We delude ourselves

From the WSJ:

> A U.S. economic expansion that just became the **second longest** in the nation's history seems to be **accelerating**, rather than slowing down.

Atlanta Fed Bostic:

> Let's begin with how the U.S. economy is performing at midyear. It appears to be in a pretty good place. Unemployment is at its lowest rate since the early 2000s, and inflation is running close to 2 percent. **As I've said recently, the economy is about as close to target as we've seen over this expansion**. That does not mean that the FOMC can go on recess until conditions change. I think just the opposite is true now. The job of a monetary policymaker is becoming more difficult.
>
> For the past nine years, the Fed's goal has been to **help bring the economy back to a more normal place following the financial crisis**. Now, with conditions reasonably close to the FOMC's dual mandate of full employment in the context of stable prices, the real work begins.
>
> We'll continue **to pick apart the incoming economic data** and combine it with real-time information from our business contacts as we set the path forward. The goal is to keep this expansion going in a sustainable manner. We want to ensure that the economy is not **overheating**, but we also do not want monetary policy to become **too restrictive** and **threaten to choke off the expansion**.

Powell:

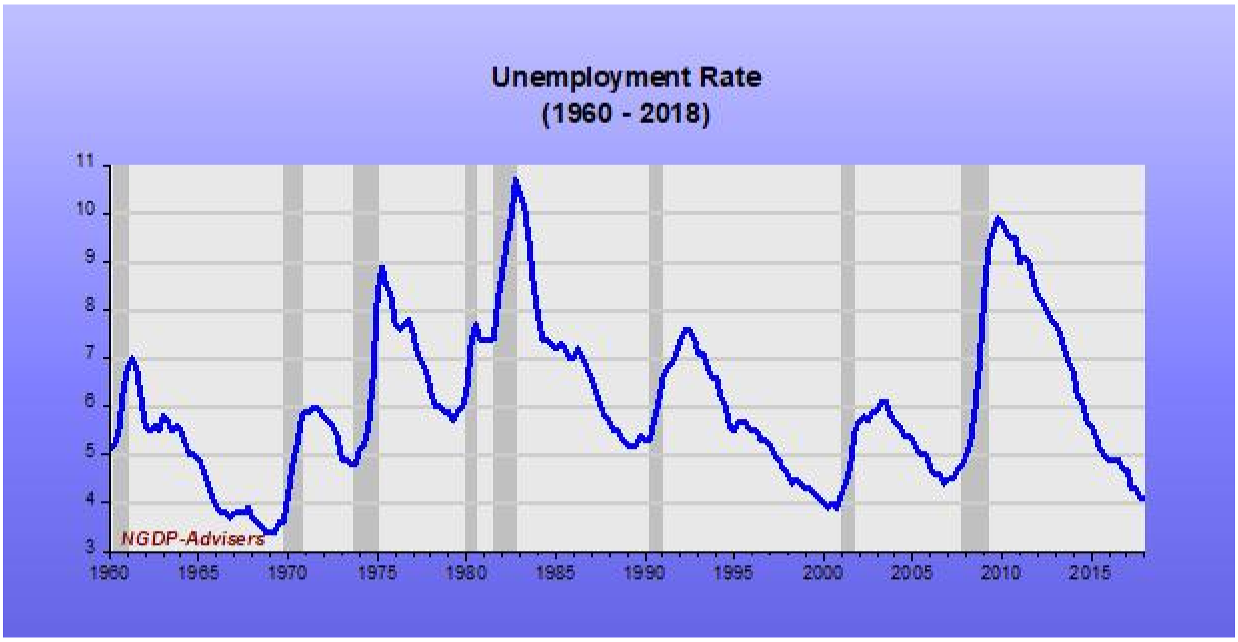
> Because we have so **little experience with very low unemployment**, it is interesting to compare today's labor market with that earlier period. Unemployment was below 4 percent from February 1966 through January 1970. During that time, inflation as measured by the price index for

personal consumption expenditures increased from below 2 percent in 1965 to about 5 percent in 1970. In hindsight, unemployment is now widely thought to have been unsustainably low at that time and to have contributed to escalating inflation.

