Transcript

Cleveland Fed Conversations on Central Banking: Inflation and Monetary Policy: Parallels to and Differences from the 1970s

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Opening remarks:

Dr. Loretta J. Mester, President and CEO, Federal Reserve Bank of Cleveland

Panelists:

M. Ayhan Kose, Chief Economist and Director of the Prospects Group in the Equitable Growth, Finance, and Institutions Practice Group of the World Bank
Athanasios Orphanides, Professor of the Practice of Global Economics and Management at the MIT Sloan School of Management
Julia Coronado, President and Founder, MacroPolicy Perspectives LLC

Moderator:

Neil Irwin, Chief Economic Correspondent, Axios

Chengcheng Jia:

Welcome, everyone, to the Cleveland Fed Conversations on Central Banking series. Thank you all for joining us today. I am Chengcheng Jia with the Cleveland Fed. Today's topic is inflation and the monetary policy, parallels to and differences from the 1970s.

We have an outstanding program today in our usual short format. We will jump into that in just one moment. Before we start, please ensure that you are muted, and your video is off if you are not a presenter. We will hopefully have time for questions at the end, so if you have a question, please put it in the chat box for our moderator to consider. We will turn now to Loretta Mester, president and CEO of the Cleveland Fed for our opening regards. Loretta, the virtual floor is yours.

Loretta Mester:

Thanks, Chengcheng. I also want to thank everyone for joining us for the Cleveland Fed Conversation on Central Banking, and I also want to really express my appreciation to the panelists and the moderator today. I'm really looking forward to this conversation. Of course, this event, or this webinar, is part of the work that we're doing at the Cleveland Fed and our Center for Inflation Research to help researchers, policy makers, and the general public understand inflation better and understand how it impacts the economy and people's lives. I invite everyone who's listening in today to go to our website and look at our Inflation Center's body of work. We have a bunch of inflation measures that the Cleveland Fed is known for, surveys, research analysis. We also run an annual inflation conference joint with the European Central Bank and that, we're happy to say, will take place at the end of September in Cleveland.

So, of course, I don't have to tell anyone listening, inflation is on everybody's mind these days. It's unacceptably high in the United States. It's the number one challenge facing the US macro economy. The FOMC is committed to using our policy tools, to restore price stability and put inflation on the downward trajectory to return to 2%, which is our long run goal, and we've begun to recalibrate our monetary policy to do just that. Now, for many, this is the first experience they're having with high inflation. For others, inflation is now at 40-year highs, and they have likened the situation that we're currently in to the 1970s and early 1980s. So, today's conversation is going to really look at the parallels between our current situation and that of the '70s and our panel of speakers are going to tell us what insights policymakers, businesses, and households should, and just as importantly, should not draw from that earlier experience. So again, I'm really looking forward to the conversation. I'm going to now turn the mic over to Neil Irwin of Axios, who will introduce our panelists and kick things off. Neil?

Neil Irwin:

Thank you so much, President Mester, and thanks for hosting what I expect to be a fantastic discussion. Our topic on inflation and monetary policy, the parallels with the 1970s, it seems sometimes like we've put 15 years of economic history into the last 15 months, between the surging fiscal spending, the rise in inflation, the geopolitical stresses that have exacerbated inflation, and now monetary tightening that's trying to fight it. So, there's been a lot going on in just the last 15 months that have some parallels, and as we'll see, some differences from the '70s.

To discuss them, we have Ayhan Kose. He is chief economist and director of the Prospects Group in the Equitable Growth Finance and Institution's Practice at the World Bank. Among other things, he leads the flagship Global Economic Prospects report. He is also a veteran of the IMF. After we hear from Ayhan, we'll go to Athanasios Orphanides, professor of the Practice of Global Economics and Management at the MIT Sloan School of Management, formerly he was governor of the Central Bank of Cypress, and a member of the Governing Council at the ECB during a highly eventful time. He started his career at the Fed Board of Governors.

