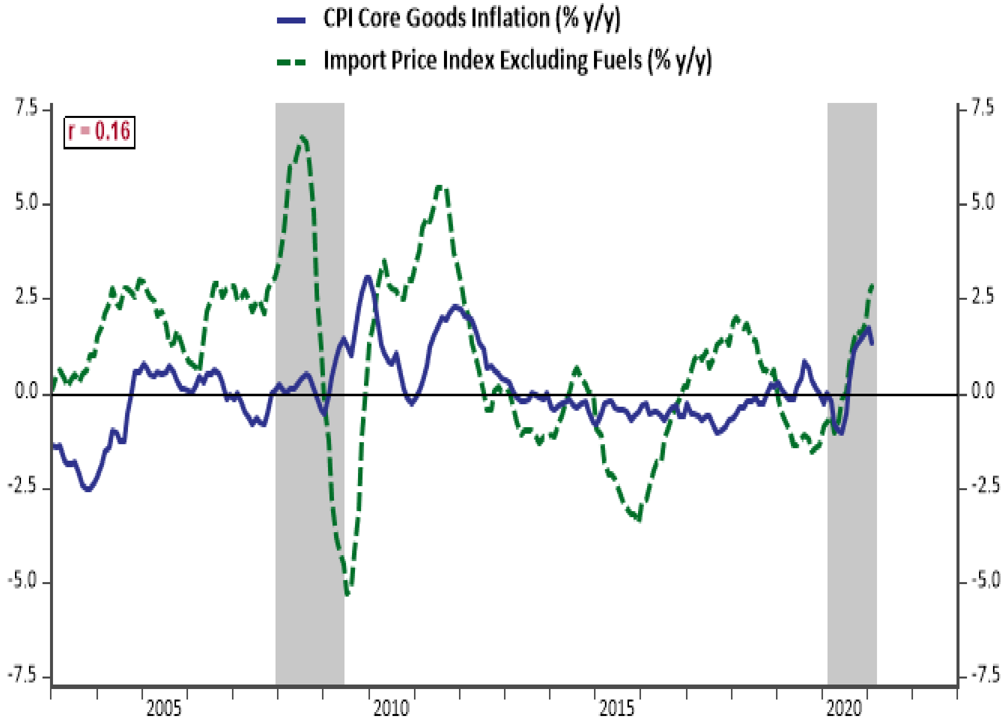
- As the population ages and the public sector becomes a more significant force in the health care market, budget and public pressure push for greater efficiencies. The legislated COVID boost is likely a one off and a number of policy proposals would restrain health care inflation.
- Shrinking cohorts of young people mean the education sector is oversupplied and education inflation has fallen below core inflation.



