Transcript
FedTalk: 2023 Economic Outlook
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Presentation

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Craig Sylvera:

Good afternoon everyone. Thank you for joining us here today and welcome to today's Fed Talk, the first of 2023. I am Craig Sylvera. I am a research economist here at the Cleveland Fed. It is my pleasure to kick off today's Fed Talk, which will be a 2023 economic outlook. Fed Talk is a Cleveland Bed series where we provide research and insights that are going to be relevant to our community.

In the past. We have covered topics such as the racial wealth gap, financial literacy, and labor market access. If you're interested in any of these, you can find these on our website at clevelandfed.org or you can find them on our YouTube channel. To get into what we'll be talking about today, a lot of the problems that we face today are the problems that we faced yesterday. We're monitoring national indicators as well as discussing with community members here in the fourth district what the economy is going to look like in 2023.

As you are probably all very familiar with, inflation is tracking well above 2% as it has for the past year, and that is going to be complimented by a labor market that is experienced in tightness, a low level of jobless claims, and high wage growth, which is at least partially explained by job openings running well above the number of employees that are able to fill it. So what we're going to try to do here today is provide you with data that might tell us where the economy is going to be headed in 2023 as well as what our labor market prospects might be in this upcoming year.

So before we get to those topics, I just want to clear up some housekeeping notes. If you were here in this event, your camera as well as your microphone are disabled. If you have any questions for the panelist, please submit them in the chat box and if you were to be disconnected from the Zoom, please dial in using the number that was given to you in the invitation and then join the call.

It is our pleasure for us to have here with us today, Bruce Fallick. Bruce is the senior vice president here at the Cleveland Fed where he heads up the Microeconomics Research Group.

The microeconomics group studies a wide range of topics, not including but not exclusive to labor economics, urban economics, public, and education economics. In addition to that, Dr. Fallick heads up the regional analysis and outreach group and provides monetary policy advice. From here, I'll let Dr. Fallick take it away.

Bruce Fallick:

Thank you, Craig. As I'm starting to share my screen, let me say that I'll remind everyone that the views that I'm going to express are my own and do not necessarily reflect the views of the Federal Reserve of Cleveland or of the Board of Governors of the Federal Reserve System.

So with that, let me give the quick outline. I'm going to say a few words today about monetary policy and financial conditions, about inflation and about the state of the labor market, and about prospects for labor force growth going forward.

So first on monetary policy and financial conditions, as you all probably aware, the FOMC started to raise its target for the federal funds rate back in March 2022, so about 10 months ago and has increased it fairly steadily since then so that it in total it's risen from close to zero to near four point a half percent.

The idea is to tighten financial conditions in order to slow the economy and fight inflation and indeed financial conditions have tightened since the committee started raising rates. What you see here is the Financial Conditions Index that is produced by the Federal Reserve Bank of Chicago. It is a summary of a large number, more than a hundred of different indicators of financial conditions. The dashed vertical line that you see over at the right there is the date at which the FOMC began to raise rates. So that's March 2022, and you can see that the Financial Conditions Index has risen indicating tighter conditions since then.

You'll also note that it started rising before the FOMC began to raise rates, which I think is a testament to the effectiveness of the advanced communication that the committee was giving to financial markets about what its intentions were. I should note that this is an index, don't try to read anything into the actual number of the level it says there. The current reading is -0.2, that doesn't have any cardinal meaning by itself. You really have to look relative to past history and that's where you can see this increase.

Now why has the fed reserve been tightening policy? Well, in order to fight inflation. What has been happening with inflation? Well, here you see three different measures over the past couple of years. This is inflation shown on a 12-month change basis, so this is 12-month percent changes. The top line, the blue line is headline inflation, so this is the PCE price index. It's the personal consumption expenditure index, which is the measure that the FOMC prefers. The headline PCE inflation number, which is that blue line is the total. It encompasses everything and you can see that inflation by that measure peaked sometime last summer and has been coming down somewhat since.

However, that measure is moved to a large extent by such things as energy prices and food prices, which are not necessarily a good guide to what we can expect inflation to do in the future.

A better guide might be the core inflation number, which is the orange line that removes the prices of food and energy from the index and has historically been a more reliable indicator of underlying inflation, that is to say where we expect to be in the near future.

