# Macroeconomic Outlook
## Slides

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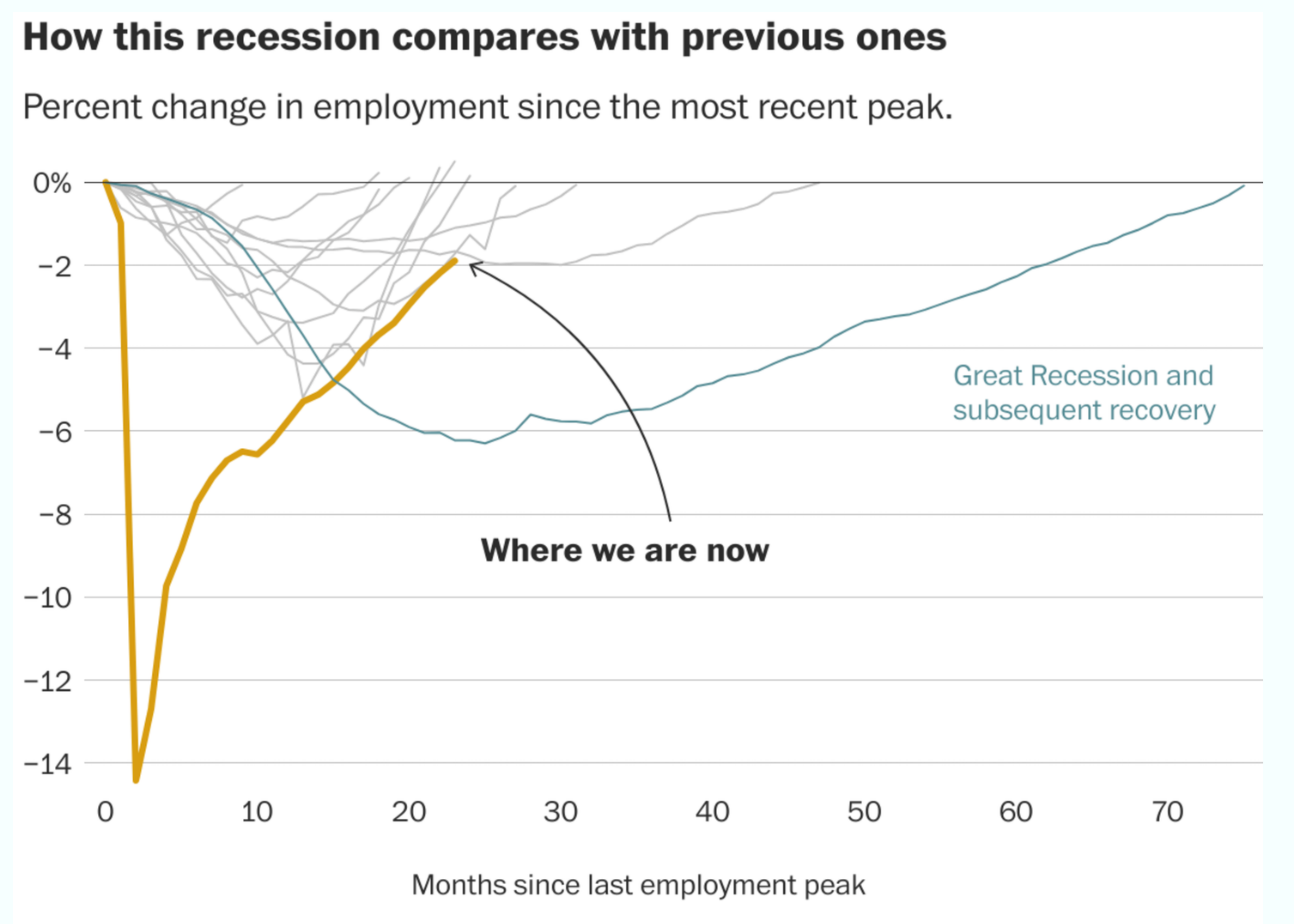
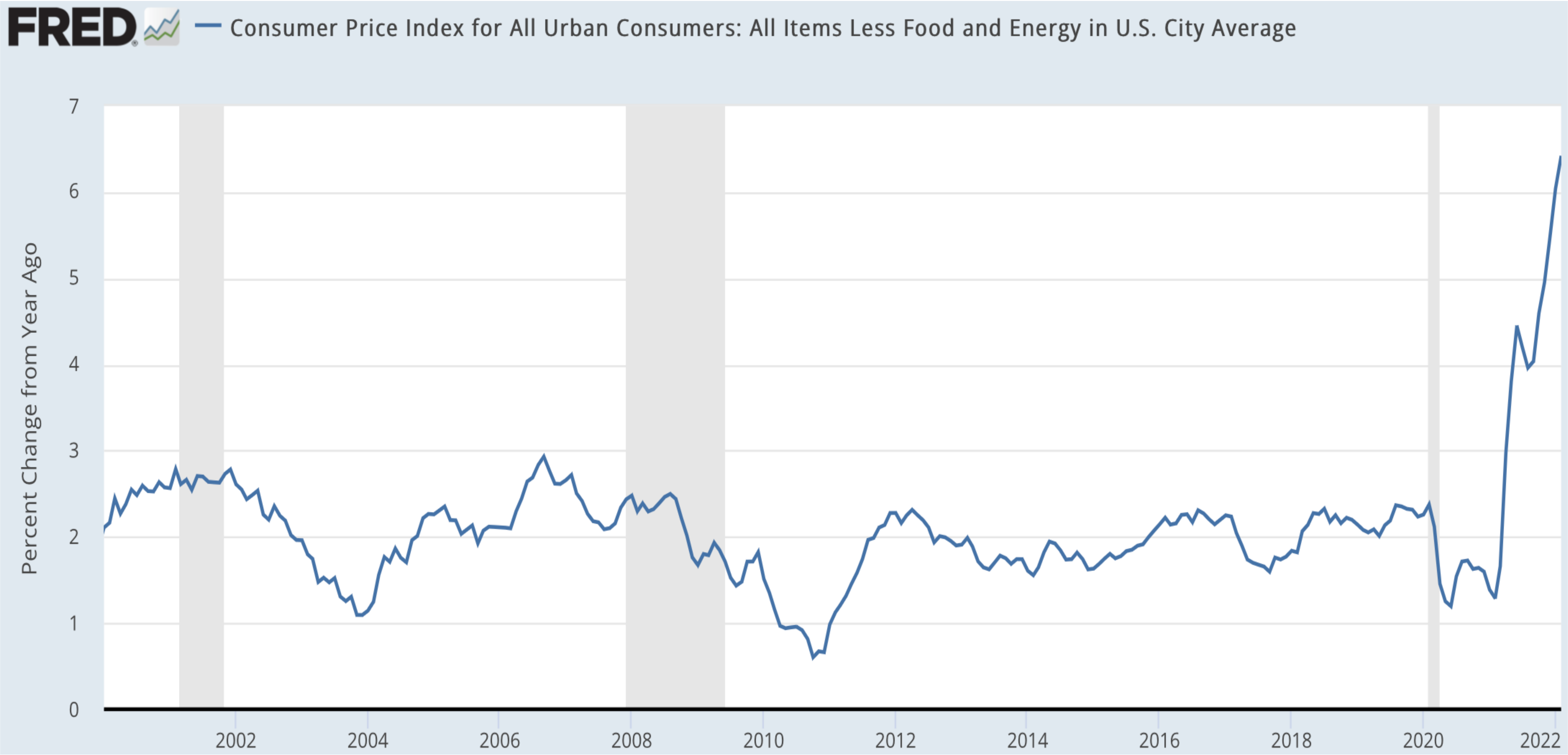
# The Fed Has Done an Amazing Job!

