Inflation in America: Experts react to the latest CPI release
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WESSEL: [00:00:00] Good morning, everybody, I'm David Wessel, director of the Hutchins Center on Fiscal and Monetary Policy at Brookings. There is a great deal of interest and anxiety about inflation in the United States right now. The consumer price index increased 0.8 percent in February, which is a little more than it did in January. And over the past 12 months, the CPI has increased 7.9 percent. We're going to talk a little bit about how to think about those numbers and where we're going from here, both economics and the politics. I'm very pleased to be joined by Neil Irwin, formerly of The New York Times, now at Axios. Justin Wolfers of the University of Michigan and author with his wife of a very successful economics textbook, Principles of Economics. Wendy Edinburg, who is director of the Hamilton Project here at Brookings, formerly the top economist, the Congressional Budget Office. And Elaine Kamarck, my colleague at Brookings in Governance Studies, who has been very active in democratic politics and worked in in in the administrations of Bill Clinton and Barack Obama. We welcome your questions. Send them along. We'll get to them as they come up. Don't, don't wait for the end. We're not going to have a Q&A session. But I'd like to start with you, Neil. Give us the bird's eye view. What did we learn today about inflation from the Bureau of Labor Statistics? 8:30 release of the Consumer Price Index.

IRWIN: [00:01:34] Thanks a lot, David. Well, I guess the good news is that the numbers came in at about the levels that Wall Street analysts were expecting. As you said, 0.8 percent month on month headline inflation, 7.9 percent over the last year, that's the highest since 1982, a new high for kind of the last generation or two. So a big part of that is being driven by energy prices even in the run up to the war in Ukraine started at the very end of the month. But as the weeks progressed through February, we saw energy prices march up. That's reflected in these numbers. Take out energy, take out food, you're looking at a 0.5 percent month on month inflation rate and that came to 6.4 year over year. So not quite as dramatic, but still awfully high and still far above the two percent inflation the Federal Reserve aims for. Really an uncomfortable number if you're the Biden administration, if you're an American worker sitting on a kind of more modest pay increase than that. Certainly, the kinds of numbers that suggest that inflation remains a major problem in the U.S. economy.

WESSEL: [00:02:38] Thanks. I've never been very comforted by knowing that the numbers came in as Wall Street expected. If you have to buy food and gasoline, it's nice to know that Wall Street expects you to pay more, but it's not much help at the pump. And Justin, why are we having so much inflation? Is this because we had too much fiscal stimulus during the pandemic? Is it because of COVID or what?

WOLFERS: [00:03:05] Another way, posing a question, David is, is what's going on all about supply or all about demand? And I don't think anyone can give you a clear answer on this. You know, the it's demand question would be we're running the economy too hot. The fiscal stimulus was too big. Unemployment is at an historic low and this is what the Phillips curve would lead you to expect. The its supply answer is just look around you. Life is still really weird. And if your life or my life is still not what it once looked like, that then means that the accumulation of all that the economy, it's also pretty weird. And there are all sorts of supply side problems in the US. One way of understanding or seeing that supply is at least part of the story is to look at the fact that inflation is also rising in other

countries that did not have the same sort of fiscal stimulus. It's not quite rising as fast, but I think really that's very much the terms of the debate. And it matters because as we get back to normal life, we expect supply to get back to normal, which would then suggest that this is all just going to go away. Whereas if this is demand, this says we're running the economy too hot. This isn't sustainable. We can't have unemployment this low. We don't... we can't have good things. And the Fed would need to engineer some sort of a slowdown. I don't think the today's report actually tells us a lot either way. We know a lot of the inflation is coming from the good side. We know the good side is where there's a lot of supply constraints, but we're starting to see inflation rising in the service sector and that's less COVID afflicted, suggesting that maybe there's something to the demand story to.

WESSEL: [00:04:53] So just want to stay with you for a minute. One thing that people always wonder about are wages going up fast enough for the typical worker to keep up with the rise in prices. It's sometimes really hard to figure out how to read the data. We get some numbers today, but if you have a lot of low wage workers coming into the back to the workforce as, say, restaurants and hotels open, that can pull down the average, but it can be misleading. So what's your best read on whether wages are keeping up with inflation?

