Transcript
FedTalk: 2022 Economic Outlook
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Presentation

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Guhan Venkatu:

Good afternoon, everybody. And welcome to the first *FedTalk* program for 2022. I'm **Guhan Venkatu**, Group Vice President for Regional Research here at the Federal Reserve Bank of Cleveland. It's my pleasure to kick off the first 2022 *FedTalk*, again the first of 2022, with an economic outlook presentation by **Ellis Tallman**, our Executive Vice President and Director of Research.

As you all know, 2022 sees the country in the third year of the pandemic, but also approaching the second anniversary of the start of the current economic expansion. Ellis will share his analysis of what an array of economic indicators are signaling for the year that's ahead, and perhaps tell us whether we're in for six more weeks of supply chain challenges or not. Sorry, that's my Groundhog Day joke. No more.

All kidding aside, just one note before we begin, this event is being recorded and we will have time for Q&A following Ellis's prepared presentation. Please feel free to add your questions to the chat throughout his remarks. So with that, let me turn the virtual podium over to my colleague, Ellis Tallman. Ellis?

Ellis Tallman:

I would like to also wish everyone a happy Groundhog Day despite the fact that Punxsutawney Phil saw his shadow. With my conversation with you today, I'm actually going to be taking notes as well as giving you my views of what the economic outlook should bear in mind for this year. The outline's going to be this, I'm going to discuss briefly the pandemic-related infections and the economic effects a bit.

Bluntly, the economic recovery has depended on the path of the pandemic. We are responding to the pandemic as opposed to affecting it. It's evolving. Initially, we were hoping for the recovery to be spurred by vaccines as a solution. Now we're seeing it's just part of an evolution.

Next, where are we in terms of the recovery and expansion? Largely we have growth momentum, but we faced a bit of a shock with the spike in the Omicron infections. Then I'll discuss what factors are likely to affect the expansion going forward. And here I'll discuss things like Guhan has already hinted at the supply chain disruptions that we faced, labor market problems, tight labor markets, and I'll highlight what factors are going to affect the next phase of the expansion.

Next, I'll discuss what's driving higher inflation rates that we've been experiencing. And what does this mean for monetary policy? With the higher inflation rates that we've been experiencing, what does this mean for monetary policy? So with that, let me get started. Now here I'm not a health expert, a public health expert. I'm not a historian of pandemics and I don't play one on TV. That said, this chart is clear. We're still in the sharpest upsurge of COVID-19 infections during this pandemic. Hospitals are struggling with capacity. The hospitalizations are at a high. There are substantial costs and economic burdens that are being born and endured.

Like I said, the Federal Open Market Committee (FOMC) statements over the past two years make it clear. The outlook for the economy depends on the path of the virus. Now, the outlook for infections is expected to peak in the next month. And if that takes hold, the surge in Omicron will have what is mainly temporary effects affecting some sectors far more severely than others. And with regard to those sectors, what have we been seeing?

Well, the public-facing sectors have been affected most directly. And here since mid-November your in-person services, spending at restaurants, and air travel have been on the decline. Also visits to movie theaters plummeted in January. And I think that might be an after effect from Spider-Man.

Through late December, many firms were actually reporting rising sales and activity but going into January, and Guhan can attest to this, we've heard more reports of reservation cancellations as the Omicron variant spread. Now, whether the Omicron surge will have longer lived effects remains to be seen as I mentioned.

We are anticipating a decline in infections. And if that comes to fruition, then Omicron will have temporary effects, but notable. And when I say temporary, they can be persistent. Not temporary like last month and it's over. Now, where are we in terms of recovery? Well, I mean, in terms of economic growth, we're in an expansion.

The NBER that determines, that's National Bureau of Economic Research, that determines the timing of recessions and recoveries in the US has announced that the pandemic recession lasted only two months. It was the shortest recession with records going back to the 19th century. But as you can see, it was extremely sharp and the recovery bounce back was fairly sharp as well.

It didn't take the United States that long to surpass the level of gross domestic product (GDP) that we were at right prior to the pandemic. And that's not something that was experienced in other countries around the world. Some of those countries are still trying to re-achieve the level of GDP that they had prior to the pandemic. So the US is doing quite well for that. And the year ended quite strongly.