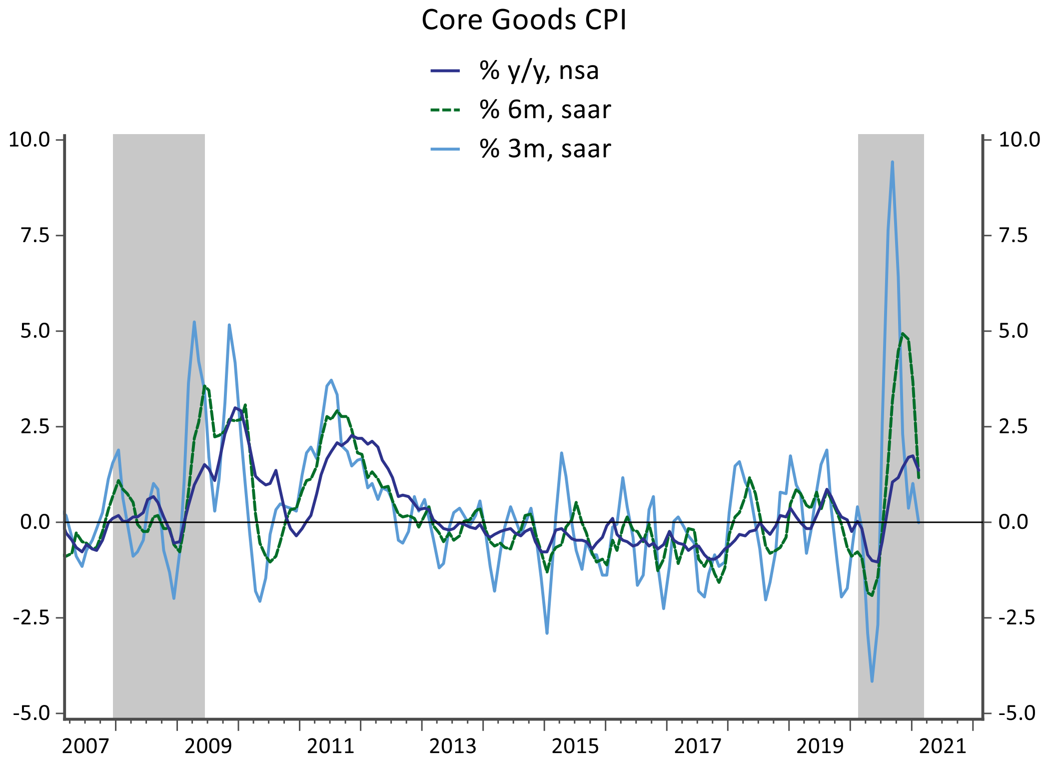

Source: MacroPolicyPerspectives/BEA/Haver

# Muted Pass Through of Supply Chain Pressures

- Former EAP member and now IMF Chief Economist Gita Gopinath presented research here in 2017 and discussed in a recent IMF blog that changes in the exchange rate have limited pass through to US inflation due to dollar invoicing and supply chain pressures tend to be absorbed in profit margins. The pop in core goods prices in 2020 was largely attributable to used car prices amid COVID migrations and is already cooling.



