Osher Lifelong Learning Institute, Winter 2023

Contemporary Economic Policy

University of Pittsburgh
May-June, 2023

Host: Jon Haveman, Ph.D.
National Economic Education Delegation

NATIONAL ECONOMIC EDUCATION DELEGATION

1

1

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.

NATIONAL ECONOMIC EDUCATION DELEGATION

2

2

Who Are We?

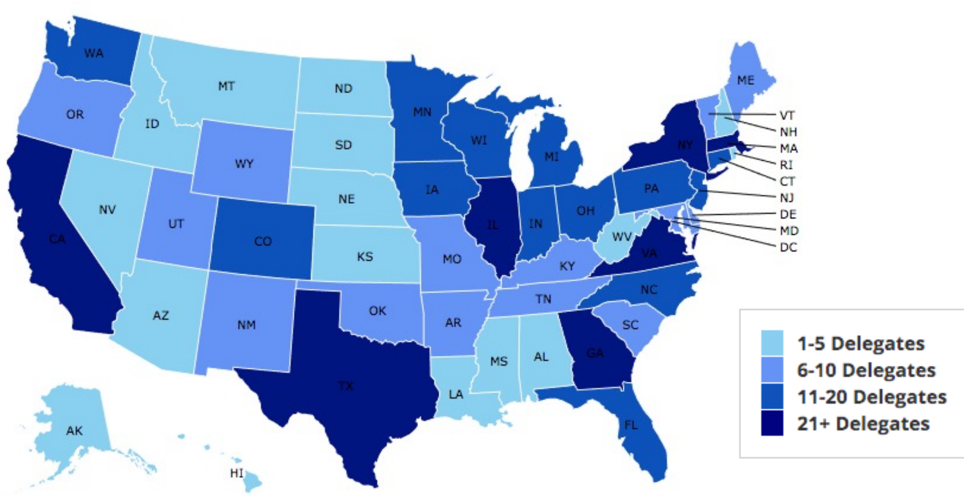
- **Honorary Board: 54 members**
  - 2 Fed Chairs: Janet Yellen, Ben Bernanke
  - 6 Chairs Council of Economic Advisers
    - Furman (D), Rosen (R), Bernanke (R), Yellen (D), Tyson (D), Goolsbee (D)
  - 3 Nobel Prize Winners
    - Akerlof, Smith, Maskin
- **Delegates: 652+ members**
  - At all levels of academia and some in government service
  - All have a Ph.D. in economics
  - Crowdsource slide decks
  - Give presentations
- **Global Partners: 48 Ph.D. Economists**
  - Aid in slide deck development

NATIONAL ECONOMIC
EDUCATION DELEGATION

3

3

Where Are We?



NATIONAL ECONOMIC
EDUCATION DELEGATION

4

4

Available NEED Topics Include:

- US Economy
- Healthcare Economics
- Climate Change
- Economic Inequality
- Economic Mobility
- Trade and Globalization
- Minimum Wages
- Immigration Economics
- Housing Policy
- Federal Budgets
- Federal Debt
- Black-White Wealth Gap
- Autonomous Vehicles
- Healthcare Economics

NATIONAL ECONOMIC EDUCATION DELEGATION

5

5

Course Outline

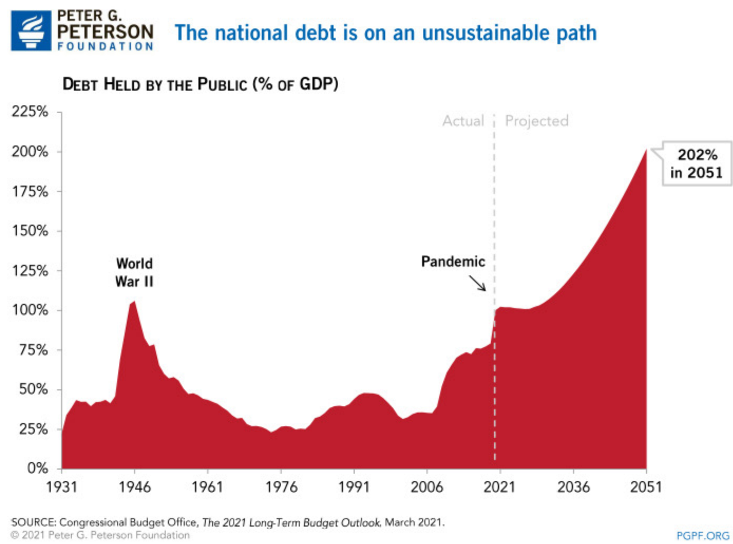
- Contemporary Economic Policy
  - ~~Week 1 (5/17): US Economic Update (Jon Haveman, NEED)~~
  - Week 1 (5/24): US Economic Update (Geoffrey Woglom, Amherst College)
  - Week 2 (5/31): Federal Debt (Brian Peterson, Lagrange College)
  - Week 3 (6/7): Economics of Immigration (Jon Haveman)
  - Week 4 (6/14): Economic Mobility (Jon Haveman)
  - Week 5 (6/21): The Gender Wage Gap (Jon Haveman, NEED)

NATIONAL ECONOMIC EDUCATION DELEGATION

6

6

The Federal Debt is Becoming A Problem



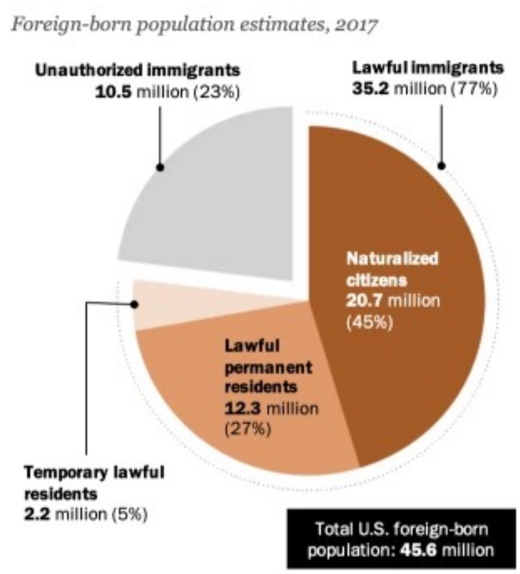
NATIONAL ECONOMIC EDUCATION DELEGATION

7

7

Immigrant Population in 2017

Categories of the total number of immigrants in the United States.

