Growth and and Inflation

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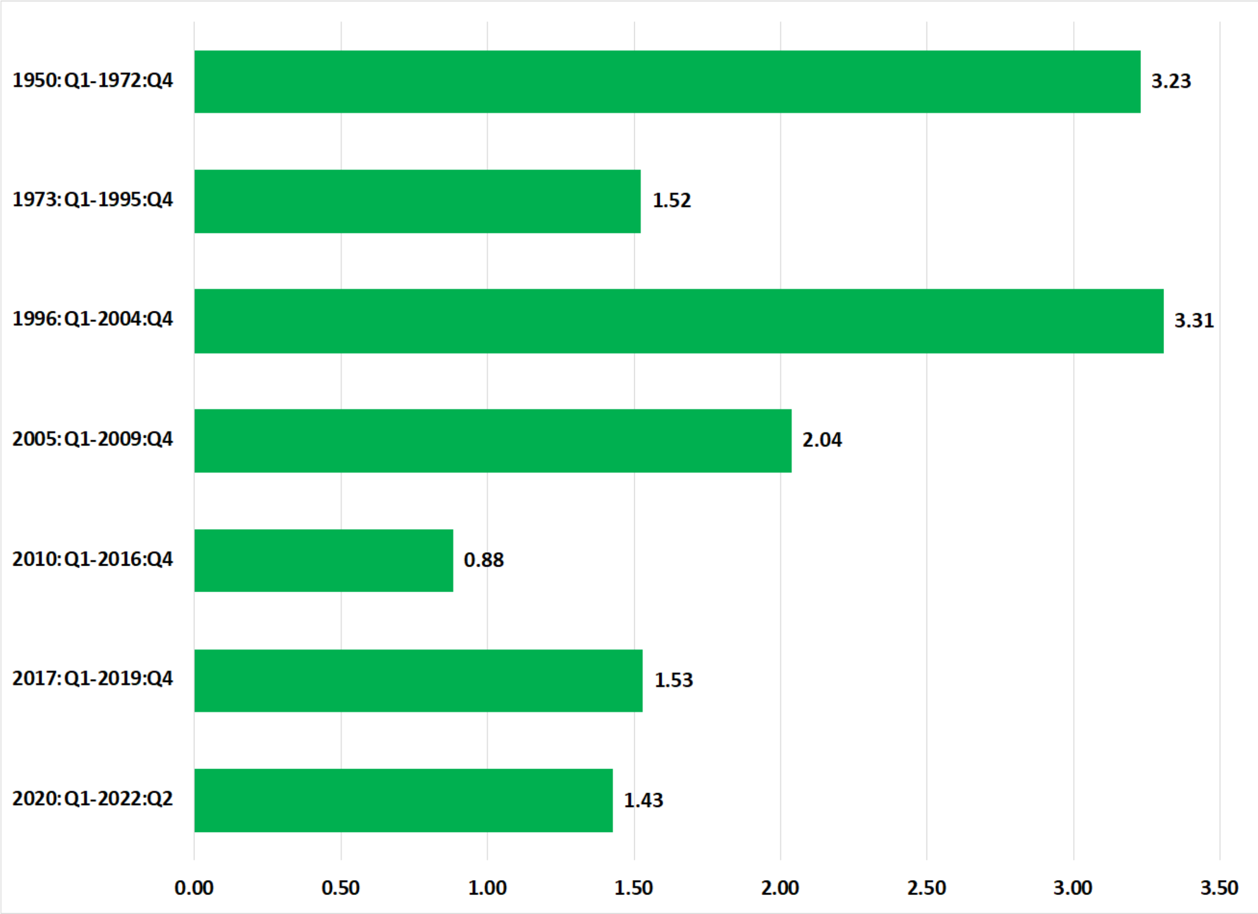
Growth and Inflation

- Key to both topics is productivity growth
- Why inflation?
  - Because what matters for inflation is not wage growth but growth in unit labor costs
- Growth in potential output equals
  - Growth in labor hours plus productivity growth
  - CBO assumes H growth of 0.4, LP growth 1.4
    - Total 1.8, marked down from 1.9, before that 2.1
  - That's for total economy. Let's look first at business sector, CBO implies 1.4+0.3 = 1.7