GDP growth in the fourth quarter was around 7 percent and annual growth for the year was 5.5 percent. Now, that's nice to know where the economy was and how it was performing, but what about the outlook? So the chart offers one set of projections. In the panel to the right, the orange line shows the expected trajectory according to the most recent projections from the summary of economic projections from FOMC participants.

Now, that projection anticipates about 4 percent growth this year, which is fairly strong. And then in the following two years, something closer to 2 percent, which is in 2023 and 2024, which is closer to the trend. Now, I will say that some commercial forecasters are more optimistic, some are less optimistic. And the current quarter is likely to be revised down closer to 2 percent, something akin to what we experienced in the third quarter of last year when Delta affected the economy.

Now, I want to also say that spending has generally been strong among consumers and consumer goods, and that's something that we should keep in mind as we reopen the economy again, more toward services. And I'll get to this about service prices going forward. These are the concerns I think I have about where inflation might go. Now, employment.

This chart says that payroll employment numbers, they look a little bit less impressive than GDP. And that's because we actually have not re-achieved payroll employment levels that we had prior to the pandemic. Now, is that surprising? Well, it's still been pretty good if you look. I mean, we've had in 2021 job growth averaging over 500,000 jobs per month.

Certainly it slowed at the end of the year, but non-farm payroll employment has increased by almost 19 million since April 2020. However, it's still down 3.6 million or 2.6, 2.3 percent from its pre-pandemic February 2020 level. What does this imply? The workforce is down noticeably since the start of the pandemic. And the next slide is important for this perspective.

As you can see in the panel to the left, the national unemployment rate has fallen since the recession ended. At about 4 percent as of December, it is less than a half percentage point above where it was when we entered the pandemic. And at that point, the pandemic, the pre-pandemic unemployment rate was at about its lowest level in 50 years.

So these data alone suggest that the labor market's tight and likely to put upward pressure on wages. At the same time on the right side, the supply of individuals in the workforce is down notably since the start of the pandemic. Now, there's been a lot of speculation about what's keeping people out of the labor force. Could be a lack of childcare, lack of adult care, an increase in retirement, things called the Great Resignation.

At this point, I think it's too soon to tell, and these are really cool quips that get journalists really interesting articles, but we also have the aging of the workforce that was already driving the participation rates down. And it turns out that the current reading of about 62 percent is consistent with pre-pandemic projections, including those from the Fed researchers and the Congressional Budget Office about what labor force participation rates would be.

So here we have a tight labor market and labor supply constraints, no surprise. This leads to upward pressure on wages. And we see in this chart, an upward tilt in each of the wage growth rates measured among these series. Now, there are three series, average hourly earnings, the employment cost index, and a wage tracker that measures the wages of job stairs, those who do not change jobs, at a pace we have not seen for years, all three moving in the same direction.

So why are wage rates rising so much with restrained labor supply and rising labor demand? For workers, wages are being pushed higher. Job openings are at more than 10 million. They remain close to the highest level recorded through the last 20 years. The release yesterday didn't really change that sense. They're 50 percent higher than at the end of the previous expansion.

And there are good things. Wage growth supports continued consumption growth, but it also increases business costs. And we will see each of these elements in the following charts. So one additional factor that supports spending and activity more generally is a notable level of accumulated savings. And this chart I'm going to go through slowly.

Personal incomes as shown in the blue line, have remained high since the start of the pandemic, primarily as a result of generous government assistance, fiscal policy. Aggregate incomes have been well above a simple projection of previous trends, something indicated on the chart with the dotted blue line. At the same time, households consumed less than expected based on pre-pandemic trends as shown in this case by the dotted orange line on the chart.

We know it's likely services. So when you combine the two areas between the dash and solid lines, excess income and foregone consumption, it suggests that households may have accumulated something in the order of an additional $2.5 trillion in savings. For context, that's more than 15 percent of current annual consumption rates. And the additional savings is evident in elevated bank account balances.

In addition, many households have seen increases in their wealth. Home values have appreciated and equity values are up throughout this pandemic. So in one more addition, measures of household debt remain well below what we saw at the time of the Great Recession. All this translates into relatively strong spending now and likely going forward.

And much of this arises from the pandemic, responses to the pandemic, and expectations of a recovery from the pandemic when we re-socialize. So here's one of the pandemic effects that have not been very helpful. Some effects of the pandemic on economic activity have persisted longer than anticipated. And I'll have more to say about persistence in a bit.