And then we'll hear from Julia Coronado. Julia is the founder of Macro Policy Perspectives, an advisory group. She also teaches finance at the McCombs School of Business at the University of Texas. She is also a veteran of the Fed Board of Governors and has worked as an economist at Graham Capital Management, BNP Paribas and Barclays. Ayhan starts off with some perspective on the US inflationary situation.

M. Ayhan Kose:

Thank you, Neil I'm going to show just one slide. So let me share that one. Everyone can see this. So, there are significant parallels between the 1970s and now in the context of inflation and policies, I will focus on these parallels from the perspective of the global economy. As other panelists will discuss the case of the United States. One thing is clear, not just the US economy, but the global economy as well, experience very high inflation rates in the ‘70s as their experiencing now inflation was highly synchronized then, and it is highly synchronized. Now this synchronization was partly driven by large negative supply shocks in the form of sharp increases in oil prices in the 1970s. We now have broader energy and food price shocks as well as persistent disruptions in global supply chains driven by the pandemic related interruptions and the war in Ukraine.

I would like to discuss two major similarities and one major difference between the 1970s and now. My main point is that these two similarities are cause for concern about global growth prospects going forward. But one important similarity is reason to be hopeful that this inflationary period can be managed successfully. So, what are the two major similarities? The first important similarity is that then and now, monetary policy was accommodative prior to the supply shocks I mentioned. With interest rates negative in real terms, as you see in the panel on the left. The experience of the 1970s, in fact, underlines that delay in raising monetary policy rates or reducing monetary growth in the 1970s, ultimately made the required policy adjustment much greater. The necessary policy tightening to contain elevated inflation took place in the early 1980s and played a major role in triggering a global recession in 1982.

The second important similarity is the elevated debt levels of developing economies in these two episodes. As you see here in the middle panel. The 1970s coincided with the surge in debt in developing countries delivered by low global interest rates, as well as the emergence of syndicated loan markets. When central banks in advanced economies and especially the US federal reserve started to forcefully tighten monetary policy in the early 1980s, a series of debt crisis erupted in developing economies, along with the 1982 global recession. During the 2010s, developing economies have experienced the largest, fastest and most broad-based increase in debt over the past 50 years. A number of developing countries are already facing significant challenges because of elevated debt levels.

So, these two similarities should be caused for concerns about another string of debt crisis in developing economies. When global interest rates rise has happened in the early 1980s. However, history does not need to repeat itself.

There is one important difference that should make us optimistic about policy makers' ability to lower inflation without a sharp global downturn. The big difference is that there has been a paradigm shift in monetary policy frameworks since the 1970s. In the 1970s, some central banks switch between competing objectives, including output and employment, as well as for price stability. Almost all developing economies had managed exchange rate regimes that limited their ability to effectively employ monetary policy. In contrast, central banks in advanced economies and many developing economies now have clear mandates for price stability typically expressed as an inflation target. As you see in the right panel over the past three decades, many established a credible track record of achieving their inflation targets, and long-term inflation expectations have remained mostly stable while inflation has risen sharply over the past two years, thanks to these monetary policy frameworks and credibility of central banks.

So, if central banks stick to their mandates, calibrate their policies accordingly and clearly communicate them, they will hopefully succeed in delivering lower inflation without causing a major global economic downturn. Of course, there are some other differences between the '70s and now such as labor market flexibility, lower energy intensity, globalization of trade, which I will not cover here in the interest of time but will be happy to discuss. Let me stop here. Thank you back to you, Neil.

Neil Irwin:

Thank you Ayhan. And thank you for sticking to the five minutes. Athanasios, five minutes. What do we need to know?

Athanasios Orphanides:

Thank you, Neil Irwin. It's a pleasure to be here. Let me thank also the Cleveland Fed and president Loretta J. Mester for the opportunity and really congratulate you for the wonderful job you're doing with the inflation research and dissemination of information. I might share some slides.