You can see that on that measure, there has not been as much improvement so far as there has been in the headline number. Now we at the Cleveland Fed produce another measure called median PCE, which is an attempt to produce a measure that may be even better than core inflation at identifying the underlying tramps. That's the red line there and you can see that it has shown less improvement than headline inflation as well. This is on a 12-month basis. However, on a three-month basis, there are some more hopeful signs. In this graph, I'm showing you only the core and median inflation numbers and showing you the month-to-month percent change.

Now 12-month change is what you might be most used to seeing because it smooths out a lot of the monthly wiggles and there are a lot of monthly wiggles in these series. This is the one-month change, and here you can see if you look through those wiggles that recently, over the past few months, there are signs that inflation is coming down. Don't want to lean too hard on that yet since these measures can be noisy month to month, but there are some indications of slowing.

Another element that influences inflation or our expectations for inflation going forward are your expectations for inflation going forward, that of consumers and of businesses. Here we have measures from the University of Michigan's survey of consumers, showing you two measures of inflation expectations. The blue line of the top is short-term expectations. That is, what do people expect inflation to be in the coming year? You can see that's a measure that went up sharply after the pandemic and has started to come down but remains quite high.

The more useful measure we tend to find, however, is a longer-term measure of expected inflation, and that is the orange line that I'm showing you here. It also rose after the pandemic and has shown some signs of coming down. But I think what I want to draw your attention to is that the level of those long-term inflations, although it has risen, is really at a level pretty comparable to where it was for most of the 2000s. So it is not alarming, let's put it that way, that it's risen to the level that it has and it has shown some signs of coming down. It's something of course that we will be keeping a close eye on.

Now these two things are related, a monetary policy is aiming at bringing inflation down and is doing that largely by attempting to moderate the strength of the labor market. So let me say a few things about the labor market.

First, employment growth. This is the measure of employment growth on payrolls. This from the establishment survey. It can also be a little jumpy month to month, so I'm showing you here three-month moving average of employment growth, of the change in employment. And you can see that since the beginning of the year, that is to say since the beginning of last year, over the course of 2022, employment growth has come down quite substantially from the very high levels that we saw on the order of 5, 600,000 a month as we were coming out of the worst of the pandemic down to the latest reading, which is an average of 247,000 over the previous three months. That's still a pretty strong number if you were to look over the past say 20 years, but it's definitely slower than it was early.

For a sense of labor market tightness, we can turn to a measure that is often used by economists, which is the ratio of job openings to unemployment. This is the number that Craig alluded to in his introduction, the number of job openings versus the number of people available to fill them. And what you can see is that as we pulled out of the pandemic, this ratio shot up to unprecedented heights. It has since come down over the past year roughly, still very high, but it's showing some signs of moderation, which is what we're looking for if we want to tame inflation.

Now, I should mention that the particular ratio, which you can see here, 1.7, you'll often see that depicted in the media as being the number of job openings per unemployed person in the sense that if everyone who was currently unemployed were to be magically employed tomorrow, there would still be a large number of unfilled vacancies.

Now, I just want to temper that. These numbers come from two different surveys. They're not strictly comparable. They're not quite measuring consistent concepts, so when you hear that in the media, take it with a grain of salt, what you really want to take away is that this ratio historically is very high and has come down some since. Now, why has it come down? Which of the two elements, that is job openings or unemployment is responsible?

Well, it's not from unemployment. You can see the unemployment rate here, and over the period in which that ratio has come down, over towards the right, the unemployment rate has been remarkably flat. We haven't seen much change in the unemployment rate over the past year. What we have seen is the job openings rate falling over that period.

Now, I want to come back up here for a moment and point out something about this series over time. It is not straightforward, shall we say, to compare these levels over the long period because of changes in the way that firms may have been using job openings. But I think it's fair to say that we have some indication that at the business cycle peaks, it's become tighter from the end of the 2000s to the end of the 2010s till now.

One possible contributor to that tightness is labor force growth. What do I mean? Well, let's go back down. Here, we have a graph of the level of the labor force, and I'm showing it to you on a log scale so that you can see it consistently over time. And I would divide the growth in this labor force, the degree to which this line is rising into three rough regions. Over on the left in the sort of light blue/green is a period of fast labor force growth. Then we get to a period in the pink, which is maybe lavender, which is a somewhat slower labor force growth, and then a period in the sort of whiteish, off white, that is a period of slower labor force growth, still.

