EconoFact Chats: A U.S. Economy Roaring Back from Recession

Julia Coronado, MacroPolicy Perspectives

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Michael Klein:

I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Michael Klein:

We are in unprecedented times in many ways, not least among them with respect to the economy. After COVID caused the most precipitous rise in unemployment on record in the spring of 2020 and the biggest peace time ramp-up in government spending, in the wake of this, we are now looking at a recovery. But will this recovery be durable as government support is withdrawn? And will the recovery along with the generous government support lead to high inflation?

Michael Klein:

Someone who is especially well positioned to address these questions is Dr. Julia Coronado, the founder and president of MacroPolicy Perspectives. Prior to founding MacroPolicy Perspectives in 2017, Julia served as chief economist for Graham Capital Management, and BNP Paribas, and as a senior economist at Barclays Capital, and as an economist at the Federal Reserve Board of Governors. Julia, welcome to EconoFact Chats.

Julia Coronado:

Thank you, Michael. I'm delighted to be here.

Michael Klein:

It's great to have you on. Julia, you're a regular commentator in financial media, including CNBC, Bloomberg, Marketplace and The Wall Street Journal. In these appearances you're commonly asked to give your forecast for the next quarter or the next year. Rather than ask you to do this now, I'm more interested in how you and your team at MacroPolicy Perspectives organize your thinking about the economy, especially during such unprecedented times. First off, how do you think about the impact of vaccinations on the recovery of the economy?

Julia Coronado:

So first I'll start by saying these have been humbling times for forecasters. Our conventional models and rules of thumb have been completely disrupted and the pandemic has been the undeniable driver of the economy. And yet the relationship between public health metrics, like you mentioned, vaccinations or case counts, and economic measures like GDP or jobs has been far from linear, or predictable. So, for example, GDP and employment bounced back very strongly last summer, despite surging case counts, partly due to the fiscal support that households were receiving and were spending even as they were hunkered down in their homes and businesses were learning how to operate safely as much as possible. Now then we did see a lull in the winter when case counts rose and fiscal support evaporated. And then now we're in the middle of a roaring comeback on the back of vaccinations and additional fiscal support.

So it's been hard to calibrate and so we stay humble and do the best we can and triangulate as many data sources as we can get our hands on.

Michael Klein:

So today there were new GDP numbers released. I believe that for the first quarter of 2020, the growth in GDP was 6.4%. Was that right?

Julia Coronado:

That's right. A very strong performance. And Q2 is tracking closer to 10%.

Michael Klein:

Those are historically very high, but coming from a very low base.

Julia Coronado:

Correct.

Michael Klein:

Julia, a recovery in national income is typically associated with a recovery in jobs, but in the wake of the 2008 Great Recession, job growth really lagged. Now we're also seeing lower job growth than what might be expected, given those very strong GDP numbers. And people are giving a variety of possible reasons, ongoing concerns about COVID, a lack of childcare, a wave of early retirements, among others. What do you see as the current important dynamics of the labor market and what does this portend for the recovery of employment?

Julia Coronado:

So, first I like to remind myself that the data that we have in hand are the preliminary estimates of economic activity and they're subject to huge revisions. And we saw this after the great recession. And in addition, measuring the economy has been particularly challenging during a pandemic because data collection methods have been disrupted. So I tend to put more weight on the labor market data than the GDP data, which I take with a big grain of salt for now. And I think what we're seeing in the labor market is that there is strong momentum, certainly by historical standards, but that what we saw last summer, which is the reconnection of employees on layoff with their existing employers which drove job gains in the millions, that low hanging fruit is behind us. And now we have to make new matches between employers and employees at a time when business models and the geography of living and working and entertainment has been transformed, and is still in a state of flux.

Julia Coronado:

So there's a debate as to whether there's some sort of speed limit to these connections, these new matches. For example, large companies reduced their HR departments during the pandemic and are scrambling to rebuild them so they can onboard new employees. And then, in addition, you mentioned some of the pandemic related frictions in labor supply, childcare, health concerns I can tell you, I can give you a personal anecdote, my daughter teaches at a preschool, they just had a COVID outbreak and just yesterday had to send 20 kids home. And that disrupts the ability of those parents to work, et cetera. So we know there's ongoing disruptions with childcare and schooling and health concern[s]. And so I think that we do expect continued progress, continued strong job gains. And then I think there's another dynamic we're seeing, and this gets a little bit more politically controversial. You've seen people cite the fiscal support as something that's leading people to stay on the sidelines.