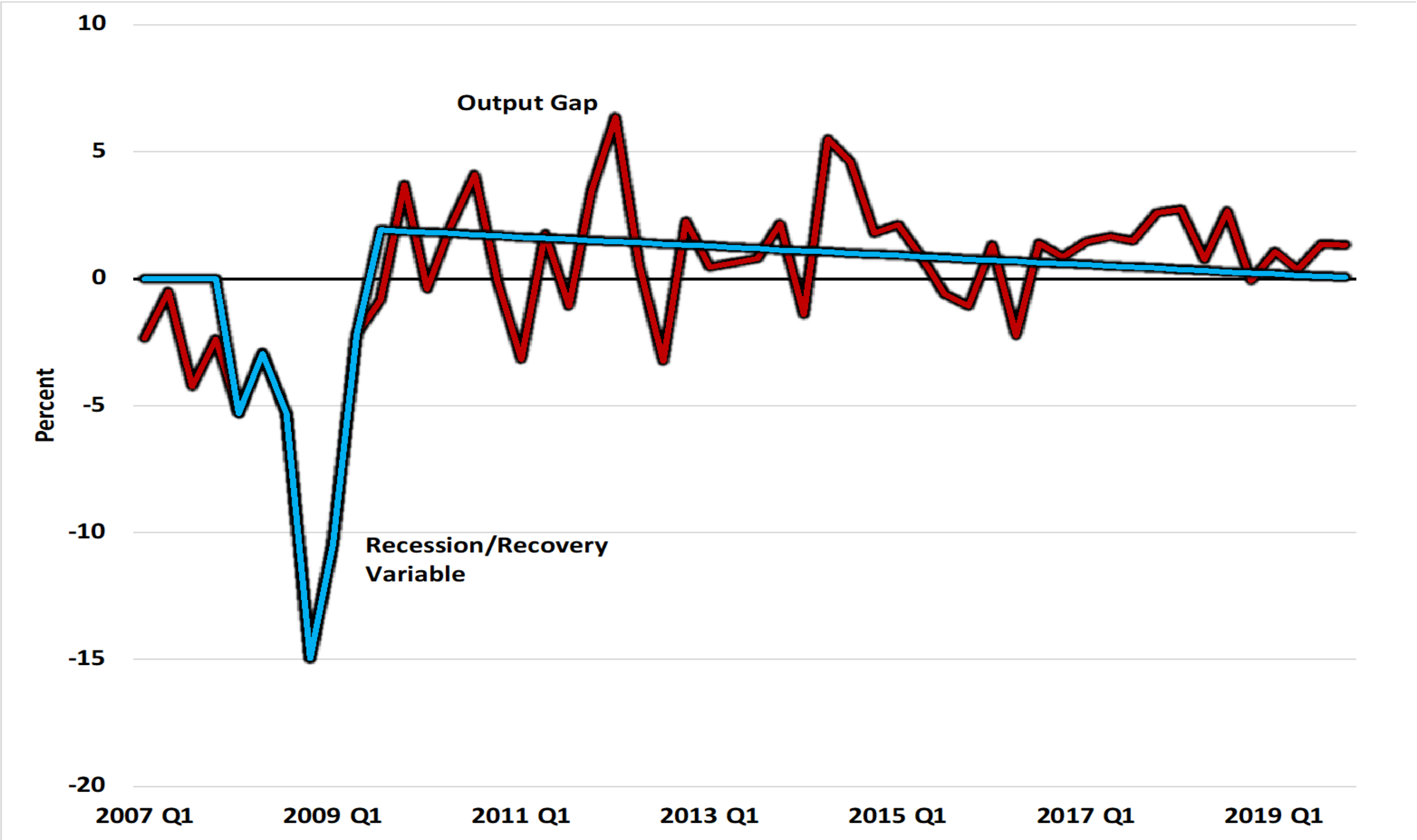
Business Sector Productivity Growth, Seven Intervals, 1950-2022



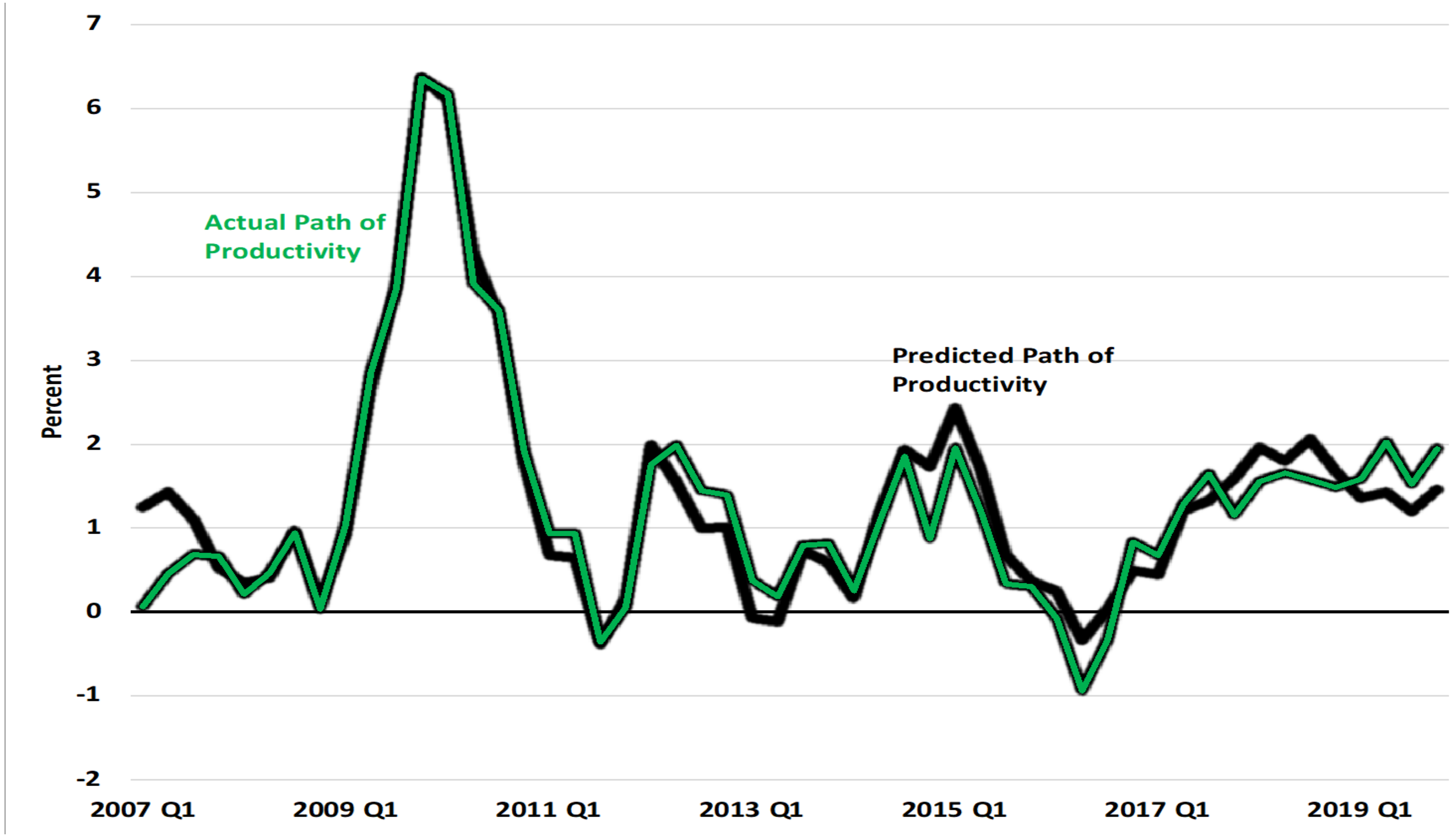
New Paper, Regression Study of Changes in Hours Relative to Trend