Supply disruptions have been a key challenge and concern for many months now. This chart shows recent results from a Census Bureau survey of small businesses. Nationally across all industries, about half of those surveyed reported experiencing some supplier delay or difficulty in the last week, a few weeks ago. A notable increase from the results of firms reporting toward the end of the second quarter.

By industry, these seem most acute among retailers and goods producers. When will these disruptions abate? Okay, so about three quarters of the panel we've talked to suggest that they won't be resolved 'til the second half of 2022 or later. And some contacts suggest that things won't normalize until 2023. This is a lot more persistent than we had anticipated last year.

So, what I presented above, rising costs of goods as a result of shortages, excess demand, input cost increases, along with labor supply shortages relative to labor demand and relative wage increases. They've led to cost increases, and the cost increases then have been passed on to final goods prices leading to increases in measures of inflation.

So here I'm presenting the consumer price index, the core CPI, which is less food and energy, and the median CPI, which is a central tendency measure that's helpful for forecasting and evaluating inflation trends. All are moving higher. Nowcasts of CPI and core CPI also remain high. Those are the dashes that come from the Center for Inflation Research, which I highly recommend you use as a resource for inflation, all things inflation on the Cleveland Fed website.

Now, forecasts from a year ago, I investigated. Commercial as well as other forecasts typically thought that these supply disruptions would be temporary and resolved within the year. Well, we miscalculated. We miscalculated, mea culpa. That includes most economic forecasters. I can give you one person that I would recommend you. He deserves credit. He was forecasting higher inflation. He was correct. His name is Jason Furman.

He's a former counselor of economic advisors for the Obama administration. He deserves some credit, throw him the accolades. He did claim that the amount of fiscal and monetary stimulus that was being addressed to the pandemic was likely to raise inflation. So he was on it. I'm going to go quickly through this. These are measures of inflation expectations that are helpful to monitor how consumers and businesses think inflation will behave over the different time horizons.

These measures can indicate whether inflation is expected to rise or fall, remain stable around the Fed's 2 percent target. Now the recent rise in expectations raises some concern about whether inflation expectations are anchored at the Fed's 2 percent target, but I only say some concern because these series fluctuate a good deal. It's worth watching, but personally, I think these are just things to keep monitoring.

It's not really scary to me. Now, here's probably the most informative slide for inflation. The orange line displays the personal consumption expenditures (PCE) goods inflation, which has risen notably over the past year. If you notice it's largely below zero for much of this time period. However, the rise in services, the blue line, is also worth noting because this typically is a more stable less volatile series than goods inflation, but it's moving in the same direction.

And it's important to investigate whether the services inflation is going to persist. And there may be some good reasons why this is something to be concerned about. Yeah, you might have noticed the number of inflation shorts I've displayed. Inflation has been central for discussions of monetary policy, because inflation is one of the two goals of monetary policy.

Now the red line here is the 2 percent average inflation goal of the Federal Open Market Committee. Now, PCE inflation, that's the blue line, and the green PCE core have risen far above the target starting in early 2021. At that time, it was assumed the relative price adjustments were largely supply driven. That's accurate, but unlikely to persist, which was, of course, inaccurate.

Now, it was also perceived that it was unlikely to spread to other prices in other less directly affected sectors. Now, these two additional measures, I have the trimmed mean PCE and the median PCE. Those two measures are central tendency measures aimed to indicate the movement of the trend in inflation and avoid being driven by large price movements in one or two outlier items.

If you recall, back in the beginning of the inflation spurt, things like used car prices were noted as well. It's focused on very few goods or very few items, but the increase in these two central tendency measures indicates that inflation had spread to other areas. Right now, we are monitoring whether we have a long-lived inflation problem or whether the prediction of supply chain recovery and temporary price increases was not completely wrong.

It was just wrong in its timing. In a sense that was a little joke. But I mean, eventually these supply chain issues may actually run their course. I'm just going to go briefly through financial markets. They've been responding to news on the economy, as well as on the Fed. The stock market has retraced its surge a little bit in January, but the index finished up by over 30 percent, almost 30 percent in 2021.

That's a very strong increase. The bond market, the yields on the 10-year Treasury note have turned up after having hovered around 1.5 percent for quite some time. These yields rose by roughly 30 basis points in just a few days of the year and they're hovering around that 1.8 percent right now. The Fed and Fed policy is the end of this talk, and I've left myself only about five minutes for it. So I'm expecting a lot of questions.