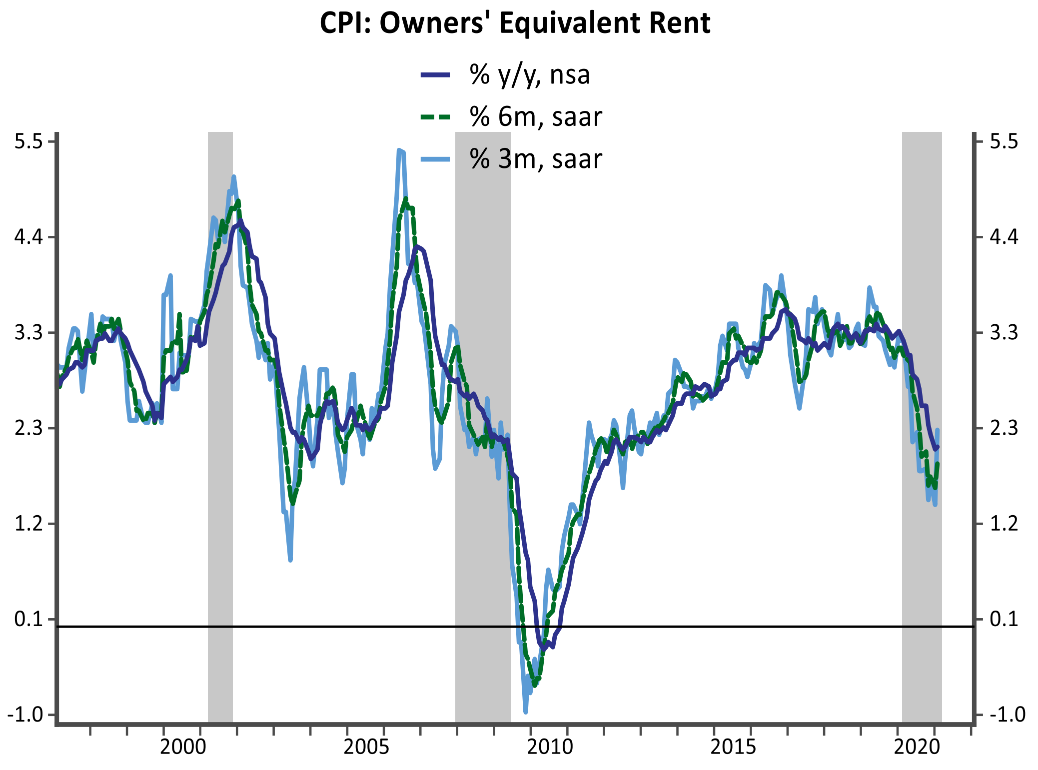

Source: MacroPolicy Perspectives/BLS/Haver




Source: Bureau of Labor Statistics/Haver Analytics

# Shelter Inflation Appears to Be Following a More Normal Cyclical Pattern

- Rent and Owner's Equivalent Rent together are the largest single component of the consumer basket and are slowing in