EconoFact Chats: Performance, Perceptions, and Prospects for the U.S. Economy

Binyamin Appelbaum (NYT), Scott Horsley (NPR), Greg Ip (WSJ), Heather Long (Washington Post)

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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
The economy surprised everyone last year with falling inflation, low unemployment, and solid economic growth. One would think that this means that people are happy with the way things are going, but that doesn't seem to be the case. Economists may not be as well placed to understand this disconnect as journalists reporting on the economy. It's a great privilege and pleasure for me to welcome once more a panel of very distinguished economic journalists to EconoFact Chats to discuss the performance of the economy over the last year, and people's perceptions of that. I welcome back Binyamin Applebaum 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 October. Heather, Greg, Scott, and Binyamin, welcome once more to EconoFact Chats.

Greg, my comments in the introduction about the surprising performance of the economy in 2023 directly is quoting a recent article that you wrote. In that article, you attribute this good performance to improvements in the supply side of the economy, but you also note that this supply-based curative has its limits. Can you explain that?

Greg Ip
Sure. Well, let's first of all look at the question about why we think last year was surprising. We think it was surprising because on the one hand, you had the unemployment rate staying very low, below 4%, you know, longest period below 4% since the 1960s. You also had economic growth surprising most economists. I think it's going to come in at around 2.6% for the year. By comparison, we think of the long-term growth rate of the U.S. as 1.8% – so doing much better, not just better than expectations, but better than what you would expect over the long term. And yet at the same time, inflation fell, it fell faster than most people had expected. You don't normally expect to have better than expected growth, very low unemployment, and falling inflation. Well, the way you explain this unusual set of facts is that historically, most of the time, the economy is driven by demand. You get a lot of demand and inflation tends to rise. Too little demand and you get a recession. The last few years, it's all been about supply. First of all, we had a pandemic that shut down a lot of the economy. And when the economy reopened, you had essentially scrambled supply chains, you had rearranged patterns of demand, people living in different places. And most of the economy just could not keep up with supplying the goods and services that people asked for. So you got very high prices as a result. The last year too has been

all about the supply side of the economy adjusting to these differences, and finally being able to generate the goods and services that people want.

I'd like to say that people think that prices are high because companies are trying to maximize their profits. I'd like to say that prices are falling because companies like to maximize their profits. By which I mean, if you're an airline and there are unmet demands for flights, you want to put out more flights and hire more people to fly on those airplanes. If you build apartments and there is unmet demand for housing, you want to build more apartments. And that's exactly what happened in the last year. American businesses did what American businesses do, which is they said, hey, there's high prices, there's strong demand, I'm going to go out there and get some of that. And that's exactly what happened. And if you understand that this is mostly a story about supply, last year isn't really that surprising at all.

Michael Klein
Scott?

Scott Horsley
I think the reason that so many people anticipated we would have a weaker economy last year was because we did have the Federal Reserve aggressively raising interest rates to try to tamp down inflation. Those higher interest rates are designed to work against the demand side of the economy. They did put a damper on some things. They certainly depressed the housing market to an extent. You do see maybe some reduction in demand for big ticket items that people tend to finance. But as Greg points out, a lot of the improvement on the inflation front has come from the supply side rather than from depressed demand, which is what we usually expect to tip us into recession.

I will say, even though people are grumpy despite these strong economic indicators, there are some signs that public sentiment is starting to turn around a little bit. The last couple of months, the University of Michigan consumer sentiment figures have shown a big improvement, in fact, the biggest improvement in three decades. Public sentiment is still not great. People aren't singing ‘happy days are here again.’ They still are unhappy with elevated prices. But we are starting to see people recognize the improvement on the inflation front and feel a little bit better.

Michael Klein
When they were singing ‘happy days are here again,’ originally, that was back in the depths of the depression, so I'm glad we're not there. Binyamin?