WOLFERS: [00:05:23] Well, the question for people's, you know, the cost of living and therefore the quality of life that you're buying with your wages. This is where you would look at the headline inflation number because that's actually people's actual costs rather than core inflation. And there's no question that headline inflation is running faster than wages. But if what you're thinking about is not what's happening today, but what's likely to happen over the medium run, I can tell you that having studied inflation's across many countries over many years, it is almost always the case that eventually wages will keep up with prices. The idea that inflation is what sets the real wage is one that doesn't make sense in any standard economic model. It may not be very comforting for people to hear right now that their cost of living is rising faster than their wages, but I think there's good reason to be confident that wages are going to catch up. The question is how quickly - How long will it take?

WESSEL: [00:06:17] Right. Wendy, how do you read the inflation picture now? Do you think that we're going to see a gradual decline in inflation? Perhaps not as quickly as Jay Powell, the Fed chair, had in mind when he referred to it as transitory before he banned that word from his vocabulary? Do you think we're in for a long run of higher inflation or do you think it's going to calm down or on what does it depend?

EDELBERG: [00:06:43] So I was more optimistic that we would see a slowdown in inflation before this morning's report. And and here's why. One of the one of the the big sector where we've seen extraordinary inflationary pressures in the goods sector. So approximately two thirds of the extraordinary increase in inflation that we've seen over the last, say, six months has been because of goods prices, not because of services prices or in more specifically, core goods. And I think more than anything that has reflected a surge just off the charts, surge in demand for goods by consumers. And yeah, indeed that was partly financed by all of the fiscal support. And the unfortunate thing is that all of that fiscal support seems to have been focused on this one sector that is just buckling under the pressure. All right. So now what does that mean for going forward? As the pandemic recedes, consumers will inevitably pivot from demanding goods to demanding more services. And so, you know, past is not necessarily prolog here. The inflationary pressures that we've seen in the goods sector don't necessarily tell us much about inflationary pressures going forward, because that's going to be all about the service sector and there's going to be some lurching around as consumers go to the service sector and we'll

see if the service sector can keep up. There were a few signs that concern me. We saw some unwelcome inflationary pressure in personal care and transportation, you know? But but other parts of the service sector didn't seem to reflect, you know, strong inflationary pressure where that inflationary pressure would be coming from in the service sector is from wages. It would come from people simply not wanting to work for lots of different reasons. Some of those reasons are pandemic related, and so they will hopefully go away. But we haven't seen a lot of pass through from wage inflation to overall price inflation yet. But if the service sector sees a big, you know, burst of demand and supply can't keep up there, that will be because they can't find the workers and they will pass on that wage pressure and to enter into prices. So I just talked for a long time, and now we don't hear anything

WESSEL: [00:09:20] that's because of I had my mike off.

EDELBERG: [00:09:21] I was I was keep going. I was going to see real wages. Wages are indeed going up for lower wage workers. That was the one piece of good news that I wanted to add to what Justin was saying.

WESSEL: [00:09:32] OK. Real wages meaning inflation adjusted. So I was

EDELBERG: [00:09:36] wages for lower and lower wage sectors. We have actually seen a nice, positive real wage gains.

WESSEL: [00:09:43] One thing I noticed, I'm looking at the CPI report is really a lot of a cornucopia of little things that are also often very bizarre. Like I noticed that newspaper and magazine prices went up five point three percent in February. I have no idea what's going on there. And I was a little distressed to see that the price of beer at home went up two point two percent. On the other hand, after a big run up, more than 40 percent used car prices actually fell a little bit. So there's a light at the end of that tunnel. When I was on mute, I was saying that unfortunately, Elaine Kamarck is having difficulty, technical difficulty, won't be able to join us, but I'm going to tell you what I think she would say. She would point out that Americans live in two different worlds when it comes to inflation. And while the numbers we're talking about are largely about the average, for some people, particularly at the bottom, when prices at the gas pump go up, it makes a huge difference. And they're very sensitive to prices going up. In fact, I've heard a number of economists observe that they sometimes have to be reminded that people dislike inflation more than economists think they should or expect them to. But Elaine would point out that for upper income people, if the price of gasoline goes up a bit, if you have to pay more at the grocery store, if the heating bill in your house goes up a little bit, they have a lot ... most people at the top of the income distribution, they might sigh about it, but it won't really affect their lives. And she points out that the people, some of the people who are most likely to be sensitive to inflation are blue collar workers who were swing voters in the Trump. They voted for Trump and they voted for Biden, which is why she thinks the administration is so concerned about inflation and the perception of inflation. Because the very voters the Democrats need to keep the House in and the Senate in 2022 and reelect a Democratic president are the ones who are most likely to be wincing at this increase in prices. Neil, I wonder if we come back to you? So we don't really yet see the effect of the Russia-Ukraine war in these data, right? So isn't that a reason to believe that we'll begin to see prices of oil and wheat and other key commodities rising in the months ahead unless something remarkable happens in Ukraine?