This may be easier to see in this graph, which shows the year-over-year percent changes in the labor force. It's obviously noisier than the previous picture, but I think the pattern comes through that in the pale green blue region on the left between 1970 and 1980, roughly, we had pretty rapid labor force growth, which moderated to some extent in the 20 years following between 1980 and 2000 roughly, and then slowed further, came down further in the past 20 years. And then of course, there's the pandemic, which I will get to, which did some odd things on the right side at the end there.

Now the point that I want to make is that this slower rate of labor force growth may have been contributing even now to the tightness in the labor market and it may continue to contribute to tightness in the labor market as businesses and other economic actors learn to adapt to this slower level of labor force growth. Now, the labor force is determined by two elements, I think is fair to say: the labor force participation rate, that is to say the percentage of the population who is participating in the labor market, and the population itself. So let's take these in turn because that'll give us a better sense of what the prospects are for future labor force growth.

So here you see the labor force participation rate over the last 50 years. Overall, I think we can say there are three periods here as well. There's the period between 1970 and 1990 where the aggregate participation rate was rising pretty steadily. Then it flattens out between 1990 and sometime in the 2000s and then starts to fall. And then of course, we have the pandemic. Let me just say one thing about the pan pandemic before giving you the broader sweep. We did see a large decrease in labor force participation during the pandemic. That's pretty obvious from the graph here, and then we've seen a reasonably robust recovery, but not up to the level we saw before the pandemic, and I'm going to argue and what you're going to see that where we are now may represent pretty much a trend phenomenon, not a lack of complete recovery from the pandemic.

So let me say something about these periods here. Why was the participation rate rising so rapidly in the 1970s and the 1980s? Well, that is primarily because of the entry of more and more women into the labor force. This continued up until around 1990 when female labor force participation studied pretty well. Now, one thing that I want to point out as, and my research has shown, that the increase in women's labor force participation is not because a particular, the same cohorts of women as they aged became more likely to participate in the labor market. Rather, it's young cohorts of women who came of age participated at higher rates than their predecessors and continued throughout their lives to participate at higher rates than their predecessors. This phenomenon continued up until around 1990 when the entering cohorts of young women were participating at about the same rates as those that preceded them.

That phenomenon, therefore, we don't expect to resume. That's pretty much played out then as we get in the 1990s and into the two 2000s, with the female participation stable at a cohort level, what we get is two other elements overlaid on top of that. The biggest one is the aging of the population, and we'll see that in a moment. That's put downward pressure on the participation rate for some time and the population continues to age, so we can only expect that kind of pressure to continue for some years yet.

The other is a long-term downward trend in the participation rates of prime-age men. And see that better. Here you see labor participation rates within broad age groups. The top orange line is the participation rate of prime age men, and as I mentioned before, you can see that this has been trending down not terribly rapidly, but pretty consistently over the past 50-some years. This has mainly taken place, I should say, among less educated prime-age men. Then we see the red line, which is the participation rate of prime-age women, and this is the story that I just alluded to. Before, we see the increase in participation rates amongst prime-age women here. I'm showing it starting from 1965, which is a little farther back than the previous graph. Up until around 1990, as the success of cohorts of women have higher participation rates. It then flattened out, started

to trend down a little looking more like prime-aged men, and then comes back up. You can see the dip in the recovery from the pandemic.

So here, again, I don't see a lot of prospect for this participation rate to rise much unless there are other changes that take place. Then the blue line is the participation rates of young persons 16 to 24. There, there are essentially two phenomenon going on. The increase that you see in the left side of the graph is again the increase in participation rates of women in this age group, since this line lumps men and women together. Then the decline you start to see later, that has to do with an increase in educational enrollment, but actually, a lot of it has to do with lower labor force participation in the summertime. What we saw over that period for a lot of that period was a downward trend in the percentage of young persons who were working in the summers, particularly young people who were in school, who had less of a tendency to have summer jobs.