Binyamin Appelbaum
Yeah, I guess I would frame this a little bit differently, because I think if you go back a year ago and you asked economists what they expected to happen this year, the story most of them told was that the Federal Reserve was going to squeeze the economy sufficiently to push it into at least a mild recession. That was what the Fed expected to happen. It was what many outside observers expected to happen. And the Fed did squeeze, and demand remained surprisingly resilient. And as Greg has noted, supply expanded pretty sharply in a number of areas to accommodate that demand and to meet it. And the economy kept growing as a consequence. Was that surprising? Well, it seems to have taken most observers by surprise. I think we all know

economists who got this right and predicted it, but they were not in the majority. And to me, it raises some interesting questions, in particular about monetary policy and its role in the economy and its power over the economy, and the degree to which the Fed was able to anticipate what was going to happen. Because if you look back a year ago, it looks like they once again got surprised, this time in a way that was good for us, but surprised.

Michael Klein
Heather, you wrote an article in which you said that the performance of the economy last year was not just surprising, but in your words, 'a miracle.' You also note that 'while the US saw it, other countries' economies' performances were mediocre.' Economists tend not to believe in miracles. So, what happened in the US and why was it different from what happened elsewhere?

Heather Long
Yeah, thanks. I was going to say that while most of us on this podcast focus on the US economy, that I think this is one time that we really have to look globally as well. And the entire world faced a pandemic, the entire world faced a supply crisis, and the entire world pretty much saw inflation come down a lot last year. But what really sets the United States apart is that demand side that Binya was talking about, which remained really strong despite all these various headwinds. And many parts of the world saw their central banks raise interest rates. You know, and I think what really, as I tried to look at this and look through the data, what just really stands out about the United States is consumption in many ways looks better than it did, stronger than it did pre-pandemic, which is a surprise. And some of that you can attribute, of course, to our government fiscal policy, which was very, very generous compared to most other nations. But the other big surprise, and I have to give some credit to the JP Morgan economists for figuring this one out, was really the wealth surge. You know, the way that our housing market works is very unique. Most people saw a huge jump in their housing values and their stock market values. And, you know, that really also insulated them because we do the 30-year mortgage rate and other countries don't lock in for 30 years. It really insulated the vast majority of Americans from one of the biggest ramifications of the Fed hiking interest rates. And so, all of this sort of came together. And also the labor supply, you know, Greg talked a lot about supply issues, but I think the other big surprise was labor supply turned out to be a lot bigger than a lot of people anticipated, particularly women with children coming back into the labor market a lot faster and stronger than a lot of people initially thought. And so, you put all that together, people had more money, people felt wealthier and people continued to spend at rates that certainly very few people were forecasting. Even if they were forecasting that inflation would come down and we weren't going to end up in a recession, a lot of people did not forecast Q3 GDP shooting through the roof, for example. So that, I think, is a helpful international context as we look at why did the U.S. stand out so much last year?

Michael Klein
As someone whose research was in international macroeconomics, I really appreciate that perspective. And yet, you know, as Scott said, people are grumpy. Binyamin, you co-authored an article with your colleague, Peter Coy, around Thanksgiving, that people were not giving thanks. In fact, they were, as you also said, grumpy, although it does seem like this so-called 'vibe-session' might be easing right now. What do you think is going on? What was going on then? And what do you think is going on now?

Binyamin Appelbaum
So I guess the first thing that I'd say is that a leading theory of what was going on, one school of thought, was that there's just a significant lag between conditions and sentiment. And the more recent readings of the Sentiment Index give a lot of credence to that. It appears to be the case that sentiment is rebounding quite strongly as people sort of, I guess, take stock of their financial lives and their economic prospects. The point that I made in that piece, which I think remains true, is that when people are asked about present conditions, their eyes are often on the future. They often answer those questions, not just in terms of how they're doing today, but about their expectations for how they will be doing going forward. And I think, you know, when I've talked to people around the country about their economic situations, what one often heard over the last year was a lot of uncertainty and a lot of lack of confidence about where things were headed. So yeah, things might be good right now, but where are we going? Do I feel like I'm going to be able to sustain the income growth that I've seen? Do I think I'm going to be able to afford a house? Do I think I'm going to be able to put my kids through college? And a lot of Americans have a lot of uncertainty about those things, or outright skepticism about those things. And I think that has tended to weigh on consumer sentiment quite a bit. But I think the bigger story, which we have to take cognizance of now, as Scott noted, is that we are now seeing a rebound that appears to make consumer sentiment look more like the macroeconomic data.