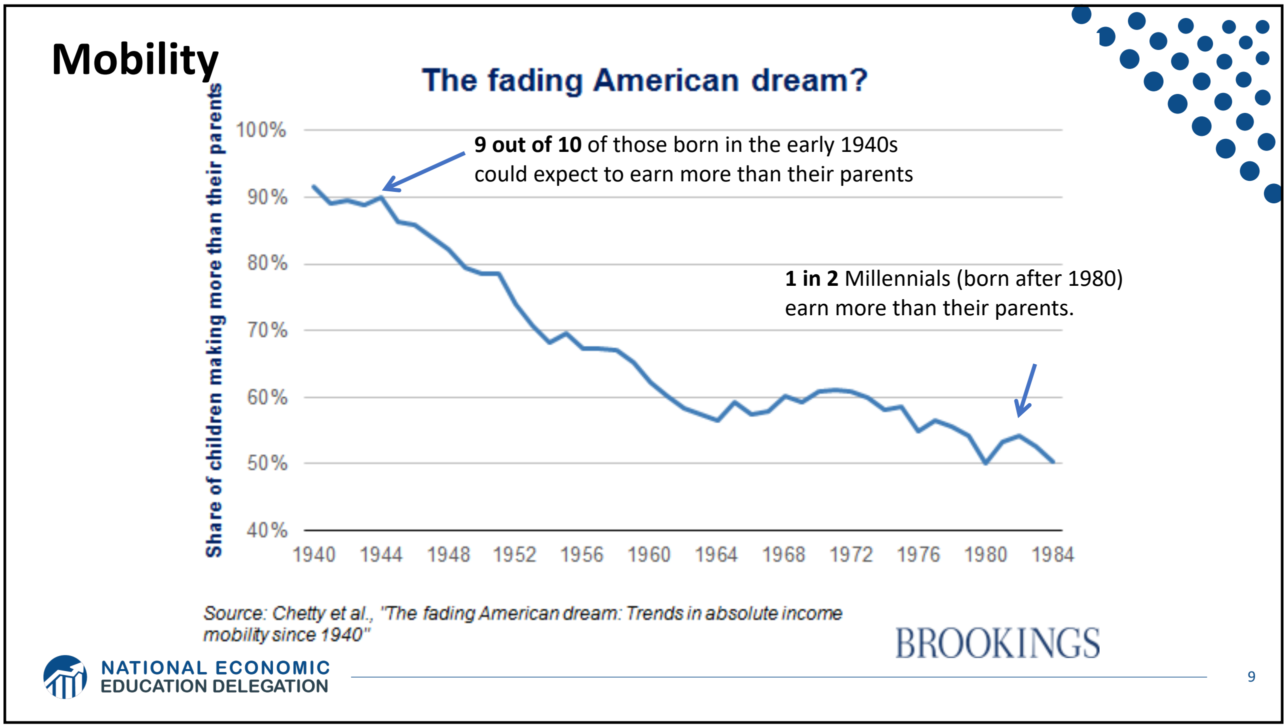


NATIONAL ECONOMIC EDUCATION DELEGATION

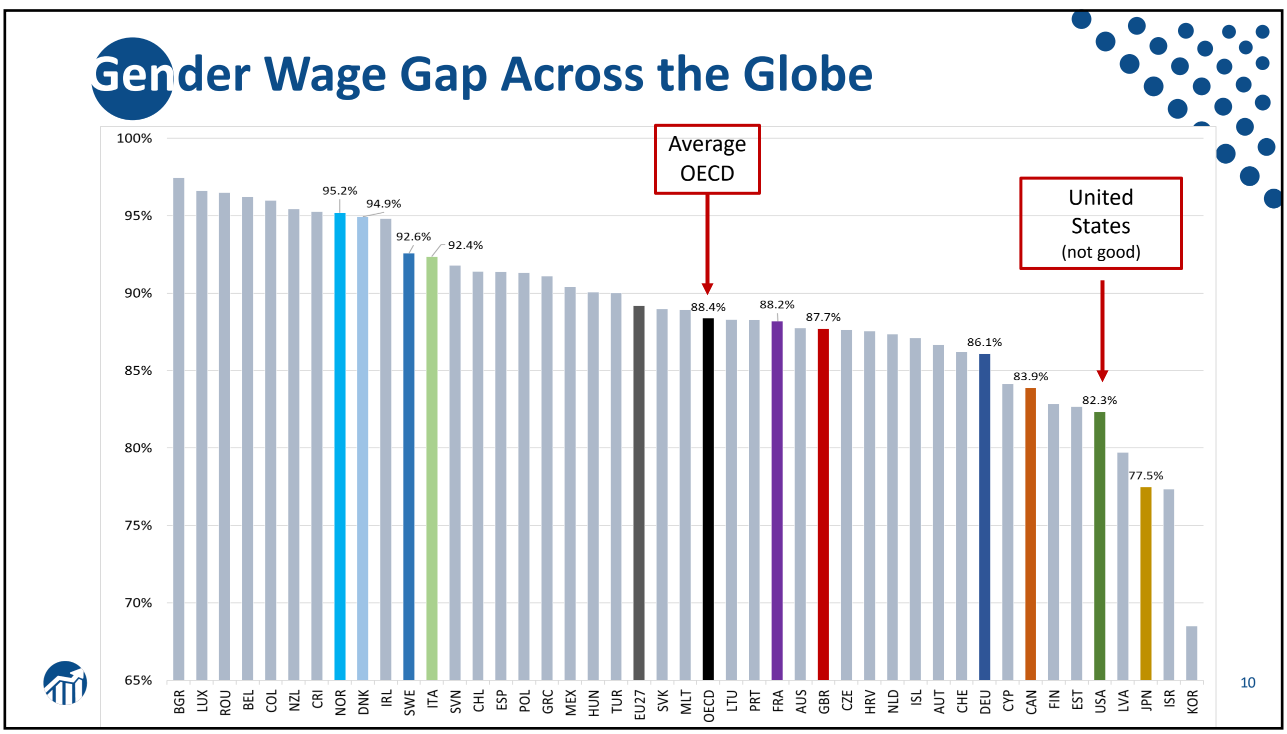
8

https://www.pewresearch.org/fact-tank/2019/07/12/how-pew-research-center-counts-unauthorized-immigrants-in-us/

8


Mobility
The fading American dream?
Share of children making more than their parents
100%
90%
80%
70%
60%
50%
40%
1940 1944 1948 1952 1956 1960 1964 1968 1972 1976 1980 1984
9 out of 10 of those born in the early 1940s could expect to earn more than their parents
1 in 2 Millennials (born after 1980) earn more than their parents.
Source: Chetty et al., "The fading American dream: Trends in absolute income mobility since 1940"
BROOKINGS
NATIONAL ECONOMIC EDUCATION DELEGATION
9

9


Gender Wage Gap Across the Globe
100%
95%
90%
85%
80%
75%
70%
65%
Average OECD
United States (not good)
95.2%
94.9%
92.6%
92.4%
88.4%
88.2%
87.7%
86.1%
83.9%
82.3%
77.5%
BGR LUX ROU BEL COL NZL CRI NOR DNK IRL SWE ITA SVN CHL ESP POL GRC MEX HUN TUR EU27 SVK MLT OECD LTU PRT FRA AUS GBR CZE HRV NLD ISL AUT CHE DEU CYP CAN FIN EST USA LVA JPN ISR KOR
10

10

Submitting Questions

- **Please submit questions of clarification in the chat.**
  - I will try to handle them as they come up.
- **We will do a verbal Q&A once the material has been presented.**
- **Slides will be available from the NEED website shortly after the talk (https://NEEDEcon.org/delivered_presentations.php)**

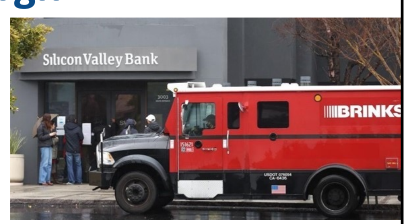
NATIONAL ECONOMIC EDUCATION DELEGATION

11

11

US Economic Update

OLLI – University of Pittsburgh



May 25, 2023
Geoffrey Woglom, Ph.D.
Amherst College

NATIONAL ECONOMIC EDUCATION DELEGATION

12

12

Credits and Disclaimer

- **This slide deck was authored by:**
  - Jon D. Haveman, NEED
  - Scott Baier, Clemson University
  - Geoffrey Woglom, Amherst College (Emeritus)
  - Brian Dombeck, Lewis & Clark College
  - Doris Geide-Stevenson, Weber State
- **Disclaimer**
  - NEED presentations are designed to be nonpartisan.
  - It is, however, inevitable that the presenter will be asked for and will provide their own views.
  - Such views are those of the presenter and not necessarily those of the National Economic Education Delegation (NEED).

NATIONAL ECONOMIC EDUCATION DELEGATION

13

13

Outline for the Talk

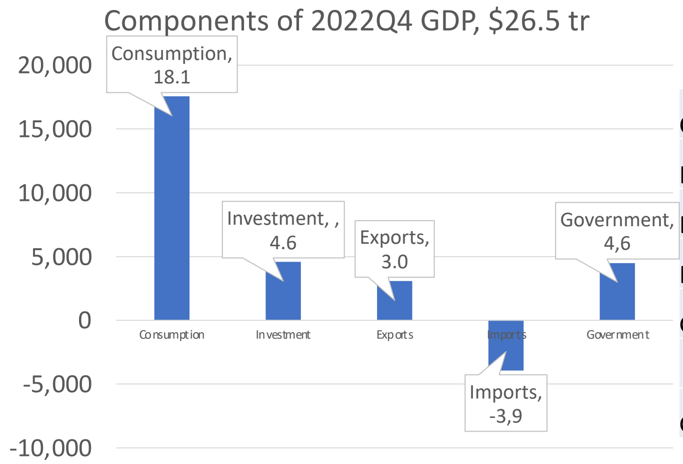
1. **Summary of the state of the economy.**
2. **The Effect of M&F policies.**
3. **Primer on Monetary Policy.**
4. **What's at Stake in Controlling Inflation**

