

US Macro in Transition

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Outline

- Lessons from the previous cycle:
 - The “fault in our stars” and its implication for a data-driven Fed
 - “If you build it, they will come” (tight labor markets boost labor force)
 - Procyclical fiscal policy, yet inflation still below target
 - Trade wars
- The pandemic
 - “The risk of doing too little greater than the risk of doing too much.”
- Inflation takes off
 - Strong demand + weak supply (+ expectations)
- Hitting the monetary and fiscal brakes
- Current transition, ideally to steady, stable growth

From star-driven to data-driven

- Foundational insights from the pre-pandemic cycle
 - u^* --lowest unemployment rate consistent with stable inflation—unknowable within policy-relevant confidence interval.
 - y^* --same
 - r^* --falling in all advanced economies
 - inflation: persistent downside misses.
- Conclusions
 - Flat price Phillips curve
 - “Secular stagnation”
 - Demand shortfalls
 - Credit bubbles, role of capital inflows

The Pandemic

- Fiscal policy hit back harder than ever
 - “Shots in arms and checks in pockets”
- Supply chain disruptions
- Shifts in consumer preferences
- The launching of the strongest price pressures in 40 years.

Strong demand + disrupted supply (+ expectations) = higher inflation

- The T word (transitory): Not wrong, but far too temporally ambiguous.

Period	Episode of Fiscal Expansion	Average Annual Support (percentage of GDP)
1941–43	World War II mobilization	13.0
2020–21	COVID-19 pandemic	9.2
2008–9	Great Recession	5.5
1949–50	1949 Recession / Korean War	4.9
2001–4	2001 Recession and aftermath	4.7

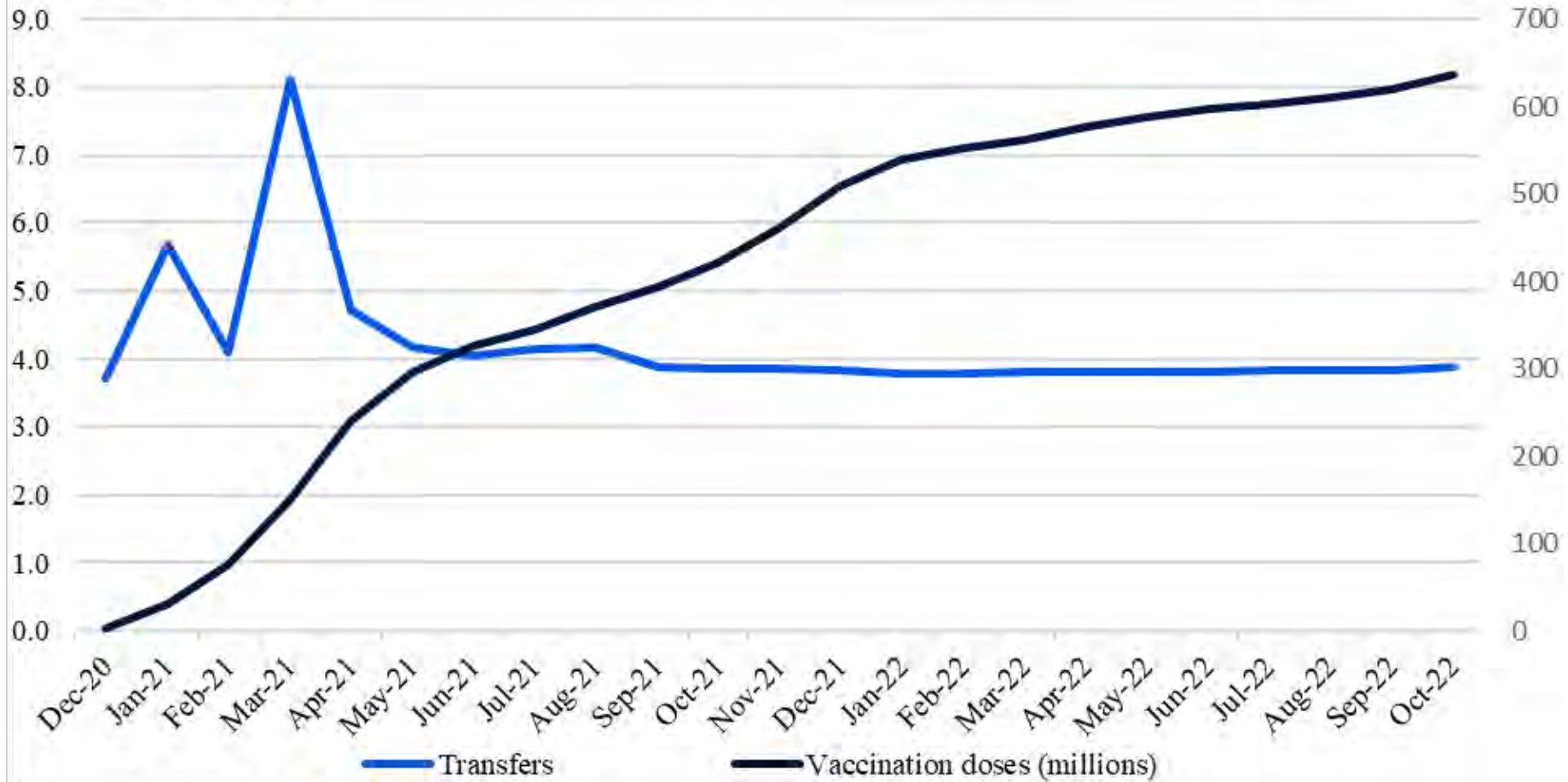
Sources: Office of Management and Budget; CEA calculations.