IRWIN: [00:12:21] Yeah, I mean, we did see, you know, energy prices were rising throughout February but have really spiked since February 28th was the kind of real date of the invasion. So it's really been a very short period. We've seen oil gone up to 125 or so a barrel. I think it's about 110 right now. Wherever that settles, that's going to flow through to a lot of goods, other energy products as well. You mentioned agriculture. Look, you know, I mean, for U.S. consumers, the raw agricultural commodities are not as big a part of what you're eating. So when you buy a box of corn flakes, the commodity corn in those corn flakes was actually a small piece of what you what you spent. But I will add, in addition to food and energy, some of these metals that are that are in short supply now a palladium, nickel, things where the prices have skyrocketed because they're mined in Russia or Ukraine. You know, these are these are going to make more complex these preexisting supply chain problems that a lot of heavy industries are having. I don't know exactly how bad that will be, how quickly or slowly that will play out, but I think there's reason to think that this entire crisis in Eastern Europe is really going to have ripples through the entire world economy and U.S. supply chains that we don't fully understand yet and don't know quite how severe the wind up being.

WESSEL: [00:13:36] I just want to remind people, if you have a question, DM it at Brookings Institute, that's our Brookings Twitter handle, and it's really hard for us to know what things people don't understand are puzzled by. So we kind of rely on you, though let us know. Justin, when you often hear economists and you always hear officials of the Federal Reserve talk about something called inflation expectations. What is that and why do we care about it?

WOLFERS: [00:14:10] Right, so the way to think about this is so you want a restaurant, you've got to print your menus for next year, and as you do that, you think what prices should I set for my pasta and all the other dishes, and that will depend partly on what prices you think your competitors are going to set. And it also depends partly on what do you think's going to happen to the costs of buying raw pasta and so on. And so therefore your price that you're going to set now for the next year depends on what you think is going to happen to prices over the next year. So another way of saying that is your inflation expectations are central to the actual prices you set. So therefore central to inflation. What that means is if people expect inflation to be low, then stores will keep their price adjustments pretty small and inflation will turn out to be low. The problem is, if everyone starts to expect inflation is going to be higher than when I print my next menu, I'm going to raise my prices by a lot. And if lots of people do that, that's going to cause overall prices to rise by a lot. That's going to cause high inflation. So you can either have a virtuous cycle of low expectations creating low inflation or a vicious cycle of high inflation expectations creating high inflation. Much of what this fed has spent the last 40 years doing is trying to get Americans to believe inflation will always be so low you don't need to worry about it. And it turns out that, you know, people below the age of 50, inflation has been low through their entire lifetime. And so the Fed is hoping that those folks are going to continue to expect inflation is low and that will bring about its own reality. The fear is people are looking at inflation of eight point nine per cent and they're like, Oh, maybe I should be raising my prices by more. And so if inflation expectations rise, we're worried that will create a longer-term inflation problem.

WESSEL: [00:16:01] Justin, it's hard to measure inflation expectations. We look at financial markets and they do all these surveys. But based on what you see today, do you think that the inflation virus is spreading, that people now expect inflation to be high in the future or not yet? Or don't we know?