NATIONAL ECONOMIC EDUCATION DELEGATION

14

14

Gross Domestic Product



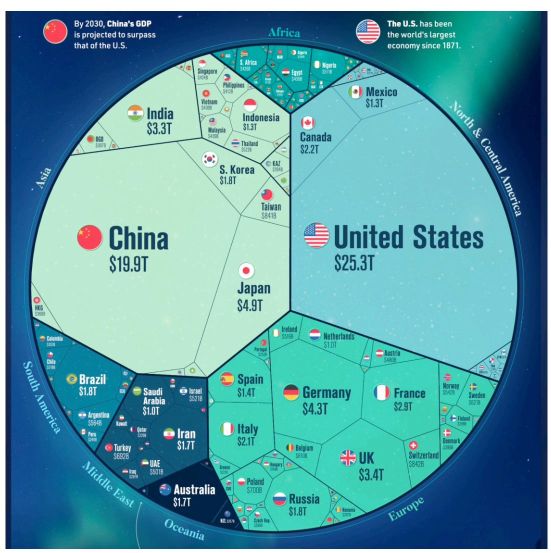
Consumption	68.4%
Investment	17.2%
Exports	11.4%
Imports	-14.5%
Government	17.5%
GDP	100.0%

NATIONAL ECONOMIC EDUCATION DELEGATION

15

15

The $100 trillion Global Economy (2022)



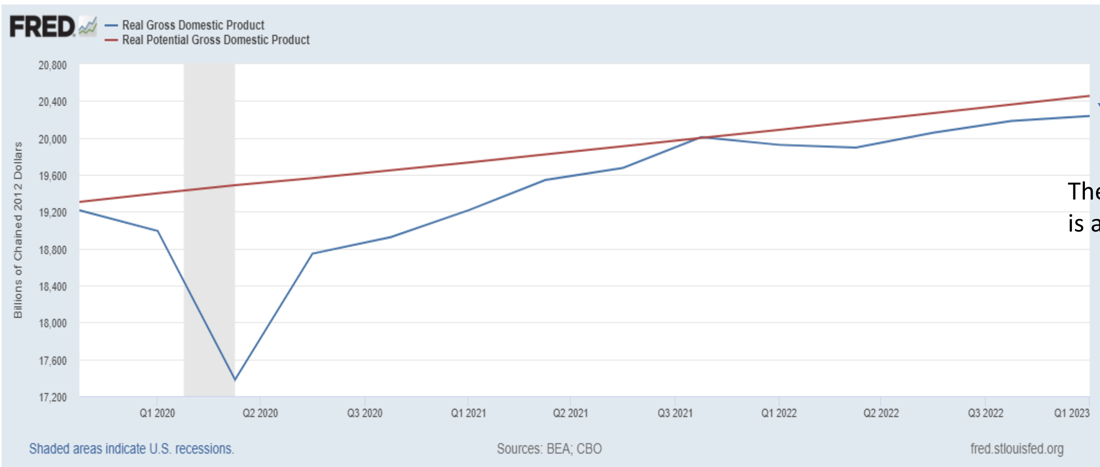
NATIONAL ECONOMIC EDUCATION DELEGATION

16

Source: https://www.visualcapitalist.com/100-trillion-global-economy/

16

Real GDP and 'Potential' during the Recovery



The "output gap" is about $250b

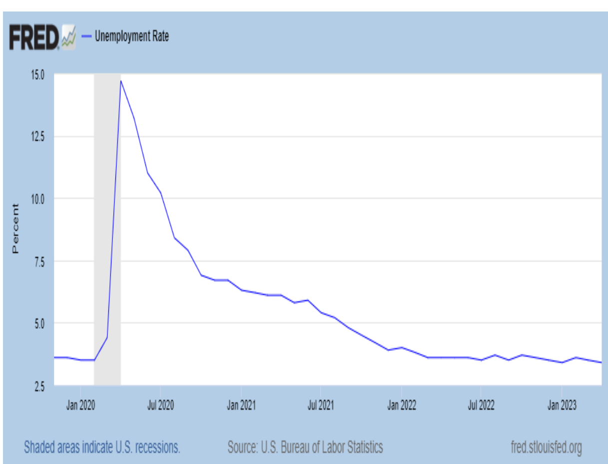
Source: Fred, St Louis Fed

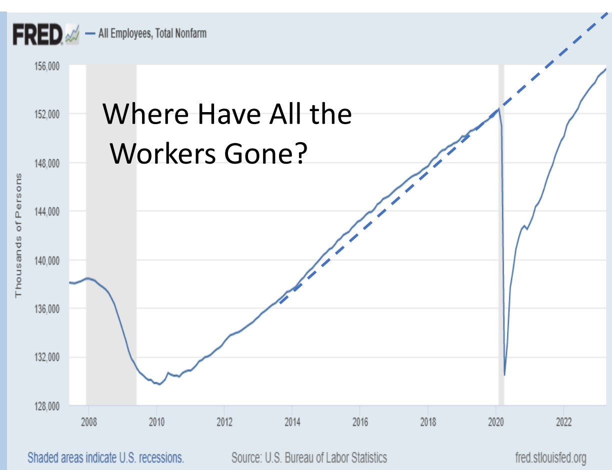
NATIONAL ECONOMIC EDUCATION DELEGATION

17

17

Labor Market Fully Recovered





NATIONAL ECONOMIC EDUCATION DELEGATION

18

18

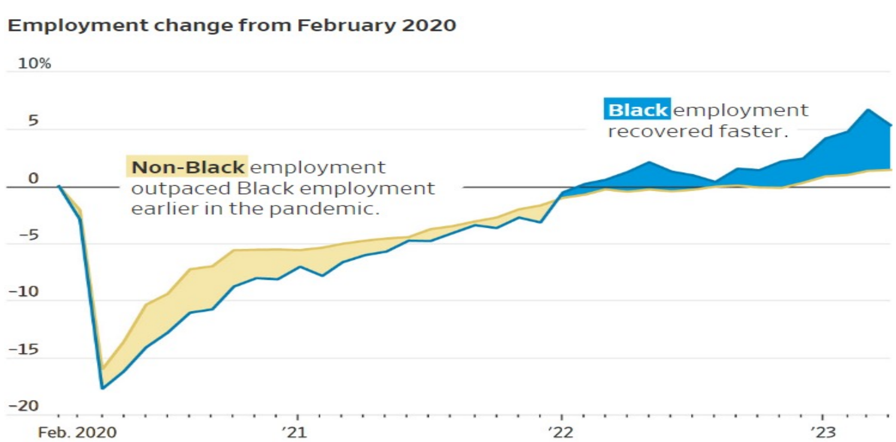
The Great Resignation?

