

# Prospects for Inflation

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## Outline for the Talk

1. A little background on the Fed and how it affects the economy.
2. The importance of “well-anchored” inflationary expectations.
3. Recent economic performance and my explanation for why the Fed has been slow to react.
4. Dangers that lie ahead.

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# Stabilizer in Chief: the Fed



Jerome Powell  
February 2018

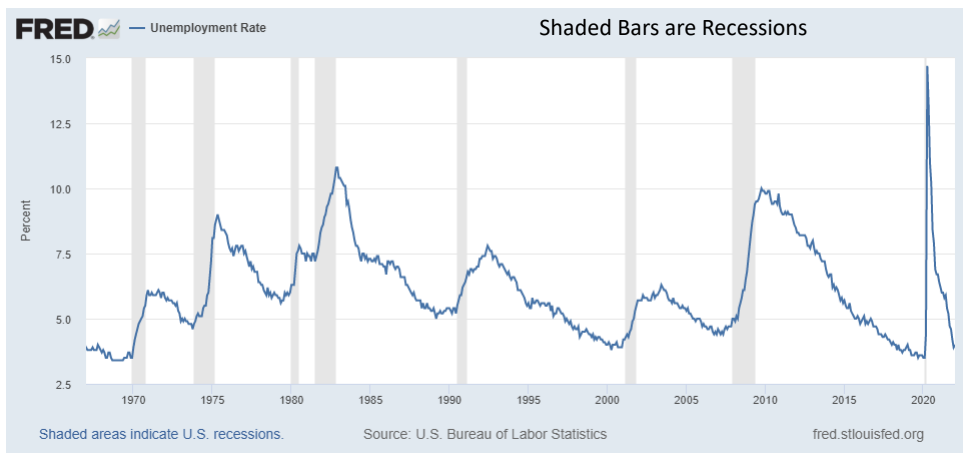
- **The Fed’s Dual Mandate:**

1. “Stable prices” which means 2% rate of inflation in the Personal Consumption Price Index (which corresponds to about 2.5% inflation in the more well-known CPI).
2. “Maximum employment” which means the highest level of employment (lowest unemployment rate) consistent with mandate 1.

- **Fiscal Policy (taxes and spending, President and the Congress) can affect inflation and unemployment, but it is the Fed’s job to achieve the dual mandate**

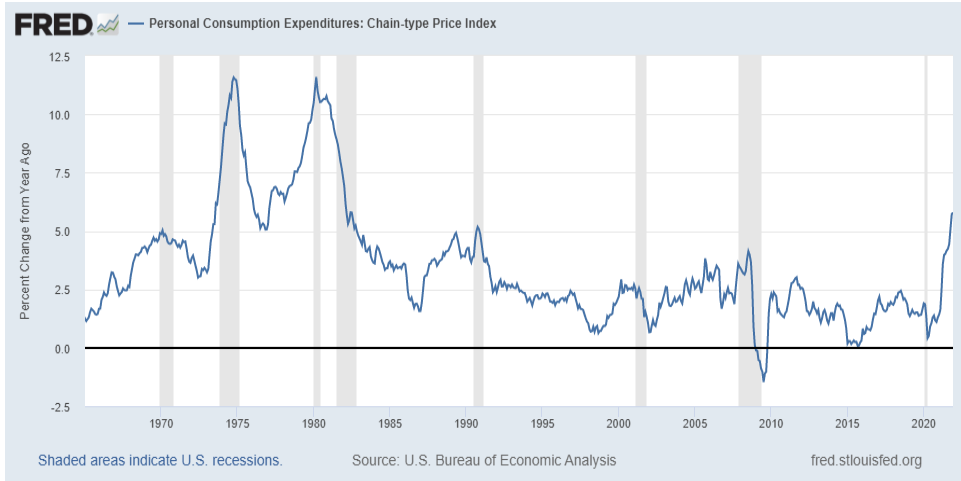
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# Track Record on Unemployment



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## Track Record on “Price Stability”



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## Determinants of Unemployment & Inflation

- **Unemployment:** The higher the level of total spending (“aggregate demand”), the lower the unemployment rate.
- **Inflation:**
  1. Too much spending and inflation rises (Vietnam).
  2. Increase in production costs (e.g., “supply chain bottlenecks.”)
  3. Expectations of high inflation can cause inflation to be high.

