EconoFact Chats: Making Sense of a Complicated Economy

Binyamin Appelbaum (New York Times), Scott Horsley (National Public Radio), Greg Ip (Wall Street Journal) and Heather Long (Washington Post)

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Michael Klein:

I'm Michael Klein, executive editor of EconoFact, a nonpartisan 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've been very fortunate to have a panel of distinguished economic journalists join us for four previous episodes of EconoFact Chats; Binyamin Appelbaum of The New York Times, Scott Horsley of NPR, Greg Ip of The Wall Street Journal, and Heather Long of The Washington Post. We last spoke in December 2021. A lot has happened since then. The most dramatic and impactful event has been the Russian invasion of Ukraine. Along with the obvious geopolitical and humanitarian issues, this has also had an effect on the world economy, by contributing to the spike in fuel and food costs. Partly as a consequence of this, but likely for other reasons as well, inflation in the United States is at a 40 year high. Since we last spoke, there is a resurgence of a new variant of the COVID virus, but with much of the country's population immunized or just tired of masking and social distancing, it certainly felt to many of us, that there was less of a shutdown than at times of other surges.

Michael Klein:

Although the preliminary numbers show 1.4% decline in GDP in the first quarter of this year, which follows on the heels of a 6.9% increase in the last quarter of 2021. Payroll employment rose by over 430,000 in March. And the unemployment rate fell to 3.6%. The lowest rate since just before the pandemic began. The Fed is trying to engineer a soft landing to bring down the inflation rate. Something that is notoriously difficult to do. Binyamin, Scott, Greg, and Heather, welcome once more to EconoFact Chats.

Scott Horsley:

Great to be with you.

Greg Ip:

Thanks for having us.

Binyamin Appelbaum:

Thank you.

Heather Long:

Thank you for having us.

Michael Klein:

Let's start out with a bit of an overview. Scott, last month you were in a podcast episode titled the Economy is Weird Right Now. The word weird doesn't come up much when I teach macroeconomics, but maybe it should. What did you mean by that?

Scott Horsley:

Well, I think you got at this in your introduction. There are lots of measures that suggest the economy is in good shape. As you said, we've been adding jobs at a rapid clip. Unemployment's really low, consumer spending, which is a major engine in the economy has been humming along. It's true, GDP contracted a bit in the first few months this year, but last year the economy grew with the fastest pace since Ronald Reagan was in office. Considering all the shocks we've had to weather, not only the pandemic, but now of course the war in Ukraine as well, the economy has proven surprisingly resilient. But you've also got this dark cloud, which is inflation. So even though, paychecks are getting bigger, people's real purchasing power is going down. That's why a lot of people tell pollsters they feel gloomy about the economic outlook.

Michael Klein:

So, inflation is at the highest rate in 40 years. Greg, what do you see as the various sources of inflation and their relative importance?

Greg Ip:

So, George Bernard Shaw once said, "to get an economist, all you have to do is teach a parrot to repeat over and over, supply and demand." And that is kind of the story of inflation, right? So, inflation happens when demand exceeds supply, and we have very strong demand and very constrained supply right now, so they're both operating. The demand side is fairly well known. The economy leapt out of the pandemic shutdowns, people going back to work, they wanted to spend. People wanting to go back to stores and so forth. They had the fuel of the fiscal stimulus, extra checks, for example, stimulus checks, and the lowest interest rates in many years, making it very easy to borrow and driving up stock prices. So, a very strong head of demand, but then that collides with supply. Now, normally like Michael, in your class, I'm sure you teach your students that supply curves slope upwards, which is just another way of saying is that when demand increases, we see that usually manifests itself both in higher output and higher prices.

Greg Ip:

But what we've had is a series of shocks to the global supply chains, which mean that, for example, in the case of automobiles, rather than making more cars because of a shortage of semiconductors, we're actually making fewer than before the pandemic and all that extra demand is showing up, not as more cars being sold, but as higher prices. What this means is that for inflation to come down, one of two things has to happen. Demand has to drop, or supply has to improve. The federal reserve by raising interest rates is looking after the demand part of the equation. But what we'd really like to see is the supply side get a little bit better, but it keeps actually getting a little bit worse, even as there was some sign of progress on all the disruptions caused by COVID. Then you had Russia's invasion of Ukraine, which drove up commodity prices and has created artificial shortages of many commodities such as wheat and oil. So, it's kind of like a wild guess as to exactly when these two differing forces shake themselves out.