NATIONAL ECONOMIC EDUCATION DELEGATION

19

19

Hot Labor Markets are Good for Disadvantaged



Source: Labor Department

NATIONAL ECONOMIC EDUCATION DELEGATION

20

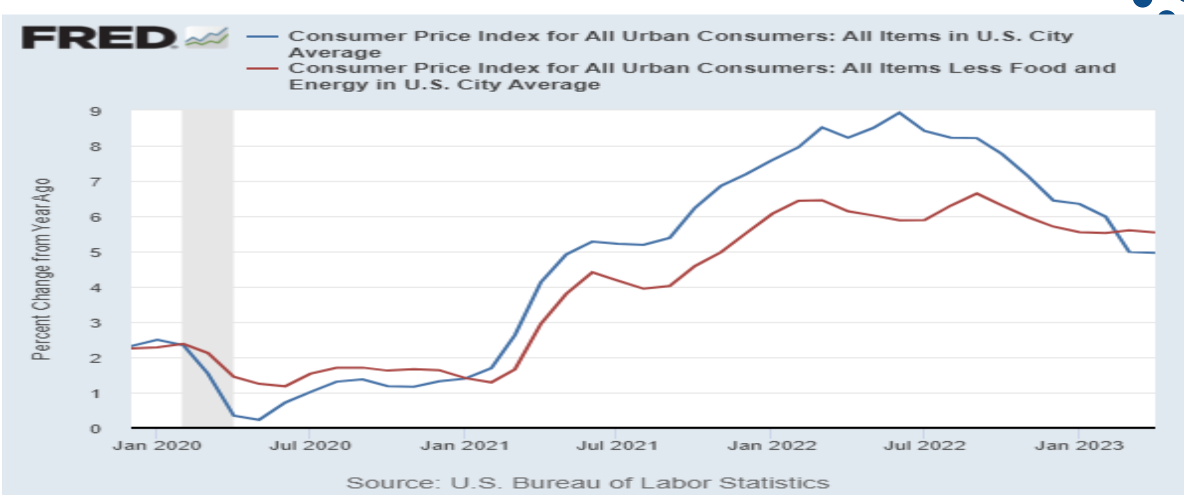
20

Overall Good News on the Real Side

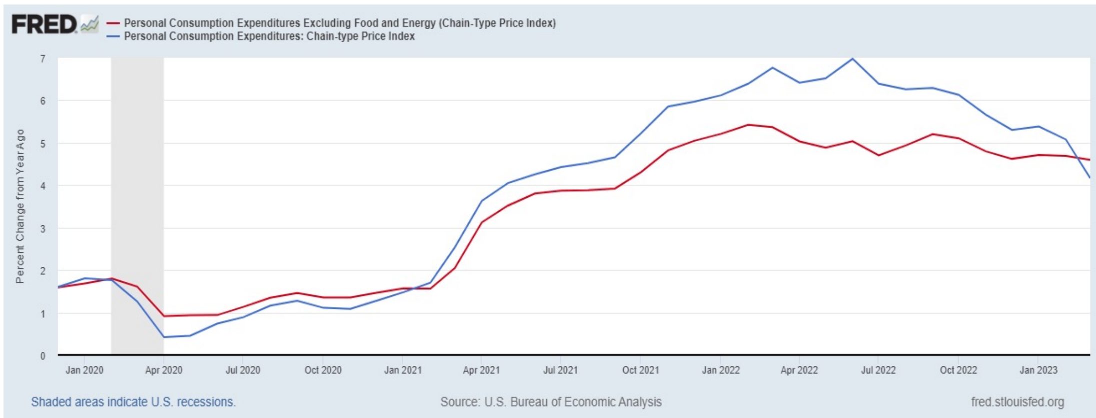
- GDP is very close to its potential.
- The labor market as measured by the unemployment rate is fully recovered.
- There was no apparent Great Resignation

- But there is also a *nominal* side: inflation and wages.
- News isn't so good!

Inflation during the Recovery (CPI)



Fed's Measure (PCE)

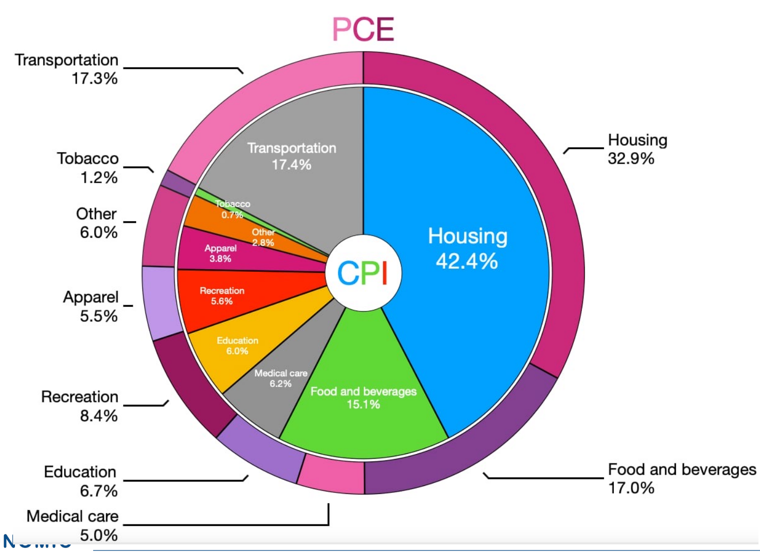


NATIONAL ECONOMIC EDUCATION DELEGATION

23

23

CPI vs. PCE: Differences



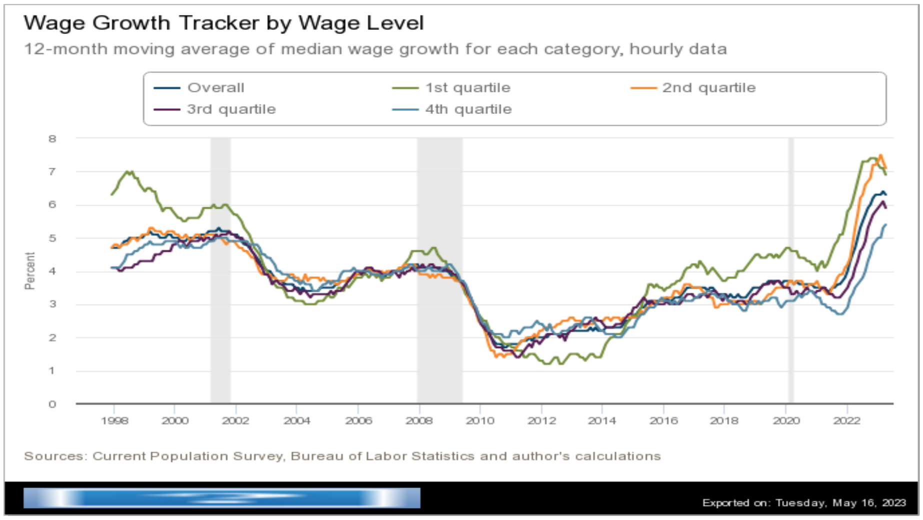
NATIONAL ECONOMIC EDUCATION DELEGATION

24

https://en.wikipedia.org/wiki/Personal_consumption_expenditures_price_index#

24

Wages Haven't Kept Pace with Inflation



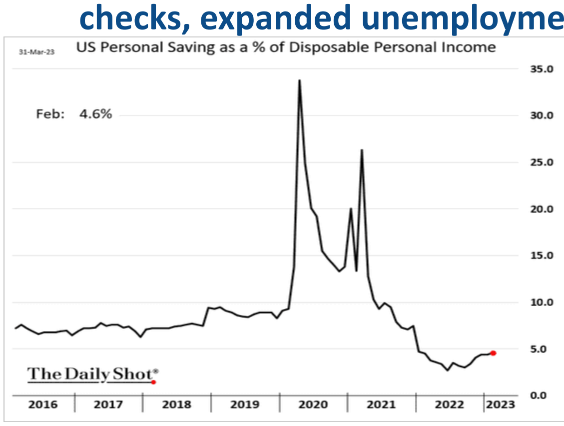
NATIONAL ECONOMIC EDUCATION DELEGATION

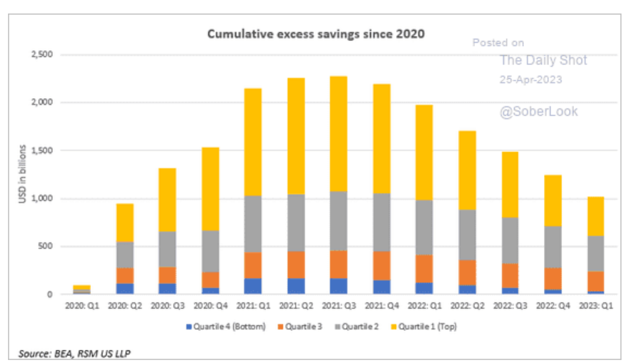
25

25

Policy Effects: Fiscal

- **2020-2021: massive stimulus. Cares Act, 3 rounds of stimulus checks, expanded unemployment benefits, Payroll Protection Loans.**





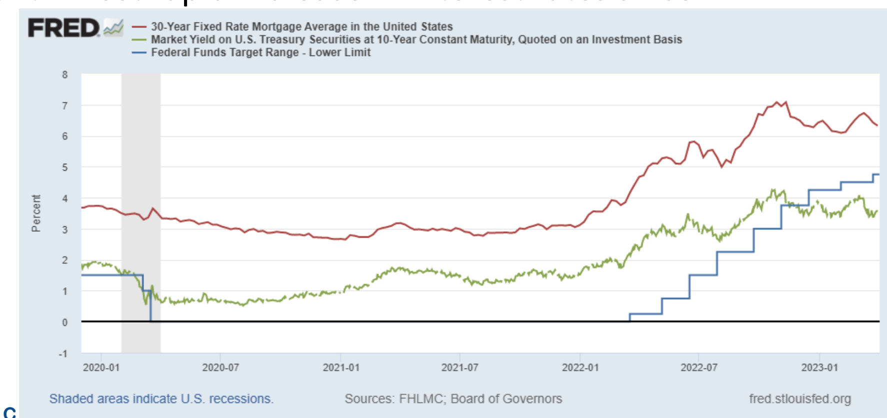
NATIONAL ECONOMIC EDUCATION DELEGATION

27

27

Policy Effects: Monetary

- 2020-2/2022: policy interest rate at zero, new round of quantitative easing.
- 3/2022-present: most rapid increase in interest rates since Paul Volcker



28

Where we Stand

- **Inflation: There is a lot of work still to be done.**
- **The ARP was probably too big, but helped many poor families, and the Fed was aware of the size of the stimulus.**
- **Monetary policy was too easy for too long, but since March of 2022 years has been much more restrictive.**
- **Yes, there were supply chain issues that temporarily raised inflation, but there was (is?) too much total spending.**

So, where are we headed?