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## The Fed's Affects the Economy via Interest Rates

- Higher Interest rates discourage firms from buying new plant and equipment, households from buying new homes and tend to lower stock and house prices (!).
- Reduced spending tends to lower production and employment and eventually lowers inflation.



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## Become a Central Banker in One Slide!

- If you are more concerned that inflation is too high, raise interest rates.
- If you are more concerned that unemployment is too high, lower interest rates.
- Inflation and unemployment just right: keep rates the same.



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## One Big Complication: Lags

- **Milton Friedman: Monetary Policy affects GDP and Inflation with Long and Variable (Unpredictable) Lags.**
- **Raising interest rates today does nothing to spending today nor to inflation.**
- **But over time spending slows and eventually inflation falls.**
- **Friedman believed that lags led to the Fed to “oversteering” the economy consistently.**



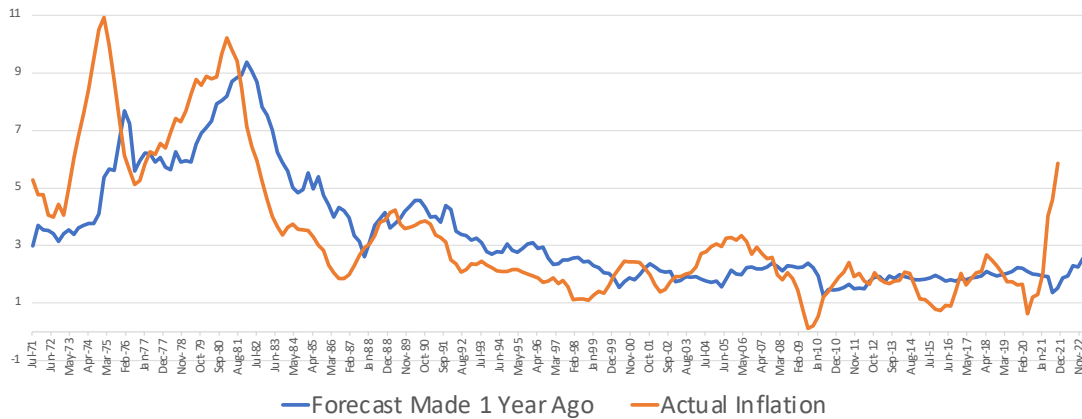
## The Great Moderation

- **From 1990 until 2008, the performance of the US economy was extraordinary and even Milton Friedman gave kudos to the Alan Greenspan.**
- **We (economist) thought we knew why: Central Bankers finally listened to us on the importance of stabilizing inflationary **expectations**, starting with Paul Volcker.**
- **Volcker was determined to reduce inflationary expectations.**



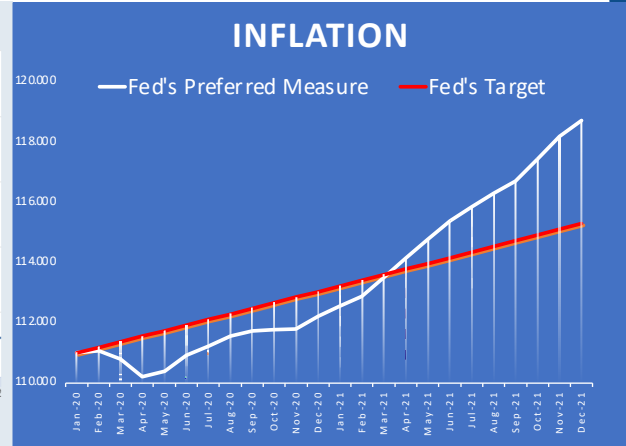
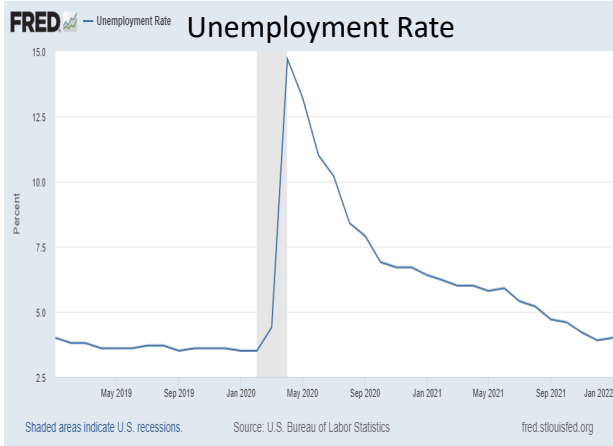
# "Anchoring" Inflation Expectations