Note: This table shows the average annual increase in the primary deficit-to-GDP ratio, relative to the final year before the expansion (it includes both new and expanded programs).

Vaccinations and government transfer receipts, 2020-2022

*Government current transfer receipts
(trillions of dollars)*

*Cumulative vaccination doses administered
(millions)*

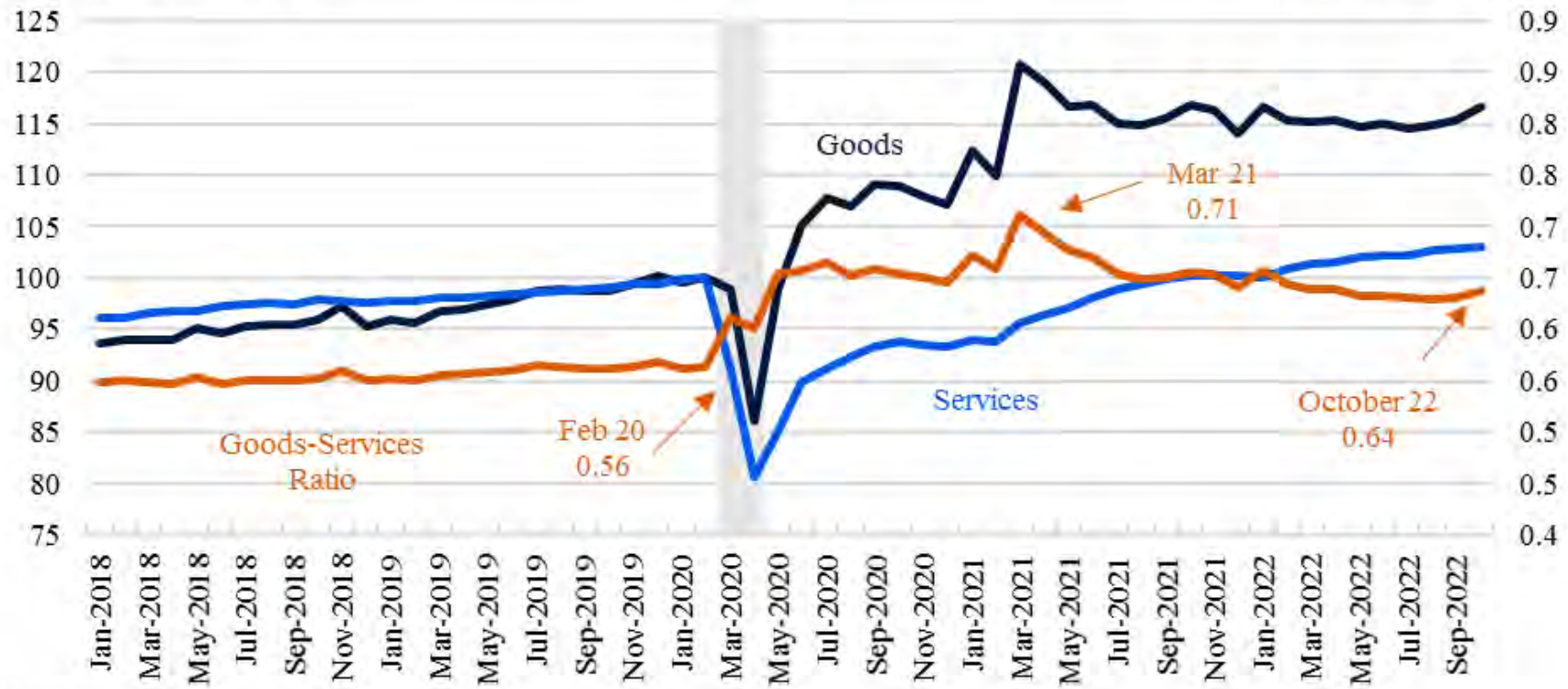


Source: CDC, BEA, CEA calculations.