What will the Fed do?

29

Stabilizer in Chief: the Fed


Jerome Powell
February 2018

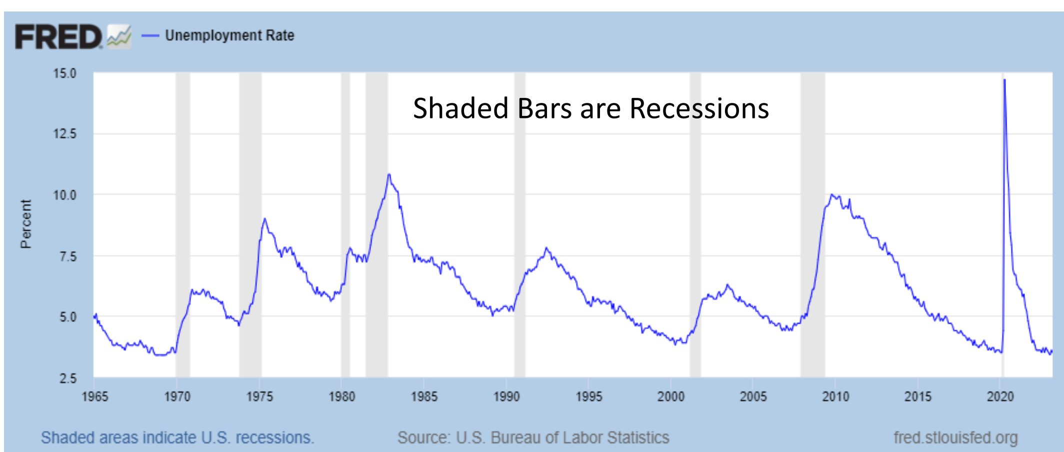
- **The Fed's Dual Mandate:**
  1. "Stable prices" which means 2% rate of inflation in tl on Expenditure Price Index (which corresponds to about ıore well-known CPI).
  2. "Maximum employment" which means the highest level of employment (lowest unemployment rate) consistent with mandate 1.
- **Monetary policy is made by the Federal Open Market Committee (FOMC), comprised of the 7 Fed Governors and 5 of the 12 Presidents of the Regional Federal Reserve Banks on a rotating basis.**
- **The FOMC has scheduled meetings 8 times a year, but can hold unscheduled meetings at a moments notice (e..g., March of 2020)**

NATIONAL ECONOMIC EDUCATION DELEGATION

30

30

Track Record on Unemployment

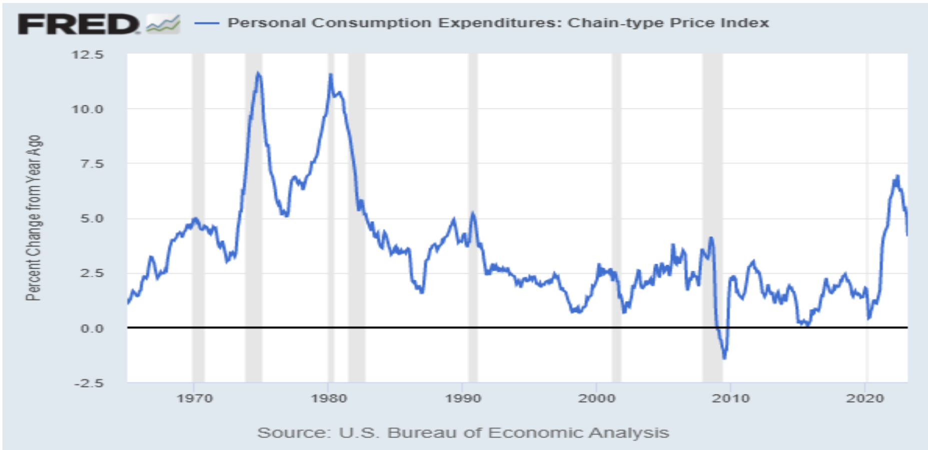


NATIONAL ECONOMIC EDUCATION DELEGATION

31

31

Track Record on "Price Stability"



NATIONAL ECONOMIC EDUCATION DELEGATION

32

32

Determinants of Unemployment & Inflation

Short run:

- **Unemployment: The higher the level of total spending the lower the unemployment rate.**
- **Inflation:**
  1. "Too much Spending:" Total spending above the economy's normal capacity ("potential output") tends to *increase* inflation.
  2. Increase in production costs (e.g., "supply chain bottlenecks.")
  3. Expectations of high inflation can cause inflation to be high.

NATIONAL ECONOMIC EDUCATION DELEGATION

33

33

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 housing prices (!).
- Lower spending tends to raise unemployment and eventually lowers inflation.

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.

Note: in deciding on appropriate interest rates you must take account of what fiscal policy is doing that affects total spending

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.

NATIONAL ECONOMIC EDUCATION DELEGATION

37

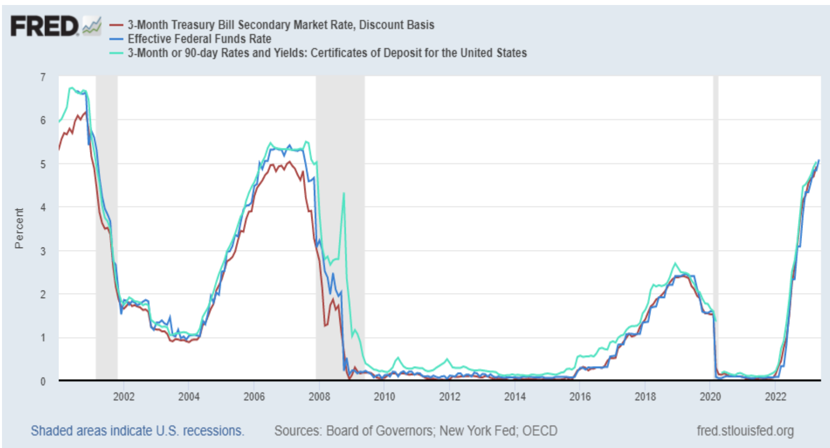
A Closer Look at Interest Rate Control

- *Primary Tool*: the Fed targets the *federal funds rate* (or fed funds rate for short), the interest rate on overnight loans between banks.
- The Fed adjusts bank reserves so that the federal funds rate is within a target range 25 basis points wide.
- From the bank’s perspective these loans are very close substitutes to other short-term, safe assets such as Treasury Bills.
- Therefore, controlling the fed funds rate gives the Fed close control over all safe, *short-term* interest rates.

NATIONAL ECONOMIC EDUCATION DELEGATION

38

The Fed and Short-term Interest Rates



Blue is the fed funds rate.
Red is the rate on 3 month Treasuries.
Aqua is the rate on 90 day Bank CDs.

39

What about the Money Supply?

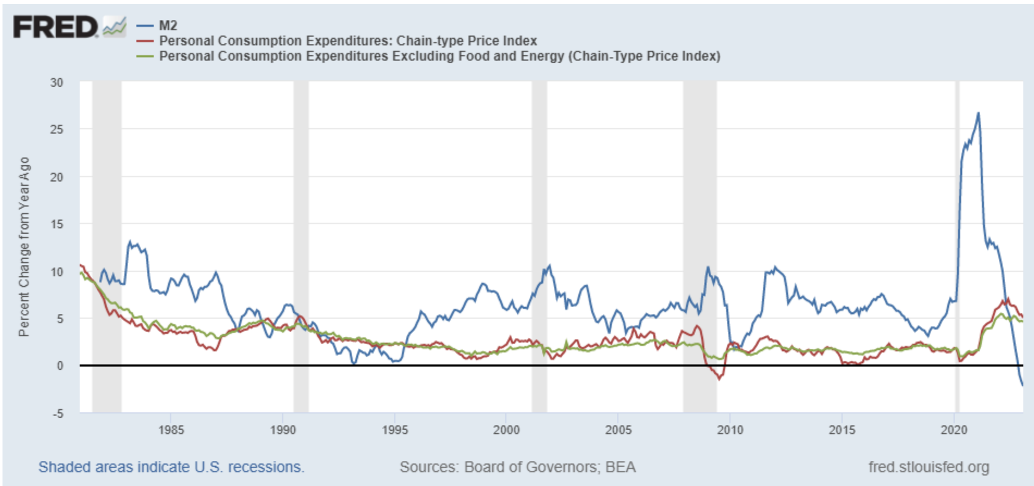
Notice the absence of the money supply. The Fed does not believe there is a reliable, short-run link between the money supply and total spending or inflation.