## Expectations and Subsequent Inflation



Forecasts: Philadelphia Fed, "Survey of Professional Forecasters"

# A Closer Look Has the Fed Been Doing Recently?

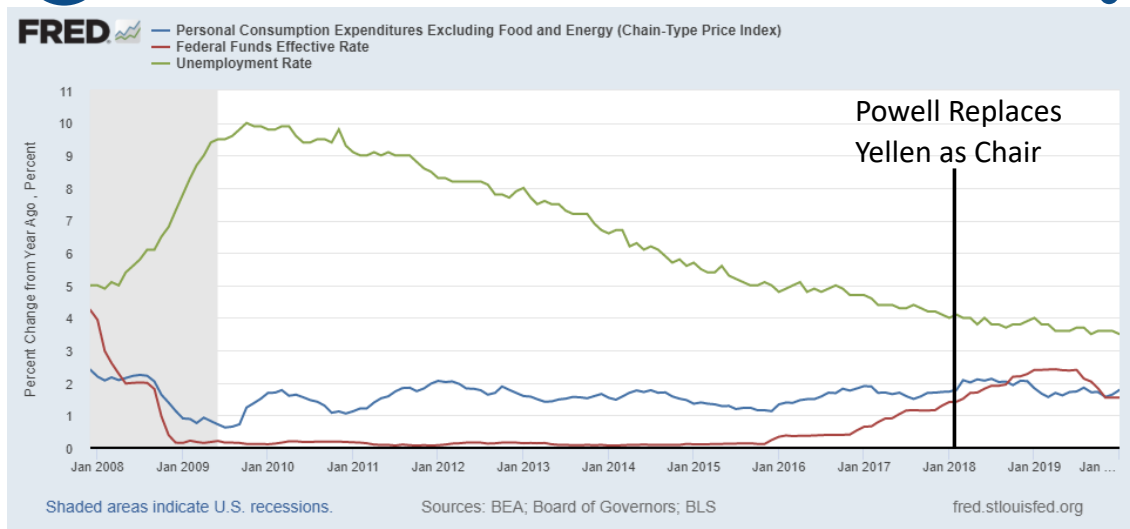


## My Diagnosis for the Uptick in Inflation

- Yes, there were supply chain issues that affected some areas in particular (e.g., computer chips).
- But there is too much total spending and in the absence of bold Fed actions is likely to continue.
- Fiscal stimulus led households to increase saving over 2021 by more than \$2 trillion and today's strong retail sales numbers suggest they are prepared to spend it.
- Whose to Blame: ARP probably too big, but the Fed could have acted sooner.

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## Why Did Powell Do It?



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## Policy Changes under Powell

- In the Fed's dual mandate put more emphasis on the employment goal relative to the inflation goal.
- Inflation goal switched from targeting forecasted *future* inflation to trying to achieve average *realized* inflation of 2%

Have they forgotten about Lags!



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## So Far Inflationary Expectations Look Stable

- Professional forecasters, financial markets and the Fed itself think that inflation in 2022 will be in the 2.5-3%, range

Variable:	Median Fed Forecasts from 12/15/21 FOMC Meeting			
	2022	2023	2024	Longer run
Unemployment rate	3.5	3.5	3.5	4.0
Inflation	2.6	2.3	2.1	2.0
Interest rate	0.9	1.6	2.1	2.5



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## Latest Fed Readings

The Minutes of the FOMC meeting 3 weeks ago were released today at 2PM.

- Most participants suggested that a faster pace of increases in the target range for the federal-funds rate than in the post-2015 period would likely be warranted.
- Most participants noted that, if inflation does not move down as they expect, it would be appropriate for the Committee to remove policy accommodation at a faster pace than they currently anticipate.