What is this? This is the balance sheet of the Fed. Now in December, the Fed announced it would reduce the balance sheet at a fast, pardon me, reduce the asset purchases at a faster pace than it had previously announced in November. In January, it confirmed that. Asset purchases will end mid-March. As you can see, the beginning of that pandemic, asset purchases increased the Fed balance sheet by $4.5 trillion.

After the January meeting, the FOMC released principles for reducing the size of the Federal Reserve's balance sheet and notably in those principles, the reduction of the balance sheet will not commence until the first fund rate lifts off zero. At the press conference Chair [Jerome] Powell indicated that reducing the size of the balance sheet is under consideration.

That is, the accommodation provided by four and a half trillion in purchases may be scaled back in the near future. Finally, the Summary of Economic Projections (SEPs) are just that, projections, and here the projections are of appropriate monetary policy given the outlook for the economy in the form of real growth employment and inflation.

If the outlook follows the projected path, then appropriate monetary policy may involve increases in the federal funds rate. Given this chart, each dot represents projection of one of the participants in the FOMC with respect to policy. As indicated with the orange arrow, a majority of participants in the December SEPs expected that the federal funds rate will increase by three quarters of a percentage point by the end of 2022.

That's more than 50 basis points above the committee's previous projections in September. Moreover, the federal funds rate futures market appears to have priced in additional increases in the funds rate by the end of the year. The January FOMC statement added the sentence that expressed that it may soon be time.

It may soon be appropriate to raise the target range of the federal funds rate. The SEPs are dependent on the outlook for growth employment and inflation, as I have suggested. And there is some confidence that the Omicron surge will not throw off the expansion. There will be a new set of projections following the March meeting. The question then is what will appropriate monetary policy be at that point? Suspense.

Stay tuned. Though only projections, they are still an important piece of information in the communication of the Fed for monetary policy. So overall summing up within my allotted time, I want to express that the pandemic remains an important element of the economic outlook, at the same time, there's a perception that sequence, the sequence of surges have had some effect on economic growth, but limited the expansion rather than forced a contraction.

I think we have momentum going forward. The economic outlook is strong. Monetary policy is shifting some of its attention toward the removal of monetary policy accommodation that was appropriate for the pandemic at its outset, but appears less appropriate under the current circumstances with rising inflation and a tight labor market.

So with that, I'll just say the outlook looks challenging for the Fed, but it also looks quite promising for economic activity. And with that, Guhan, I'll pass it back to you and let you handle the questions.

Q&A

Guhan Venkatu:

Very good. Thank you, Ellis. And while we're waiting for questions to come in in the chat, I did want to encourage people again to post their questions there. I wanted to begin by asking you about the report this morning from ADP, which showed a decline in jobs according to their payroll processing that they're involved with.

So do you have a reaction to that? Are you concerned about that report? Do you think it changes any of the things with respect to the committee's plans that you walked us through?

Ellis Tallman:

Thank you for that question Guhan. I would say that ADP is useful information. We know that ADP is not necessarily a great indicator of the near-term employment numbers for the monthly labor market report. I also don't want to spend too much time on a monthly labor market report. We know what happened with the surge in Omicron.

We know that where there were recoveries, Omicron set some of those recoveries back. If there is a negative payroll number, it, I think, will not offset the likelihood of infections coming down and we move forward with the recovery, that the employment numbers might be made up within the next several months.

So I'm sort of not surprised that Omicron had such a sharp effect. It could have. At the same time, ADP is suggestive as opposed to predictive of payroll. Does that help?

Guhan Venkatu:

Yeah, very much. And just as you suggested with Omicron, I guess I should ask the question. I mean, is your view what we've sort of been through here in the last month to six weeks is not likely to change where we are in terms of the recovery, the expectations for 2022? In other words, do you think the impact is likely to be limited and I hate to use the term transitory that will eventually work through it fairly quickly?

Ellis Tallman:

So I think Omicron will have sharp and notable effects in the first quarter. It's likely going to reduce the growth rate to somewhere below 2 percent, maybe more sharply than Delta did in the third quarter. At the same time, it does seem to be, if the pandemic analysts are accurate, it might be over more quickly and people will push through it.