The Minutes of the 3/21-3/22/2023 FOMC Meeting mentions:

- Money Supply, M1, M2 – 0 times
- Federal funds rate – 15 times

40

Do You See a Relationship?



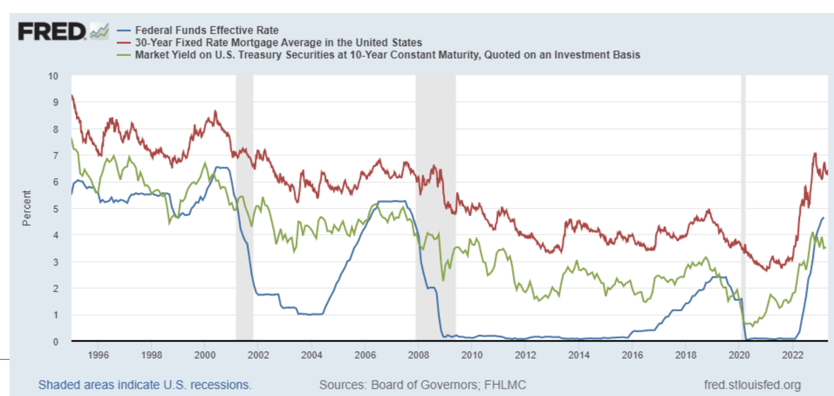
NATIONAL ECONOMIC EDUCATION DELEGATION

41

41

The Importance of Long-Term Interest Rates

- Nobody buys a house because of the level of 90-day interest rates, and unfortunately, the current federal funds rate has much less influence on the rates that matter.



NATIONAL ECONOMIC EDUCATION DELEGATION

42

Long-Term Interest Rates

- **Long-term interest rates depend on two factors**
  1. The average of expected, future short-term rates over the life of the long-term bond.
  2. “Risk” premia that reflect the possibility of unexpected changes in interest rates and the possibility of default.
- **The Secondary Tools are aimed at affecting these factors.**

NATIONAL ECONOMIC EDUCATION DELEGATION

Two Secondary Tools to Affect Interest Rates

1. **Forward Guidance: Communicating the Fed’s intentions for the future path of short-term interest rates.**
2. **Long-term Asset Purchases better known as quantitative easing or QE.**

Both of these tools also affect interest rates, and thereby aggregate demand. But their effect is on the interest rates of longer-term and riskier assets.

NATIONAL ECONOMIC EDUCATION DELEGATION

Changes to the Policy Statement in May

The U.S. banking system is sound and resilient. ~~Recent developments are likely to result in t~~Tighter credit conditions for households and businesses and are likelyto weigh on economic activity, hiring, and inflation. The extent of these effects ~~is~~ remains uncertain. The Committee remains highly attentive to inflation risks.

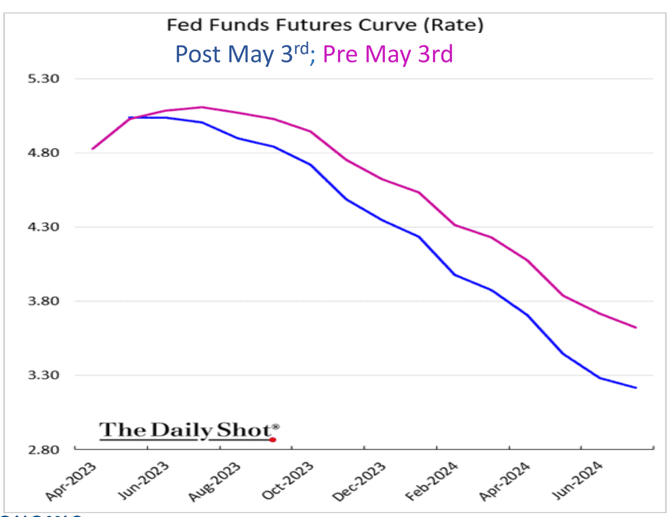
The Committee seeks to achieve maximum employment and inflation at the rate of 2 percent over the longer run. In support of these goals, the Committee decided to raise the target range for the federal funds rate to ~~4-3/4 to 5~~5 to 5-1/4 percent. The Committee will closely monitor incoming information and assess the implications for monetary policy. In determining the extent to which additional policy may be appropriate to return inflation to 2 percent over time, ~~The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time. In determining the extent of future increases in the target range,~~ the

NATIONAL ECONOMIC EDUCATION DELEGATION

45

45

Forward Guidance: May 3rd



NATIONAL ECONOMIC EDUCATION DELEGATION

47

47

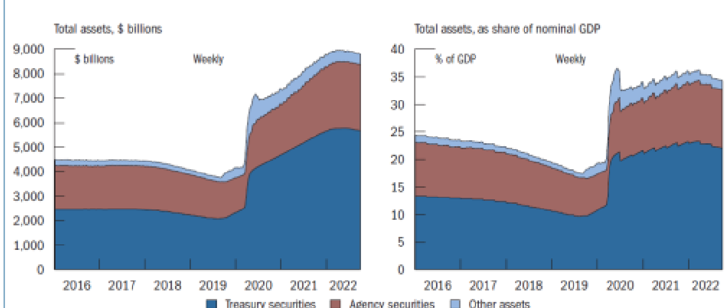
QE And Long-term, Risky Rates

- Financial investors require a higher interest rate on risky bonds, than on safe short-term Treasuries.
- The greater the supply of risky bonds, the higher the required risk premia needed to get enough private investors to buy them.
- QE lowers the supply of long-term bonds held by private investors and thereby lowers to required risk premia and the interest rate on these bonds.

48

QE Has Been a Big Deal

Figure 1. Balance sheet assets, 2016–22



Note: Other assets includes swaps, repo, loans, and liquidity and credit facility LLCs; Asset values are weekly Wednesday. Key identifies curves from bottom to top.

Source: Federal Reserve Board.

Note: Asset values are weekly Wednesday; nominal GDP data are quarterly averages. Key identifies curves from bottom to top.

Source: Federal Reserve Board; Bureau of Economic Analysis.

Source: Federal Reserve Board

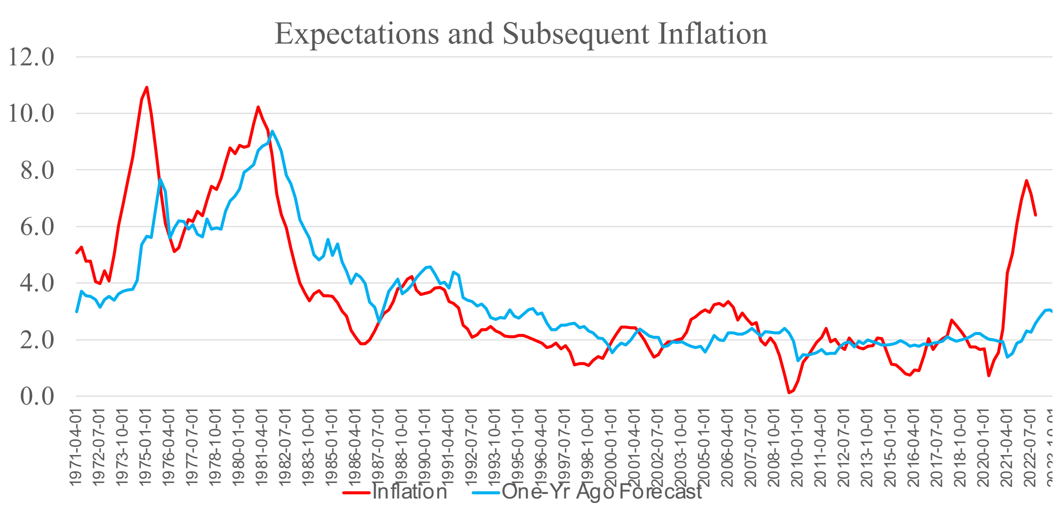
49

A Policy Strategy: Stabilize Expectations of Inflation

- Monetary Policy is much easier if people believe that the Fed will achieve its inflation target.
- In central bank jargon, if expectations are stable and "well anchored."