- Labor productivity "growth gap" is actual minus trend growth
- Identically equal to output growth gap minus hours growth gap
- Hours growth gap is regressed on output growth gap, current and lags
- Slow adjustment of hours means productivity growth overshoots, positive 0.6 response followed by negative
- Key insight, extra hours response in 2009, panicked firms => "excess layoffs" then recovery rehiring

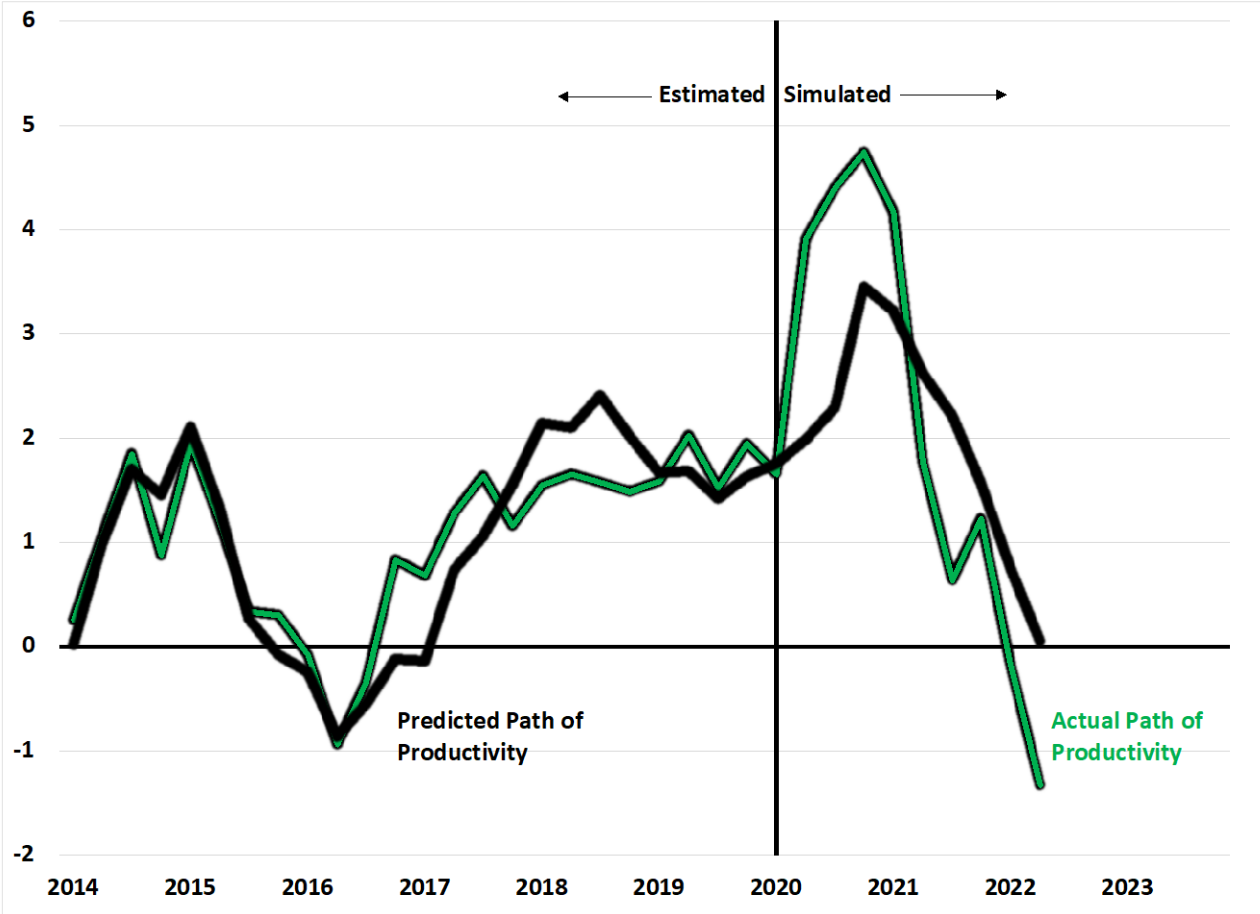
2008-09 Recession Effect and 2009-2019 Recovery Effect (Blue)