I mean, we don't also have a seasonal aspect that once spring comes, I think there will be more activity. There is a sense in which Omicron could have more effect on supply chain. It could endure. It could delay the recovery there a bit, maybe a month, maybe two. That would be unfortunate. It might have a longer-lived effect on inflation rather than if it is short-lived, it might not have this durable effect on employment.

I hope it doesn't have that much of an effect on long-term unemployment. But again, I, I have to... I'm naturally a half-empty kind of guy. I'm usually a bit pessimistic. Helps me get through the disappointments. And how many times have we been disappointed? I'm ready to be surprised by joy.

Guhan Venkatu:

Got you.

Ellis Tallman:

... If it comes out better. I'm keeping an eye on the clock. I think we still have 29 minutes, so I'm not taking too much time on these answers.

Guhan Venkatu:

Not at all, plenty of time. And I actually, there's a question that we just got in the chat on supply chains, which of course, you talked through during the course of your prepared presentation. It's been very much in the news, very much an element of this recovery, the challenges thereof.

So one of the questions was related to the longer term, the likely longer-term implications and whether or not we're starting to see more onshoring or we think that that may happen. Anything that helps companies work through the difficulties that they faced over the last again, year or two? Is it likely to have, in your view, a durable impact on the way supply chains are structured?

Ellis Tallman:

I'd really like to refer to experts on this. My hunch is that there has already been some movement to onshore some supply so that I think there will be some durable effects in that regard. I think also supply chain issues arise also with regard to the labor challenges. And I think going forward, we have to be more creative about how to address labor shortages.

It could come about from firms investing more in automation, but I think still you need labor. And I think we've experienced the period where immigration's been a bit hindered, labor force growth. I mean, there are a number of people who are perhaps unable to participate fully in the economy because of home demands.

These things could have durable effects as well. I mean childcare is a complicated service provision. Healthcare is being taxed. There are many, many durable effects. And I think supply of healthcare is a crucial element as well.

Guhan Venkatu:

I wanted to maybe transition a little bit to the end of your presentation and thinking about the rate outlook, you mentioned the information in the most recent statement about the balance sheet as well.

I guess, how should we think about... I was wondering whether, we've got the tools on our website, whether you can help us kind of think about Taylor Rule-type projections, where we are with policy, how to kind of put these things together, particularly given what we've done with the balance sheet.

Ellis Tallman:

Okay. So I'm very comfortable expressing a lack of complete understanding of the effects of Fed purchases of assets, Treasury, mortgage-backed securities, and the effects on the economy. So given that, I think when that issue arises, it's less clear what the effects are. We have a better sense of what the interest rate effects are.

Taylor Rules have been a useful rule of thumb. There are periods where the Fed deviated notably from Taylor Rules, and critics have pointed at those periods as having Fed deleterious outcomes, say, in the financial markets. I really don't know; there are many facets to monetary policy. These things are elements that are part of what keeps me employed.

So ambiguity is important to bring out there. I remember a Fed participant once made a comment, and I think this is the way I like to express it. That when it comes to monetary policy decisions, reasonable people can disagree. And there are important arguments on, on both sides. And I see a number of questions about low- and moderate-income individuals and communities, how do these fit into monetary policy?

These are crucial questions and they will have effects on what outcomes are chosen by monetary policymakers. So I'm not dismissing the fact that simple Taylor Rules suggest that monetary policy prescriptions from those models are for rates that are higher than not only the Fed, but... And I'm not really blaming the commercial forecasters.

They're trying to forecast what the Fed does. Not necessarily what's proper policy. But I think one of the words that I want to emphasize is that these Taylor Rules are simple rules, and policy is much more complex. So does that help?

Guhan Venkatu:

Yeah, very much.

Ellis Tallman:

Or did I obfuscate?

Guhan Venkatu:

No, not at all. I mean, I think the key point there is, as you say, they're a guide, but different circumstances are going to lead to the committee to do different things and they're going to be taking more on board. Okay, so I wanted to ask you a little bit about Central Bank digital currency.

That was one of the questions that we got prior to the program. So of course, the Fed released a paper. Do you have any thoughts on central bank digital currencies (CBDCs), how we should think about that? I know we're trying to get public comment at the moment.

Ellis Tallman:

I encourage people to read as much about central bank digital currencies, as well as Stablecoin. These are new technologies and Guhan you know that what... So let me draw out a couple of contrast between Guhan and myself. So note Guhan has ear pods. I got old school earphones and a microphone.