Real Consumption of Goods and Services

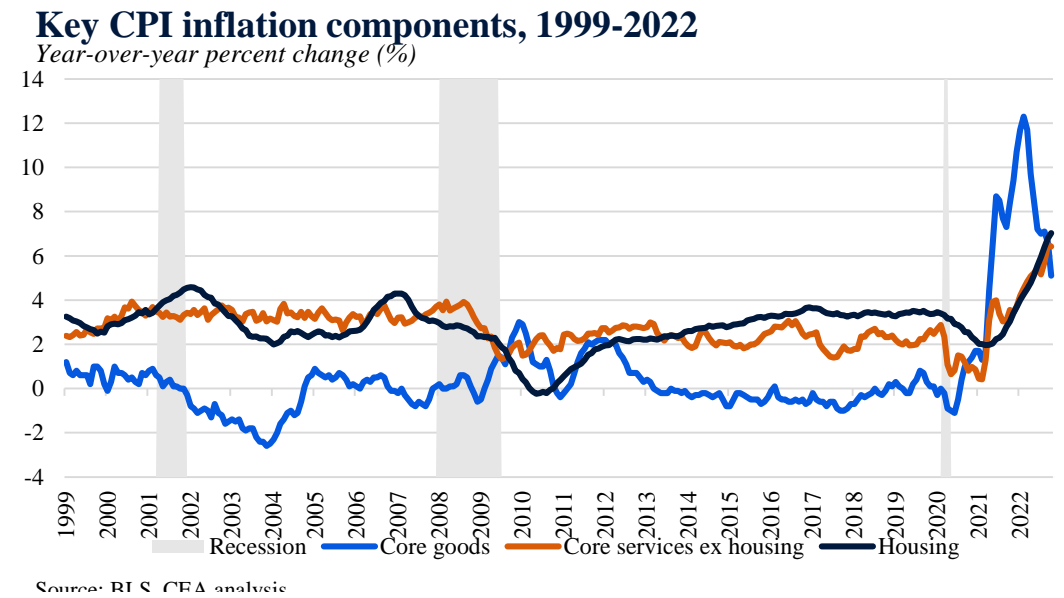
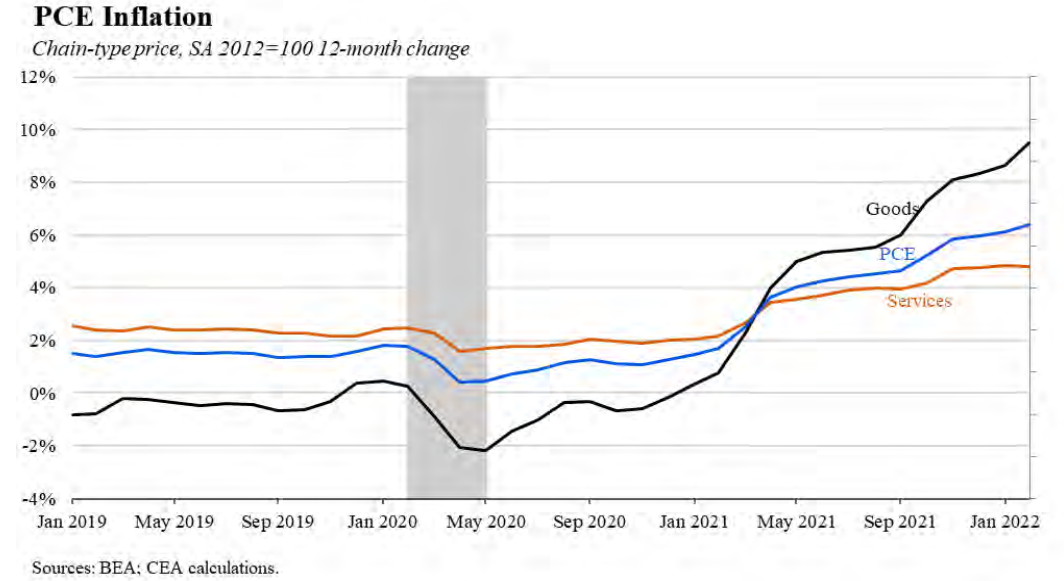
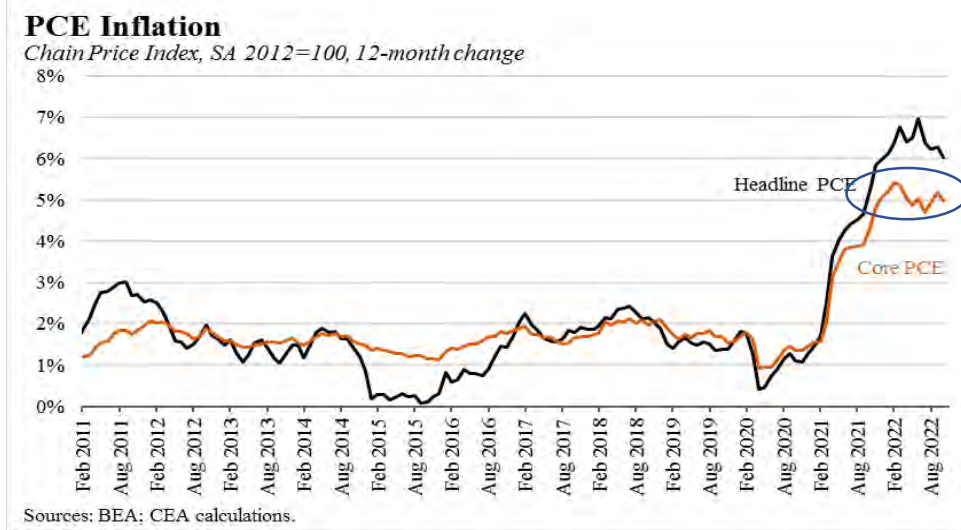
Real personal consumption expenditures (Index, February 2020=100)

Ratio of real goods consumption to real services consumption



Sources: BEA; CEA.