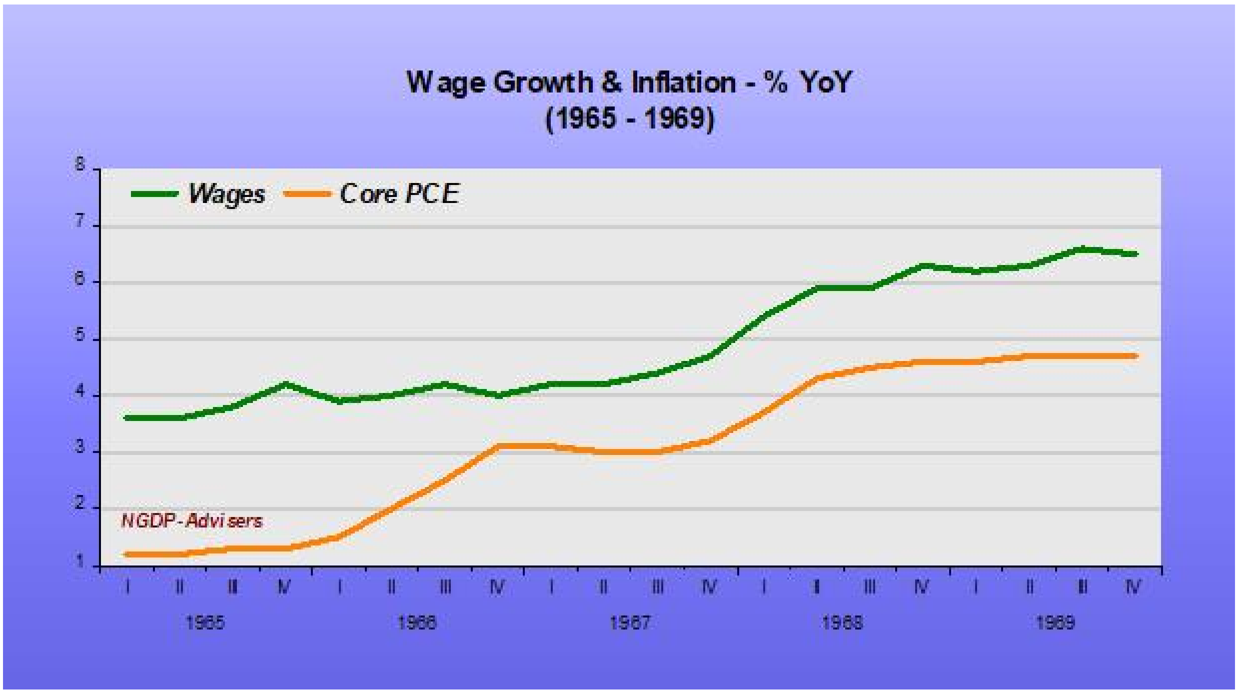
But how significant is this precedent for today? The U.S. economy has changed in many ways over the past 50 years. By some estimates, the natural rate of unemployment is substantially lower now.

I´ll start with Powell. Why do "we have so little experience with low unemployment?" Likely, because the late 1960s experience was traumatic, giving rise to the almost unshakable belief that too low unemployment (forget "natural", use the 5% rule of thumb) will pressure wages and therefore prices.

After that experience, whenever unemployment drops below or even approaches 5%, the Fed gets nervous and does everything to get the unemployment rate up, i.e. pulls the recession rabbit out of the hat!