Mine's wired, he's wireless. I'm one of those kind of old curmudgeon-y type people who suggest that okay, these technologies are different, but the risks and the transactions that are taking place are kind of old school. It's just on a different platform. That said, I think it's important to research these issues. What is it that a central bank digital currency will do? And it's not just an economic question.

There are questions about privacy and it gets into politics I think. I do want to go to Stablecoin, however, because I think Stablecoin is a tricky thing. And my co-author, Gary Gorton, has written about this. That Stablecoin actually reminds him of free banking prior to the Civil War in the United States where you don't know if the assets that support the Stablecoin are actually sufficient to cover the liabilities implied by Stablecoin, which essentially provides the opportunity for a run.

So there, I think we need at least more investigation, perhaps regulation since it is one of the fastest growing forms of essentially banking. I mean, essentially their bank. I'm sure there are a number of questions coming in Guhan, and you have to juggle to figure out what next to address.

Guhan Venkatu:

I do. We're getting a couple questions in the chat. You addressed a few of them and I'd encourage participants to please continue posting their questions in the chat. I was going to ask you about the rotation of this kind of long-weighted expected rotation.

I think we're still waiting a bit for this rotation away from, say, goods purchases to services. And whether you think that might take some of the pressure off in terms of A, inflation or B, the supply chain challenges that we're still kind of working through.

Ellis Tallman:

So with regard to that rotation, it's been more delayed than most people thought, just like everything else. This does remind me of things from the 90s when there was a perceived asset bubble in Japan and people kept saying in '87, there's a bubble, '88, there's a bubble. By '89 people were going, do you think there's a bubble?

And then boom, it pops. So when that transition occurs, it will take, I assume, some pressure off of good purchases and an increase in services. But really the problem that I foresee is the services in order to survive the period of relatively lower, not stable demand is probably pared down its labor. And if they have to scale up, and services tend to be labor intensive, then we have to face that issue as well.

So there might be an inflation aspect for services as well, even if goods prices come down. And to be honest, that's more like we were used to, if you remember that chart that I showed with goods and services. For about 20 years, goods prices were zero or negative. They were actually declining from global supply and services.

Inflation was fairly stable, a little bit above. But now it's actually increased. So I think when you say, will it take pressure off inflation? It may, but it may just change its form for a bit. And then the question is, is it demand? I mean, this comes down to the real key, is it demand that's causing the price increases or is it really the supply shots alone?

And I think we, at this point, we can't tell and we're monitoring it to see if it is basically the supply. Right now the supply chain issues are still there, so long-winded answer.

Guhan Venkatu:

No, no.

Ellis Tallman:

... To that very central question.

Guhan Venkatu:

Yeah. No, not at all. And I was going to say really you're suggesting there, too, that it kind of is what's happening on the labor market side is critical there as well and whether or not we see more participation rates rise. That could have an impact on services prices as well, as well as some of the supply chain disruptions that are ongoing.

So as you suggest, it's not really just about elevated goods purchases, it's also really at least in part about the ability of firms to get the workers they need to meet that demand. And that's going to be just as true on the services side.

Ellis Tallman:

I think you've put it much more succinctly than I expressed it.

Guhan Venkatu:

Let me transition to something else. I think I'd be remiss if I didn't ask you at least in broad strokes to comment on the gyrations and financial markets in the last month or so.

I mean, how should we think about that? Should we think about it? I mean, how concerned should we be, I guess? Without asking you to say too much.

Ellis Tallman:

Okay. Actually, you don't want my portfolio. I'm a very conservative person, but there is somebody I like to read in the *Wall Street Journal* and his name is Jason Zweig. And Jason Zweig would tell you if you're invested in the stock market, you've got to ignore these gyrations.

And when I say invested in the stock market, I'm not talking about day trading or crowd sourcing or anything. It's like, you've got some savings and you're putting it in the long run for your investment for retirement. And if that's the case, Jason's Zweig suggests just forget about it, because the costs are getting in.

It's easy to get out, but when do you buy in? And what do you do with the money? Do you hold it in cash? I don't know. Essentially, this is recorded. I don't really want this coming out on YouTube. This is where I'm oversharing. Guhan save me.