I'm going to start to where Ayhan left off by saying that yes, inflation is currently high, and this is one major similarity with the 1970s. But as you can see in this chart, the spike only starts at last year. We're nowhere yet to a sustained high inflation episode. And really the question I had is what policy should do to avoid getting us there. Indeed, if you look at this picture, I would say that in terms of the historical comparison, we're probably closer to the mid-60s where we can see an increase in inflation in the late '60s, second half 1960s. The Federal Reserve did not handle that well at all. And this is how we ended up with inflation in the 1970. We have some similarities. Yes, there was a policy mistake made over the past year in delaying the removal of accommodation that I think was obvious to many, many people, but there is an opportunity to correct this going forward.

Now I'm going to focus on some of the differences and why things are not quite as worrisome as the ‘70s. I see we're still in the situation of like mid-60s, where we can avoid the trouble ahead. And my focus can be just on the US, and I will make just one point in a series of charts. And that one point will be the monetary policy strategy and the focus on inflation expectations. So having this chart is just core inflation.

In the blue line I have the Philadelphia Fed 10-year PCE inflation expectation. You can see them blip here. I will return to this blip later on giving us some concern. Is this episode similar to the ‘70s? No, it's not. To complete this series backwards I actually use the PTR variable from the FRB/US model. This goes back to work that Peter Tinsley and Sharon Kozicki had done to estimate what the survey expectations 10-year horizon would have looked like if they appear and bringing together as much survey information as was available in the ‘70s and ‘80s. There was some survey on inflation and so forth. You can see from this how different this episode is. Yes, inflation has showed up, but inflation expectations have remained relatively well anchored. And the question is, can we make sure that this element here does not deteriorate going forward?

What’s the basis for that? I will actually repeat one very, very important thing from what Ayhan pointed out one big difference relative to what we had in the ‘60s and ‘70s is that the Fed, since 2012, has communicated very clearly then definition of price stability it adopts. 2% inflation. This is very clear. And these are the reasons why it can anchor inflation expectations better. One similarity with the ‘60s and ‘70s, which is unfortunate in my view, is that the Fed doesn't really have a very clear-cut policy strategy. Overall, still does not communicate a rule-like behavior and this is kind of the thing that makes. It is risky going forward.

So, let's focus on inflation expectations. This is a 10 year ahead average, as I mentioned. This is the SPF survey on PCE with interquartile range. You want to see here that in 2012 when the Fed announced the target, it actually managed to anchor inflation expectations, extremely tightly. The interquartile range was really between 1.9 and 2.1%. Really, really remarkable stability. And this, in my view is one of the factors that allowed the fed to ease massively monetary policy and not lose control of the nominal anchor.

So, the question is now, over the past few quarters with this particular measure rising, should we worry? I'm going to argue not yet. And the reason for that is that if we actually look more closely at the survey, the SPF also has a question on five-year average of inflation in the orange line and from the 10 and the five-year one can compute and imply five years forward. You can see that when it comes to professional economists and, Julia, I say this for you, I say this for me, and there are a bunch of other former Fed people that participate in this survey. This shows some trust in the Fed actually staying true to the 2% mandate. Since you see here, the green line is the implied five year forward, five-year average forecast provided by professional forecasters. And it's exactly at 2%. This is exactly 2% in the last three quarters, which is quite remarkable if you look at it like that.

This should not be surprising to those of you who are following markets. If one looks at break given inflation rates, exactly the same analysis, the 10 year, the five year and in the green line, once again, the five by five, we see that financial market participants are not really as concerned about losing the anchor inflation. And I say it well, this is the positive side. The announcement by the Fed that it has a 2% objective and the strategy it pursued over a number of years, all the way until last year I would say, has built up a lot of credibility that has not yet been lost.

The concern is what needs to happen so that that credibility is not lost going forward. And I will actually end with an observation that ties very nicely to president Mester's observation. The Federal Reserve needs to communicate much better how it plans to systematically respond to developments, to bring inflation down, to be consistent with its mandate. And this is not in a way that would only be understood by financial markets and professionals, but in a way that would also be understood better by households. The concern I have at the moment, if I look at the survey of consumer expectations that the New York Fed is putting together three years out, two things have been happening since last year. One is that the median expectations have been drifting up, which is quite worrisome, and the other element is that there is a lot of disagreement among participants in this survey, which means that the public out there is really looking for guidance as to where monetary policy is headed and whether the fed will indeed stay true to 2%.