Michael Klein:

Well, in my class, I would call that a supply shift, not an upward movement, but that's excessively nerdy for this conversation, I think. Scott?

Scott Horsley:

We did say early on, because people were changing the way they behaved because the pandemic, the demand shifted somewhat too. We had more demand for goods, less demand for services. There was this expectation in some quarters that as that normalized, as people started going back to consuming services, going out to ball games and shows and traveling more and consuming less goods, that would help with the inflationary picture. But it doesn't seem to be working out that way. In fact, now it seems like the inflation is kind of spreading to the services sector.

Michael Klein:

Binyamin, you had an article about six months ago in which you cite market power as one source of high prices. What did you mean by market power? And how do you see this working out?

Binyamin Appelbaum:

You know, for years before the current crisis, we used to hear corporations complaining that they didn't have a lot of power to raise prices. That they essentially had to pad profit margins by suppressing the cost of compensation for employees, by getting more efficient, but that the market really wouldn't tolerate much upward movement in prices. And inflation has jarred that loose. We're now in a period where people do expect to pay higher prices, and they don't know exactly how much more they should be paying. And corporations have suddenly gained a lot of power to raise prices, both to compensate for higher inflation, but also to pad profits. And so we see across a wide range of industries, corporate profit margins are up significantly.

Binyamin Appelbaum:

Strikingly, even though, in an inflationary environment, you'd expect wage demands to be pushing up prices. Much of the increase in prices is being taken as profits rather than going to employees. Wages are rising much more slowly than prices in this environment. And I think... I've heard a compelling argument made by some economists that you can actually hear companies coordinating price increases when they get on their earnings calls. That they go out there and say basically, "we are going to be raising prices. We have the power to do that in this environment." And other companies can hear a signal that they also have the opportunity to raise prices and corporate America has to some extent taken advantage of that environment to pad its bottom line.

Michael Klein:

Greg?

Greg Ip:

I think as Binyamin said, there's no question companies have a lot of pricing power right now, and they're definitely exploiting it. I think there's an open question right now as to whether they get that pricing power because of high concentration monopolistic behavior that predated the crisis, or a set of unusual circumstances that we're seeing right now. And I think you could fairly say there might be a little bit of both. The White House, for example, I think has fairly pointed out that the meat packing industry is highly concentrated with just a handful of companies, with a very large market share.

Greg Ip:

And so you've seen meat prices go up more than say the price of eggs, which is not as concentrated. But on the other hand, it's also the case that when demand rises as quickly as it has, you simply cannot get new entries coming to the market, fast enough to exploit that higher demand. And so, it's very common for companies to have pricing power. Look at used cars. That's about as fragmented an industry as there

is. In effect, everybody selling a used car, the millions of people selling the used car, is getting a windfall profit because it's so hard to meet the demand out there.

Michael Klein:

I noted an earlier podcast that the price of meat had gone up by a lot, but dairy products had not gone up much at all. And I used that as a caution, not to mix milk and meat. Heather, one source of inflation is high energy prices. And you recently wrote an article called, "$4 Gas is Here, Get Used to it." Do you think $4 gas is here to stay in the long run? And how should we, and why should we get used to it?

Heather Long:

Well, as many people listening to this may know, writers don't always get to choose their headlines, but I would just say that piece appeared in The Washington Post on March 11th, the day that gas prices did hit a new record high, at least in nominal terms. And we'll see if we surpass that, this summer, it's certainly possible. We've already done it in the last few days on the diesel side of the equation, which is pretty worrying. I think basically in the big big picture here, as Greg was saying, it all comes back to supply and demand. Gas prices are up about a $1.30 to $1.40, depending upon how you're comparing, what day you're comparing to a year ago. Just over half of that increase has happened since the invasion of Ukraine, since the war started.