Guhan Venkatu:

I was going to say, stop, stop.

Ellis Tallman:

I really don't understand this. One thing that just strikes me is how low long-term interest rates have been despite inflation of 6, 7 percent. And one reason might be that financial markets believe that this is a temporary phenomenon. Maybe it's more durable, more persistent than they thought, but it's just one thought. That's all I'll say on that. But that said, the worldwide sovereign debt yields are fairly low.

Guhan Venkatu:

Yeah.

Erika:

Hey, Guhan. We do have one more question in the chat. This is Erika (FedTalk coordinator).

Guhan Venkatu:

Okay.

Erika:

If wage increases have generally been lower than overall inflation, does this mean we should not be looking at the labor market for explanations about inflation, or could it be a story about a mismatch in labor supply?

Ellis Tallman:

Oh, it's certainly a mismatch in labor supply, for sure. And there are people who would argue that the rise in wages is nearly a reflection of inflation as opposed to a pause of inflation. And I'd be comfortable with that articulation as well. It's something to measure. It's something to observe, but they are higher than they had been.

And the question that has been posed, and I think this is an important one is, well, if it's a supply-based temporary increase in inflation, will wage growth rates decline again following the reduction in these supply chain disruptions and the price increases that arose from those disruptions? And I think that remains the question.

The fact that wage gains are below the rate of inflation should tell you that, well, they are still rising, but they're not offsetting the costs of living that that inflation has imposed on you. And honestly, that's the reason why the Fed is so concerned about inflation. There are questions about low- and moderate-income individuals.

I mean, these are individuals who are forced to use what they're paid to pay their expenses. There's very little savings and they're getting hammered. So in terms of inflation affecting, it affects all demographic groups, but those with assets, it's just kind of reducing the gains that they have. Whereas those that are really stretched are much more, almost brutally affected by inflation. And so I do want to direct people to the tracktherecovery.org for looking at different income groups and different wage earners and how the recovery has really been dissonant. Some wage earners are back to normal; low-wage earners are still struggling.

And I think this is all part of that concern about why are people not in the labor force and it could be that it just doesn't pay under the circumstances.

Guhan Venkatu:

That's actually a very nice segue to a couple of the questions we've just gotten on the amount of government benefits and the impact on poverty. So you mentioned that there have been pretty generous transfers here over the, again, the course of the last year, 18 months, 24 months. So the question is about the impact of reductions in that support poverty rate.

And then Kyle also asked kind of along the same lines, has the recovery been inclusive? So you've directed people to the tracktherecovery.org website that essentially just kind of thinks about the various groups and sort of their experience with the recovery.

Ellis Tallman:

Okay. So I don't have good answers for these. I'll work backward. The question, has the recovery been inclusive? I think fiscal policy has been supportive. The recovery, its inclusiveness, I want to remain uncommitted at this point. It does not seem to be that way. It may progress.

I mean, one element of this recovery that has been somewhat supportive is that those earning lower wages have had increased wages at a much higher rate, but they're also a smaller component of the wage bill. But I think that's one positive, but is that enough? And then the question about, what's it going to look like when the affected stimulus is dissipated?

Yeah, I think that should be something that has the attention of many people. And I think we have a community development department that Kyle works in, the Program on Economic Inclusion. These are things we want to monitor to know because I think it is clear that even 10 years ago, monetary policy actions were having effects that were different across different demographic and income groups.

We know that. But we didn't know how to gauge it. And in the past 10 years, the amount of information that we get and is available for us to analyze has increased tremendously. So we can monitor those things. It may not alter the policies as much as one might think, but it will at least inform the policymakers of the effects of the decisions that they make more explicitly.

Guhan Venkatu:

I absolutely agree. Kind of along those lines but in a different direction, I also wanted to ask you just your thoughts again, in broad strokes about... So there were reports recently about the size of the government's debt. How should we think about where we are on that? If you would like to comment. If you would like to not comment, that's okay too.

Ellis Tallman:

No, it's okay. This is something I feel very comfortable. So again, over the *Wall Street Journal*, I'm old school. I get it delivered. When I go out on the stoop, pick it up, pull it out of the bag, sit down. The federal debt just hit 30 trillion. The debt increased by about seven and a half trillion.