My view, one of the similarities mistakes was done last year. One of the differences is that the Fed now has communicated that it understands that inflation is a monetary phenomenon. This was in dispute back in the ‘70s. It understands that it has the tools and all it needs to do is systematically tighten policy and communicate that it intends to reach 2% inflation, some better communication about how this will be done, not just in the next couple of meetings. You know, two 50 basis points move is not enough to bring the current episode under control, what is needed is some confidence, some communication on how the Fed would be responding at the end of the year and next year, depending on how developments happen and ensure that the public understands what this is, so that we don't have second round effect in wages and so forth. And let me stop here. Thank you.

Neil Irwin:

Thank you, Athanasios. Julia Coronado.

Julia Coronado:

Right. Thank you. This is two tough acts to follow. So, I'm going to share just a few slides and make a couple of points. So, in terms of the comparisons to the ‘70s, I'm going to sort of echo a lot of the points Athanasios made. It's not the ‘70s, and one of the key reasons it's not the ‘70s is if you look at the composition of inflation. So, this is CPI core goods inflation, and CPI core services inflation. And the point that Athanasios made in was that we really laid the groundwork for the ‘70s and the 60s. You can see that you did have both core goods and services inflation rising very tightly together at the same time throughout the late ‘60s. And then they moved in sync throughout the ‘70s down and up, down and up. And so, it really was a macroeconomic phenomenon, driving inflation and the composition is one illustration of that.

Then we entered a period, not only with central bank targeting, which was Athanasios focus, but also a period of two other major developments, globalization and technology. And what that produced was a delinking of goods and services inflation. So, you can see goods inflation just sort of delinked, systematically declined to very lower, even negative rates, for decades. Starting in the ‘80s, the decline started then, and then it sort of proceeded throughout the next several decades. And then we can see that as the epicenter of the disruption from the pandemic is on the good side. So, it really kind of illustrates that we have seen a massive shock, a historic global shock. It has disrupted the global economy and particularly the global goods economy. If we look at some of the recent dynamics, this is three-, six- and 12-month rates of core goods and core services inflation, going back to the ‘80s. And again, you can see the disruption on the good side is quite pronounced, but we are seeing some signs of progress.

So, there is some improvement in supply chains. We've seen imports pick up via big, huge surge imports in Q1. We've seen auto assemblies pick up and we're seeing the three-month annualized rate of core goods inflation move down. Meanwhile, on the core services side, there's a lot of upward pressure, and this is what the Fed has been responding to since last fall is the broadening of inflation. So, there is clearly not just the structural shock to the goods economy from the pandemic and from the shift in consumer spending. But also, there is a macroeconomic phenomenon here. There's a lot. Policy, both monetary and fiscal were historically accommodative. And both of those are moving in reverse now.

So, we have built up a burgeoning services inflation. It is now sort of on par with what we saw at the early ‘90s, late ‘80s. And that is ultimately what policy is seeking to get at. The good side of the economy is kind of a wild card right now. So, what the two wild cards. One thing that is not a wild card, which is what Athanasios underscored. The Fed is tightening policy. The Fed understands the ‘70s. The message that we just heard from Chair Powell today, and President Mester has reiterated this message herself. The Fed will do what it has to do to cool down inflation. And that might mean restrictive policy. It probably means somewhat restrictive policy. It might mean very restrictive policy. It might mean a soft landing. It might mean a hard landing. But we have a FOMC that is quite focused on this.