- Assisted by fiscal authorities, of course
- Employment fell by 14% because of the plague & knock-on aggregate-demand effects
- Half of that we got back more-or-less immediately
- But then we had to reknit the division of labor
- Something that took four years in the 2010s took 15 months in the 2020s



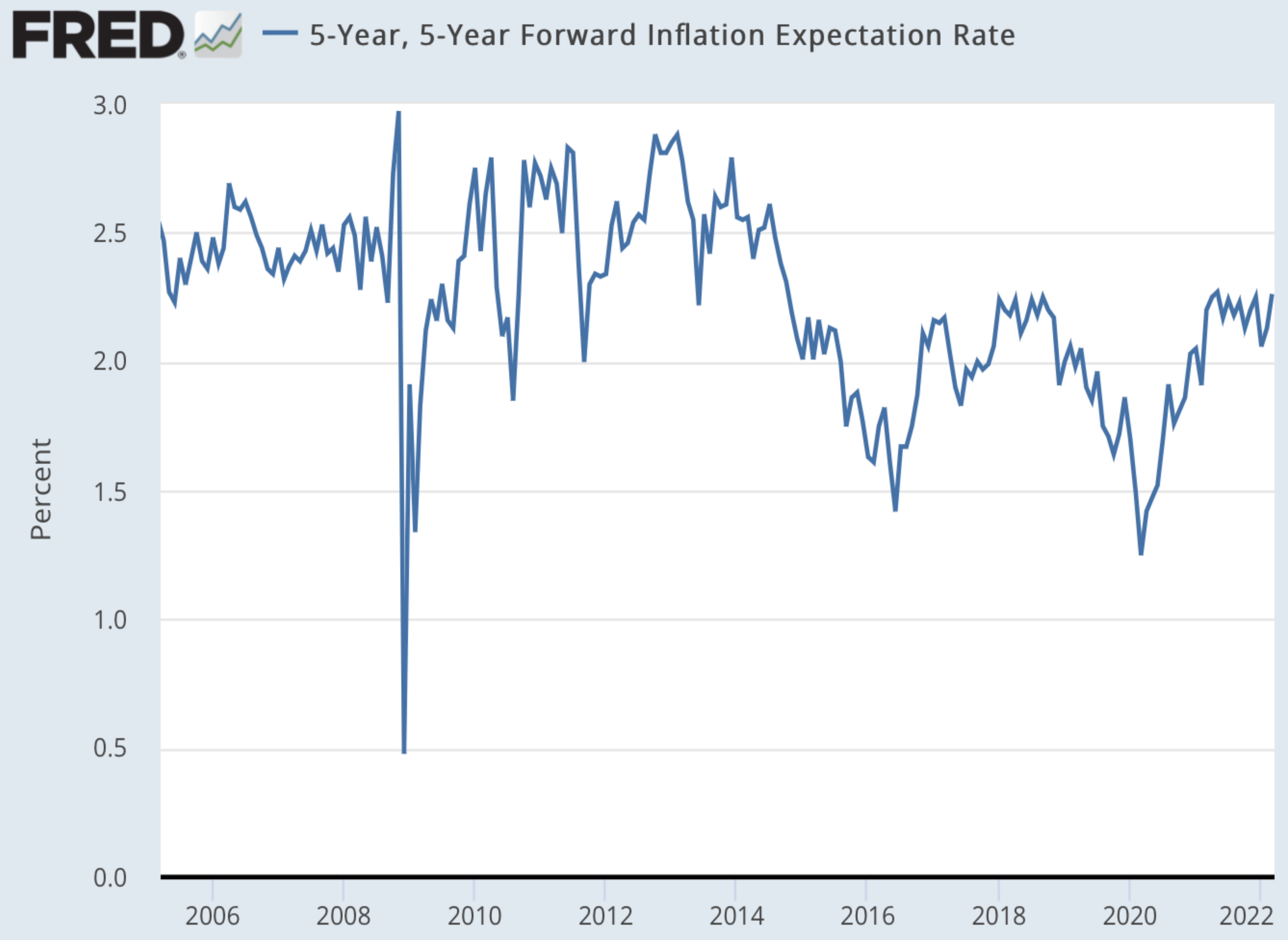
# But What Happens Next? We Have Inflation!