line with prior cycles. We expect a shorter, shallower rent deceleration cycle because of fiscal support, but in the near term it should provide some offset to reopening pops in some service prices.

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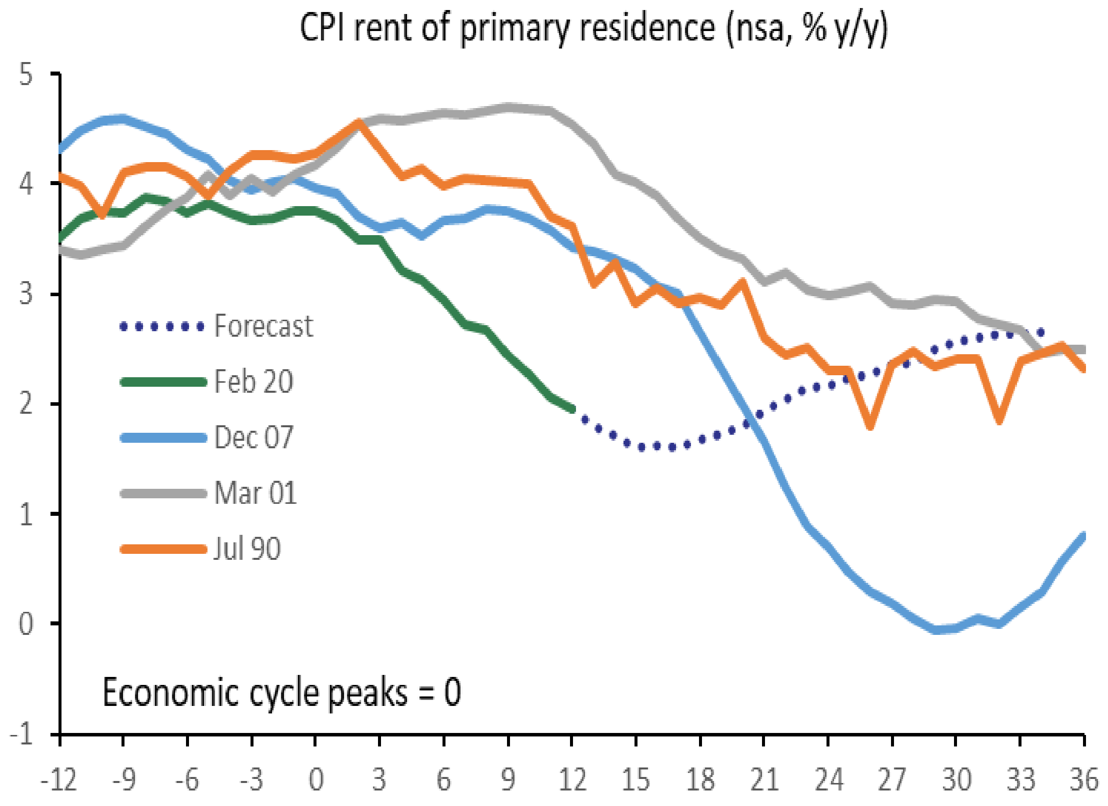
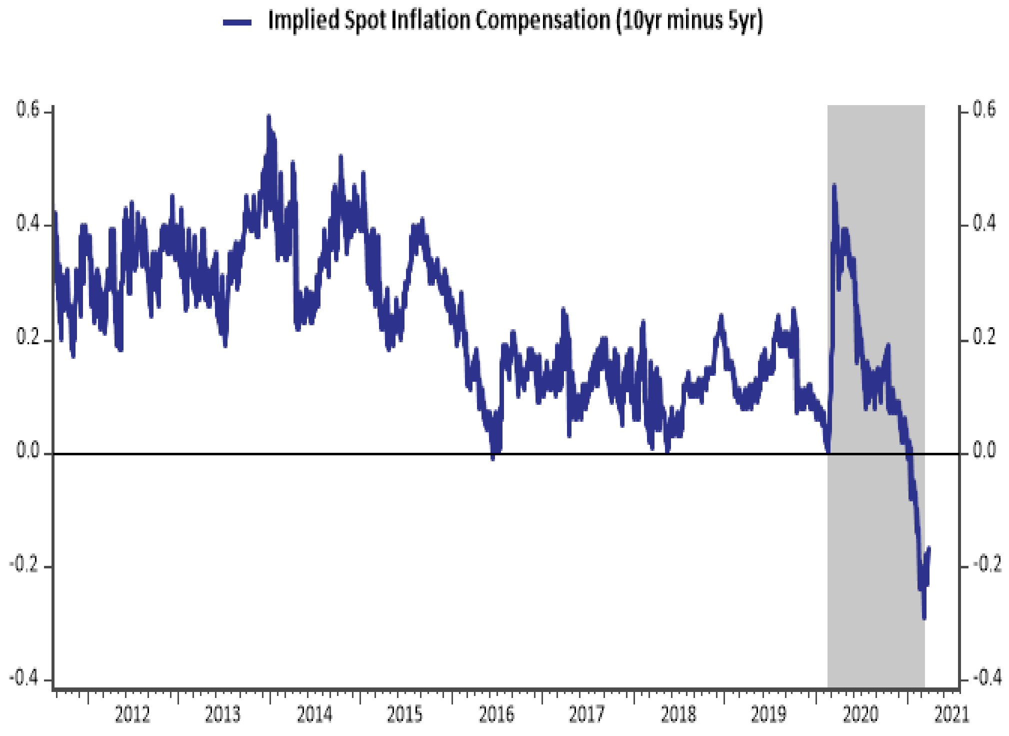