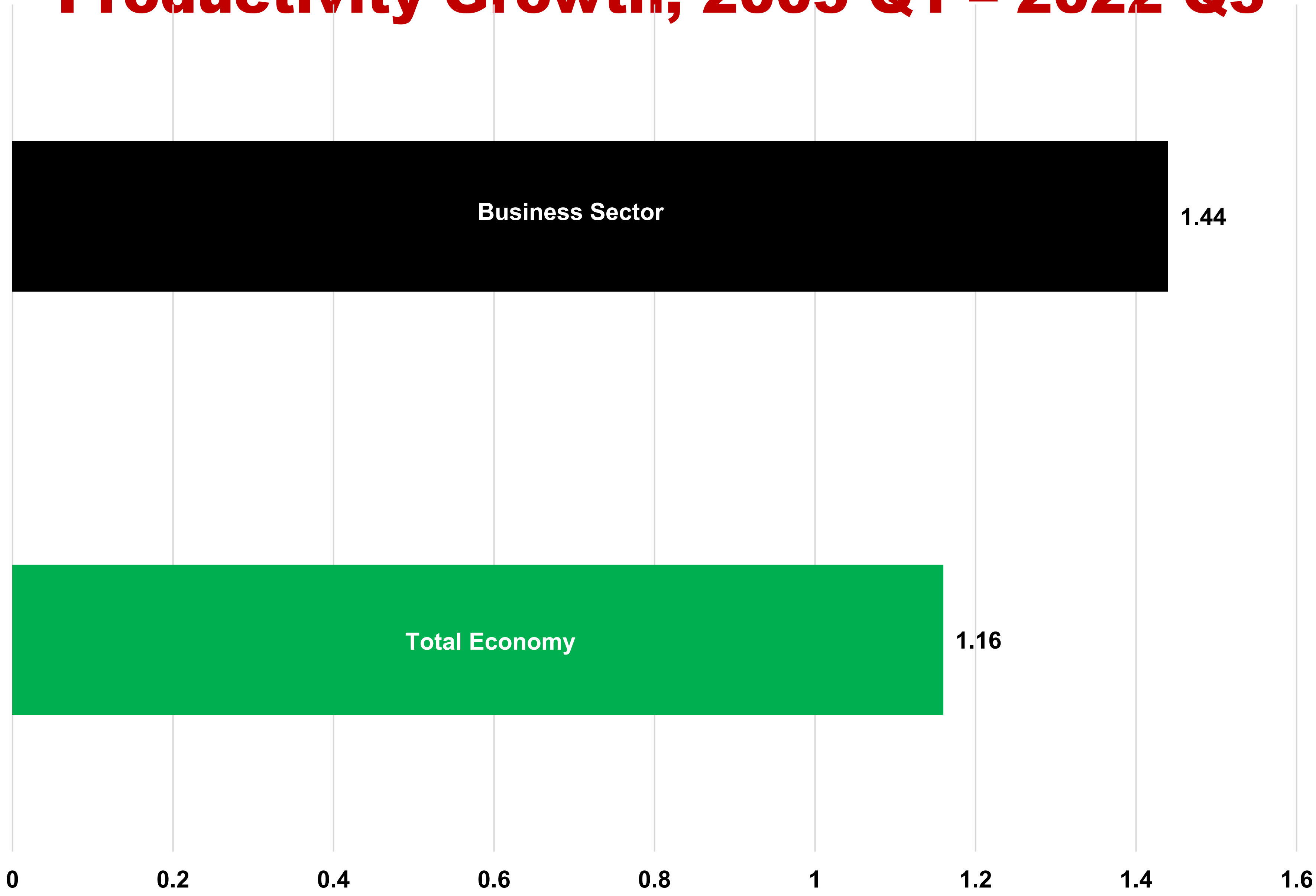
Productivity Growth 2007-19, Actual (Green) vs. Predicted (Black)