This right-hand side chart shows you a couple of metrics of financial conditions. And I think it's important to note that it's not just interest rate policy. It is communication, which leads to forward expectations of interest rates rising quite substantially, and secondly, balance sheet policy. So, there's a balance sheet policy that's been announced. It will be initiated in June, and it is already having an impact in reducing risky asset prices and risk premium across asset classes. So, you can see that accommodative policy made conditions very, very accommodative. These are sort of think of them in terms of standard deviations from normal. So, we had very accommodative financial conditions early in the pandemic as that those policies were put in place. And now we have financial conditions as a headwind. Latest data indicators from this morning showed that the home builders are expecting much less buoyant conditions going ahead. So, we're starting to see the impact of this policy, and it's going to ripple through the economy in over the next six months or so before we can start to see a real impact of this. And the Fed will calibrate accordingly.

That leaves us the two other wild cards, which are, where do we go on globalization and technology? The left-hand side just illustrates one thing that's been a very encouraging development, which is that we are seeing massive investment in innovation and business transformation. We track earnings reports across industries. Companies are reporting that they are working to be more efficient to solve supply chain issues, to use technology, to reduce their labor footprint. And so, there's just no hesitation. In fact, if anything, the pandemic focused energies and attentions and accelerated a number of fronts of digital transformation. That is not a tool that was available to firms in the ‘70s. We simply didn't have these kinds of technology advances that firms could use to very easily transform and improve the efficiencies of their operations. So that's a very encouraging sign.

The bigger unknown is globalization. We know that we're seeing a shifting in the global order. We know that that's going to require a restructuring of global supply chains. I don't believe in deglobalization, but I do believe in re-globalization. There will be some restructuring in supply chains to build in resiliencies, to build in more political security. And so, the question is that a onetime process that raises the relative price of goods. And then we proceed to an inflation regime that looks more like the past. And I think that the Fed is going to pretty much make sure that that happens one way or another.

So, one, I don't think that the comparison to the ‘70s is particularly helpful from either the structure of inflation or from a monetary policy standpoint. I think it's much more relevant for as an inflation forecaster. Fed policy and Fed communication has been the easiest thing to follow. It's very clear. The objective is very clear.

Athanasios would like more clarity on exactly where we end up or what they're satisfied with. I'm less dissatisfied. I think it's very clear that whether we end up at two and a half, three, three and a half, 4% on the funds rate for a time, we're going to do what we need to do. And whether that's a softer or a hard landing. Again, I think that there's a chance of both. But to me, in terms of thinking about structural inflation, trends, and actually really, it gets down to trend growth. How much of a headwind to growth is de-globalization? And to Ayhan's points earlier, how much pain is inflicted on more vulnerable economies from the Fed's tightening is another concern that I think is quite front and center for the next year or so. I'll just stop there.

Neil Irwin:

I'd like to jump off of that and maybe go back to Ayhan. You know, part of the dynamic of the 1970s was that there were a series of shocks and maybe each one you could look at as a onetime shock, but they kind of built on top of each other and created this inflationary psychology. Julia talked about deglobalization, global supply chains changing. We have conflict in Ukraine. Things keep happening that seem to disrupt global supply. How much is there a risk that a bunch of one-time shocks kind of feed into a bad inflation dynamic as this decade proceeds?

M. Ayhan Kose:

Thank you, Neil. I think there is a significant risk. So central bankers can do as much as they can. They can be very clear in their communications. They can tighten the policy, but at the end of the day, you need a little bit of luck in life to be successful. When you think about what happened over the past three years, we had a series of supply shocks that started with the pandemic and then different variants of the virus, and of course the increase in commodity prices. And with the war in Ukraine, those disruptions have been pronounced. And now you have outbreaks in China that are going to weigh on supply chains as well. So, what happened in the 1970s, you had a series of supply disruptions as well, and that's why 1970s experiencing in that sense is informative. And those supply disruptions kept inflation elevated.