Now, for all three of those groups, I don't see a lot of prospect for their participation rates to rise, absent some bold government policies, and I'm not even sure that there are bold government policies that I could see making a big dent in rising those participation rates. I mean, there are some that have been proposed, things that would make, for example, childcare more available and less expensive. I don't know how much that would matter to the overall picture.

The gray line at the bottom is the 55-years and older group. What I want to emphasize here is not so much what the trends in that group are because I'm going to dissect that in a moment, but just the large difference that you see between the level of the gray line, that 55-and-older group and the levels of the three lines above them. That is why the aging of the population has made such a large difference to the participation rate. That is why the aging of the population has such a large depressing effect or has had on the participation rate. When people move from the younger ages with those higher rates to the older ages with the lower rates in the gray line, pretty much regardless of what's going on in the gray line, you're going to see downward pressure on the participation rate.

Now looking at the gray line itself, you'll see kind of a down in and up. That is a bit of a misleading actually, because that also reflects the aging of a population. You can see that in this graph, which shows narrower age groups for that 55 and over group. So these are 10-year age groups by ... well, they're five year age groups, and then the 70 above. So you got 55 to 59, 60 to 64, 65 to 69 70 and over in descending order.

And the things that I want to point out are really the two points that I want to make. The first is that all of these lines over this period, by and large have been trending up. That's flattened out some over the last 10 years, 15, 20 years, more so for the 55 to 59s than for the others, but they've all been trending up. That is a consequence of lower mortality and lower morbidity. That is people are living longer and they're living healthier at each age. Both of those things propel them more into the labor market.

One because they're more able to work and the other because financing longer retirements requires working longer. However, despite that, even within this 55-and-over group, you can see how large the differences are in the participation rates. So as the age distribution, even within this 55 and older group skews towards older, as the baby boom moves further into these age

ranges to older age ranges, even within the 55-and-older group, you're seeing downward pressure on the participation range. I don't see that changing. The aging of the population is a large force that overwhelms the increases in individual population rates that we're seeing here in this 55 and older group.

So I don't see a lot of prospect for labor force participation rates rising much. Now the other element of course of labor force growth is population's been pushing in the same direction. This is a graph of year-over-year percent changes in the population. So this is population growth and what you can see is that starting somewhere in the early nineties, the rate of population growth started to fall and it's been falling pretty steadily for the last 30 years so that we're down to a pretty low level at this point. Why is that happening? Well, two things. There are lower birth rates, so birth rates have been falling for women of childbearing age, but in addition, the aging of the population again means that there's a smaller proportion of the population who are of childbearing age. Both of these have been putting downward pressure on population growth, and that's been putting downward pressure on labor force growth.

As a nation, we've been here before. Here's a graph of population growth that goes all the way back to 1980. Now a couple things about the data. One is that you'll see some gaps. Those are the world wars. These data show us only civilian population, and so as you can imagine, you get a lot of action, a lot of change in the civilian population during the world wars as so many men and women went into the military. Also, you'll notice on the left in the 1889 to 1900 period, it's pretty much a straight line. That's because the data we have there is from decennial censuses. So we have to interpolate in those years.

So what do I see here? What I see is that in the 1920s, 1930s, really over the entire period from 1880, population growth was declining, and in the 1920s and 1930s, it was declining pretty sharply. If you look back at the popular and the business and the economics literature of that time, of the 1930s in particular, you see a lot of concern about this slow population growth and what its macroeconomic effects could be. We are back in that situation now. Back to the 1930s, they couldn't foresee the baby boom that would occur after World War II, and it may be that I now sitting in 2023 cannot foresee some radical change in population growth moving forward.

But again, in the absence of some pretty radical bold policy, I don't see this changing. Now, the one policy that could make a difference for the United States is immigration. I'm not going to express an opinion on that, but that would be one way of raising population growth. Otherwise, I don't really see it. So I think the prospects for labor force growth, either they will continue to be slow for some years to come, and this may contribute to tight labor markets for some years to come if businesses and other economic actors don't adapt. Now I want to close with one statement, and that is that it's not obvious that slow population growth is a bad thing. It is an macroeconomic challenge that we need to face up to and we need to discuss. Thank you very much.