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## If Expectations Start to Increase

The Fed will have a very difficult choice

- a) **Raise interest rates a lot (in an election year) to slow inflation**
  1. stalling the recovery.
  2. disrupting financial markets.
- b) **Raise interest rates slowly and moderately to cushion the effect on employment**
  1. avoids a recession (maybe).
  2. inflationary expectations become unanchored



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## More Information

- Slides will be available the NEED web site tomorrow ([www.NEEDelegation.org](http://www.NEEDelegation.org))
- Similar analysis in today's *WSJ*, "The Fed Missed Inflation. Can Jay Powell Tame It Without Causing a Recession?" (<https://www.wsj.com/articles/behind-the-feds-slow-pivot-to-tackling-inflation-11644930180?page=1>)



## Who Are We?

- **Honorary Board: 54 members**
  - 2 Fed Chairs: Janet Yellen, Ben Bernanke
  - 6 Chairs Council of Economic Advisers
    - o Furman (D), Rosen (R), Bernanke (R), Yellen (D), Tyson (D), Goolsbee (D)
  - 3 Nobel Prize Winners
    - o Akerlof, Smith, Maskin
- **Delegates: 649+ members**
  - At all levels of academia and some in government service
  - All have a Ph.D. in economics
  - Crowdsource slide decks
  - Give presentations
- **Global Partners: 45 Ph.D. Economists**
  - Aid in slide deck development



## National Economic Education Delegation

- **Vision**

- One day, the public discussion of policy issues will be grounded in an accurate perception of the underlying economic principles and data.

- **Mission**

- NEED unites the skills and knowledge of a vast network of professional economists to promote understanding of the economics of policy issues in the United States.

- **NEED Presentations**

- Are **nonpartisan** and intended to reflect the consensus of the economics profession.



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## Let's Hear from You!

**Geoffrey Woglom**  
**grwoglom@amherst.edu**

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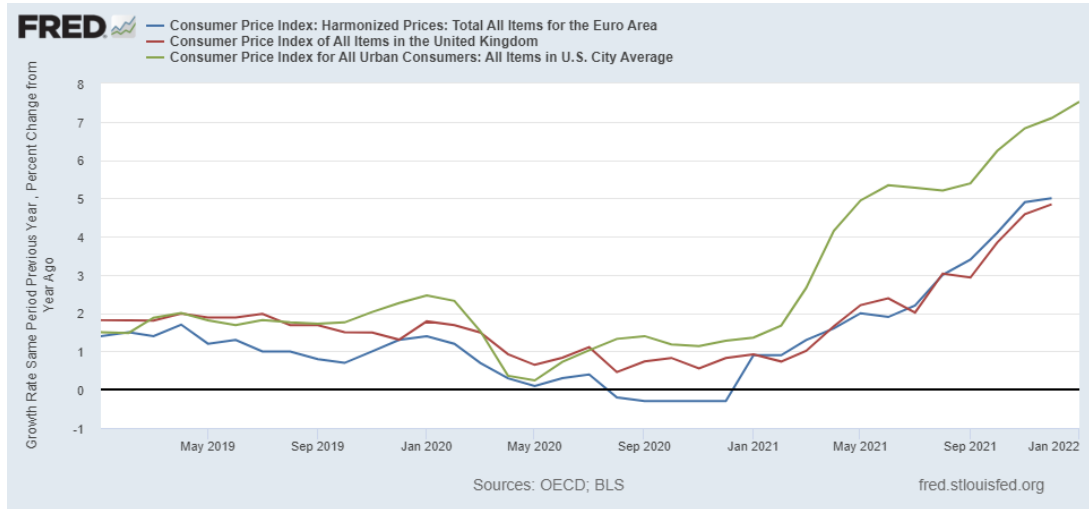