Heather Long:

And obviously the White House has tried to really emphasize that message, but the Republicans are obviously stressing the other half of the equation, which was that gas prices were still up, quite a bit, even before the invasion, and mostly for the demand factors that we've been talking about so far. I think what's important going forward is there's just very little to change this picture in the short term. We just don't have a lot of excess global supply of oil right now with Russia, sort of being half off the supply system and OPECs ongoing reluctance to really make up the difference. Particularly I think a lot of people have been surprised that the Saudis just are not... half the time aren't even taking President Biden's calls. And a surprise to me was to learn how run down Venezuela's infrastructure is.

Heather Long:

So, I think the obvious solution for the United States was just to turn on more capacity in Venezuela, which just isn't possible. There's obviously a lot of calls. Another thing that's really been surprising to me, as I look more into energy, is the state of US refineries. So there's all these calls, "why don't we just drill more at home?" And when you actually start looking at that solution, yes, it is feasible to increase some supply from the United States and Canada, but our refineries are not built for that. The United States and Canada produce largely, a very light crude oil, and our refineries were designed in many cases decades ago, and they need more of a mix of light and dark crude. And that dark crude was coming from Venezuela or from Russia in the last few years. And so, we either have to change our refineries or we have to get somebody else, back on this market.

Heather Long:

And so, I think there's just a real open question in the medium term, not just for the summer, are we going to see probably $4 gas being a pretty normal thing, but sort of what happens, even heading into 2023? I think there's been a lot of frustration and rightfully so with the Biden administration that they're still not really laid out a big picture plan for energy. They still sort of say, "Oh, we've released from the strategic petroleum reserve. We've done a few of these things to try to help in the next few weeks." But there's really no medium term plan for, What does this look like? Are we hoping to produce more at home? Are we hoping to strike more deals with Venezuela or the Saudis or whomever? And they're trying to walk this fine line of also still trying to talk up their climate solutions.

Heather Long:

So anyway, I think there's just a lot of uncertainty around where the United States energy future is going. Obviously, the energy spike in March made up of half and drove half of the inflation increase in March. It could possibly help inflation in April and then potentially hurt it again in May June. I think this diesel price increase, will also start to flow through. But I think the big big big picture here, is really what is the US plan for energy? We still don't have a concrete plan. The EU done a much better job outlining that. And second of all, this continues to hurt confidence. The confidence as we were talking about, of Americans in the US economy is also one of these weird, strange factors that we can have a number of good economic indicators, and yet, still have confidence measures that look like we're in a recession. And a big part of this, unfortunately, is people driving by the gas stations and seeing these ongoing high energy prices.

Scott Horsley:

And if it were gas prices rising in isolation, you'd think, well, that would encourage people to invest in more fuel efficient vehicles or maybe even electric cars. And you are seeing that, but of course the high price of cars, both new and used cars is makes it that much more challenging.

Michael Klein:

Binyamin?

Binyamin Appelbaum:

Yeah, I think the energy market is a really great example of, the way that these dynamics play out differently in the short term and in the long term, because right now, the supply of gas is what it is basically. There's fairly limited flexibility. The United States opened up its strategic petroleum reserve and put a little more gas into the market. But basically, supply is constrained in the near term, but we have seen repeatedly that, that industry has a remarkable capacity to increase production in response to increased demand. We invented an entire new industry called fracking, the last time that long-term gas prices appeared to be headed higher, all of a sudden things were viable that had never been viable [inaudible]. So I think, if the question is $4 gas here to stay? I think one wants to be extremely cautious about predicting the supply-side future of that industry. Setting aside the demand side questions about how effective we are in constraining the use of gas. I think it's really hard to be confident in predictions about what the supply of gas is going to be in the long term.

Michael Klein:

So as mentioned, the increase in energy prices has contributed to inflation, but the pain of inflation is not going to be evenly born by people. Scott, who do you think will be bearing the highest cost of inflation, and who's going to be relatively lightly touched?

Scott Horsley:

Psychologically everybody's affected by inflation. Everybody sees those gas prices. It affects people's attitudes about the economy broadly. Certainly for businesses, when they see the prices of their supplies climbing, it affects their ability to plan and make decisions. I remember talking to a steelworks a company executive, who at one point prices were going up so fast, she was only offering quotes to her customers that were good till the end of the day. So in broad terms, when inflation's this high, it does affect everyone. But as is often the case, it's poor people who suffer the most.