50

"Anchoring" Inflation Expectations



Forecasts: Philadelphia Fed, "Survey of Professional Forecasters"

51

Anchoring Requires Credibility

Credibility, the public believes that the Fed will achieve its goals.

- **Requirements for Credibility**
  1. Transparency (Communication)
  2. Accountability (Performance)
  3. Political Independence

NATIONAL ECONOMIC EDUCATION DELEGATION

52

52

The Great Moderation

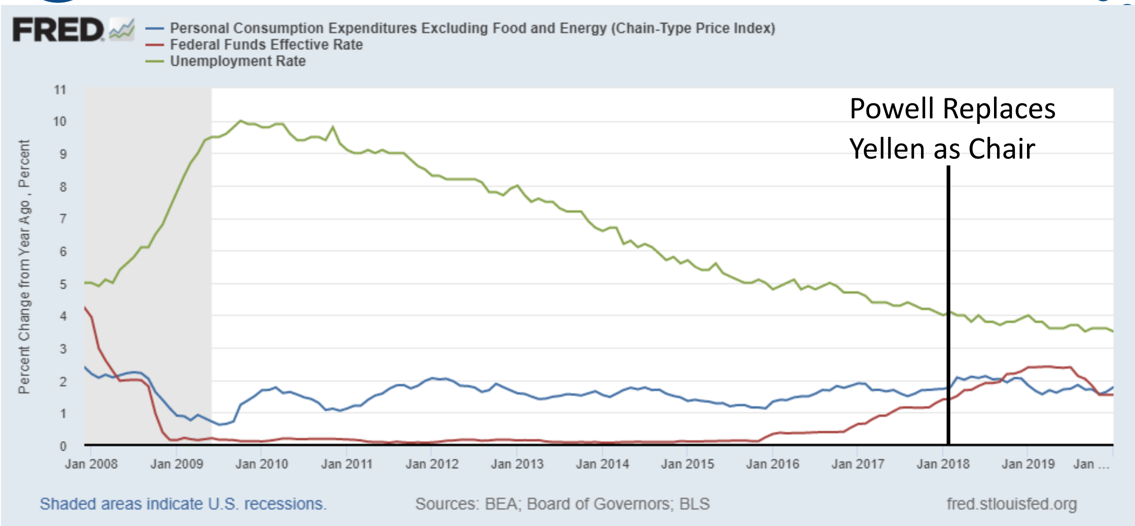
- **Volcker paid a price in the early 1980s, but the price paid dividends from 1990 through 2008.**
- **During the latter period the performance of the US economy was extraordinary and even Milton Friedman gave kudos to the Alan Greenspan.**
- **Has Powell jeopardized Volcker's legacy?**

NATIONAL ECONOMIC EDUCATION DELEGATION

53

53

Why Did Powell Do It?



NATIONAL ECONOMIC EDUCATION DELEGATION 54

54

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%

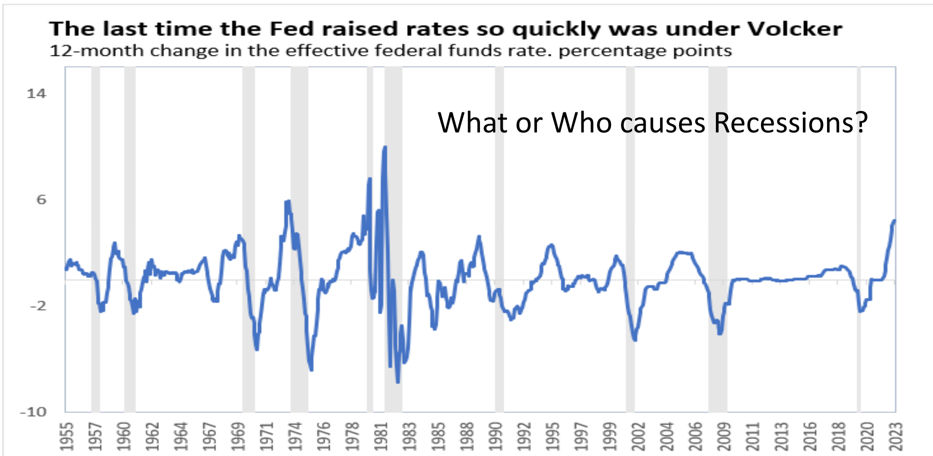
Have they forgotten about Lags!

- But starting in March of 2022 a complete reversal of policy goals: sole focus is on inflation.

NATIONAL ECONOMIC EDUCATION DELEGATION 55

55

Is Powell Now Channeling Volcker?



Source: Federal Reserve. Note: The shaded areas are recessions according to the NBER.

Amazingly, (to me anyway), the Fed reaffirmed targeting average realized inflation!

NATIONAL ECONOMIC EDUCATION DELEGATION

56

56

Fed Plans, as of March 22

Variable (in percent)	Medians			
	2023	2024	2025	Longer Run
RGDP growth	0.4	1.2	1.9	1.8
Dec.	0.5	1.6	1.8	1.8
Unemployment	4.5	4.6	4.6	4.0
Dec.	4.6	4.6	4.5	4.0
Inflation	3.2	2.5	2.1	2.0
Dec.	3.1	2.5	2.1	2.0
Core Inflation	3.6	2.6	2.1	
Dec.	3.5	2.5	2.1	
Federal Funds	5.1	4.3	3.1	2.5
Dec.	5.1	4.1	3.1	2.5

Is this a so-called "soft" landing? Why is the Fed forecasting a rise in the unemployment rate and can't they do something about it?

NATIONAL ECONOMIC EDUCATION DELEGATION

57

57

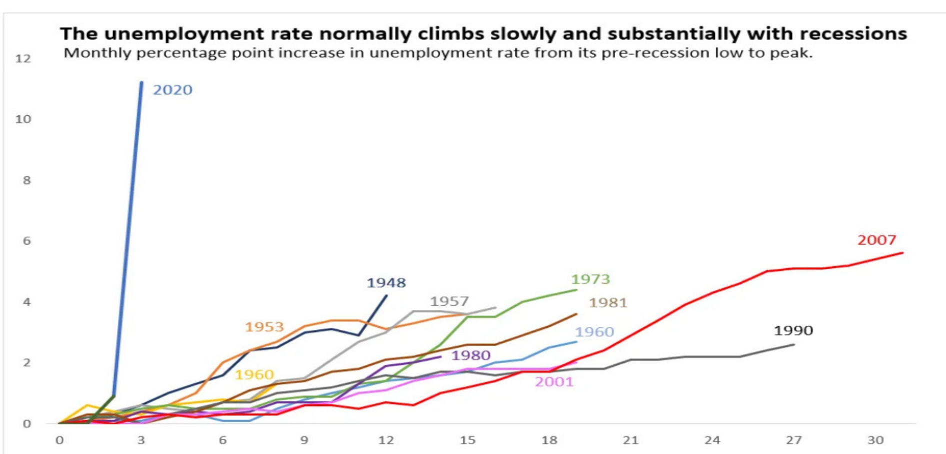
Why is Sen Warren so Angry?

NATIONAL EDUCATION

58

58

Senator Warren is Right



Source: Bureau of Labor Statistics. Calculations by Claudia Sahm.

NATIONAL ECONOMIC
EDUCATION DELEGATION

59

59

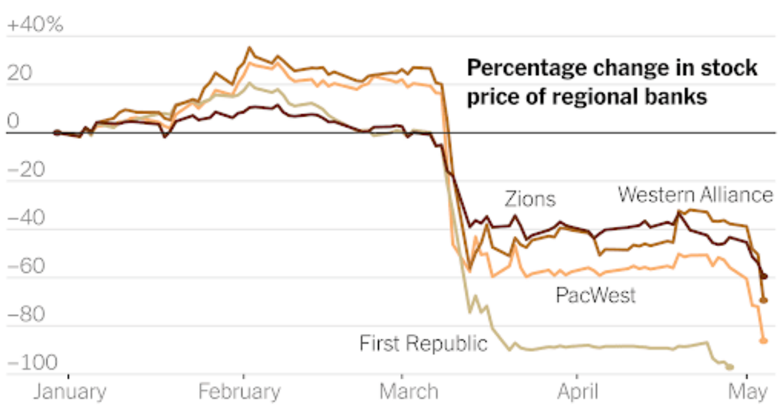
What's at Stake

- A rise in inflationary expectations would probably mean higher and more variable inflation.
- Oversteering leading to a steep recession ("hard" landing).
- Curbing inflation could lead to widespread bank failures (Pacific West?).