# Inflation Expectations Will be an Important Guide

- Measures of inflation expectations have responded to the policy shift but remain anchored. Inflation compensation in TIPS has responded the most but there are a number of supply/demand factors that may be influencing the recovery above and beyond expected inflation—new inflation investors are buying ETFs focused on the short term where the Fed is also buying while issuance hasn't picked up.

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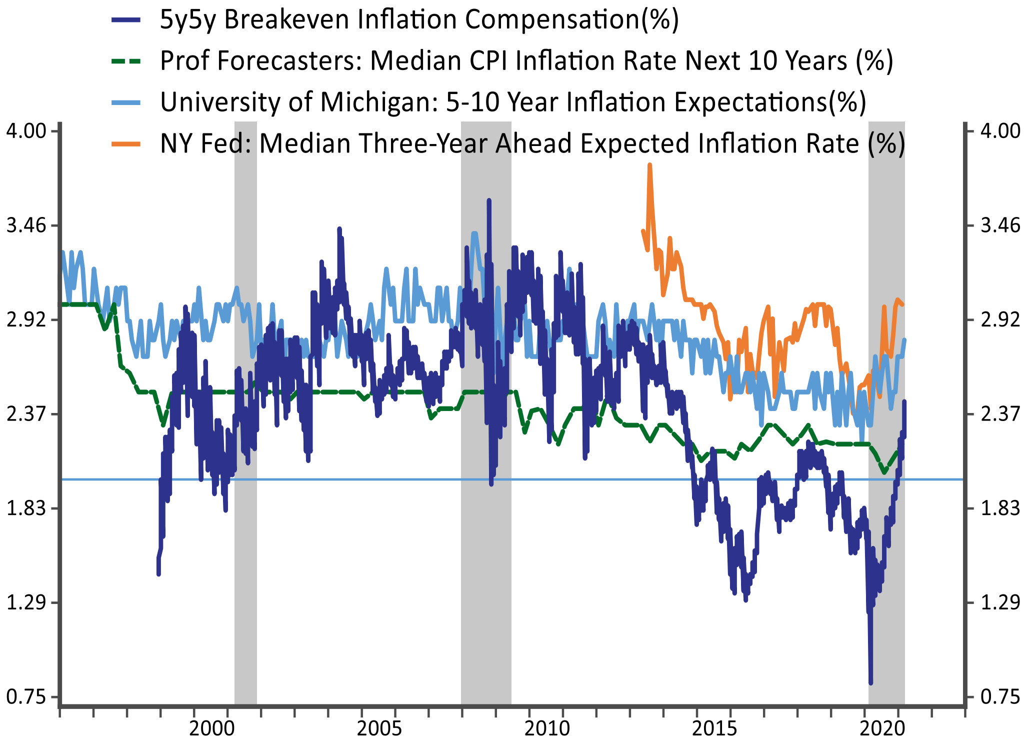
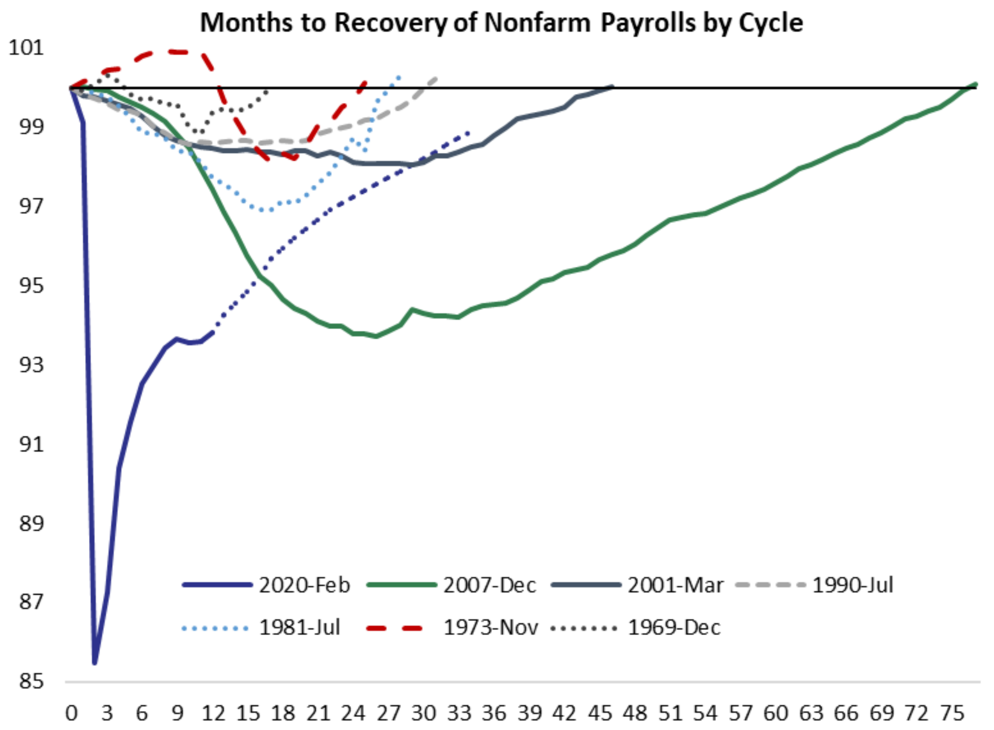
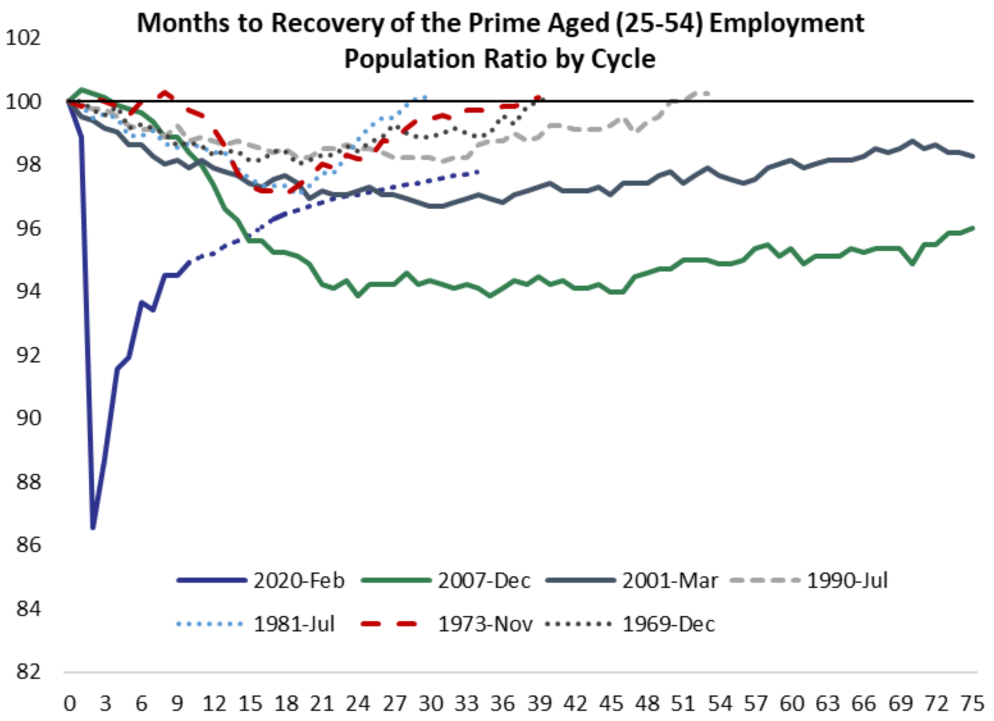