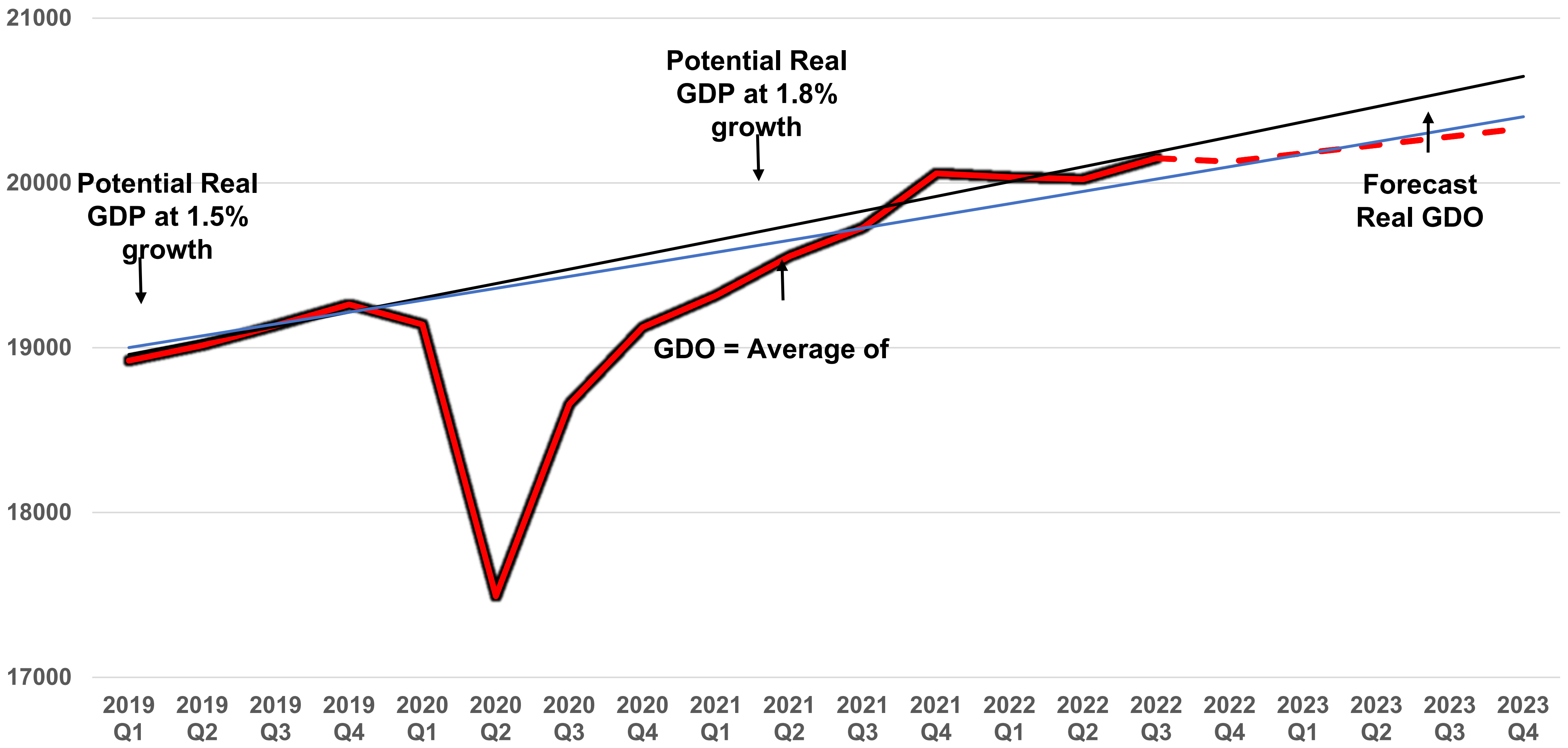
Actual Productivity Growth vs. Fitted (2007-19) and Simulated (2020-22)