Inflation takes off

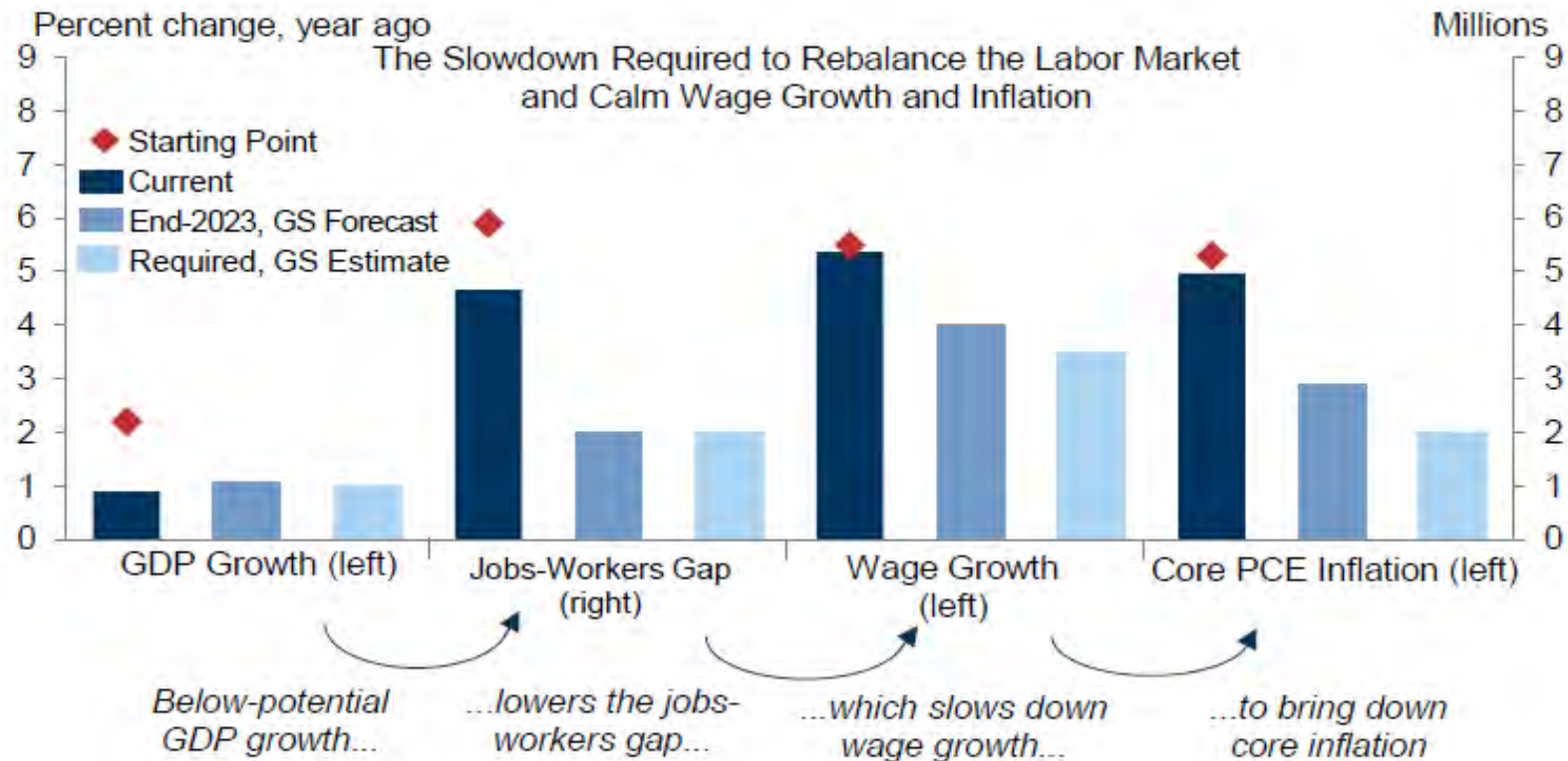


Transition ahead!

- Goldman Sachs model (which Fed also appears to be following)
- Challenges to transition
 - Fiscal/monetary overshoots
 - High sacrifice ratio
 - Non-linear reactions to tightening
 - Unforeseen shocks (e.g., energy, political “own goals”)
 - Wage-price dynamics
- Tailwinds to transition
 - Strongest job market in decades
 - Balance sheets
 - Energy price declines
 - “Informed” fiscal and monetary policy
 - Inflationary pressures improving