Much of that increase, the Fed essentially purchased about three, three and a half trillion in Treasury; these are complicated issues going forward. And I think it is important to know that... Oh, so what did we learn from the pandemic? Well, we learned that the federal government, the fiscal authority can generate quickly programs that provide resources for the economy, for people to endure the ramifications of a pandemic.

I mean, that's impressive. I think it is important. I mean, one of the things that Jason Furman, who I've already mentioned, has been arguing is that it's important to look back and say, maybe we overdid it. But the question about what's going to be the impact of an increase in poverty once the stimulus is dissipated, is a very important question.

What is sustainable policy? And I think that's where Jason Furman is certainly supportive of the actions. Jerome Powell in response to a question by Michael Derby of the *Wall Street Journal*, who said maybe you guys overdid it. And Powell said when we were there and I was part of the Fed during the response to the pandemic.

And I remember, I don't know what euphemism to use, but I was a bit nervous. You don't want to go short. It's sort of like if you're going to go, go big and they went big. The Fed went big and the Congress went big and the Treasury figured out how to finance it. And we got through it. Do we have a bill going forward? Yes. Is inflation part of the outcome of this? Possibly.

My hunch is we've got more inflation than we think. But again, reasonable people can disagree. We can monitor this in the next six to eight months to see if I'm accurate that inflation is persisting, or others are accurate and that supply chain disruptions will dissipate and prices will decline.

Guhan Venkatu:

Right. And I'll just note, I know we're getting close to the end of our time, but I just note kind of where you started maybe to sort of come full circle in a way, you mentioned at the top or during the course of your remarks that other economies have not recovered quite as fully as the US. So that's part of what needs to be borne in mind as well here.

So the pandemic responses you pointed out were substantial but people didn't know quite what to expect. And so they seemed like preferred to err on the side of doing more rather than doing less. Perhaps you disagree.

Ellis Tallman:

So I would just request you repeat that again, please.

Guhan Venkatu:

So I was saying just there's a question about how much support was provided in the US. And I'm, I guess, drawing the distinction between the US and other places. But in those other places, as you noted, the recovery has not been quite as full as it turns out could be the case in the US. So that's one of it.

Ellis Tallman:

So I think, though, and I see we're running a little low on time, but I'll just say that there are other metrics of recovery that maybe they are doing better. For example, their labor market might be more recovered, so GDP hasn't recovered. It's how we measure.

It's one of those things where I remember when I was teaching at Oberlin College, name dropping, we had a visitor come who was arguing that we need a better measure of output than GDP. And I was quite sympathetic at the time, but it was before we had all these additional data sources. And I just thought, well, it's likely not going to happen, but great idea.

And I think this might be one of those things where, sure, the GDP hasn't recovered as much, but maybe it's more sustainable, I don't know. I mean, I think one of the things that the question that raised about when the stimulus dissipates, what happens, the other economies have a more sustainable policy to retain the support for low- and moderate-income individuals and reduction of their poverty rates.

I don't want to judge when I don't have as deep an understanding, but I think it's a great question. I mean, it might be why we're looking like we have a strong recovery and we continue to have the strong recovery, but we have higher inflation than the other countries as well.

Guhan Venkatu:

Right. No, it's a very good point. I mean, it's sort of like asking the question, how's your health? Well, what do you mean? How are we measuring that? What are we talking about exactly? To offer one, perhaps shifted analogy there to... as we're coming close to the end.

Ellis Tallman:

So can I pick on one? I like similarities and difference to 1980. And I think the person who raised this [question] must know that I lived through that. So I think we don't know yet. It's more like '72. We don't know if inflation is persistent. By '80 we knew it was persistent. We had inflation and we also had Paul Volcker and the Fed actually implementing restraint to the point of slowing the economy.

Here, I think the Fed is trying to thread a needle, which is to restrain, reduce accommodation to the point where inflation, given the outlook, diminishes, reduces itself to a kind of a near trend or at least coming down to trend. And the economy retains its momentum and the labor market recovers. I see we're out of time, buddy.

Guhan Venkatu:

That's a perfect way to conclude. I want to close by thanking Ellis for sharing his time and thoughts with us today, and I want to thank you all for your questions as well and for taking time out of your day to join us.

Information referenced in today's program will be shared in a follow-up email and a recording of this program, as well as past *FedTalk*s can be found on clevelandfed.org. Please also join us for the next *FedTalk* on February 16. Thank you all again. Have a wonderful afternoon.