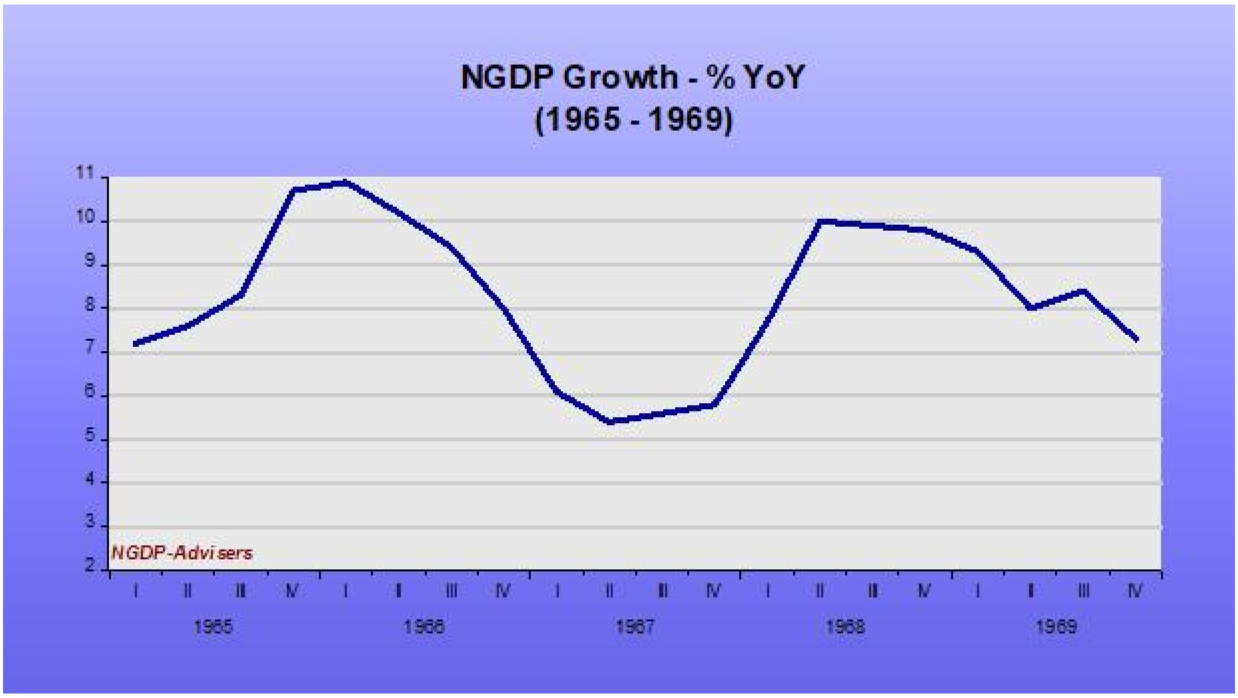


Low unemployment in the late 1960s happened together with rising inflation and wages. Note, however, that wages only began to rise after inflation had almost tripled! At the time, for lack of experience with inflation, expectations were slow to adapt.