WOLFERS: [00:16:19] My optimism comes about because I'm hopeful that inflation expectations are not rising very much. The difficulty with measuring inflation expectations is we're never quite clear whose expectations matter. So it's very easy to see what very sophisticated traders on Wall Street are thinking because we see that in financial prices, but they don't actually set most of the important prices in the economy. We know what consumers think, but again, consumers, most of us, don't set many prices. What we wish we knew was for people who own stores and restaurants what they were thinking, and we don't really know. The difficulty is we see some people's inflation expectations have risen a little bit over the next couple of years. But when you ask about their longer term inflation expectations, they haven't moved very much. It's going to risk sounding like a sociologist, not an economist, David. But as you listen to people in this debate, I think it's worth thinking, like literally taking note of their age because for people who lived through the inflation of the 70s, they're much more on edge, much more worried about it and much more worried that we're going to see a repeat. But people who've never experienced inflation in their lives, I think they've got every reason to think, I've never seen inflation, I don't expect to see it again. And I think their expectations are going to be a lot more stable.

WESSEL: [00:17:35] Yeah, that's a really good point. I spent some time for the Wall Street Journal in Germany, and it was almost a cliche. Any time you mention the word inflation, someone would talk about their grandmother's experience during the 1920s, as inflation moved from one point seven to 1.8 percent a year, they'd be talking about the hyperinflation in the Weimar Republic. Wendy, a couple of people are asking about the Fed and how does this work? Will the Fed need to raise interest rates more because oil prices are going up and will have a higher inflation? Or does this temper their need to raise interest rates because higher energy prices will tend to slow demand for other things or both?

EDELBERG: [00:18:17] So I think it's the latter. I think it will mean that the Fed has to do a little bit less. So in normal times, if the Fed weren't trying to, you know, deal with unwelcome inflation or try to bring demand back down to where it could reasonably be sustained, in normal times, if we saw a big spike in oil prices that led to a big spike in gasoline prices, the Fed would probably just sit on its hands. They would do what we call looking through it. They would say this is not, this is not a change in inflation that we have to worry about. This is a change in the price level, which is just to say it's a one time shift and either going forward, it's just going to stick - so I don't think that that's anybody's expectations right now - more likely going forward, prices, oil prices and gasoline prices will come down. But these are not normal times. And right now, what the Fed is on track to do starting at its next meeting and going forward is to actually remove some of the very significant accommodation that they've had in monetary policy, and I'm putting it that way on purpose and not saying that they're tightening. I mean, it's basically just semantics, they are tightening. But it's not that they're trying to create tight monetary policy, it's that they're trying to create less loose monetary policy. And the reason that they want to make monetary policy less loose is because we just have too much demand in our economy and specifically demand for goods, demand for services is still below pre-pandemic levels. We have too much demand for goods right now and our economy is just not able to keep up with that demand. And that's, I think, what we're seeing inflation. And so the Fed is going to remove some accommodation to try to gain some equilibrium back, as you say, David. The fact that we see an increase in energy prices is going to mean that that that in itself is going to temper households demand for, you know, all the goods that they've been gorging on. And so in a sense, that's going to do some of the Fed's job for it. And so they're not going to have to raise as much.

WESSEL: [00:20:33] Right. So I think it's important to remember that the Fed cut interest rates to zero in March 2020 and removing accommodation is what economists say when basically the Fed lifts its foot off the gas pedal some but hasn't yet moved his foot to the brake. And I think that that's what you're saying where we are now. Neeleman an

EDELBERG: [00:20:55] excellent metaphor.

WESSEL: [00:20:57] Neal and I are good at metaphors, although I've learned that the metaphors I used at the Wall Street Journal to explain how monetary policy work sounded really good when I wrote them at The Wall Street Journal. And now that I understand a little more about how little economists really understand about how monetary policy works. I worry about the metaphors. You know, one questioner asks, I know with unemployment, with the employment report we see lots of revisions on the payroll numbers come out. Each month, we learn revisions. Does inflation, does the CPI get revised the same way?

IRWIN: [00:21:30] I do not believe so. Yeah, what these numbers are telling us is kind of the direction of things, and I believe it's, you know, a bunch of price checkers who spiral out around the country and and look at what's what things cost on store shelves and then do some statistical adjustment to adjust for quality changes and a lot of other things.

WESSEL: [00:21:53] Justin, correct me if I'm wrong, but I believe that on purpose, these numbers aren't revised because the CPI gets written into contracts and so would be a screwed up if we started saying, Oh, it wasn't up three percent, it was up two percent.