# The Bond Market Thinks: Well-Anchored Inflation

## Out-Year Breakevens

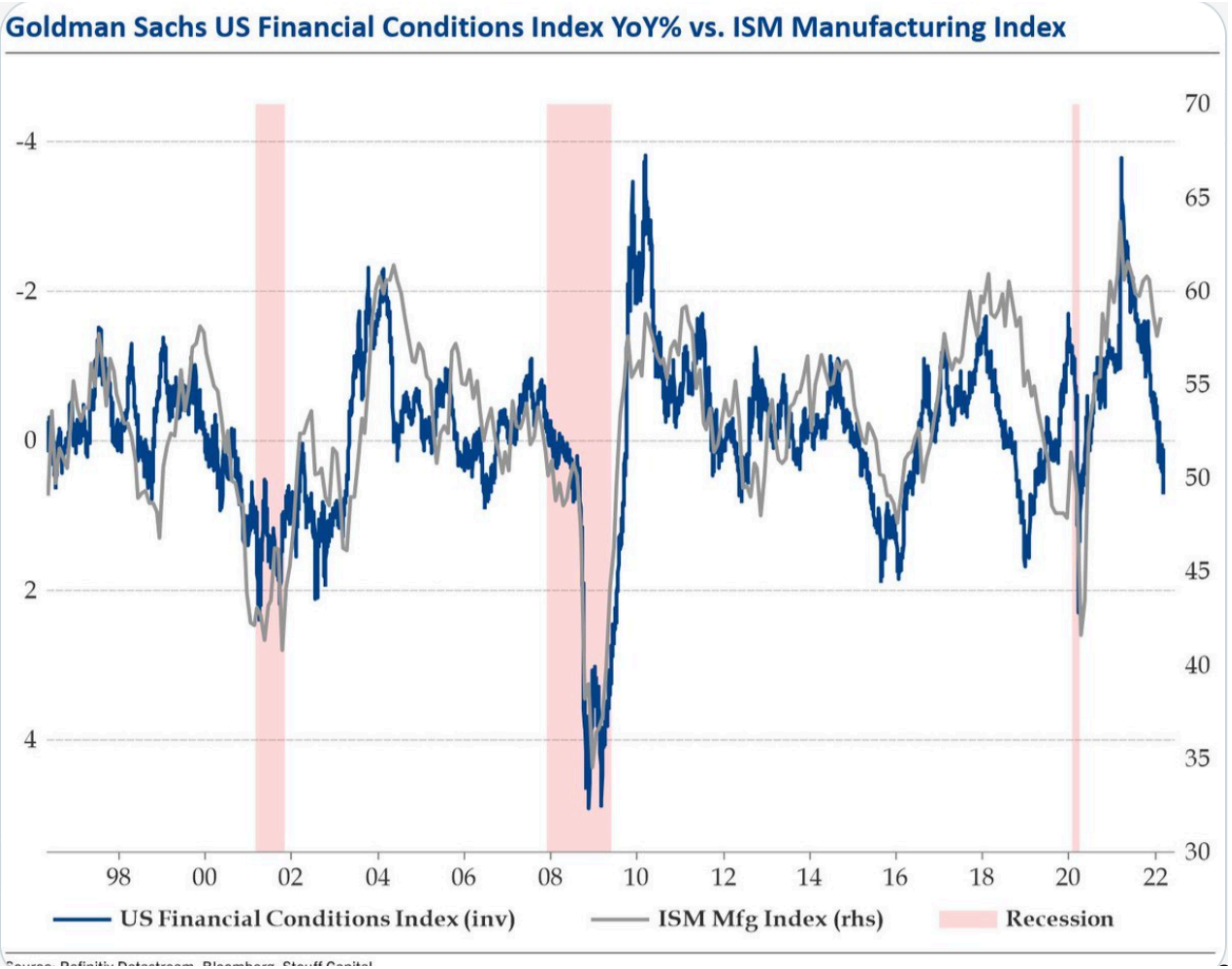
- They look very good
- Yes, bottlenecks, oil shocks, wheat shocks, and China-lockdowns
- Short-term inflation is dicey
- But the bond market is still very happy with the medium- and long-term inflation outlook