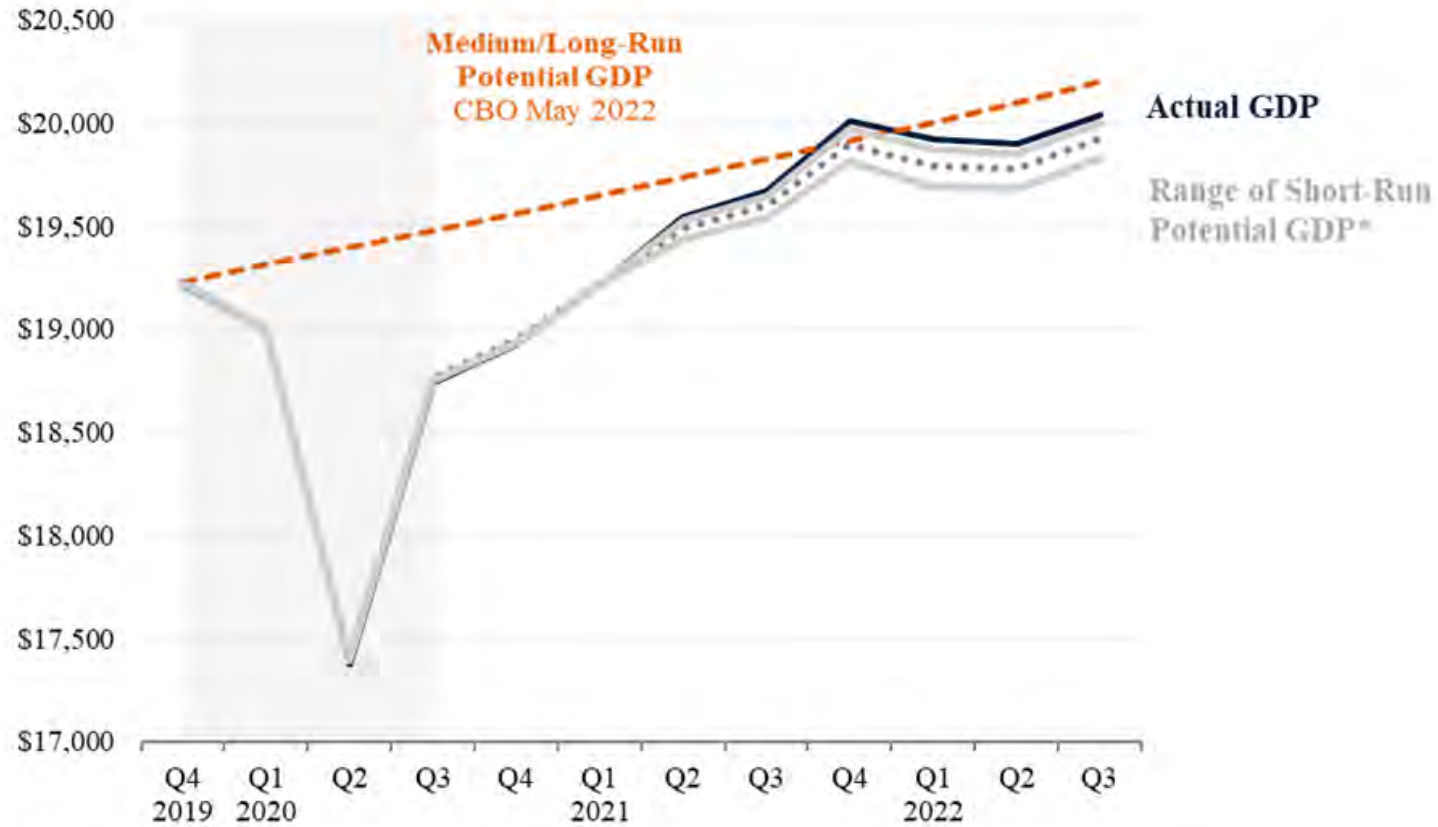
Goldman Sachs Transition Model

Exhibit 1: . We Expect Another Year of Below-Potential GDP Growth in 2023 to Rebalance the Labor Market and Slow Wage Growth and Inflation, but Reaching the 2% Target Will Take Longer



US Real GDP Since 2019 Q4

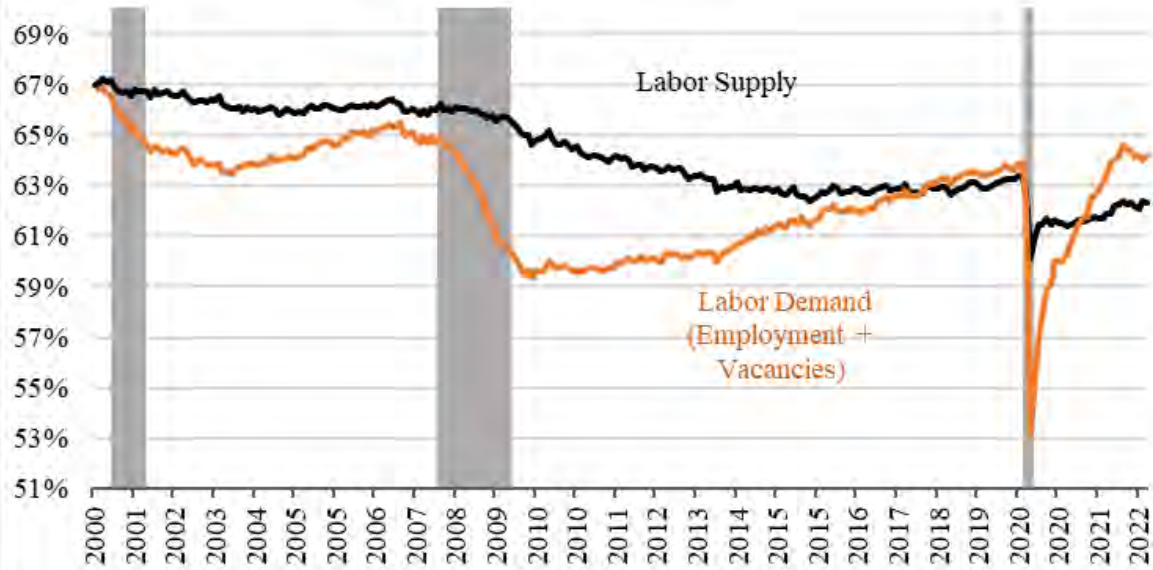
Billions \$2012



* Range implied by actual GDP, core PCE inflation, and various Okun Ratio (1.7-2.3) and Phillips Curve slope (0.17-0.83) estimates.
Source: BEA, CBO, CEA calculations.