So, the big question going forward, whether we will see these supply shocks moderating, or basically away from the global economy and central banks can, in a sense, fight with the inflation without constantly fighting with these new shocks that basically push the inflation up. That has to be seen. I can just talk about our forecast. We expect elevated commodity prices for the foreseeable future. We see significant challenge in the context of energy prices and how those increases in energy prices, especially in natural gas, having an impact on prices of fertilizers, prices of fertilizers having an impact on food prices. And that basically the second-round effects, Athanasios mentioned, could be a challenge to manage down the road. So, I think what you ask in terms of persistent sharks is something we need to monitor carefully but let me stop there.

Neil Irwin:

I'm struck. I've read some old speeches by Arthur Burns the Federal Reserve Chairman in the 1970s. And they made a lot of excuses in that era of all the reasons inflation was somebody else's problem and a fiscal policy challenge. That seems like not the mindset we're hearing from Chair Powell and President Mester in this era. How much is the reaction function and behavior of central banks fundamentally different now than it was during that period?

Athanasios Orphanides:

That's a tough question. Because that's effectively the question I'm asking of the committee to clarify for us. I would say that in the Volcker Greenspan era, the Federal Reserve established a policy strategy framework that was preemptive, somewhat more systematic than it was in the past, and avoided risks of either overheating the economy or rising inflation. That was the framework. This is the framework that I saw the FOMC codified in 2012, adding very, very important innovation of saying, and we have a 2% inflation objective. And I think the committee did quite well with that framework and effectively an implicit policy rule. The difficulty I have answering your question is that since the committee changed this policy strategy in 2020. It has actually deviated from that framework, and they have not yet clarified what they will be doing to address the current challenge.

And let me mention one specific way in which they deviated. I think that's the reason why we got into this mess right now. And this is, that is going forward rather than be symmetric in terms of promoting growth and price stability. In 2020, the FOMC said, well, look, we will actually tolerate an economy that is overheating, and we will only care about shortfalls of employment from maximum employment. So as long as their employment rate keeps going down, which people like you and many others and me would say, hey, what shouldn't you worry about overheating? The committee said, no, no, no, we're not going to worry about overheating. As long as inflation expectations are fine, we will keep policy accommodating and so forth. As a result of this change in strategy, the Fed was not as preemptive as it was in the past.

So, what I see in the last couple of meetings is the recognition that this has not worked very well. Now, committee members have not yet told us that they are knowledge that this has not worked very well. They have not told us if they will adopt something else. But I see that in the last two FOMC meetings, the behavior has changed somewhat. My hope is that the behavior would return to what the 2012 framework had and be even more systematic than it was at the time. So right now. And actually, I want to comment on something Julia said earlier on, nobody knows what the end point on the Fed Funds rate is going to be. It could be three, it could be six, it could be 10. I would worry a lot about if it were 10, but you know, cannot rule anything out. This is how certain we are.

What would be useful to know is how the Federal Reserve will respond with policy if inflation stays unexpectedly higher than two for a couple more years. Will they actually have the courage to do what Paul Volcker ended up having to do, even take the risk of weakening the economy considerably? The reason I put this out is because as was noted earlier, unless the committee acts decisively to avoid inflation expectations becoming embedded in second round effects, then we will actually have very adverse consequences in two, three, five years from now. Then we will be talking about comparisons with the '70s. Right now, we don't have to worry about these comparisons. If the committee acts in a reasonable way, tighten policy systematically, and communicate what it is doing well.

Neil Irwin:

Thank you. So please, if you have questions for these last few minutes, put them in the chat.

Julia, let's kind of build on that. At the end of your presentation said, soft landing, hard landing, it's hard to say. The key feature of the 1970s inflation was that it took the Volcker recessions to achieve the Volcker disinflation and they were quite severe actually. Is there a pathway out of this that does not involve recession and kind of those channels of monetary policy working in that way?