# One Reason I Do Not Think the Fed Is (Far) Behind the Curve

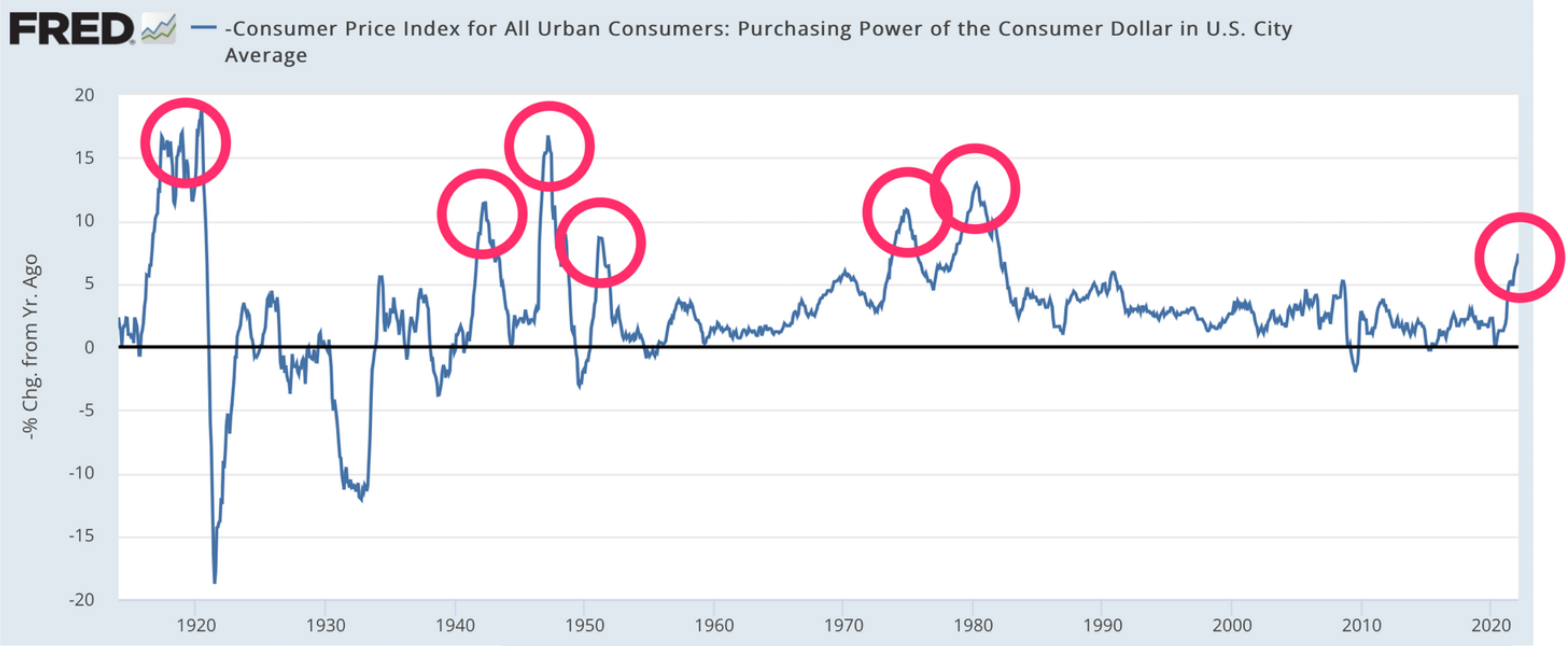
## Financial Conditions

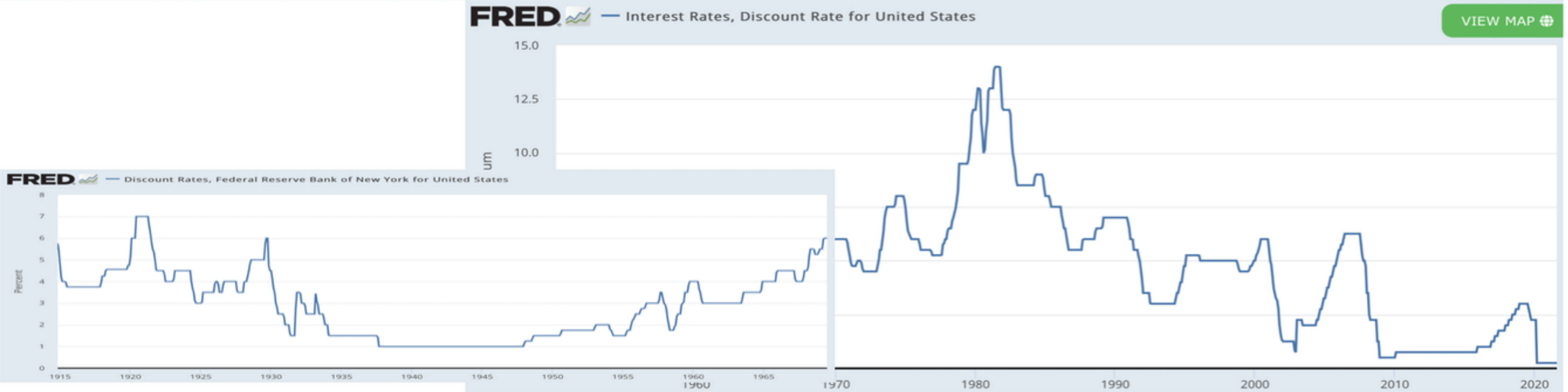
- They tell us that at least the manufacturing component of the economy is slowing
- And that is with what the Fed has already done.
- I.e., one rate rise, and some jawboning about what it is expected to do.
- Would one want more slowing than the FC index tells us is already baking in the cake?
- If you think so, why?