Sources: MacroPolicy Perspectives/FRB, FRBPHI, UMICH, FRBNY/Haver

# The Labor Market Faces a Different Mix of Dynamics

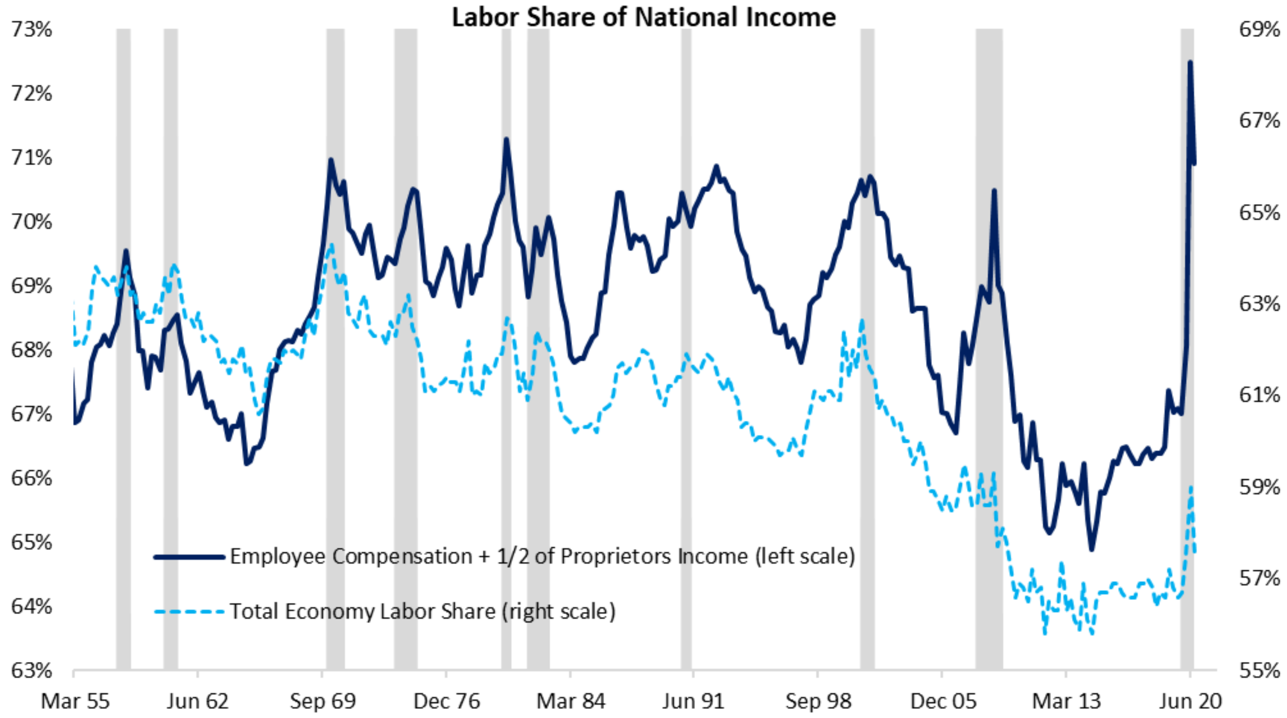
- A service led recovery can rapidly reemploy workers. Technology era cycles feature disruption and longer jobs recoveries, business model change was accelerated by COVID. The net should be a faster recovery of jobs but one whose momentum could slow notably after the initial burst
- Labor force participation tends to be sticky and has recovered late in cycles. School reopenings could provide an early boost.



