Minutes of the Fall 2022 Economic Advisory Panel Meeting

Present: **Chair**: John Williams. **External Panelists**: Kathryn Dominguez, Janice Eberly, Kristin Forbes, Karin Kimbrough, Lisa Lynch, Alexandre Mas, Raghuram Rajan, Paula Campbell Roberts, Linda Tesar, Laura Veldkamp, Mark Zandi, Ellen Zentner, Gabriel Zucman. **New York Fed staff** : Jaison Abel, Ozge Akinci, Mary Amiti, , Richard Audoly, Gianluca Benigno, Kristian Blickle, Nina Boyarchenko, Rajashri Chakrabarti, Hunter Clark, John Clark, Matteo Crosignani, Jeff Dawson, Julian Di Giovanni, Keshav Dogra, Leonardo Elias, Linda Goldberg, Justine Hansen, Beverly Hirtle, Hyeyoon Jung, Tom Klitgaard, Gizem Kosar, Anna Kovner, Michael Lee, Jonathan McCarthy, Meg McConnell, Davide Melcangi, Paolo Pesenti, Maxim Pinkovskiy, Julie Remache, Joshua Rosenberg, Argia Sbordone, Asani Sarkar, Or Shachar, Giorgio Topa, Wilbert Van der Klaauw, Patricia Zobel.

Following introductory remarks by John Williams, Kristin Forbes presented "Inflation: Peeling the Onion". She drew on the "peeling the onion" analogy (previously used by President Williams) to outline the underlying drivers of inflation. She discussed that the outer layer pertains to global factors which constitutes 80% of movements in CPI inflation in major advanced economies . On the other hand, for core inflation and wages, the largest driver pertains to domestic factors, such as lagged inflation, inflation expectations and domestic slack. She noted that while the global factors have a large effect, this effect usually attenuates, and hence it is important to focus on domestic factors. She indicated that the inflation decompositions differed across the U.S. and Europe. While food and energy are the key drivers in Europe, service inflation is the most important driver in the U.S. The latter will be even more important in the U.S. as global shocks fade. One new pattern today, however, is that high inflation—no matter what the initial driver--is having a larger effect on wage inflation. Finally, she addressed the question on whether high inflation abroad matters for domestic inflation. Discussing estimates from the U.K., she suggested that inflation in neighboring countries can have small effects on domestic inflation.

The second presentation was delivered by Mark Zandi on "[Structural Tailwinds to Inflation]." He argued that several factors have turned into tailwinds that could continue to support higher inflation. First, China has been decoupling from the U.S. since the trade war, which is raising prices just as increased connection to China lowered prices. Second, population is aging and migration flows are falling leading to a longer-term tightening of the labor market. This is also lowering productivity growth. Third, climate change and efforts to address climate risk, such as global carbon tax, might add to inflation. Additionally, he observed that carbon prices would increase rapidly under a late policy action scenario. He suggested that there may be an argument for pursuing opportunistic disinflation and for considering a different inflation target, arguing that 2% may not be an appropriate target in the presence of these structural tailwinds.

In the following discussion, panelists expressed a range of views on monetary policy, inflation, and economic outlook. Panelists opined that there is not much evidence of a wage-price spiral, and in fact, wages have been lagging behind and there relatively little indexation in the U.S. economy. One panelist remarked that a new tool on real time inequality that provides statistics on how economic growth is distributed each quarter finds that the tight labor market has increased wage growth at the bottom, which may reverse if monetary policy is tightened enough. One panelist posited that climate change may increase migration from the tropics to cooler and developed countries. Additionally, it was observed that growth in Chinese and emerging markets are expected to be lower which could dampen global inflation. One panelist observed that there are a lot more risks now -- long Covid, supply chain shocks, political risks -- that may make firms more reluctant to invest. Accordingly, the pass through from other countries is not just inflation, but also these risks which are restraining the response of output to higher prices, thus keeping prices high. Panelists commented that relatively low labor force participation for 65+ workers may reflect the appreciation of house values, (indexed) social security payments, and workers' portfolios. However, given the recent decline in house values and in the values of retirement accounts, labor force participation of this group could begin to rise. Panelists observed that there has been an increase in unionization, especially organizing of lower skilled workers in the retail sector, which is consistent with wage increases in the lower part of the wage distribution. One panelist posited that U.S. efforts to lower inflation is leading to a strong dollar, which in turn is raising inflation in European countries, which have dollar-denominated energy contracts. Thus U.S. efforts to counteract inflation may be creating negative externalities for other countries. Another panelist opined that shelter inflation will likely remain elevated, exacerbated by the effect of higher interest rates on the housing market. As an example, the panelist remarked that Sun Belt markets that have been traditionally lower housing inflation areas are now becoming increasingly unaffordable. It was observed that the rising interest rates are disincentivizing housing starts and that this impact will depend on how long rates remain high. Panelists discussed that while inflation is widespread across countries, there are key differences in drivers, and hence interests of the U.S. and the rest of the world do not necessarily coincide. It was accordingly opined that internal policy coordination with weights on spillovers across countries may be a path forward.