Craig Sylvera:

Okay, so now we'll be taking questions from the audience. A few have been given, I had some thoughts during that presentation even though Bruce covered many of the thoughts that I had. I

think I'd like to get started with one that talks about aggregate stats and individual experiences. So the question is, I understand Virginia's inflation rate is around 8%, but separate family members and friends have told me their budgets, inflation rates are around 35%. How can I explain the differences between those two very different numbers?

Bruce Fallick:

Thank you, Craig. Yes, that's a good question. I'm going to take those numbers at face value while recognizing that local inflation rates are not measured as well as the national inflation rate. The key point is that the inflation numbers that you hear are averages. They refer to what an average family buys in an average week, and of course, there is no actual average family. Some people spend a lot more of their income on say housing or on gasoline or on food away from home. And each of these elements have different rates of price increase. So we've seen energy prices, for example, rise quite rapidly in the aftermath of Russia's invasion of Ukraine. We've seen housing prices rising quite rapidly in the aftermath of the pandemic. So someone for whom a larger proportion of their spending are on these rapidly increasing categories are going to see their own personal inflation rate higher than what the average is. Of course, that also means that there are some people who are seeing their own personal inflation rate lower than the average, and of course, without detailed information we wouldn't be able to parse that out.

Craig Sylvera:

Yes, thank you. So I think this next one is also going to depth up into this question nicely because it's a little bit about, if I were to pick random household from a particular subpopulation of the distribution, what is the likelihood that their particular budget is going to be spent on these high rising prices of goods? So the question is what are key indicators that are monitored to assess economic inclusion and economic mobility for various subpopulations? And then it was further by county or by city, or, however, you want to take this question.

Bruce Fallick:

Yeah, so I want to preface this by ... I hate to have to keep giving these caveats, but our data at the local level are just not as good as our data at the national level. And for something like prices, our data by demographics is not as good as our data for the population as a whole. So what do we monitor? Most of the indicators that we have at the national level are available in some form at the regional level, maybe for the state, maybe for large metropolitan areas. We monitor those data closely. For inflation, we also have some more information by demographics because we have some idea of how consumption bundles differ by demographics, and there I'm going to the audience to work that is being published by the Federal Reserve Bank of New York. Just saw this the other day. They have a project on looking at inflation by demographic group, and they should be, if it's not already on their website within the next week, you should be able to find information about that there.

Now, in addition to these kinds of what we might call hard data, these sorts of indicators, we spend at the Cleveland Fed, just like at other federal reserve banks, we spend a lot of time and effort with our ears to the ground. We have lots of contacts in the business community, in the

labor community, in the economic development community, and we talk to them constantly trying to get a better sense of what's going on in our district and in particular parts of our district and within particular populations of our district.

Obviously, each of those types of information has its place. There's the harder data that come from surveys and from various agencies of the government, and then there's this, if you will, softer data that come from our conversations with various parties in our district.

Craig Sylvera:

Thank you. And this will be about one of the slides you presented. Does the unemployment ratio include those who are unemployed and not seeking active employment?

Bruce Fallick:

So, the definition of unemployment, the sort of official definition of unemployment is someone who does not have a job and is actively looking for one. So if you're not actively looking for a job, you're not considered unemployed, that doesn't mean you're not measured. The Bureau of Labor Statistics is the federal government agency that measures unemployment. They produce several measures of what you might call underemployment. So you can see this in their monthly news releases. There's the official unemployment rate where the definition is, as I said, without a job and actively seeking a job. There is a measure that includes people who are not actively seeking a job and are saying they are not seeking one because they don't think any are available. There is another category of people who do not have a job, are not actively looking for a job, but have looked sometime in the past 12 months. So it's reasonable to think they might be available.

There's a yet broader category of people who do not have a job, or are not actively looking for a job, but say they want a job. And then there's also other dimensions such as people who are working fewer hours than they would like to be working. So we have measures of a variety of definitions, if you will, but the official unemployment rate is only people who are actively looking for work.

Craig Sylvera:

Yes. How should we being the audience and we being the Federal Reserve Bank, think about the feedback from wage growth to inflation? Do you have a preferred approach?

Bruce Fallick:

Okay, so that is a difficult question. The feedback from wages to inflation?

Craig Sylvera:

Yes.