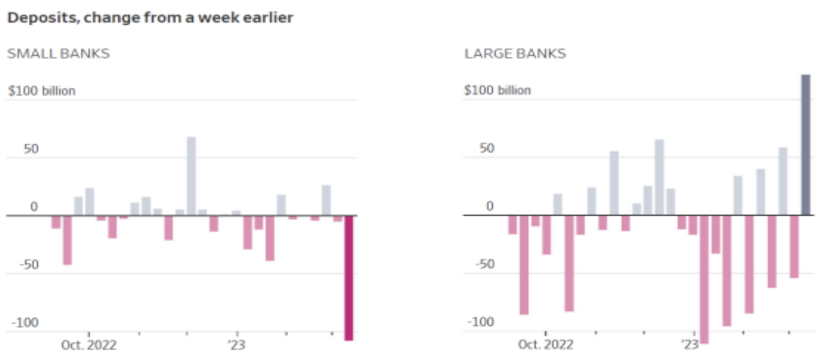
And, the Fed needs to navigate:

1. At the start of a presidential election cycle, with
2. Pervasive uncertainty. (e.g., credit crunch & bank failures).
3. Debt Default

The Banking Crisis is Not Over



Short-term and Long-Term Problem?



Note: Includes domestically chartered commercial banks. Large banks are defined as the top 25 ranked by domestic assets. Small banks are those not in the top 25.
Source: Federal Reserve
Nate Rattner/THE WALL STREET JOURNAL

NATIONAL ECONOMIC EDUCATION DELEGATION 62

62

And, Then There is the Debt Ceiling Fiasco

- **Biden Can:**
  1. Declare Debt Ceiling unconstitutional due to 14^{th} amendment.
  2. Direct the Treasury to Mint a $5 trillion coin.
  3. Direct the Treasury to replace existing bonds with very high coupon payments, so that they sell for more than their face value.

NATIONAL ECONOMIC EDUCATION DELEGATION 63

63

Recommended Reading

- https://www.nytimes.com/interactive/2023/05/18/opinion/jobs-inflation-economy.html?smid=nytcore-ios-share&referringSource=articleShare

Silicon Valley Bank

- Regional mid-sized bank with \$212b in assets; \$6billion in capitalization (15th largest).
- Focused on loans to venture capital and managing the desposit accounts of startups.
- Very rapid growth in deposits and assets between 2021 and 2022, which led to big investments in “safe” long term Treasury bond.
- The market value of these bonds fell drastically due to the Fed’s rise in interest rates.
- No problem! The bank does not incur “losses” unless it sells the bonds before maturity.

Whoops!

- Concentrated and sophisticated depositors see the problem and want to get their money out (FDIC insurance guarantees deposits up to $250 thousand, and 90% above this amount!).
- Deposit withdrawals force SVB to sell those bonds.
- Precipitating a classic bank run and leading to the FDIC seizing the bank on Friday.

NATIONAL ECONOMIC EDUCATION DELEGATION

66

66

FDIC Bank Closures, in General

1. "Auction" off the failed bank; all depositors paid in full.
2. Payoff insured deposits and liquidate bank assets

- Under Dodd-Frank, the FDIC is supposed to use the cheaper procedure.
- In either case, funding comes from banks' payments of deposit insurance premium.

NATIONAL ECONOMIC EDUCATION DELEGATION

67

67

But, in This Case:

- Janet Yellen announced that all depositors would be paid in full, and there would be complete insurance of all bank deposits for a year.
- Senior Executives all fired.
- Fed created a new lending program, so that banks can borrow against Treasury bonds without realizing losses.
- The rationale was to prevent bank run spreading to other midsize banks.
  - Two other banks recently closed
  - Stock prices of a number of similar sized banks have plummeted.

NATIONAL ECONOMIC EDUCATION DELEGATION

68

68

Problems with the Bailout

- Political:
  - Did political favoritism play a role in bailing out well connected, sophisticated silicon valley depositors.
  - Why didn't bank regulators see this coming?
- Economic: has the moral hazard of "too big to fail" been increased.
- For the Fed: Will the Fed have to scale back its interest rate increases to prevent wide scale financial crisis?

NATIONAL ECONOMIC EDUCATION DELEGATION

69

69

Another Shoe Drops?

First Republic Bank Is Seized by Regulators and Sold to JPMorgan Chase

The deal, which will allow 84 First Republic branches to reopen as JPMorgan branches on Monday, was a dramatic move aimed at curbing a two-month banking crisis.
5 MIN READ

The three banks that failed this year were bigger than 25 that crumbled in 2008.

Jim Wilson/The New York Times

DealBook: JPMorgan Chase has returned to the familiar role of bank rescuer.
7 MIN READ

Here's what comes next for First Republic and for depositors' money.
4 MIN READ

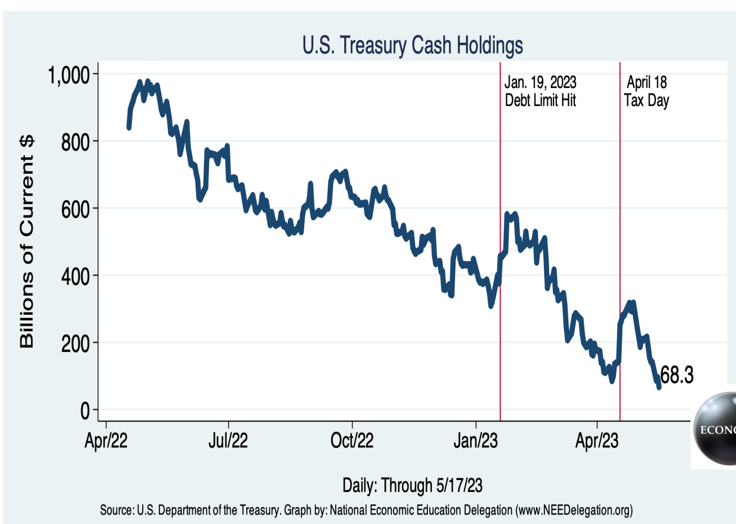
Front Page of the *NYTimes,* May 1,2023

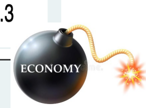
NATIONAL ECONOMIC EDUCATION DELEGATION

70

70

And, Then There is the Debt Ceiling Fiasco





Biden Can:

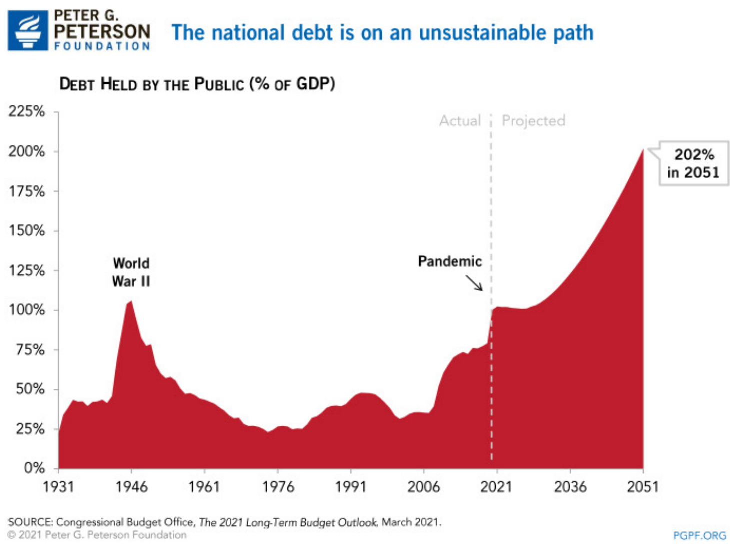
1. Declare Debt Ceiling unconstitutional due to 14^{th} amendment.
2. Direct the Treasury to Mint a $5 trillion coin.
3. Direct the Treasury to replace existing bonds with very high coupon payments, so that they sell for more than their face value.

NATIONAL ECONOMIC EDUCATION DELEGATION

71

71

The Federal Debt is Becoming A Problem



NATIONAL ECONOMIC EDUCATION DELEGATION 72

72

Let's Hear from You!

Geoffrey Woglom
grwoglom@amherst.edu

Contact NEED: Info@NEEDEcon.org

Submit a testimonial: www.NEEDEcon.org/testimonials.php

Support NEED: www.NEEDEcon.org/donate.php

NATIONAL ECONOMIC EDUCATION DELEGATION 73

73