Michael Klein
Scott, you had some reports, some broadcasts on views of the economy and also on the link between how high gas prices are in people's views of inflation. Could you talk a little bit about that?

Scott Horsley
Yeah, traditionally, the price of gasoline weighs heavily on people's sentiment. You can often plot the two together and there's a very strong correlation. And as gas prices have around the country fallen close to $3 a gallon and actually stayed in that range, even with all the turmoil in the Middle East, I think people have definitely felt more confident. The other thing is that the stock market affects people's sentiment. Even though a lot of people don't have a lot of wealth tied up in the stock market, they see the coverage every day, a rising market – it's not the economy, but it does affect people's sentiment. And so the combination of falling gas prices and Dow and S&P in record territory, I think, has made people feel a little bit better.

Michael Klein
Yeah, there aren't many prices that are every day you can see in three-foot high letters as you're driving. So it is a striking thing.

Scott Horsley
And it's one area. We've had sort of throughout the economy this disinflation where prices are no longer going up as fast as they had been. And that's what the Fed looks for. That's what a lot of economists look for. But what consumers look for is, or what consumers want, is to see prices actually come down. And gasoline is one of the commodities, one of the noticeable commodities where that's actually happened. We've now seen gas prices fall from a high near $5 back in the summer of 2022. And that, by the way, is when consumer sentiment hit an all-time low. We've now seen gasoline prices fall by close to $2 a gallon.

Heather Long
So, I'll jump in here. I wrote a column with the headline, the 'vibe-session' is likely over in July. So, I guess I was about six months earlier than our friends at the New York Times. So I appreciate Binya's point that some of it just took time to work through. I still think a lot of the story can be explained by real wages. And that really started to change last spring and summer, where we finally, yes, people have had trouble digesting a 20% across-the-board price increase compared to pre-pandemic. But we're now in a situation where, for all workers, wages are up 20%. And for production and non-supervisory workers, our middle class, if you will, wages are up 23% since that same point in the pre-pandemic. So people are, in fact, starting to really feel and see that they are better off.

And it did take a long time to get there. It takes several months, if not a year, for people to really feel that in a tangible way, in addition to all the factors that Scott was saying. So I think there's a lot of reason to be hopeful if you're the Biden team and you're heading into a situation where the next couple of months should continue to see real wages continue to significantly outpace where we are with the cost.

Michael Klein
Before we leave this topic, I'd like to mention that Aaron Sojourner and Ben Harris have a Brookings blog out where they look not at consumer sentiment, but what they call news sentiment, the way things are reported. And they do this econometric analysis of news sentiment as a function of underlying economic conditions. And then what's interesting is they look at the deviations from the prediction. And what they found was that the deviations from the prediction were biggest in the 2021 to 2023 period when the news was more dire or more pessimistic than the underlying conditions. So as people in that industry, do you have any views about that, Greg?

Greg Ip
May I, on behalf of the reporters on this call, explain why it's not the fault of the reporters that people are in such a lousy mood? So first of all, it's a very well-done study, but all they've actually shown is that there's a correlation between sentiment and economic news, not that economic news is causing people's sentiment to be low. In my judgment, essentially what the news sentiment and what people's more broadly reflected sentiment are both showing is the same thing, which is that everybody feels lousy. And journalists are not immune to that either. Speaking for myself, I'd be curious if my colleagues have noticed the same thing, we noticed that particular types of stories aroused much more reaction from people. They really were responding to stories about inflation for the last year or two, much more so than to stories about low unemployment. That tells us something, right? So it's not that the news media are out there with their own agenda saying, here, people, read about all these terrible things. Don't believe your own lying eyes. It's not like that. In some sense, the media are themselves part of the overall atmosphere. And I do want to make a couple of sort of related points to this. Just how bad sentiment is depends partly on how you measure it. Most people look at the University of Michigan Sentiment Index, but this index, the way it's constructed, is very sensitive to inflation and financial assets. If you look at the Conference Board's index, which is almost as old, but not as closely followed, it's much more sensitive to the job market. And that index never did fall as much. And then you have a whole variety of other sort of less pure indexes. When you go ahead and ask people, for example, is the country on the right track or going in the wrong direction –