Julia Coronado:

When I think about this I'm not thinking just about unemployment benefits, but also just that broader fiscal stimulus payments. I do think it's given particularly lower wage workers some financial breathing room. And while this has been used by some politicians as a justification to pull back on support, I think it has given lower wage workers a stronger bargaining hand to take some time and find the right employer-employee match, find an employer that maybe takes health concerns seriously.

Julia Coronado:

And I don't think that's a bad thing. I think after a pandemic, how can we conclude other than that food service workers and public facing workers don't deserve a better living standard and to be compensated for the risk that they're taking? So I'm personally pretty happy to see leisure and hospitality workers getting raises to come back to work, but that also might slow down that process and it might induce some structural changes in things like restaurants. They might have to do less service oriented, more online ordering, pickup at a window instead of waitress staff, delivering food, et cetera. But ultimately at the end of the day it'll be better for the broad based and inclusive realization of full employment that the Fed is trying to achieve.

Michael Klein:

So Julia, a lot of things that you're talking about are not just what's going to happen in the next quarter or even the next half year, but longer term consequences. So I'd like to talk about those a little bit. One of those is what economists called job market scarring. And we have a podcast and some memos about that. It's the idea that when people enter the labor market at a particularly inopportune time, this follows them perhaps even for their whole career. What's your view of what the effect of these last months, this last year and a half say, has been or will be for young people entering the labor market?

Julia Coronado:

That's a great question, Michael. And I think that's where we see some of the best news. We've really engaged in a fiscal experiment where instead of providing as little as possible, or fine tuning the support we provided, we provided really a lot of very broad based support to a lot of households. And what we're seeing are some really interesting dynamics. For example, households are coming out of this recession with stronger credit scores, lower loan delinquencies. And these are some of the things that can leave lasting scars. So typically you lose a job, you might get your house foreclosed on, or your car repossessed. Car repossessions are actually cut in half last year from pre-COVID levels, and that's actually adding to some of the supply constraints in the used car market. So that's a pretty unusual feature and directly tied to the fiscal support that could give households a better hand, and a stronger hand going forward.

Julia Coronado:

And I think the relatively short-lived nature of the cycle, and then the fact that, again, because of this fiscal and monetary support, we're not limping out of the recession, we're roaring out of the recession. And so we're not seeing the terrible lingering job prospects for recent graduates and other workers. And so we think that one of the results of this policy experiment will be less scarring, will be less depressed wages for workers that either experience spells of unemployment or are coming out of school. And that will give them better prospects for their wages over their life cycles going forward.

Michael Klein:

So Julia, your company is called MacroPolicy Perspectives. But if you don't mind, I'd like to ask you a little bit about micro perspectives. What kind of structural changes do you see coming out of this? For example, people are talking about the commercial real estate market having a long-term hit from this because people realized that you might not need as much office space, people can work from home and so on. There could also be, as you were alluding to earlier in hospitality and restaurant, a sea change in the way things are offered. What else do you see, besides those two, as possible microeconomic changes, structural changes in the economy as people have learned or responded to the kind of events that we faced over the last year and a half?

Julia Coronado:

It's a great question. So one, I think we have to go back to the pandemic, what are the prospects for public health going forward? And it looks like the US is not going to achieve a herd immunity level of vaccination, it looks like we are seeing variants around the world now. I think what that translates into is a lingering issue with possibility of resurgence, that it won't be disruptive in the way it has been over the past year, we won't see shutdowns, we'll figure out a way to muddle along with it and live with it, but it's not going to go away. It's not going to be like we're going to go back to a world where we're not going to be worried about transmission of the virus anymore. And I think what that means is some of the preference changes we've seen could be sticky.