Scott Horsley:

I mean, poor people are living close to the edge anyway. They tend to spend more their income on essentials like gasoline and food, that have seen some of the biggest price hikes. Low income people have fewer opportunities to find bargains. They might not have the extra cash to stock up when things go on sale. They might not be able to buy in bulk and get volume discounts. It's just a sad fact of life that it's expensive being poor. Upper income people start out with more discretionary spending, so they have more room to cut back without feeling the same kind of pain. Upper income people are also more likely to own a house or own stocks that have been rising in value, and that wealth effect can mitigate some of the emotional pain of these rising prices.

Binyamin Appelbaum:

This is an area in which we need better data. I really think the government is falling down on the job in this area. There was a lot of talk in recent years about the need for distributional GDP accounts, for the government to publish data showing how economic growth affected different portions of the population. The same is true for inflation. The government has the capacity to do a better job of answering these kinds of questions. And it's an area in which we really need better data showing not just what is inflation in the aggregate, but what is inflation, if you're at the 20th percentile? What is inflation, if you're at the 40th and the 60th and the 80th? These are knowable things that we're in the dark about to an extent, that I think is unfortunate.

Scott Horsley:

Yeah, we quote an inflation rate for a basket of goods and obviously, people of different income have very different consumption baskets. And as a result, they face different prices.

Michael Klein:

So, moving from inflation to GDP, another weird part of the economy has to do with the most recent GDP numbers that I cited in the introduction. Greg, you had an article in The Wall Street Journal that showed the 1.4% drop in the first quarter of 2022, masks in fact, some underlying strengths in the economy. In fact, you call the numbers, 'head fake.' What did you mean by that?

Greg Ip:

Well, if you actually dig into the GDP report that came out, you see that the main areas of spending, like consumer spending and business investment, continued to grow extremely strongly in the first quarter. Why did output decline? Well, it's partly because a lot of that spending was not met by new production, but it was filled out of inventories or by imports, which do not show up in domestic production. So in some sense, that's why it's a head fake. We know that imports and inventories were highly volatile parts of the national economic accounting system. And there's a good chance that will reverse in the future.

Greg Ip:

The same month that GDP was supposedly declining, we were creating half a million jobs a month and the unemployment rate was falling to near its lowest in 50 years. So there's absolutely no... so if you were to compare the GDP numbers to the labor market numbers, I would sort of say the labor market numbers are a stronger picture of where the economy is, which is still very very strong. A few days before we did this recording, we learned that the number of open jobs, vacancies, reached a new all time high. So, the demand for labor is still extremely strong. Looking forward though, the picture gets a little bit muddier. Consumer spending has been very strong, largely because we've been creating a lot of jobs. They've been paying very well, and there's been fiscal stimulus and low interest rates.

Greg Ip:

All those things to a certain extent are fading or in fact going into reverse. So, there's no more fiscal stimulus. That's all over. Interest rates are now rising. In fact, the rise in the 30 year mortgage rate in the last six months, is the fastest of any six month period since 1994. That will with a lag start to show up in things like demand for housing and other durable goods. And finally, all those wage increases people are getting, as we were just saying a minute ago, are being eaten up by the higher cost of energy and other inflation. So, we have a number of forces that are starting to operate on the consumer, that I think suggests that the future will not be as rosy as the past.

Michael Klein:

So, you're pointing to the fact that the economy is likely strong, maybe too strong, and the task of slowing the economy, to bring down inflation, largely falls to the Federal Reserve. But that's a really challenging thing to bring down inflation, without causing a recession. Binyamin, what's the history of the Fed's ability to manage a disinflation without driving the economy into a ditch?