that is, in some sense, an indirect way of asking that same question. And what we've seen is that it looks like a lot of what we think of people being down on the economy is just people being down on the country in general. And I often refer to 1967-68 when the economy was doing great, but the whole country was in flames. And it was reflected in political sentiment and the results of the 1968 election.

Michael Klein
Well, I'm sorry that the journalists on this call are feeling badly. And I promise next time I'm in DC, I'll take you all out for a drink. Binyamin?

Binyamin Appelbaum
I'd just add two things to what Greg said, which I largely agree with. The first is that I think that this was a confusing year. A lot of experts didn't understand what was happening and persisted in a more negative outlook than proved to be warranted. Journalists rely on those people or at least take them seriously. And I think there was a real lag in willingness to accept or to reflect that the economy was improving in part because a lot of very smart people weren't sure that it was true. So that's one thing that I'd say. The other is that to the extent that journalists are only human and are to some extent, you know, reflecting the vibes that they themselves are feeling, this has been a really lousy time economically for journalists. And I think, you know, a lot of people who were writing these stories were themselves struggling or uncertain about their economic futures. And I guess I would put it, I find it hard to believe that that doesn't on some level influence the tone of coverage.

Michael Klein
Fair enough. As a tenured professor who's sort of assured of a job, I guess I'm more optimistic than a lot of other people, perhaps for that reason. But in terms of optimism, Greg, you have a recent article about technological advances in which you say the future is bright, but you just need to know where to look. So where, in fact, should you look to see this bright future?

Greg Ip
Well, I'm glad you brought up that column, Michael, because in some sense, I wrote that column as a reaction to the pervasive gloom by sort of going to first principles and asking, well, what is it that makes for human thriving over the very long run? And on that front, last year, the last couple of years have actually been kind of exciting. ChatGPT and artificial intelligence, I mean, we've been hearing about AI for decades, but I think in the last year, is the year finally hit home to people, hey, this is an amazingly powerful tool that can do a lot of things and could actually have a material effect on wellbeing and economic growth in the long run. In the short run, people are worried about losing our jobs to AI. I certainly know that I, as a journalist, I'm a little bit disturbed by how good some of the answers are you can get from ChatGPT, but we're trying to sort of step out of that sort of parochial point of view. I think that most innovations of this sort have been net positive for people's wellbeing in the long run. I don’t see why this would be different. I'm even more thrilled when I look at some of the things that happen in life sciences. Like last year, we got the first, the FDA approved the first effective treatment for Alzheimer's. This is like one of the last diseases that has defeated all attempts to understand and cure. And that is just an enormous step forward. And of course, all the excitement about weight loss drugs. You know, Alzheimer's and obesity, and by the way, some of these weight loss drugs have found

that they can actually address a variety of forms of addiction and substance abuse. So, you think of those problems, Alzheimer's, obesity, substance abuse, three of the most pervasive health challenges we face as a society. So what all these advances I'm talking about have in common, it's not just that they represent the frontier of science moving outwards, because that happens every year. It's that the benefits are so widespread. These are not rare diseases. These are not isolated sorts of problems these technologies and breakthroughs are addressing. And I think that setting aside all the reasons people can have to feel negative, those are incredibly positive developments for the future.

Michael Klein
I would also mention, although it's not as widespread, the development that Vertex had in addressing sickle cell anemia, which is just was incredibly heartening to see that a friend of mine is a Chief Scientific Officer for Vertex. And I learned about this from him before the hearings. And it's just really dramatic that we have this change. Scott?