Bruce Fallick:

So the best econometric evidence at this point says that the feedback from wages to inflation is not as strong as the feedback from inflation to wages. That is to say that high inflation leads to high wage growth, nominal wage growth that we're talking about now, but much less the other way around. This is a very difficult question to tease out. I'm giving you what I think is the best econometric evidence that we have, which is not to say it's definitive, but I will say that it's consistent I think with what we've been seeing over the past couple years in this period of high price inflation. We've seen this very tight labor market. It has resulted in high wage inflation, high nominal wage growth, but that high wage growth has not exceeded price inflation. In fact, it probably hasn't even kept up.

So if we thought that wage inflation was driving price inflation, that maybe what's going on, but I think it's more consistent with the idea that the high price inflation is causing the high wage inflation. It's the best we can tell. This is something we keep a close eye on obviously, both of these measures put in a plug for the FedTalk in February, which is going to be conducted by our Center for Inflation Research. I don't actually know what topics they're planning to cover, but topics like this of this, in general, ilk are likely to be in there.

Craig Sylvera:

Yeah, I believe they're hoping, so I'll even mention that again at the end of the talk.

Bruce Fallick:

Very good.

Craig Sylvera:

Let's see. Since the gas-powered automobile affected so dramatically in the 20th century, the global economy, where do you see electric vehicles driving our economy in the 21st century? I'll leave it there and then there, there's a bit of a follow-up.

Bruce Fallick:

Okay. So excusing the pun of cars driving the economy. This is not an area of my expertise. I am pretty well up on macroeconomics and a specialist on labor markets. Cars, not so much. What I will say is in the broad strokes, there have been a number of major inventions and major innovations that have, if you will, been engines of economic activity. So their easiest point to actually around the same time that the internal combustion engine became dominant, we had big changes in the chemicals industry, in the electrification, and so forth. This change from one sort of transportation engine to another. I don't know that I can point to that by itself being a profound change in terms of economics or economic growth, but I can say that it is one example of continual innovation and continual innovation and technological change, which has been outside of labor force growth. To go back to that, the major reason that we've seen economic growth. And then of course there's the climate implications, and that may of course be the largest implication of all. There again, I have no particular expertise in that area.

Craig Sylvera:

I'm going to agree with you and I'm going to give a plug for something that I learned way back in the PhD. We called it a general purpose technology, so it was steam, then it was electrification, which would just be an offshoot of what we're discussing here. And then it was informational services like the rise of computers and computer chip manufacturing. So whether or not this is a sharp change in the production process or some sort of sharp change in technology isn't exactly clear yet. So, there are a lot of questions I guess in the sort of automation or just perhaps there is going to be this change in productivity. So I'll just keep on moving in this direction. This is more of a measurement question here, but is the gig economy fully factored into the labor force participation rate?

Bruce Fallick:

I'm sorry, would you say that again? Is the gig economy?

Craig Sylvera:

Fully factored into the labor force participation rate?

Bruce Fallick:

Ah, yes, it is. The labor force participation rate is measured from a survey of households. So the Census Bureau conducts the survey, although the Bureau of Labor statistics, they're doing it for the Bureau of Labor Statistics, what they'll they would do is they'd come to your door or call you up and ask you, are you working? And if you're not, are you actively looking for work? I mean, the questions are more sophisticated, but that's the idea.

So if you are in the gig economy, if you are driving a lift or whatever, you have a job. The way they ask it is, have you done any work for pay over the week in question. Any work for pay. So if you've driven a lift, you've done work for pay, you are employed, so that makes you part of the labor force.

The gig economy is an interesting concept. We tend to think of things like Uber and Lyft or DoorDash or TaskRabbit or Mechanical Turk, things like that as the gig economy, and therefore as the gig economy is something new, actually the best research says that it isn't, that we have new forms of gig work, but that what we might define as gig work has been at a fairly steady level for quite a long time now. So it's not clear that there's much different actually about the current gig economy than about the previous gig economy. I don't want to overstate that. Obviously driving for Uber is different than some of the equivalents that took place before. I mean, driving for Uber versus driving a cab on call. I mean, there are differences for sure, and there are differences in labor law and so forth, but I do want to sort of dispel the notion that the gig economy is really something new. It's really been there.

Craig Sylvera:

Yeah. A lot of the time, I just think about it as being self-employed, which always has been measured for some time. But so what you're saying is if a similar worker born 30 years ago is just going to have a similar ... A worker who worked in the gig economy today would've a similar gig job in 1980 is what you're saying?