Binyamin Appelbaum:

Not great. If I could just add a caveat to the account Greg just offered. One interesting dynamic, is that a lot of the money that got pumped into the economy hasn't been spent. A lot of it is still on the balance sheets of states. A lot of it has been saved by households. And one thing we've seen in recent months is that households have been drawing down those savings at a faster rate. So, there's a cushion there. The dynamics that Greg just described are real, but it's not going to happen quite as fast as you might take away from that, because there is this padding that also needs to be spent down before all of that stimulus is exhausted. But with regard to the Fed... listen, it's not a great history. The Fed, when it starts to slow things down, is typically quite good at slowing things down. And it tends to end up in a recession. I guess the two things I'd say about that, are that when you look at the Fed's past record, you're just not talking about that large of a library of historical episodes. And so, you really want to be cautious about concluding that there are definite and predictable patterns. The economy now is different than it was during those prior episodes. There are not that many prior episodes. I don't think this is a situation in which we're fated to see a particular outcome. But the reality is that the Fed's tools are blunt. And when it starts raising interest rates, it is squeezing the economy, generally.

Binyamin Appelbaum:

It is doing it without the level of precision that you might want in an ideal world. And the effect is to restrain growth pretty dramatically. And the idea that you can restrain it exactly as much as you need to, to get inflation back where you want it, and not any more than that, not enough to put the economy into a recession is something that has historically exceeded the Fed's capabilities. And just assessing the tools at its disposal is probably... it requires luck as much as anything. It's not something that one should expect them to be able to do as a matter of skill. They just don't have the tools to do it.

Michael Klein:

Well, there's a saying, "It's better to be lucky than smart." But I guess, it's best to be both. Greg, did you want to add something to that?

Greg Ip:

Yeah, I would say that Fed chairman, Jay Powell this week, put forth a theory about why they might actually pull off a soft landing this time, even though some of the preexisting circumstances aren't favorable. One is that we're in a situation of extremely high demand. That in fact, if you look at, for example, the job market, there is roughly two job openings for every unemployed person. So, one of the possibilities is that higher interest rates will reduce demand, and that reduced demand will show up in

fewer vacancies. Perhaps employers try it with fewer openings, but not compelled to actually lay people off.

Greg Ip:

A little bit earlier, I was discussing how we're actually selling fewer cars than two years ago, but there are long waiting lists for cars. What if higher interest rates has the effect of reducing those waiting lists, because some people decide they just don't need the car? You could actually get lower prices for cars without actually making fewer cars or selling fewer cars. So, that's just, I think... Binya pointed out that the sample size for recessions and soft landings is very small and statistically speaking, you want to be careful about drawing strong conclusions from such a small sample size. And this is one of the reasons why, there are certain things that genuinely are different this time.

Michael Klein:

In fact, the supply side, as you mentioned earlier, Greg is also really important and that's something that the Fed has no control over. So, a lot depends on what happens in the Ukraine and what happens with COVID and things of that nature. Another weird part of the economy, or maybe not so weird has been, what's called, "the great resignation." People leaving the labor force in the wake of the COVID shutdowns. Heather, do you think the great resignation is real? And if so, who's been resigning? Or is it that some people have suggested that the great resignation is really closer to the great renegotiation? People want higher pay, better working conditions, would like to be able to work from home and so on. So, we're in a period of renegotiation rather than resignation. What's your view of that?

Heather Long:

Yeah. Well, I wrote about this about a year ago and I called it, "the great reassessment of work." I also like the term, "great reshuffle." So, I think there will be ongoing debates in the history books about what exactly to call this, but certainly, it's undeniable that it's been going on. And I would say, even I'm surprised at how strong it continues to be. We just got the latest data for March and at least the early estimate that we got for March is more than 4.5 million people who left their jobs that month, most of them to go to another job, but that's a new high. It could get revised, but it even topped what we saw in November. So, the fact that it's still this strong even in a month like March when people were reading news and riveted by this war in Ukraine, and obviously the high gas prices and all of these things were going on that would seemingly shake confidence and make people a little bit more concerned about their prospects. We still saw this huge surge in people trying to better their lives. What do we know? We wish we knew more about who was quitting. The data from the government that we have certainly showed that it's leisure and hospitality workers, retail workers, more recently this year what's different than last year, is we've seen a pretty big uptick in business services, workers and construction workers who are leaving jobs. So, I think that'll be an interesting trend to watch, but this is still largely a low wage worker phenomenon. The other thing that we've seen from polling data, which isn't always the best, but is that there's been a higher uptick in people quitting, among women and among people of color. And I think that sort of plays in unfortunately, to who has generally these low wage jobs in hospitality, but it's an encouraging sign that different groups are feeling empowered.