Productivity Growth, 2005 Q1 – 2022 Q3



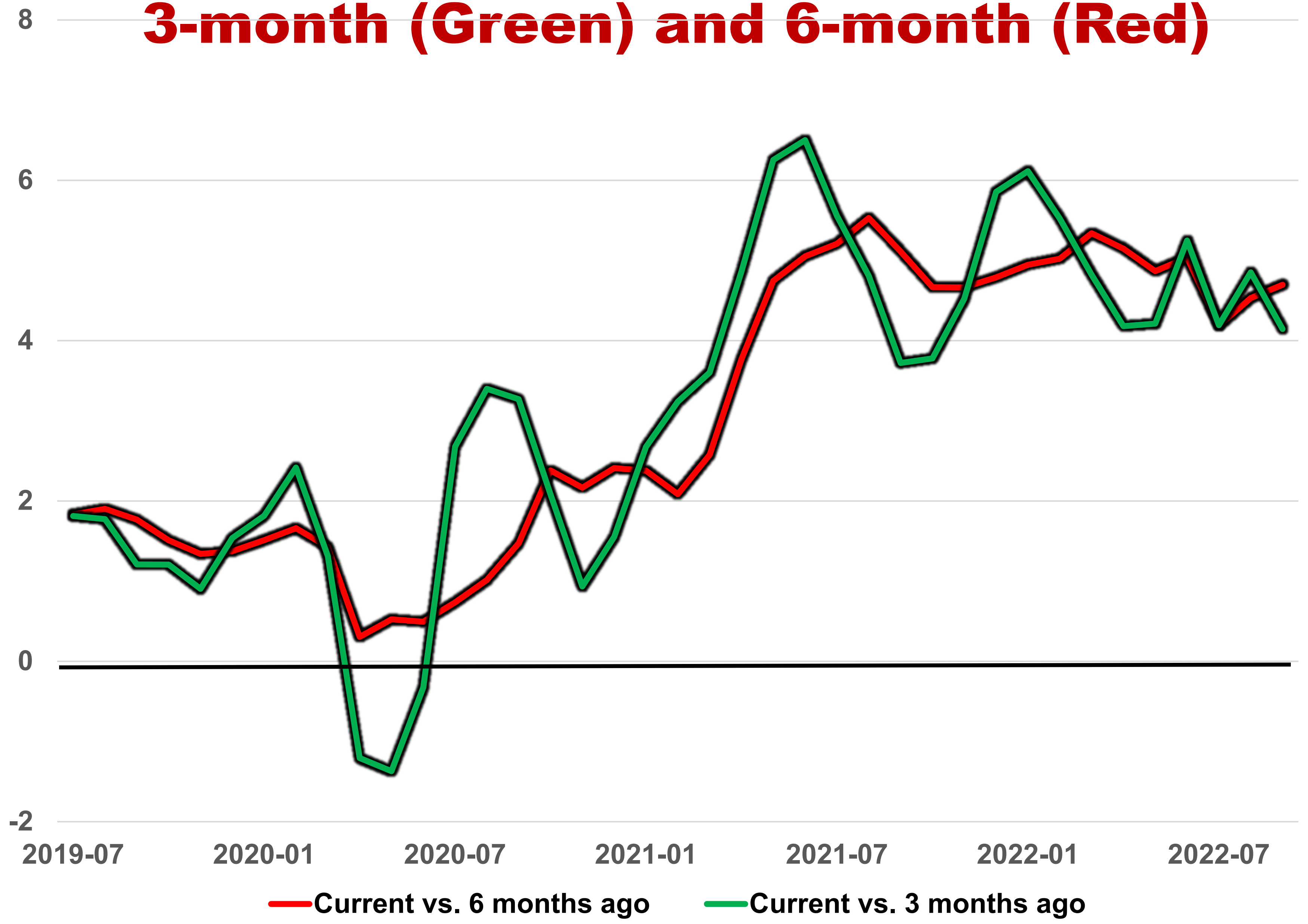
Actual and Projected GDO versus Two Growth Paths for Potential Output



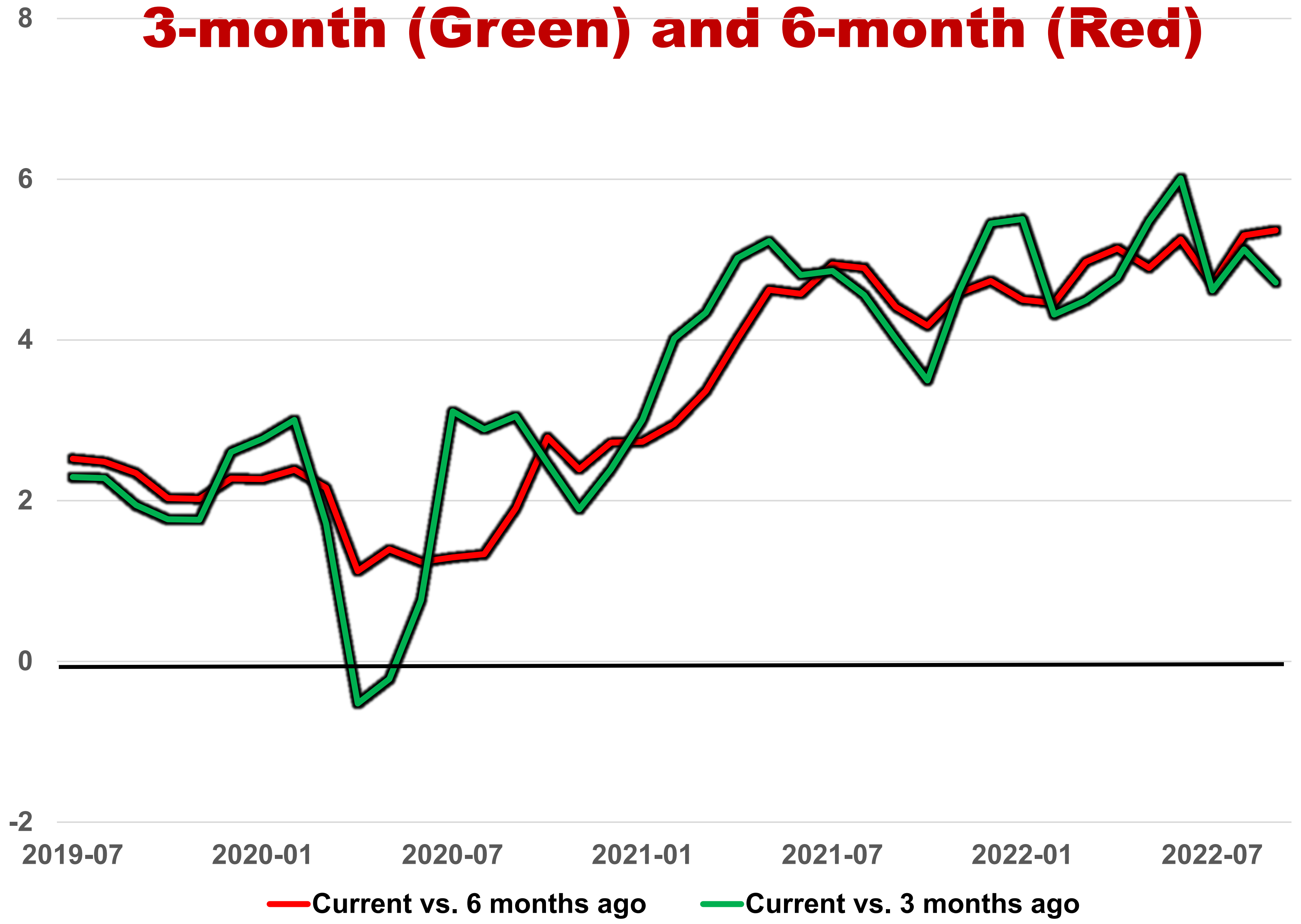
When Will Inflation Turn Around and Begin to Decline, and to What Rate?