Bruce Fallick:

Yeah, it would come through different platforms. What's new about these, something like a Lyft driver is that they have this platform on their phones that can match them with a task. Well, in the past, there were different ways of doing that. We still have temporary help agencies, for example. Well, those are, by any, I think reasonable definition. Those are gig jobs. We still have, for example, independent truckers. How do they find their loads now, independent truckers? They do it through apps basically. They know the electronic means; much in some ways analogous to what a Lyft or an Uber driver is going to do. In the old days, it was a more analog process, but it still went on. So that's my point really. It went on, just went on in a different way.

Craig Sylvera:

Yes, time moves on. So a little bit of a switch? What does this mean for the economic outlook for this year? There are some indications from the St. Louis Fed that predict recession probability. Do you see a recession moving? If so, what does that mean? Is that a white-collar Wall Street recession or will it affect wage earners more?

Bruce Fallick:

Well, that's obviously the $64 billion question to which I don't have a better answer than the questioner probably has. There are a number of recession probability models out there. They give a range of probabilities. There are surveys of businessmen and professional forecasters that also ask this question. Those surveys tend to yield fairly high probabilities that a recession is coming within the next year, somewhere above 50%. I don't have a better idea than they do, frankly. What I can say is that in addition to the question of whether there will be a recession, there's the question of how deep the recession will be, which is another big unknown. And the second part of that question, will it be white collar or will it be blue collar may have a lot to do with that. I mean, the fact is that historically, recessions have hit blue-collar workers harder than white collar workers.

There have been exceptions. The 1990 recession is a notable one. Just as recessions have almost always hit lower wageworkers harder than higher wageworkers, have hit black workers higher than white workers, there are these commonalities. I don't see offhand any particular reason that a recession now would not follow those patterns, but every recession has its own dynamics. It has its own causes, it has its own character. So I don't want to push that too strongly. I don't want to paint with too broad a brush. I should also say that recessions have different regional characters. Now, this isn't something the questioner asked, but something I want to point out. Different parts of the country are hit harder or less hard during recessions, and that varies from recession to recession. Indeed, recessions often travel across the country, if I can put it that way. You have recessions that start on the coasts and move in. You have recessions that start on one

coast and move across. So that's another area of difference between recessions that I think we want to bear in mind if we see one now.

Craig Sylvera:

And do what I mentioned to the audience that Bruce and I did not intentionally wear white and blue collars. It just happened. Are you seeing any impact of automation on inflation?

Bruce Fallick:

So, automation is an ongoing process that I think in terms of inflation is best thought of as one element of productivity growth. I don't know that there's anything special about automation as opposed to other forms of productivity growth in its effect on inflation. By and large, all else being equal, more productivity growth means lower inflation in the short term. So I don't see anything special about automation when it comes to inflation. Well, there are a lot of things about automation that might be a little different now than they have been as I think there's a lot of discussion about whether the pandemic has induced automation of particular types out there. I mean, I bring it up only to kind of shoot it down that automation is always particular to the time period that we're looking at, and we're not seeing any indication that there are greater rates of automation now than there have been over the last say, 20 years on average.

Craig Sylvera:

I think I want to follow up just a little bit because I'm really thinking about that work from the fifties to nineties about where jobs were lost. So there was a hollowing out of the labor distribution caused by the particular jobs that were automated if we're going to use that for jobs that were lost in the fifties and nineties, if automation were a problem, do you think it would hit differently?

Bruce Fallick:

Yeah, so that's a good question. I'll say the phenomenon that you're referring to, which in the economics literature is referred to as polarization. I think my reading of the research is that that was much more about trade than it was about automation. Automation clearly played a role, but I think trade played a larger role. And of course, the backdrop of all of that is a set of policies. So, I don't see a particular reason to believe that automation is going to contribute to a greater hollowing out of the middle, which by the way is a phenomenon which the data do not show any further polarization over the last, say 20 years. It seems to have been a phenomenon of the eighties and the nineties as you mentioned, and then it's kind of stopped.

Craig Sylvera:

Is the Federal Reserve rethinking the inflation rate cap of 2% given how the global economy is changing?