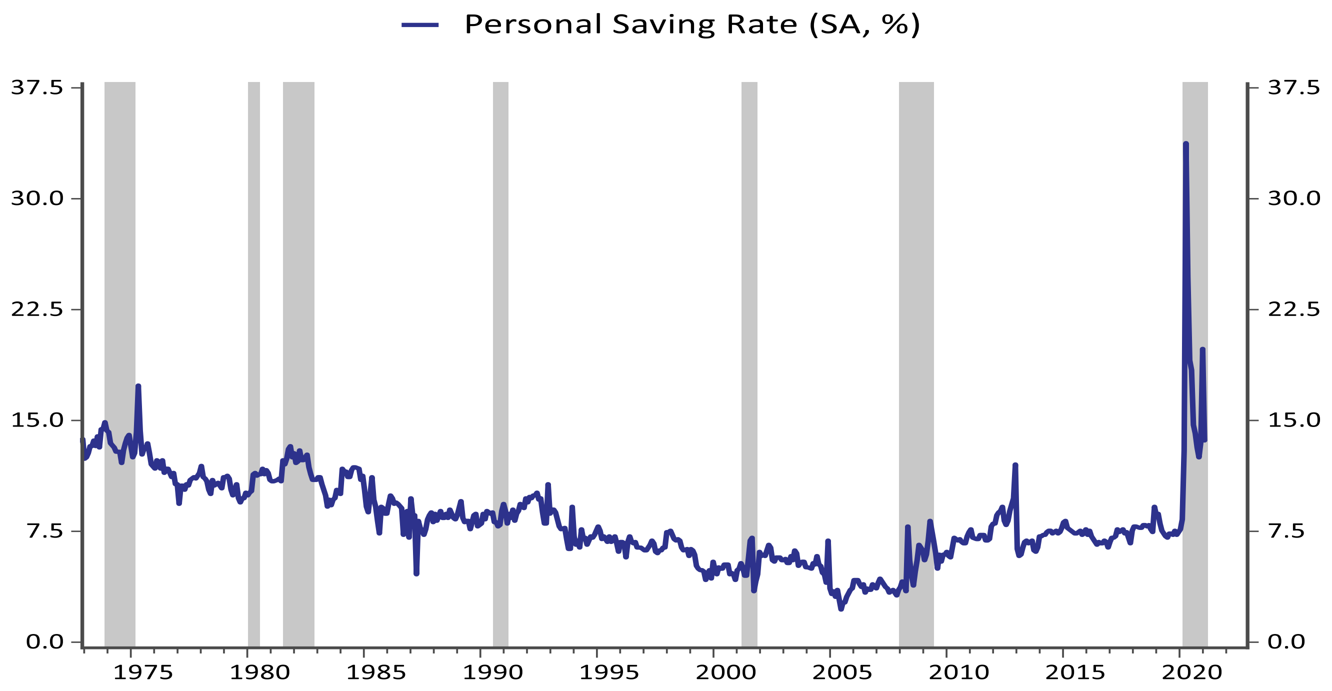
# Declining Economic Security

- Compensation for most workers has not kept pace with productivity in recent decades contributing to increased consumer caution and price sensitivity. Temporary fiscal support is unlikely to change that unless a number of more structural policies follow. Even with a 1960s style policy push to increase economic security and purchasing power for the most vulnerable (minimum wage, permanent expansion of child tax credit, an affordable public option for health care, student loan forgiveness) a shift in inflation dynamics could take a matter of years and could come alongside improved productivity.