Labor Supply and Demand

Percent of the civilian noninstitutional population 16+

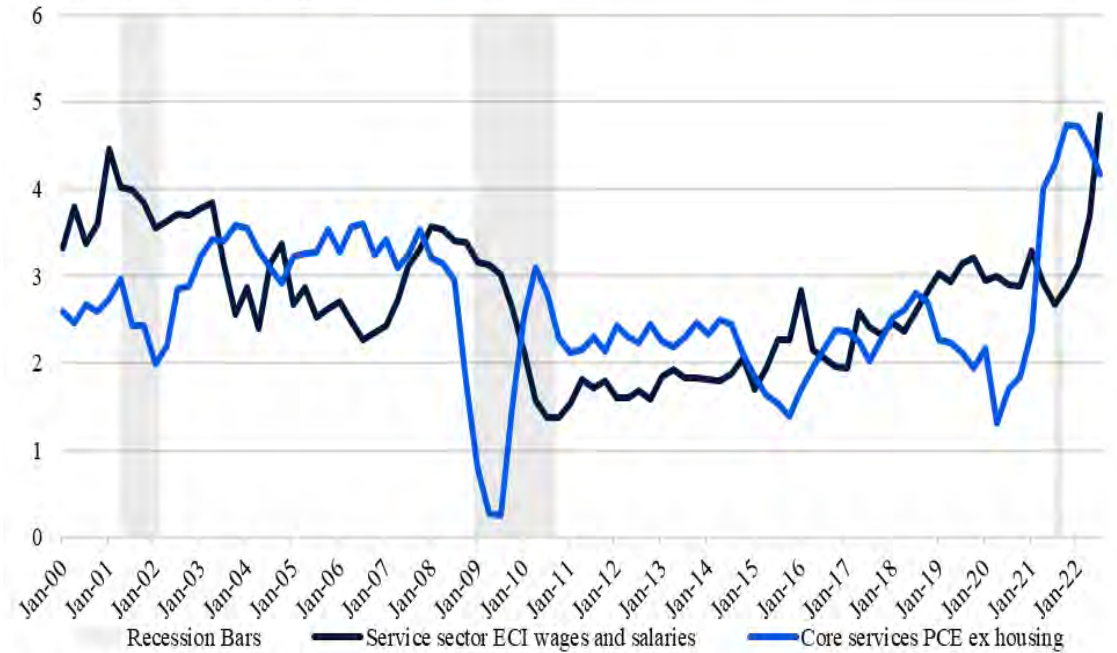


Sources: Bureau of Labor Statistics; CEA calculations

Note: Labor supply, employment, and population are from the BLS Current Population Survey (CPS). Vacancies are from the Job Openings and Labor Turnover Survey (JOLTS).

Core services inflation ex housing and ECI, 2000-present

Year-over-year percent change (%)

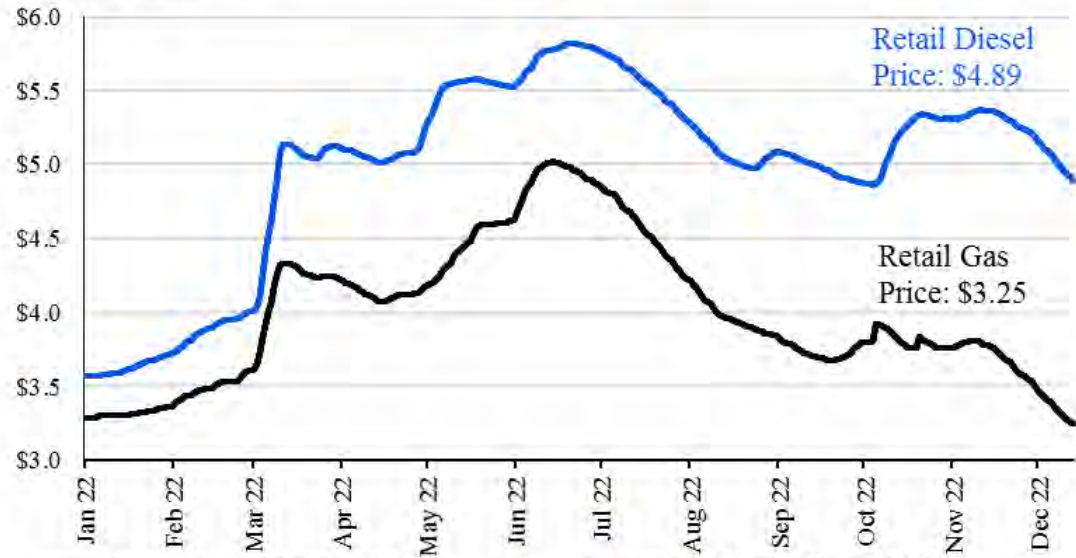


Source: BLS, BEA, CEA analysis.