Bruce Fallick:

Well, that's really a question for the committee, for the Federal Open Market Committee, not for me. Certainly, there have been calls in from some commentators to raise the target inflation rate from 2% to say 3%. The last statement that I remember seeing from J. Powell said, not 2%, we're not thinking about raising it. It's obviously the committee's prerogative to rethink it if they want to rethink it, but that was the latest statement that I've seen.

Craig Sylvera:

And then, let's see, slightly longer, but if the 1970s inflation was driven by demographic trends, the baby boomers working their way through the economy, why is inflation so high given the declining population growth trends detailed?

Bruce Fallick:

Okay, so the premise of the question that the 1970s inflation was driven by demographics, I have heard that hypothesis. I don't think it's a widely held one. The inflation of the 1970s is usually attributed to a combination of accommodative monetary policy, loose fiscal policy for a time, and a series of supply shocks, notably the oil shocks, but also there was a food shock, two of them actually in that time period.

That is what I think that inflation is typically attributed to, not to demographics. In that sense, there's really no mystery about the current situation.

Craig Sylvera:

Okay. Because you mentioned this and I just want to come back to it a little bit. There are a couple of ways to grow the population, fertility and migration being the big ones, and you said you didn't see support to families being a strong driver because if we relax the budget constraint for households, it feels like that would probably move the needle for fertility. And I do understand as people are aging through, that means any potential mother would have to be older. But it does seem like this would be an axis in which we could relax it, not getting into the politics especially, those are both third rail issues, fertility and immigration.

Bruce Fallick:

So I think the moving the needle about fertility, what I mentioned earlier where I think one can move the needle is not fertility, but rather participation of parents. That is to say you can institute policies that make childcare easier to come by, high quality childcare, easier to come by, and that has been, I think, shown in international comparisons to increased participation rates, particularly of mothers. So that would move the needle there. It's just quantitatively, I don't see it making a substantial dent in this. On fertility itself, no, I don't think that there's evidence that ease in financial constraints increases fertility. If you look at international comparisons, you can compare across countries that have very different levels of government support for families, and you don't see much change in fertility. You can look across governments who have instituted policies specifically to increase fertility, paying families to have children, basically, and you just

don't see much difference. There seem to be the low fertility rates are coming from larger forces than financial constraints.

Craig Sylvera:

Interesting. So I think we're going to have one more question and then we're going to wrap this up. So I know you're a busy man. So the last question is, and once again, I know this isn't exactly your area, but we have to end it somewhere. We have seen inflation numbers go down recently. Can we expect that to steadily continue, or will it go up and down on its way to the Fed's goal?

Bruce Fallick:

Yes. Well, would that we knew. So I think it is helpful to look at some broad components of inflation. What we've seen improvement in is goods inflation, and a lot of that seems to be coming from the easing of supply constraints that came in with the pandemic and with the invasion of Ukraine. So I think we can continue to expect those constraints to ease both as well as producers adapt, but there are wild cards there. I mean, I can't say what's going to happen with the war in Ukraine. I can't say what's going to happen with the next variant around the corner of COVID. So it's entirely possible that we would see supply constraints get worse again, although the trend has been, and I would hope will continue to be an easing of those supply constraints and therefore a continual easing of goods inflation.

Now, services inflation has not come down much, so that's still being held up there and there, you don't have supply constraints of the same kind as you do with goods. The main supply constraint for services is labor. It's not grain, it's not fertilizer, it's not semiconductors, it's labor. So that's why this focus on the labor markets. One reason this focus on the labor market is so important.

Now, the other element that I'll point to is housing, where we did see a big increase in house prices and that housing price inflation seems to be easing, and we'll also hope that that continues. Some of that seems to have been driven by shifts and preferences driven by the pandemic, and as that's settling out and as monetary policy is cooling the housing market off, there we would hope to see some further improvement in housing inflation.

Craig Sylvera:

All right, Bruce, I want to thank you for your time. I want to thank the audience for their questions. This has been an incredibly informative discussion. Info about today's programs will be sent out to you in an email. There will be a record on clevelandfed.org, and I want to re-remind you that next month's FedTalk in February, the date is to be determined. So please check on clevelandfed.org, but that will be conducted with the Center for Inflation Research.