# A Word of Caution on Data

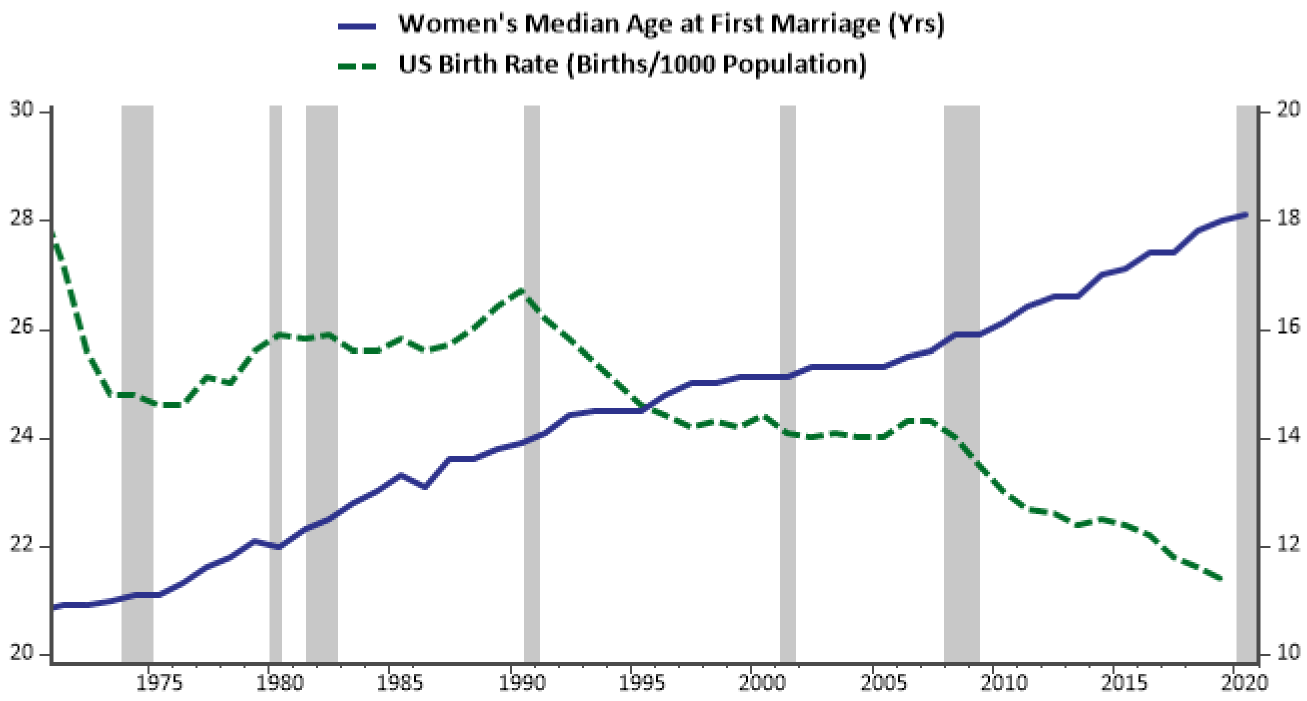
- A wise Board staffer once cautioned me not to pin my forecast for the consumer on a residual of two unbenchmarked series measured with significant error (the personal saving rate). Okun's law correctly flagged a downward revision to GDP in 2011 that changed views and the course of policy and currently suggests the GDP decline in 2020 may be more than twice what is currently measured. The composition of unemployment could explain some of this. Saving is likely elevated but is boosted by one-time payments and some has been deployed into housing down payments and the first cycle with declining consumer delinquencies.




Source: Bureau of Economic Analysis/Haver Analytics

# Conclusions

- The reorientation of fiscal and monetary policy + vaccine progress suggests a faster recovery from the COVID recession.
- While this cycle is also favored by absence of consumer deleveraging, absent greater policy reform structural/secular factors may keep inflation subdued & consumers cautious: globalization, technology disruption, an aging population, an increasingly unequal distribution of income/wealth.
- Key risks include a bad turn in the pandemic, and continued breakdown in democracy, the global order and productive, integrated global commerce and capital flows.




Sources: MacroPolicy Perspectives/CENSUS, NCHS/Haver