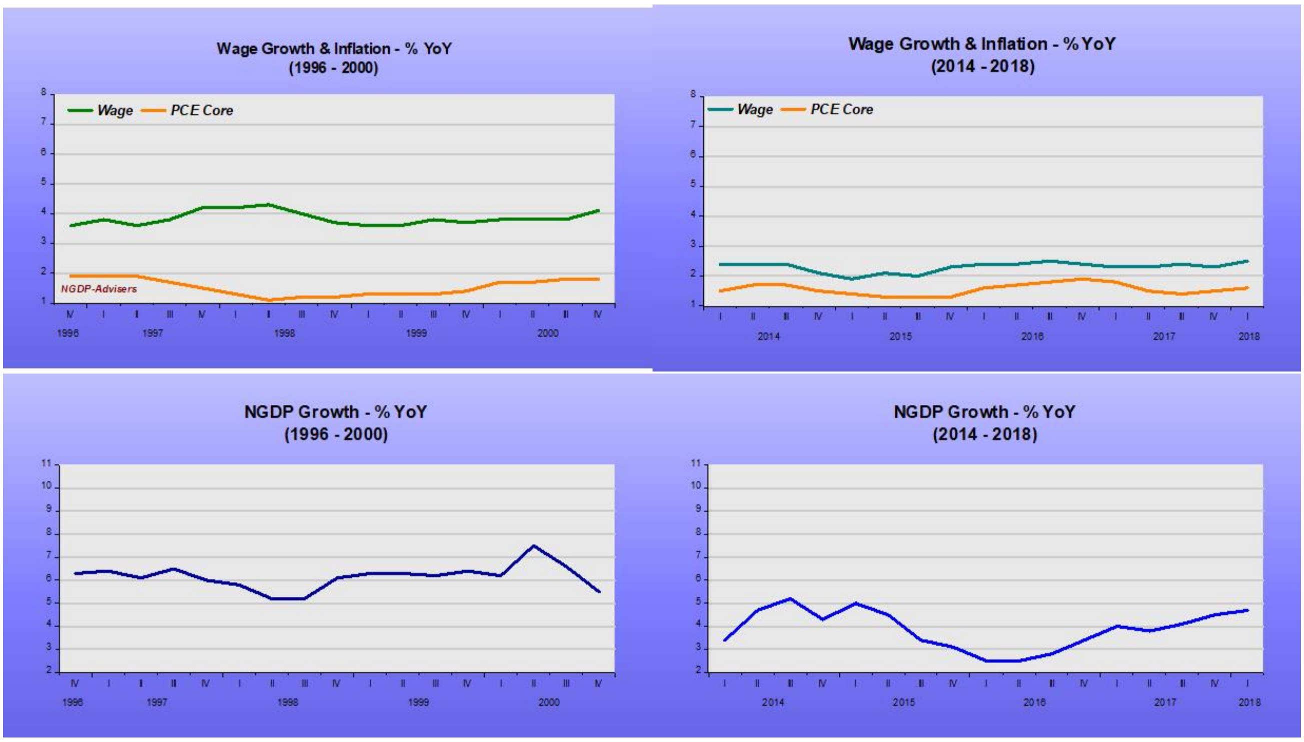


What, therefore, was behind the rise in inflation, if not falling low/unemployment and rising wages?

Best candidate is the high and erratic NGDP growth rate, which best defines the stance of monetary policy.



Below, the wage, inflation and NGDP growth facts for another two other instances when unemployment fell to 4%, the late 1990s and the past 4 years.



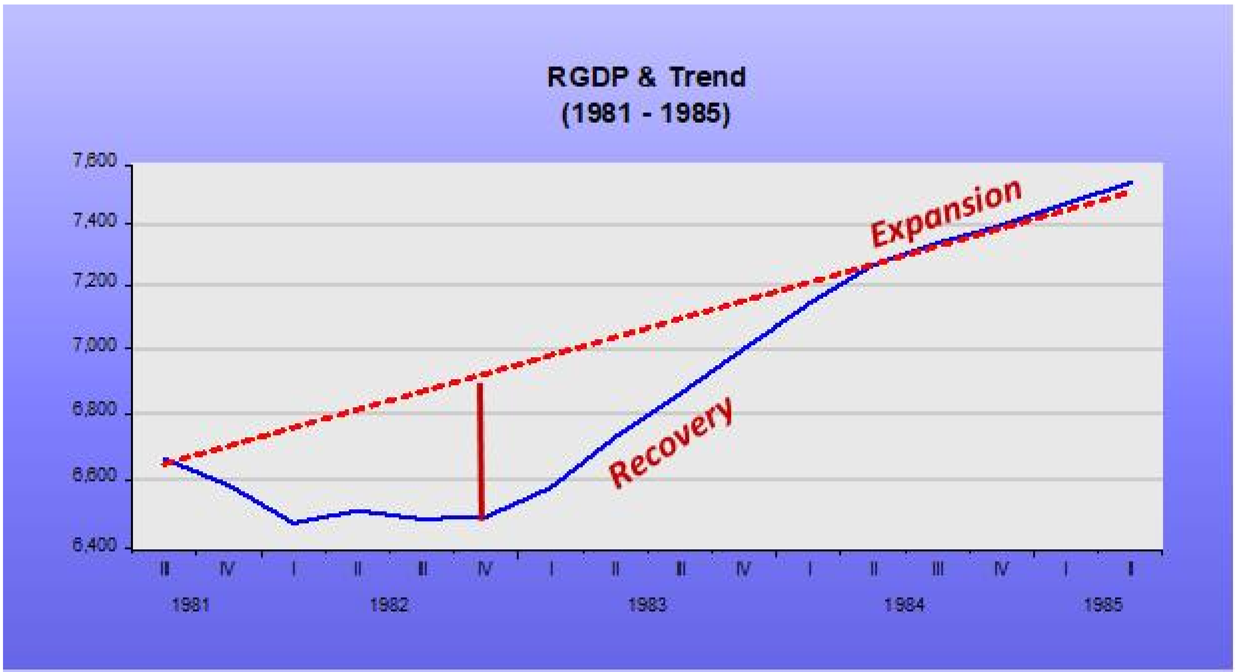
In both instances, inflation is very similar. Wage growth is significantly higher in the earlier period. That´s because, although NGDP growth is relatively stable in both periods, the level of NGDP growth is markedly higher in the earlier period.