Julia Coronado:

Sure. I mean, there's multiple pathways out of here that don't involve recession. I think it's early to conclude, that is inevitable. The inflation that we've seen has been much shorter lived. And so, it had brewed for more than a decade before Paul Volcker took interest rates into the double digits. I don't think that's the likely outcome or the most likely scenario. I address something Athanasios just said, I think that the roadmap is fairly clear. What President Mester and Chair Powell and others have been saying is, they're going to go near-term two 50 (basis points increases) but they'll keep going unless there is convincing evidence of moderation in inflation. What is convincing? It's sustained for several months, it's coming alongside a cooling in demand, particularly labor demand and wage growth. It is broad based. And so, I think the roadmap for me is a fed watcher. And this is what I do. It's reasonably clear. The Fed will keep raising interest rates un until inflation starts to moderate.

So that means that whatever lays ahead of us, it's not going to take years and years. This is going to happen relatively quickly. What I will also say is that one of the new words in the lexicon in the last couple of weeks has been pain. It will take some pain. It might take some pain that may be a recession, but it also may just be market pain. I think when I hear the Feds saying it's going to take some pain, or it may take some pain to get inflation down. What they're telling us is, see that tightening in financial conditions? We welcome that. That's good. That's how we're going to get where we want to go. We're not going to just respond and panic every time there is a correction in asset prices. Asset prices went up really far, really fast, reflecting the accommodative policies. Now they're coming down somewhat.

And so, the message I'm hearing is, we're going to let that correction keep going. Rates can go higher, mortgage rates can go higher, equity prices could keep correcting, and the Fed isn't going to step in to stop that the way they have in the past when we were in a lower inflation environment. So, does market pain translate into economic pain? Maybe.

You could see a recession that's more likely popping of the tech bubble where we did see asset price correction, because there was an overvaluation. It did come along with a recession. It was particularly a recession in business investment, which had invested into those higher asset prices. But the recession overall was quite mild. Consumers kept spending the unemployment rate went up, but not particularly high.

So, I think that there's a lot of possible paths. And again, that Volcker recession is one possible path. People also often point to the post World War II inflation, boom and bust, where we did also have supply chain challenges as the economy came out of a World War. We had a surge in fiscal policy support. We had a wave of inflation that came right down, and we proceeded to grow and not experience persistently high inflation. So, I think there's a number of paths forward that are quite possible. Some of them might involve a recession. Some of it might be the shape of that recession is harder to gauge, but it's not a recession that's coming from a buildup of imbalances for years and years and years. So, if it's a matter of cooling off the economy, it could be relatively short lived the way it was in the late 90s.

Neil Irwin:

Thank you. We are basically out of time, but I do want to get at least one question from the audience before we close. Maybe Ayhan. People are talking about concerns of a wage price spiral. How concerned are you about a wage price spiral in this current context?

M. Ayhan Kose:

Just one point, I think that in terms of Fed policy, it is very clear what the Fed will do in the coming months. It'll increase interest rates, and it can reduce inflation, but we should be concerned if it reduces inflation along with a very sharp, you know, contraction in growth. And that will translate into a global recession as it did in early 1980s. So, the Fed has to be very forceful, but at the same time has to execute this policy with finesse. And I think that's what Chair Powell is trying to do. With respect to wage price spiral, we should be worried given how tight labor markets in this country is and how tight labor markets in some other countries. And that tightness has been there for an extended period of time. Even prior to the pandemic. But it has reached to new heights now.

There's another issue I see in the chat. This demographic changes this rapid labor force growth due to population growth and increased participation of women. Of course, to help dampen increases in wages and input costs. Julia alluded to this, the benefits in terms of reducing inflation reap from this process may, however, now be at an inflection point, as the share of working age population is declining in many emerging market economies, the large emerging market economies. So, we will see inflationary pressures because of these structural changes. How those pressures manifest themselves in the short term, it has to be seen. But at least for the moment we need to pay attention to labor market tightness and how that tightness could easily translate into wage price spiral. But let me stop there, Neil,

Neil Irwin:

And I'm afraid with that we are out of time. 40 minutes flies by. Thank you so much to the Federal Reserve Bank of Cleveland, to President Loretta Mester and the staff there, and to our panelists for a wonderful discussion of a topic that is not going away. And I think we'll only become more urgent as we try and understand the dimensions of this inflation and how it might be ended. Thank you everyone.