Retail Gasoline and Diesel Prices

12/13/2022

Dollars/gallon



— Retail Gas Price: \$3.25

— Retail Diesel Price: \$4.89

Lowest gas price since: 10/7/2021

Lowest diesel price since: 10/6/2022

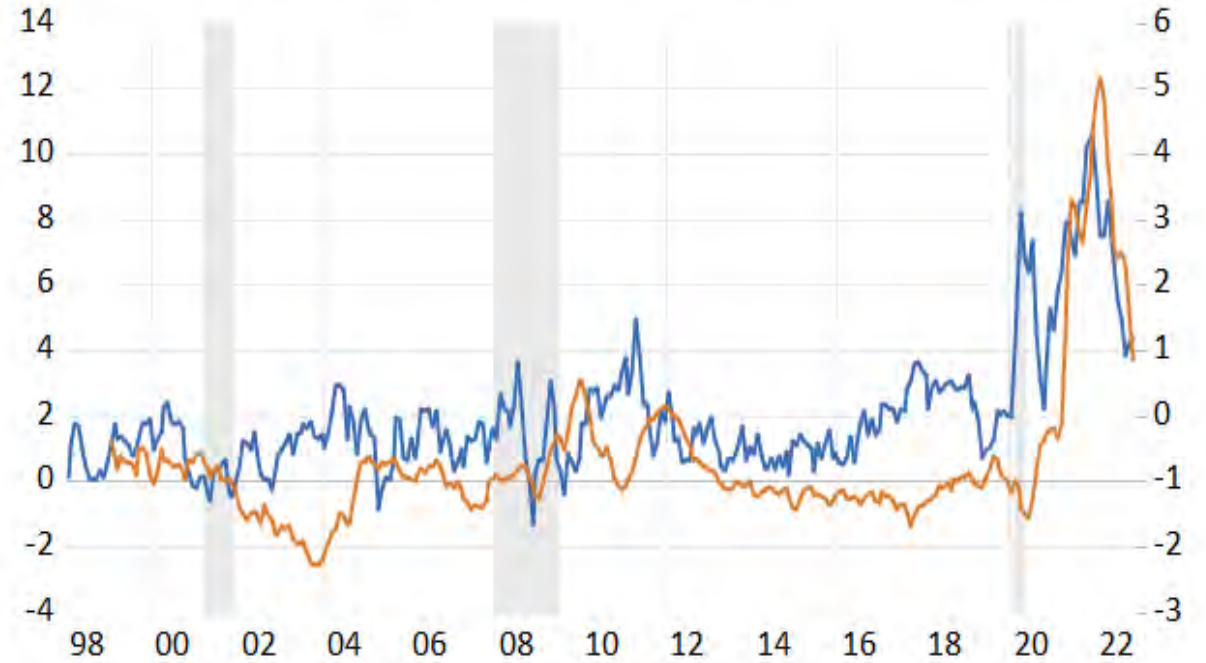
Days of gasoline price decline or holding steady: 34

Days of diesel price decline or holding steady: 32

Gas price relative to June peak: \$-1.78

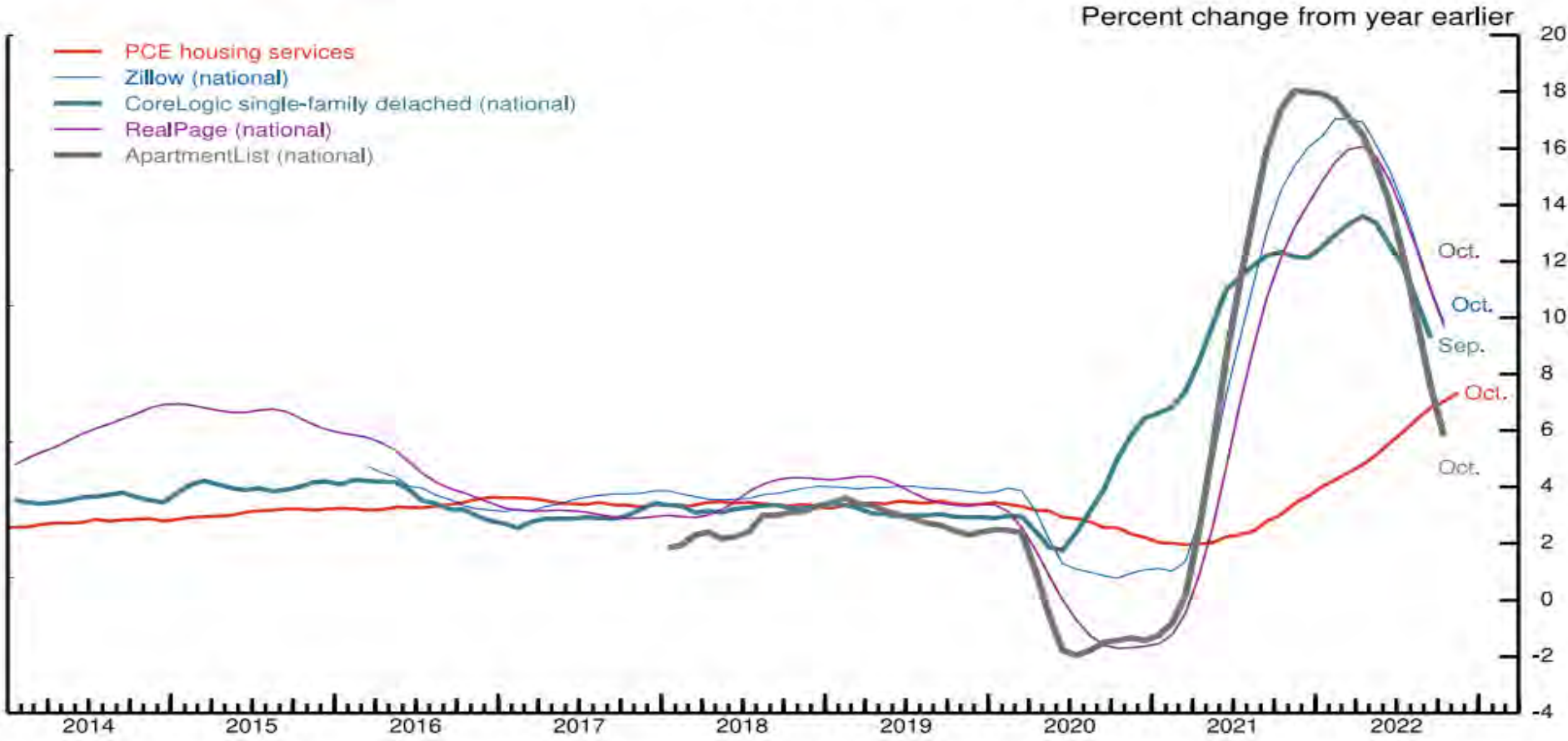
Diesel price relative to June peak: \$-0.93