Julia Coronado:

So we've seen huge waves of COVID migrations, people moving out of dense center cities to suburban areas, or to lower cost, smaller cities that's facilitated by work from home. Some of that is likely to prove sticky. You mentioned commercial real estate, what does that do to center cities and how they're used? How is that real estate used? There's some discussion of converting office space into much needed housing in some of these areas where office space might not come back to the same degree. So some of the geography and housing preferences, I think one of the things we saw with the pandemic is that it really unlocked what had been a hesitant millennial generation's view towards home ownership. We're now seeing that home ownership that people expected from the millennials pulled forward, but now we don't have enough homes for them, and so we've seen a lot of pressure on prices. So we would expect a multi-year expansion in residential construction, even as commercial construction and office space might undergo a more difficult restructuring cycle. So those are a few changes.

Michael Klein:

Speaking about pulling things forward, another thing that people have noticed is that COVID may have accelerated the retirement of people who may have been near the cusp of retirement anyway, and this has implications for the demography of the work force and ultimately for the economy. Can you spell out some of the links between demography and longer-term economic issues like the viability of social security, the impact on government finances, and the productivity and growth of the economy?

Julia Coronado:

I'd be happy to. I'm a big believer in demographics is destiny. So yes, we've seen some retirements that possibly were pulled forward as a result of the pandemic. That exit accounts for roughly by my estimates about a million people that were working that may not come back anytime soon, because they retired early, but what that means for overall labor supply really depends. I mean, I have learned one thing from the last cycle and that is not to prejudge the capacity of the labor market to expand and to be flexible. So I think, for example, some older workers might come back in different capacities as the cycle proceeds, if they find opportunities. I also think that the US is capable of higher prime age labor force participation rates. And we're seeing some of the policy proposals that would be necessary to stimulate that, infrastructure investment in rural areas, childcare investments in subsidies that would facilitate labor force participation of parents.

Julia Coronado:

These types of things, the US is lagging behind other advanced economies. We can certainly do better. That said the bigger, bigger picture is that we've seen declining birth rates that actually crashed even further during COVID -- some of that might rebound -- and reduced immigration -- some of that might rebound, some of it might not -- but what we're looking at is basically zero population growth over the medium term horizon and demographics that look a lot more European and Japanese. Then, we had been a different demographic picture, now we're very similar. And that determines a bit, the speed limit on GDP. Implications for productivity are, again, much more difficult. We are seeing a lot of investment in automation and technology transformation that could enhance productivity and be very symbiotic with a labor force that's not growing as quickly. So there's some optimism there that we could actually see decent productivity, so that living standards continue to improve even though top line growth is slowing.

Julia Coronado:

But that's very much an open question. I think there are reasons to be more optimistic about productivity growth this time around, we don't have the debt de-leveraging overhang that we had last cycle that was global and I think contributed to sluggish investment. We don't have that now. So maybe we are seeing a super strong investment rebound and that potentially could be tied to better productivity that can, again, help provide an offset to what is going to be a demographic headwind, alongside investments in human infrastructure that could unlock labor supply amongst prime age workers.

Michael Klein:

Yeah. We have some EconoFact memos on women's falling labor force participation, and we have others on immigration and the role that immigrants play in the economy and this is, as you were saying, really important issue. Looking at inflation, of course, this is one of the most hotly debated concerns these days. Some people are arguing that the generous government benefits along with supply disruptions will lead to higher inflation that will become embedded as it alters people's expectations. And others, including Fed Chairman, Jay Powell say that all we're seeing is a temporary blip and inflation will come down from its current high rates. We know that forecasting is difficult. Yogi Berra said it's especially difficult to forecast about the future. So rather than ask you what you think inflation will be, what I'd like to ask is how do you draw on your experience working at the Fed and as a financial sector economist to think about inflation forecasts?

Julia Coronado:

Well, that's a good question too. So one thing I have learned as an inflation forecaster is to not rely too heavily on macro top-down models. We run those models, we understand those models, we do use them as one guide to thinking, but we also do a very careful bottoms up to understand the different sectoral dynamics. So I'll give you an example of that. One reason that we were, I guess, ahead of the curve on the low inflation we saw last cycle is that we saw a lot of secular forces at play from that bottoms up perspective. So I'll name a few. Demographics, there's a real pressure on public policy to lower healthcare inflation as the economy ages. So we saw a number of ACA provisions and enhanced competition, push for more generic drugs, all of these measures. The government is a price setter in the healthcare market.