Scott Horsley
Yeah. Well, as someone who once lost a news writing contest to a robot, I can certainly testify to the challenges posed by AI, but it does offer lots of advantages. And another thing to be, I think, sanguine about is the really strong boost that we've seen in productivity, worker productivity in the last year. Some of that has to do with technological improvement, but some of it may also have to do with all the job churn that we've seen during the great shuffle, the great quitting, and then getting rehired in 2022. There was a lot of friction in the job market associated with that, but ultimately, maybe people wound up in better jobs, jobs for which they're better suited. And as they get longer tenure, and as we see that churn slow down, productivity has really taken off. And that's good because productivity, when workers are more productive, they can earn more money without putting upward pressure on prices.

Heather Long
Yeah, I also find myself modestly more optimistic, too, for the tech reasons Greg laid out, for the worker reasons, so many people getting into jobs they like better, that Scott laid out. There's also been a surge in government investment. I'll give a nod to Binya, had a great column on that recently, so I'll let him talk more about that. And I would layer on top of that, this is more of a question mark, but we did have a bit of a shakeup in terms of people moving, particularly millennials moving, millennials with a lot of money and college degrees were the most likely to move permanently during the pandemic. And I think we always have had this approach for much of the past century of believing that everybody just needed to move to the big cities, that the more people, sort of bigger is better philosophy. And what we've actually seen in the last couple of years is the rise of, I don't know what to call them, in real estate, they call them second tier or third tier cities, but they're really like rising star cities. We just have our talent and our dollars dispersed in a lot more places now across America. And there could be some potential for real innovation hubs to happen outside of New York, San Francisco, maybe Boston, LA, DC that was happening before. And in my eyes, all of that comes together to some really dynamic future for the U.S.

Michael Klein
Binyamin, I was also struck by that article that you wrote that Heather referenced. You in that article wrote that President Biden's efforts to reinvigorate the government's role as an investor in the economy could be, and the quote is, “may endure as a turning point in the nation's political and economic history.” Could you explain that a bit, please?

Binyamin Appelbaum
Absolutely. Yeah. But before I do, I just want to say one thing about what Heather just said, which is that to me, the trend of people moving out of large cities to smaller ones is one of the most negative and unsettling long-term trends in the American economy. We have wonderful economic evidence that the concentration of talent geographically is a huge catalyst of creativity and productivity growth over time. And the reason people are leaving these cities is because they can't afford to live there. And so we've stood on its head, the old model of the places that are strongest economically being the places that also see the largest population growth. And instead of making it possible for people to live in generative places like San Francisco and New York and Seattle, we're shipping them out to second-rate cities where they'll be isolated from innovation and capital. I'm not at all convinced that it's a good thing for this country.

That said, why do I think that the Biden administration's emphasis on investment is so important? I think a lot of the stuff we talk about when we talk about the economy is short-term fluctuations around fairly steady concepts of how the economy should work. And every so often, we get a real change in those conceptions. And what the Biden administration is pushing is that kind of change. We've been through several decades in which the government really withdrew from its role as an investor in the economy, from investment in infrastructure, from investment in research, from supporting domestic industry, and sort of said, basically, this is not our role. We're not going to do this, or we're going to do it more minimally than we have in the past. And I think we've been living with the consequences of that. And we are now seeing a really strong shift, at least ideologically, in the approach to that, first under Trump and now under Biden, where the government is re-engaging that role. I think the consequences are enormously complicated, both economically and politically, and we're still unpacking them and seeing how it will all work out. But this is a big deal. Something very big and important is happening, and it should have all of our attention – this idea that the government is going to renew its role as a more active participant in the economy and in economic development. And that's why I described it as a potential turning point.

Michael Klein
I just put in a pitch here for your book from a few years ago, ‘The Economist's Hour,’ where you really outline in a very nice way sort of the evolution of thinking, and maybe you need to have an addendum to the last chapter of that book now. And if you do, I'll buy another copy.