New York Fed Supply Chain Index and Core Goods Inflation (yr/yr)



— GSCPI (R) — GOODS_Y (L)

Figure 3. Market rents and PCE housing services inflation

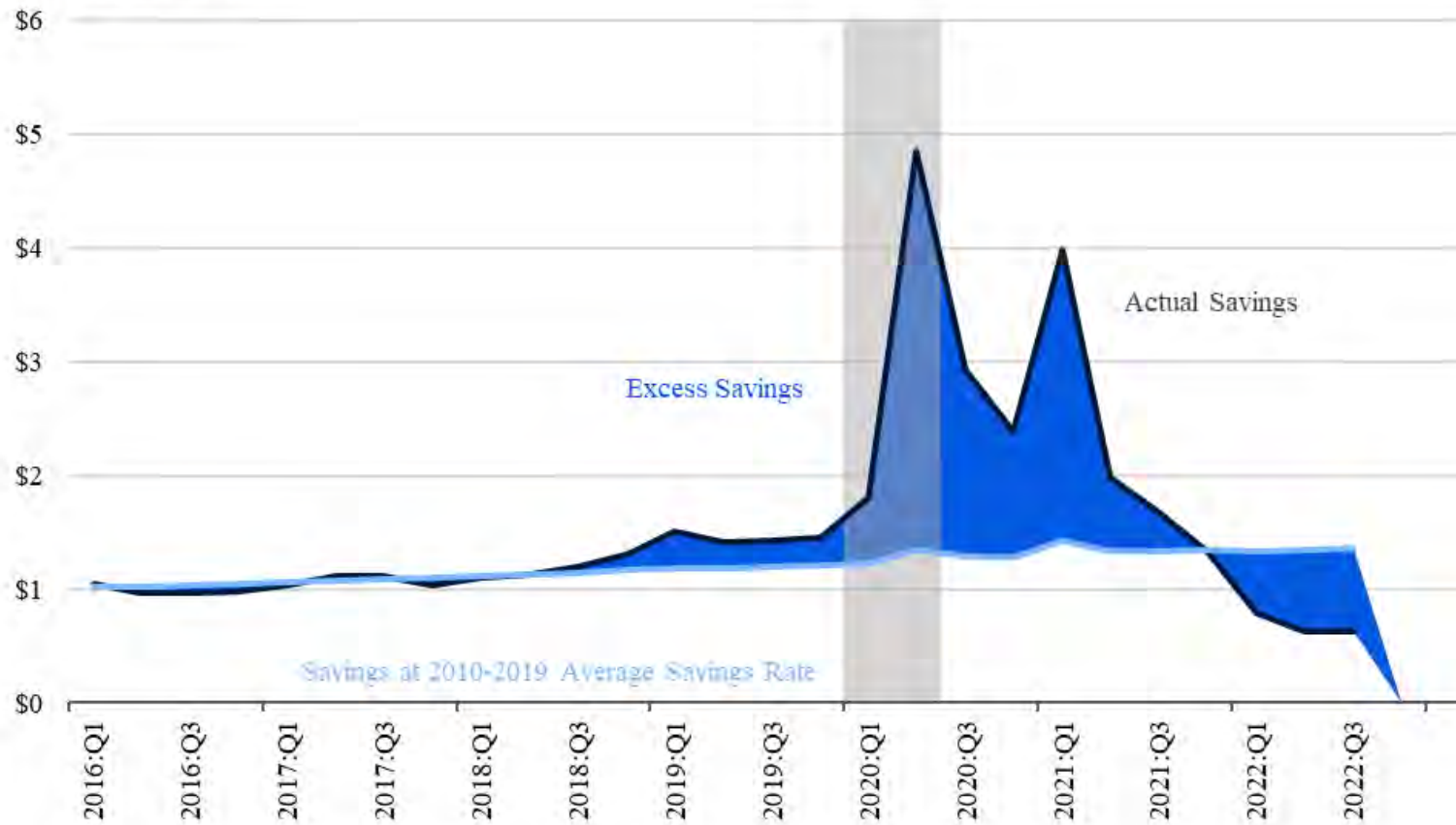


Note: ApartmentList, CoreLogic, RealPage, and Zillow measure market rate rents -- that is, rents for a new lease by a new tenant. October PCE (personal consumption expenditures) data are estimates based on October data from the consumer price index. The Zillow data start in March 2016, and the ApartmentList data start in January 2018.

Source: ApartmentList; Bureau of Economic Analysis; Bureau of Labor Statistics; CoreLogic; RealPage; Zillow; staff estimates.

Excess savings

Trillions of dollars



Sources: BEA; CEA Calculations.

Note: The average saving rate from 2010-2019 was 7.3%.