WOLFERS: [00:22:06] It's the one indicator we make sure never to revise because people are settling contracts based on that. So right, our later understanding of what truly happened, it's possible that would change. But they're never going to revise these numbers.

WESSEL: [00:22:18] Right. And Justin, how do you see the position that the Fed is in? I think there are a lot of expectations that we'll see interest rates move, I don't know, maybe as much as up to two percent by the end of the year. Do you think that they've waited too long to tame the inflation beast? Or did they just get caught little bit off guard when we had extraordinary amount of supply shocks and then now Ukraine?

WOLFERS: [00:22:48] And this comes back a little bit, to your analogy, with the accelerator and the break, but I want to add one piece of nuance to that, which is what matters for the economy and what the Fed really thinks about is not the nominal interest rate, which is the number that they announce, which is zero, But the real interest rate, which is interest after inflation. And so when inflation rises, that mechanically pushes the real interest rate down, which means if the Fed wants to leave its foot exactly where it was on the accelerator or brake, it still has to raise interest rates a little bit. So some of what it's doing is actually making sure it's not easing policy even further. Now they're at the point of, you know, we're pretty close to the other side of the pandemic. So depending on how much you think relevant inflation expectations have risen wouldn't be crazy to say they'd risen a full percentage point, wouldn't be crazy to say even much more than that. A lot of what the Fed's doing actually is, it's got to keep moving just too much in place.

WESSEL: [00:23:49] So you mean, because we have this higher than anticipated inflation, the real or inflated inflation adjusted interest rate has fallen without the Fed doing anything. So in order to get real interest rates back to where they want to be, they're going to have

to do some increases in interest rates, obviously beginning their March 15th 16th meeting. Right? So, Wendy, to what extent do you think inflation is something that helps the federal budget? And I mean that in the sense that on one hand, a lot of things that the government spends money on, like Social Security are inflation adjusted. On the other hand, the federal government is a big borrower, and in general, we tend to think that borrowers benefit from inflation because they get to pay back their loans at with with less valuable dollars. So how should I think about the federal government's Budget interest in the inflation rate.

EDELBERG: [00:24:52] Yeah. The answer to that is frustratingly complicated, but the bottom line answer is it's good for the budget. They're basically four things that likely move when inflation goes up. One, as you note, there's a bunch of different spending programs that are keyed off of inflation so that when inflation goes up, the federal government spends more. The other side of that is that even though a lot of our tax code is indexed for inflation so that you know your your tax liability doesn't go up if inflation goes up, not all the tax code is indexed for inflation, so inflation generally increases revenues. Those two things kind of wash out in a way that, you know, inflation is bad for the primary deficit. But then there are two other things that inflation does. It probably, surely increases interest rates at which the government is going to borrow when it takes out new debt, and that's going to raise its interest costs. Now, I should note, it's really important to note, that happen slowly because the Fed, the federal government actually rolls over just a portion of its debt every year. And so even if interest rates were to jump, which is not actually my projection, particularly, that would actually only feed into higher interest costs slowly over time as the Fed rolled over its debt. But I have left the biggest effect for last, which is just as you say, inflation is generally good for borrowers because they can pay the money back in nominal dollars. Inflation that lowers the real value of this very large stock of debt that we have outstanding as a country, and as you say, we will be able to basically repay that as we pay off principal with nominal dollars. And so in total, we have improved the financial position of the federal government. But let's be careful here. The federal government does not wish for inflation in order to improve its financial position. This is just a side effect of a much more, you know, thanks on the more important thing.

WESSEL: [00:27:18] Justin or Neil? One of the listeners asks. Well, we know that gas prices go up and gas prices go down. But the question is, do other prices ever fall? Do grocery prices ever fall? Do companies tend to keep prices up once new norms are set? So is there any reason to believe that we'll see falling prices for groceries or other things in the near future?