Heather Long:

I spent a lot of time tracing people, particularly in the hospitality sector last year who were quitting jobs and then the manufacturing sector. And I would just say, what stood out to me is, pay is obviously a big part of what's going on. People who were in the $15 and under wanting to move into the $15 plus an hour category. But what's really striking is I would say in economics, we need to refine our model a little bit. People are definitely optimizing for a, "better job," but it's not just pay. When you interview people, they talk immediately about mental health and respect, and even there was some good Pew Research polling

that came out in March that showed that while 63% of people who wanted to quit a job cited they thought their pay was too low and they wanted better pay, 57% also said they felt disrespected in their current job. And you just see that over and over again in polling data, that this respect category is basically equal to if not higher and sometimes than the pure dollar amount that's on the paper. And I think that's a real wake up call to businesses. And you specifically see it among younger workers. So, I would say I'm a millennial, and even among my generation, you didn't see this need for mental health and respect and the way that you see it from a lot of 20-somethings, who are in the labor market now. And I think we're still sort of beginning just at the early stages of understanding what does Gen-Z and the generations that follow really want in the workplace? How different is it really? And they are much more likely to leave a job and they are much more likely to talk very openly.

Heather Long:

Like, "I want a mental health day, I'm going to take it off tomorrow." Or, "I felt really disrespected by what you said. You need to change your behavior," In a way that I don't think, certainly my generation or older generations, would've spoken back to a boss in that way. And so, I think right now it's playing out in the great reshuffle or reassessment of work, or whatever you want to call it, but what does this mean longer term for the labor market and for the future of work in America? I think it's going to be a very exciting and interesting research topic for years to come.

Michael Klein:

Scott?

Scott Horsley:

I do think that the nature of the great reshuffle has changed during the course of the pandemic. Early on, you did see people at least temporarily leaving the workforce, maybe for caregiving responsibilities. Maybe their loved ones were sick or their kids were doing homeschool. You're not seeing that so much, now. You are seeing people leaving jobs to take other better jobs, better in one way or another, whether it's pay or conditions. But you're also seeing, I think some employers getting the message now, and working harder to keep the employees they have. So, I think there's going to be opportunities for workers to improve their working conditions without necessarily going someplace else. And so hopefully... but we're, we're definitely not seeing people in large numbers now, leaving the workforce. In fact, we're seeing people coming back into the workforce, but insisting on better terms [inaudible 00:29:50].

Michael Klein:

Binyamin?

Binyamin Appelbaum:

My hesitation about this narrative... I guess I'm just not sure that what we're seeing is actually progress for workers in the grand scheme of things. Employment conditions deteriorated dramatically, for millions of Americans during the pandemic. People were miserable. They were being asked to do things that endangered them. They were being asked to work hours that were unsustainable. They were being asked to do their work in ways that put an enormous stress on their personal lives, even as the demands of their personal lives often were increasing. And so, what you had was a situation in which many people found their lives, untenable, and they left, and they decided to do something else, not necessarily because... not sort of in the nice narrative that they were jumping to a better thing, but that they had to get out of the thing that they were doing.

Binyamin Appelbaum:

And we see this in the pay data too. The broad story that people are getting better jobs. It's true that some low wage workers have seen increases in pay. Although importantly, those increases are not keeping up with inflation in recent months, but the labor share of output that goes to workers in the form of pay, has declined during this period. Workers are getting less of the pie. And so, this narrative that we're in an era of worker empowerment, I think it's misleading. I think that the reality is that workers in many ways are worse off than they were before the pandemic, and a lot of them are scrambling to limit the damage.

Michael Klein:

So, I've used the word weird multiple times in this broadcast, and these are weird and challenging times, but during times like these, it's especially great to be able to get insights from the four of you. So thanks to each of you for once again, being my guest on EconoFact Chats.

Greg Ip:

Thanks for having us.

Binyamin Appelbaum:

Thank you.

Heather Long:

Thank you for having us.

Scott Horsley:

Great to be with you.

Michael Klein:

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