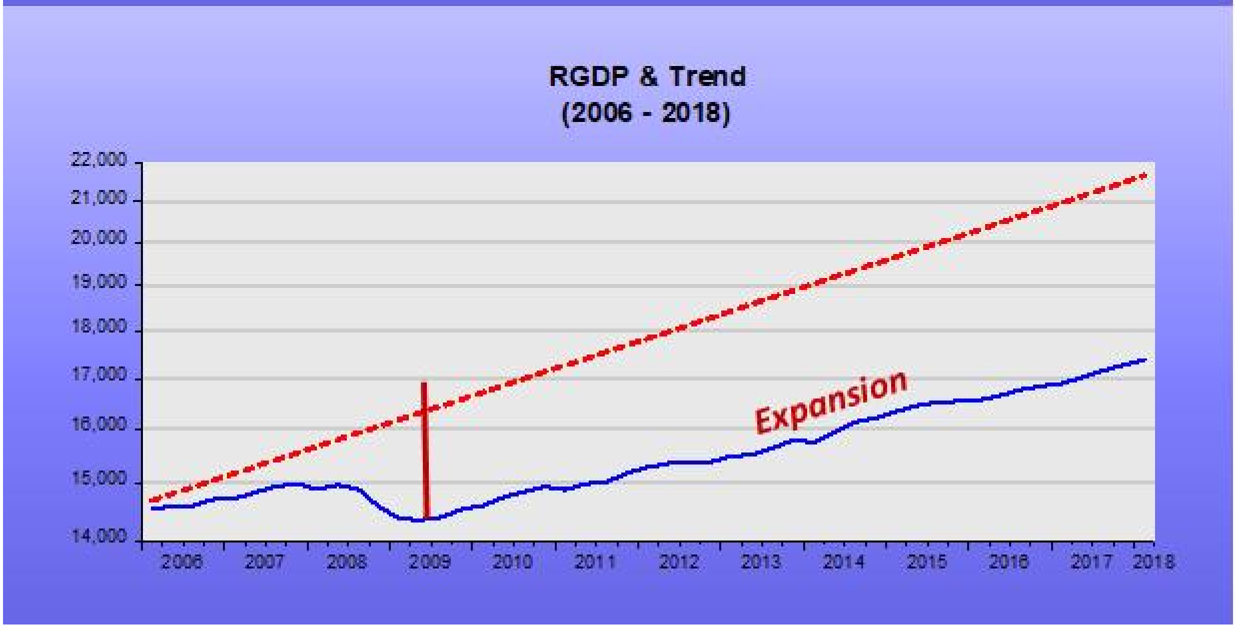
These findings indicate that wage growth is low, as is the real growth rate because (1) the level of nominal spending (NGDP) is too low and, (2) the rate of growth of NGDP is too low.

On remarks that this is the second longest expansion and that the economy appears to be accelerating, the charts tell a cautionary story.

After a recession, the economy should experience a period of recovery, where growth accelerates to put the economy “back on track”. It seems logical that if the economy goes into recession and then starts growing at rates below the previous one, the economy will remain depressed.

The 1981 recession was deeper (relative to trend) than the 2007 recession. However, following the end of the recession, the recovery is plain to see. That´s exactly what you don´t see happening after the 2007 recession, with the economy growing at a rate below the pre-recession rate, remaining, therefore, depressed.





With that, it doesn´t sound right when Bostic says, “For the past nine years, the Fed’s goal has been to **help bring the economy back to a more normal place following the financial crisis**.” It hasn´t!