# Six Episodes of U.S. Inflation Above 5%/Year in the 1900s

- The top is the CPI inflation rate
- he bottom are overlapping graphs of the Federal Reserve's discount rate
- Counting 1974 and 1979 as two episodes, there were six times the annual inflation rate got above 5%.
- World War II inflation—cut off by price controls.
- Post-WWII structural-rebalancing-and-pent up demand
- Korean War structural-rebalancing inflation
- Before those came the World War I episode.
- Then came the 1970s—the Yom Kippur War oil shock
- Then came the 1970s—the Iranian Revolution oil shock control inflation; then, after inflation peaked, it lowered
- What does macroeconomic theory tell us that the Federal Reserve should do now, in the spring of 2022?



# Six Cases of Above-5% Inflation

Which of these is analogous to today?

1920? Not 1942 (price controls). 1948? 1951? 1974? 1980?

# ??????????????????

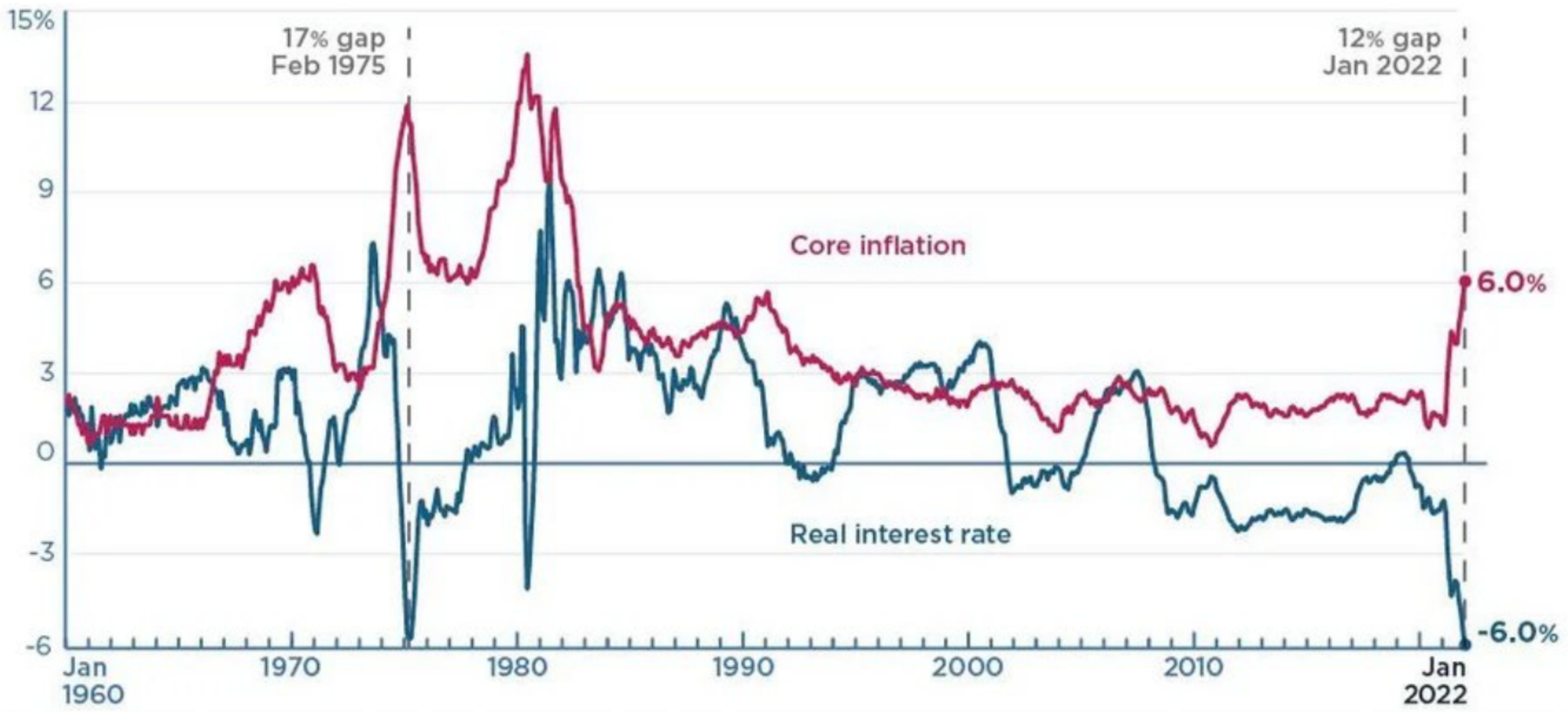
## Olivier Blanchard is very worried

- He is very, very sharp indeed…
- But I do not see why he finds the analogy to 1975 convincing…
- 1975 came after a 15-year runup of inflation, interrupted by a half-hearted Nixon-administration attempt to control it
- (Half-hearted because Nixon did not want higher unemployment ever; and Arthur Burns believed that Congress would not stand for disinflation)
- We have a generation of stability

Figure 1

**The last time the Fed fell this far behind the curve on inflation was in 1975 and it took 9 years to bring under control**

Core inflation and the real policy interest rate, percent




PIIE

**Note:** Core inflation is consumer price index inflation excluding food and energy. The real policy interest rate is the federal funds interest rate minus core inflation over the previous 12 months.

***Sources:*** US Bureau of Labor Statistics and Board of Governors of the Federal Reserve System, retrieved from Federal Reserve Bank of St. Louis (FRED).

# What Do We Make of the Current Employment Shortfall?

## Larry Summers is very worried

- He too is very, very sharp indeed…
- Domash & Summers: How Tight Are U.S. Labor Markets?
- I think we are going to get vaccinations, incentives, health concerns, and excess retirements back in the labor force
- That leaves us with population aging and immigration restrictions—2.7 million people
- That means we still have a 4.6 million employment shortfall
- The labor market looks very tight now; I do not think it will look very tight next year
- I still see a likely and probable path to a soft landing…