WOLFERS: [00:27:45] So for sure, some of the prices that are crazy right now are going to come back to Earth, so we're going to see used car prices fall. They actually there are large sectors of the economy where prices are continually falling, almost all of them in the goods sector. And that's because we learn how to make widgets a little bit more effectively every year, and that tends to make widgets a little bit cheaper. But haircuts always tend to get more expensive. And so even just think about the price of your phone, while the price of your phone, you know, most of us spend, say, $600 on a phone every couple of years. Well, that price looks like it's staying the same. You're getting a whole lot more phone every year. And so the way that's coded is that's actually a price decrease for a given quality of phones. So high tech goods prices are always falling, right?

WESSEL: [00:28:31] And and of course, one of the things you can look at the consumer price index and see that from month to month, there often are things that fall in price, even though over time a lot of them, you know, up one month and down the next. Neil, when

you think about what ordinary readers of your columns think about inflation, are there things that you think they tend to get wrong or misunderstand that we can shed some light on?

IRWIN: [00:29:02] So I think a big one is thinking about rates of change versus levels of prices, and it's a distinction that matters a lot to economists, but is less clear to civilians. So, you know, let's say, take whatever it is, take cars right and say used car prices are up 40 percent over the last year, even if those prices don't come down, if they just level off, that means that there is they are not contributing to additional inflation in the years ahead. And conversely, if they do decline back towards what they used to be, that's actually creating disinflation or deflation in the numbers. And so, you know, when we say, you know, hey, maybe inflation will be down to three percent by the end of the year, you know, that's not saying that prices will be back to where they were before the pandemic or anything like that. That's just saying that the rate of increase will return and settle at more normal levels. But it still implies increasing prices overall.

WESSEL: [00:29:57] Justin one of the things one hears in analysis of inflation going forward is that the CPI is slow to pick up increases in rent and then increases in rent figure in the CPI because the way we value, the way we measure how much homeowners price goes up is related to what rents are going on. So explain a little bit how we think about measuring shelter in the CPI and where you think that's going.

WOLFERS: [00:30:32] Yeah. So actually, let me start with a related point, which is consumers perceptions of how bad inflation is. We're in a really unfortunate moment right now, which is the stuff that is really salient, that you see, that six foot tall sign at the gas station, that price is going up a lot. The other prices you see a lot of or at the grocery store, those prices are going up a lot. But actually, gas and groceries aren't the majority of the budget for most people. The really big items are things like health insurance or housing and so on. So they're the silent killers. And what we're going to see is, at the moment it's the headline grabbing stuff that's going up very rapidly. What's going to happen over the next year, though, is the stuff that actually matters more, which is housing, that's the set of prices that are going up. Now we know this partly because we know rents are rising. But more importantly, house prices have gone up a lot. And that suggests that rents are also going to continue to rise. And this is going to be something that's going to weigh on the CPI and not just this year, but over the next few years.

WESSEL: [00:31:36] Wendy, I think I'd like to end on you. How worried should we be about a 1970s style wage price spiral where you get repeated reports like todays of six tenths or seven tenths percent increase in prices, And that leads to rising inflation expectations, and we find ourselves maybe not seeing as much inflation as we have today, but we never get back to two percent. How big a risk do you think that is?

EDELBERG: [00:32:07] So it's not a zero risk. And and, you know, I'm quite confident that it's on monetary policy makers minds as a risk, and one of the reasons they're going to take the actions they're going to take. I think the thing that we've that we haven't emphasized enough, I think in this conversation, is how very, very strong demand for goods has been and that demand for goods right now, I'm talking real goods like after adjusting for inflation, we are actually taking more stuff home from the store to the tune of like 10 to 15 to 20 percent higher than trend. And I think that is in large part because we're not spending money on services, and it's partly because we're, you know, we had a lot of pent up demand and we have a lot of money saved. Those are not persistent factors. And so, you know, one of the reasons why - I was not going to say that the that the inflation

was temporary because obviously, you know, month after month, it no longer feels temporary - but I could see the arc to it, and I still see that arc to it because the arc is, I think, going to follow consumer demand and consumer demand is going to come down. And so I don't see this just being a permanent part of our economy forevermore.

WESSEL: [00:33:31] Well, I think you should always and a conversation like this on an optimistic note. So I'm going to end it there for fear that the next comment will not meet that criteria. I want to thank Justin, Wendy, and Neil and everybody who listened. And I hope you'll join us again.