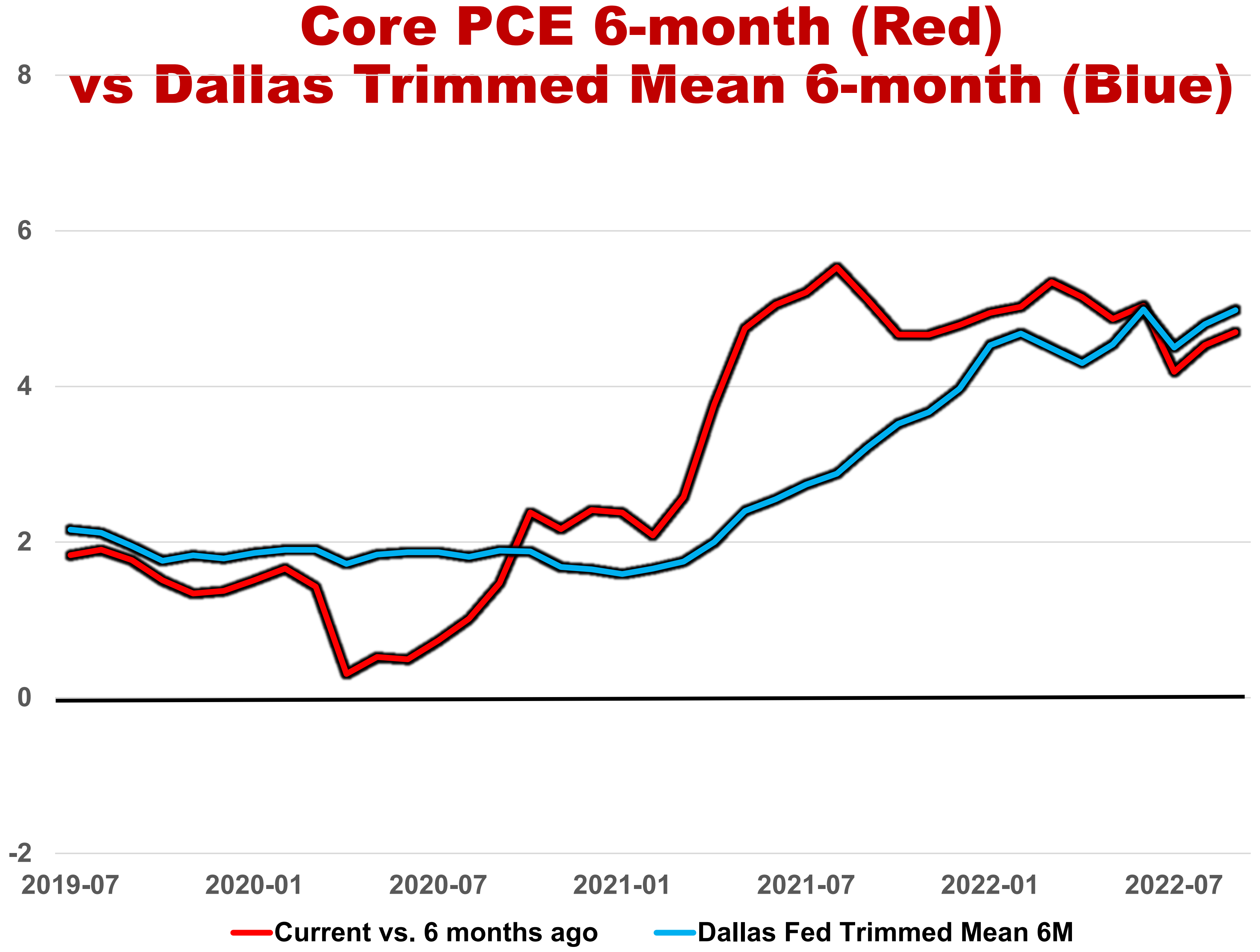
- The ingredients for an answer come from examining 3-month and 6-month annualized inflation rates for core PCE deflator and PCE services
- 12-month changes are old news. Here are 3-month and 6-month changes
- Summary:
    - Core inflation has leveled off at 4 to 5 percent
    - Services inflation has leveled off at 4.5 to 5.5
    - Steady inflation consistent with output gap near 0