Figure 5: Employment shortfall relative to pre-pandemic trend

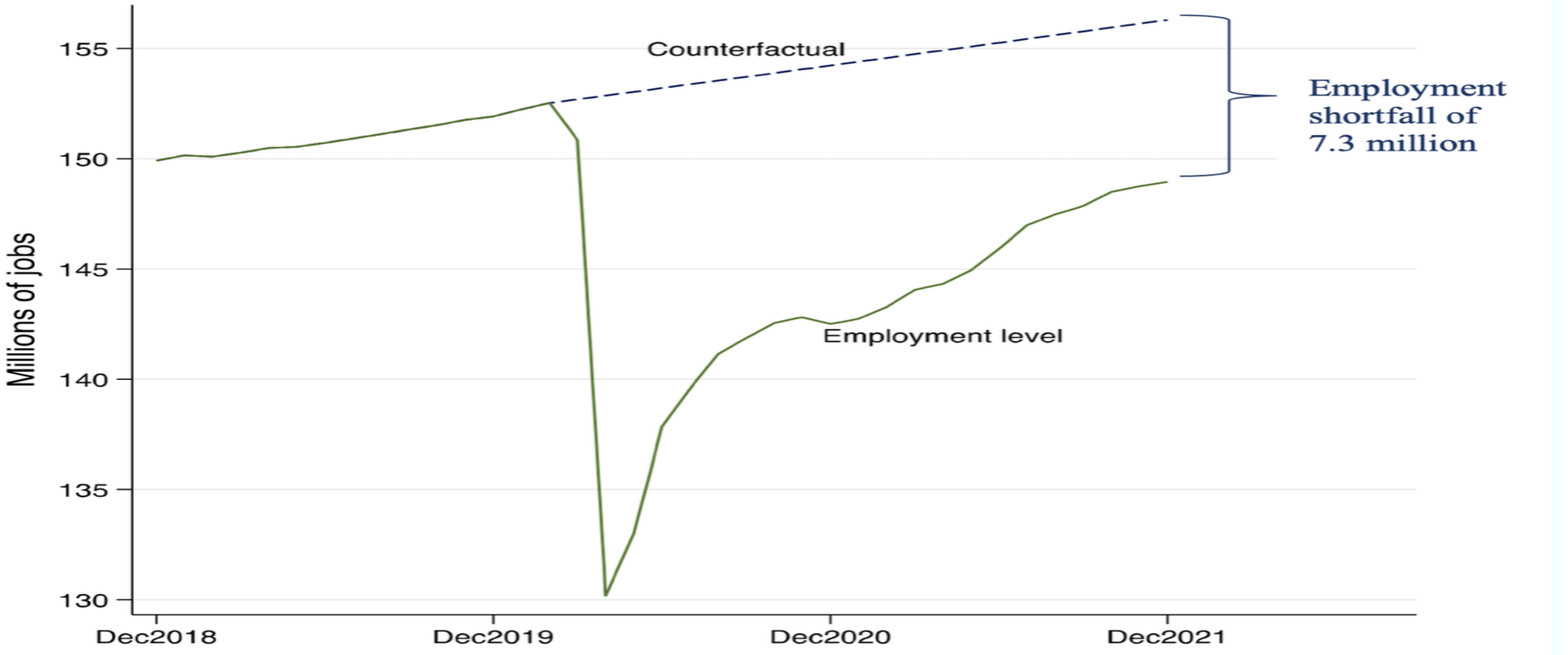
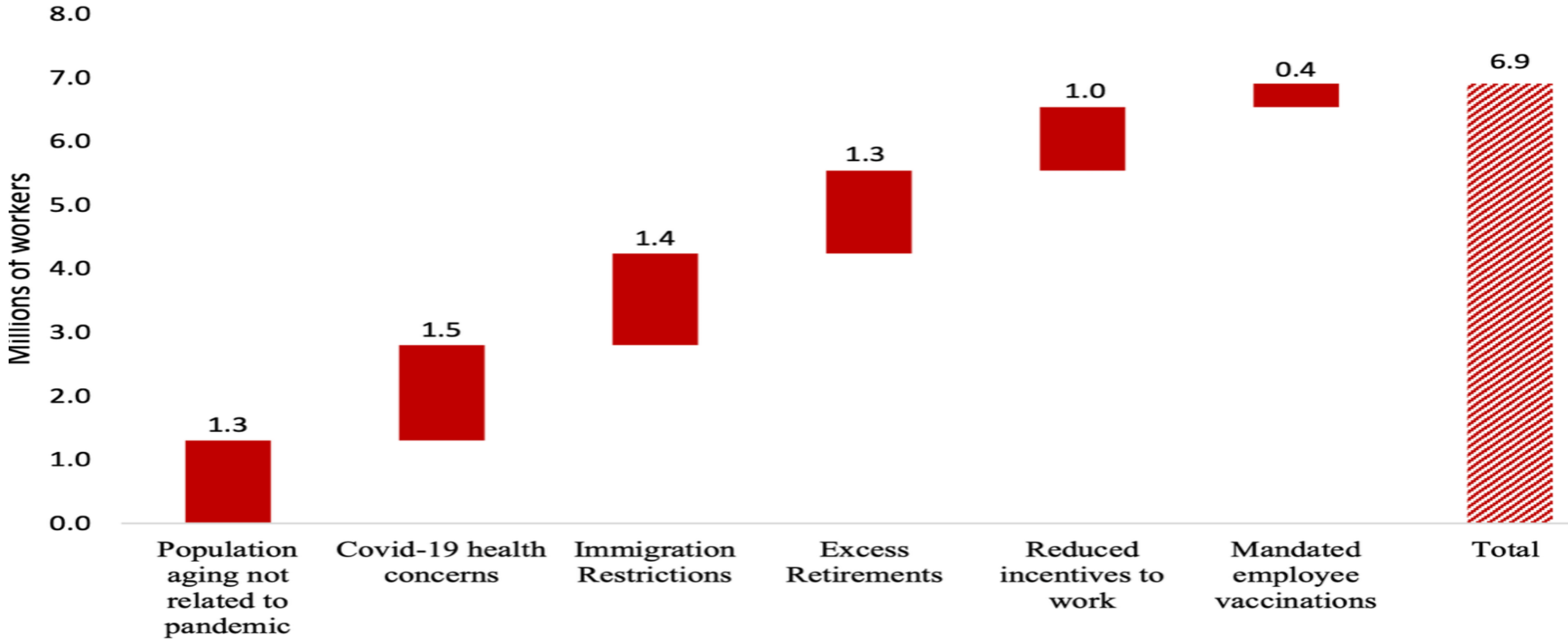



Figure 6: Estimated shortfall in labor facing employers in 2022, relative to Feb 2020




*Source*: Authors' calculations.