Julia Coronado:

They insure almost half the population and that's growing. And so they have an influence and can play a restraining force on inflation and have been, we've seen healthcare inflation come down dramatically. And then another restraining force is globalization. So, again, workers have not had the bargaining power from the wage side, the labor share of GDP has been stuck very low. That could change. And so that's one thing we're watching, does the labor get a stronger bargaining hand? Do they have more purchasing power to become less price sensitive? They've been very price sensitive because they haven't had that. So that's one of the things we're watching. And then the third force is technology. Technology comes in as a restraining force, both because a lot of elements of consumer prices are quality adjusted in our inflation metric. So the faster the quality adjustments, the slower the inflation, and also the transparency that comes with technology.

Julia Coronado:

We all walk around with smartphones. We can comparison shop costlessly in seconds. And that has meant that even in very concentrated retail markets, retailers have not had pricing power. So these forces are all still in play and in place. And so we're watching them to see whether there's a transformation. We also watch, as you mentioned, psychology of inflation, inflation expectations, and I think it's worth recalling that there was an intention by the Fed to restructure its reaction function to generate better wage price dynamics. I think we're seeing some elements of that. I agree with Chair Powell, most of the nearer term pops in inflation is an economy that's rebooting. We shut down, we rebooted, we saw wild swings in the composition of spending, the wildest we've ever seen. The shift from services spending to goods spending, and now we're starting to see it shift back to services spending. That leaves businesses and supply chains scrambling, and a lot of near-term frictions.

Julia Coronado:

We were already seeing them settled down. Lumber prices have come down, used car prices are leveling off. These are some of the things that have driven some of the very high prints that we've seen. So, we got to be humble, but I tend to be in team transitory, that we're going to see inflation settle back down to something that's much more manageable and not a 70s style dynamics. So some people lean towards the 70s comparison, others lean to the post-World War II comparison, where we had a burst of fiscal spending, a burst of inflation as supply chains were catching up from a post war era. And then everything settled back down to something that was much more sanguine. And I think I lean towards that comparison, but of course we're keeping our ear to the ground.

Michael Klein:

Julia, for my last question, I'd like to shift gears a bit. One thing that I've learned from you is that MacroPolicy Perspectives only has women employed. And that's really unusual in economics and especially unusual in macroeconomics and finance. What have you found in your various roles as an economist with respect to gender inequality or gender discrimination? And do you think things are getting better? Or are we still stuck in a place where women are not treated as well?

Julia Coronado:

I'll start Michael by saying that I love being an economist. I love what I do. I've had an exciting career and I have no regrets. I have however been a woman in a male dominated profession. And my experience has been that the more... I don't know, I feel like the environment in academia is probably the most toxic in terms of gender balance and treatment and of women. I think at the Fed there were definitely some issues that just in terms of a lot of it comes down to the subtle biases, the unconscious bias, I think, is the term that people use, where you have to as a woman in a room where a forecast is being debated or research is being presented, you have to prove yourself twice, three times over before you're taken seriously.

Julia Coronado:

And so the bar is a bit higher to reach the status. So the promotions that follow are lagged and I did find out at the Fed and, in fact, the Feds recognized that when I was there the women that were getting promoted had been there for much longer than the men promoted to similar positions and had published more articles and done more policy work. And they're working very hard, I think, to establish protocols that will change that.

Julia Coronado:

In the private sector, again, similar unconscious biases. Although I think what I like about private sector economics is that if you're right and you're smart and people find your views useful in terms of making decisions, they will listen to you. And so I found actually a great home in finance and despite the fact that it's got a pretty terrible reputation and there aren't a lot of us out there, but we did actually, myself and my business partner, Laura Rozner, we did decide to go independent partly so that we didn't have to deal with some of these things, and we could just do what we do best and not be in an institutional environment where these kinds of unconscious biases can hold us back. Our clients signed up because they value our views. We exchange our views with them openly and respectfully, and it's very gratifying and we've built a successful business. So it's been a lot of fun and the right place for us.

Michael Klein:

Well, I hope that the prominence of people like Janet Yellen and Lael Brainard, who was actually my boss at Treasury, and is now on the Board of Governors of the Federal Reserve, and you yourself, Julia. I hope that that helps demonstrate a new world, and a way in which this gender discrimination is reduced. So thank you very much for joining me today. I really enjoyed our conversation.

Julia Coronado:

Me too. I did too. Thank you for having me.

Michael Klein:

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