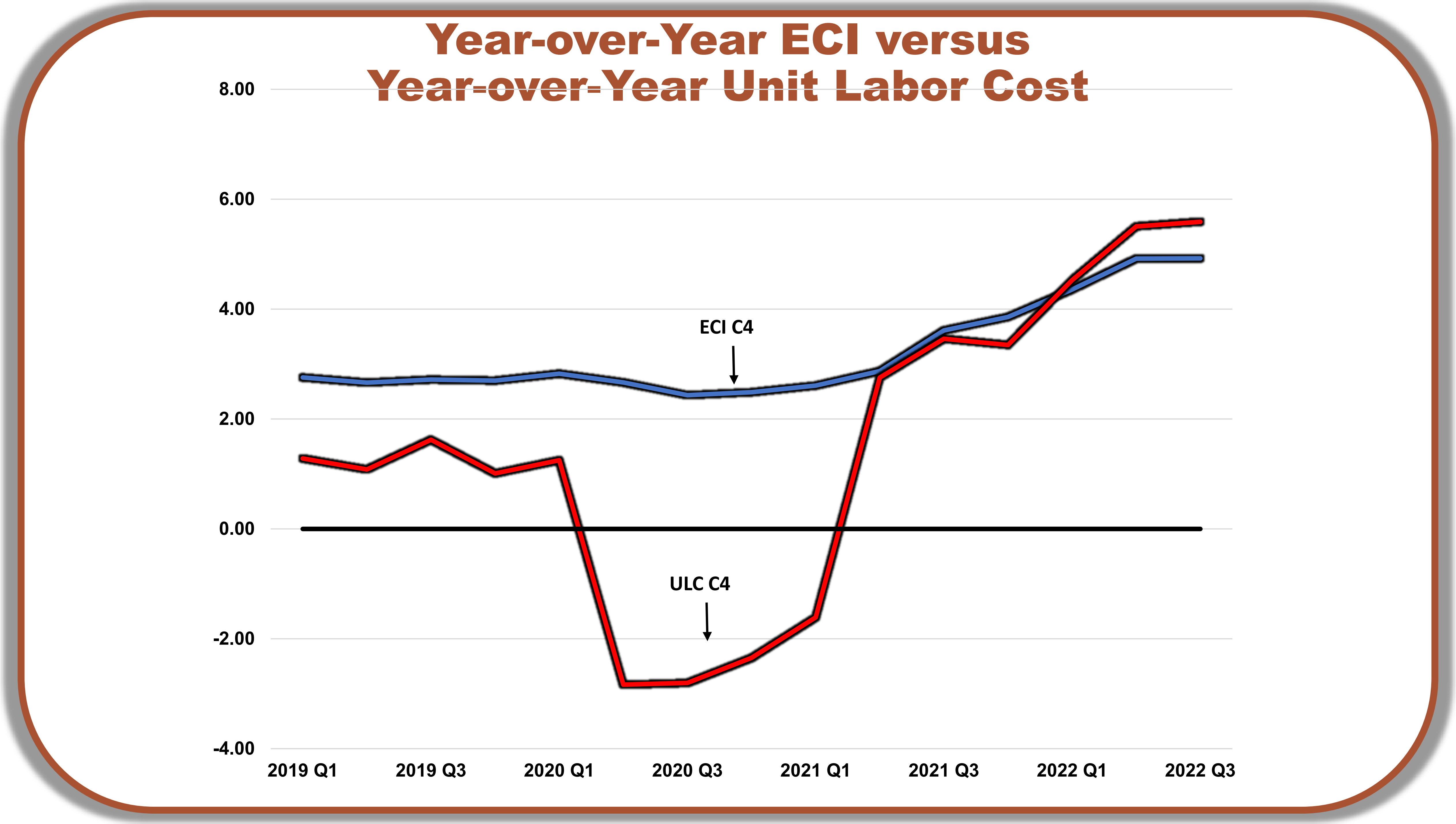
Core PCE Inflation, 3-month (Green) and 6-month (Red)



Services PCE Inflation, 3-month (Green) and 6-month (Red)




Core PCE 6-month (Red)
vs Dallas Trimmed Mean 6-month (Blue)
8
6
4
2
0
-2
2019-07
2020-01
2020-07
2021-01
2021-07
2022-01
2022-07
Current vs. 6 months ago
Dallas Fed Trimmed Mean 6M



Year-over-Year ECI versus
Year-over-Year Unit Labor Cost
8.00
6.00
4.00
2.00
0.00
-2.00
-4.00
ECI C4
ULC C4
2019 Q1
2019 Q3
2020 Q1
2020 Q3
2021 Q1
2021 Q3
2022 Q1
2022 Q3

When Will Inflation Turn Around and Begin to Decline?

- Excess demand for labor and high lagged inflation implies ECI likely to increase rather than decrease
- Continued rehiring amid labor shortage imply productivity growth will continue zero to negative
- Going the other way, health insurance
- Critical to determining the balance, rents
  - Anecdotal evidence of decline in new leases
  - But upward pressure on rents from high home ownership costs (prices and mortgage rates)
- Real interest rate is still negative