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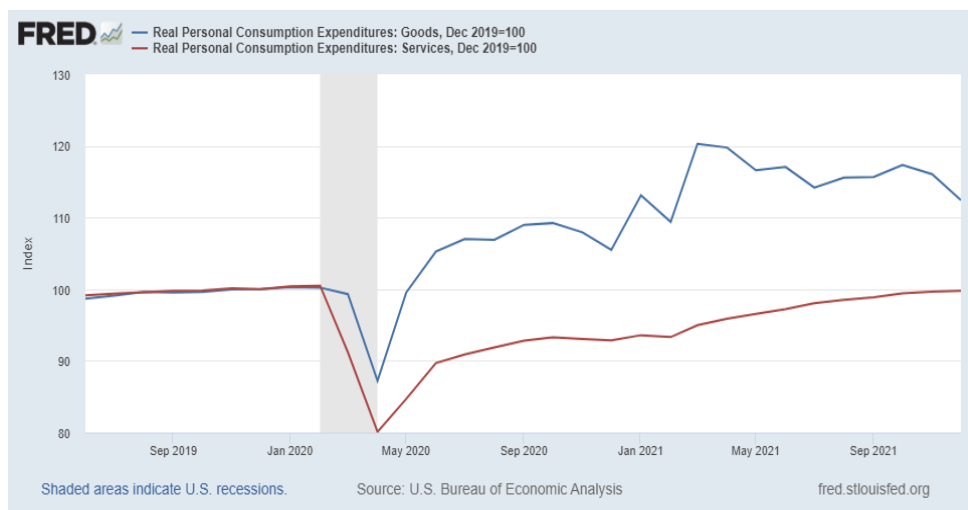
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# Inflation in 3 Areas



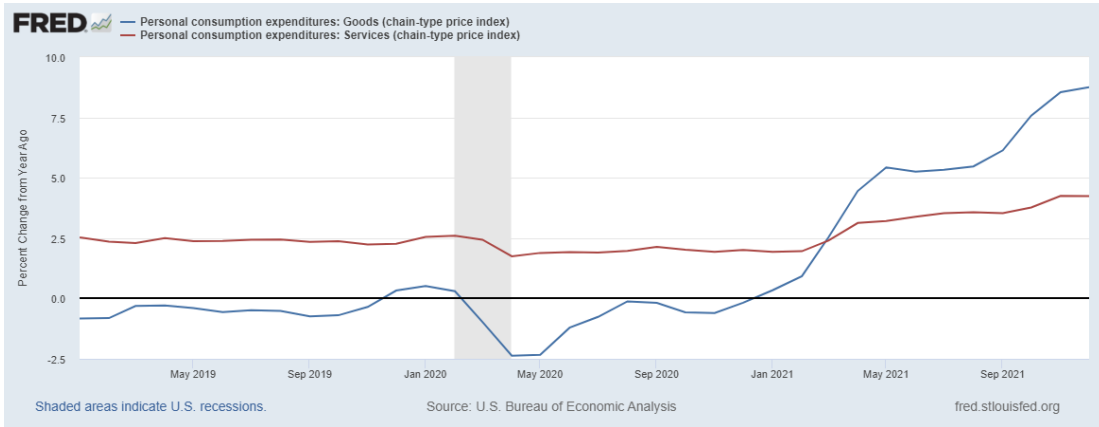
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# What about Supply Chain Disruptions?



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# Macro Imbalances & Inflation



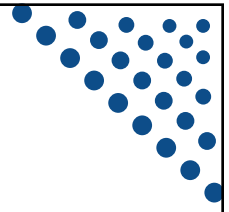
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# The Bond Market's Take on Inflation

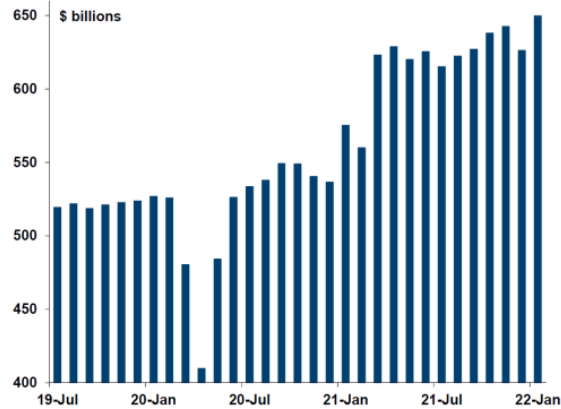


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# Consumer Demand is Still Strong



Retail Sales



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Source: U.S. Census Bureau via Haver Analytics