While things are looking up in terms of the US economy, and Heather already mentioned that other countries aren't doing as well, but some other developments are even much more concerning. There's conflict in the Middle East, the attacks on shipping. These could have big economic ramifications since it could cause another supply-side shock. How do you think these events and other military conflicts will impact the US economy? I know, Scott, you talked about that a little bit in one of your segments.

Scott Horsley
Yeah, we have certainly seen an uptick in the cost of shipping goods by water because of the trouble both in the Red Sea, and Suez Canal, and also the drought-related problems in the Panama Canal. These are less of a concern for the United States than they are for Europe, because most of the stuff that comes to the United States from Asia comes via the Pacific, so it doesn't need to go through the Red Sea and Suez Canal. But obviously, the stuff that goes to Europe, some of it eventually winds up in the US, and we talk about inputs, and it can have global ramifications. It's not nearly as dramatic as the uptick in shipping costs that we saw during the early period of the pandemic, so it's not on the same sort of scale, but it's not something you want to see. It does seem as if the Houthi attacks on shipping in the Red Sea are not going to be easily quashed by US military action or other allies' military action.

Michael Klein
Binyamin?

Binyamin Appelbaum
I'll just add a longer-term point, which is that the share of the economy that goes toward national defense spending has been in steady decline for decades now, and one possible ramification of a world in which there is more conflict and more threats to the United States is that we need to start spending more on defense again. That has interesting economic consequences. It has in the past been an engine of national investment in infrastructure and research, as we just talked about. It's been a reason for doing those things that people are capable of rallying behind, but it also means that resources are being diverted from other potentially productive uses. I think one interesting thing to watch is whether the United States decides that the gap between its commitments and its capabilities has grown too wide and that we need to begin reinvesting in national defense on a large scale.

Scott Horsley
And it is also just interesting to see the world's most powerful military not necessarily able to deal with a ragtag group of rebels who are bent on attacking a critical shipping corridor. It certainly seems like the kind of thing that the international community wants to defend is free shipping lanes, and yet all the money that all the militaries spend are sort of humbled by the Houthi rebels.

Greg Ip
I was in Davos just recently for the World Economic Forum. It's not as fun as it sounds. However you do end up speaking to a lot of…

Michael Klein
Kind of seems like it's pretty fun.

Greg Ip
Yeah, well, sometimes appearances are deceptive. And certainly one of the impressions you get from talking to a lot of economic and business leaders there is that the sorts of things that they used to think about most in terms of how will this affect my business in the coming year: interest rates, inflation, recession, commodities – Those are now in some sense subordinated to

geopolitics. Will there be a war going on? Will there be export bans or other tariffs or other conflict between China and Western nations and so forth? And what's going on in the Red Sea is I think it came along exactly as these folks were meeting and it drives that home. In our conversations, geopolitics was one of the first things that came up. And I think it has a couple of implications. Like I think Binya was saying, that it certainly tests the ability of the United States to be the world's policeman. Our defense industrial base is woefully unprepared for fulfilling these duties and our allies aren't much better. And I don't see it getting better before it gets worse. And I think it's one of the reasons why one wants to be very cautious about declaring the war on inflation having been won. Because what all these supply interruptions have in common is the ability to very suddenly raise costs. And I think it's one of the things that businesses and economists will have to get used to for the long run.

Binyamin Appelbaum
I heard Jamie Dimon say recently that his biggest economic risks aren't economic, they're political, which is sort of a nice pithy way of summarizing what Greg was talking about.

Michael Klein
Well, as always, I really enjoy these discussions that we have four times a year, and your insights are really valuable and enlightening. So, thank you once again for joining me on this podcast and I hope for all of our sakes that supply shocks don't emerge.

Heather Long
Certainly not in newsprint. That would be nice.

Michael Klein
This has been EconoFact Chats. To learn more about EconoFact and to see the work on our site, you can log into www.econofact.org. EconoFact is a publication of the Fletcher School at Tufts University. Thanks for listening.