Adam: 00:00:00

Good afternoon, Claudia. I know it's custom to say how excited I am to have you on the show. But I am actually really excited to have this conversation. So, by way of background, I'm the CIO of a quant futures trading firm. So, this is a bit of a side journey for me. It's sort of a pursuit of passion for me to kind of start to dig into and climb the learning curve on economic policy, the interplay between fiscal and monetary policy and regulatory policy, that sort of thing.

So, I've been starting to have, trying to have more conversations with experts in the field of which I would certainly classify you as, as an extremely credentialed expert in all of those domains. So, I'm really excited to have you on. Thank you very much for coming. Maybe just to start us off, and you could outline some of the more salient milestones of your career to kind of give appropriate gravity to the points that you'll make on today's conversation.

Backgrounder

Claudia: 00:01:18

Great, thank you. I'm excited to be here too, and happy to hear about your learning journey. Welcome to my world, in terms of macro and fiscal and Fed. And so in terms of my background, so I am a macro economist. I had my PhD at University of Michigan. Go Blue. When I finished there, I went to the Federal Reserve, the Board of Governors in DC, and I worked there for a little over a decade. I started in the summer of 2007, as one of the leads on consumer spending. So, you can only imagine what my first year --

Yes, I learned probably 10-20 years of macro within my first few years at the Fed. So, I worked on the forecast for 10 years. I also, when I finished, was managing the group that runs one of the big household surveys at the Fed. So, I do macro, but I often do it from the perspective of families and workers. So, that makes me a little bit of an odd duck. But I think it's been important. While I was at the Fed, I spent one year at the White House in the Council of Economic Advisers, towards the end of the Obama administration. And that was very much the same kind of work, working on the macro economy, following developments, advising the president on what was happening. So, that was a great experience. And when I --

I've done a lot of work on fiscal policies, so particularly how to fight recessions, stimulus checks, automatic stabilizers. I have a recession indicator that I've talked a lot about lately that was actually designed as a way to automatically send out stimulus checks. So, it's supposed to be a good thing. It also is very accurate at recession, saying that we are in a recession. I wanted to do more work on fiscal policy. So, I left the Fed because you can't do that as a Fed economist. And I have been advising Congress. I mean, six months after I left, we had a big recession, right, so that I got right to work. And I've been advising Congress since then, I've worked with various think tanks. And right now I have -- I started my own consulting firm just so like I could keep an independent voice. So, I'm consulting and I write on Substack too.

Economic Policies, Families and Individuals

Adam: 00:03:51

Yes, I've noticed, which is great. So, maybe a really interesting place to start is you said that by virtue of your experience, sort of where you started, the role you started out at the Fed, and some of the other positions that you have taken on that you approach economic policy and economics in general, from the perspective of families and individuals, which makes you an odd duck. And I think that's a really interesting statement on economics in general. Like, I mean, you would think that -- I mean, the whole objective of economics is to optimize outcomes, presumably for citizens, which largely are individuals and families, right? So, what do you make of the fact that I find that really strange that you're an odd duck by coming at it from that angle?

Claudia: 00:04:50

Well, I should say in particular, what I'm speaking to is macro economics, and even more specifically, macro economic policy. So, the advising that we do -- I mean, the kind of work that they do with the Fed or the large fiscal packages that we had through the COVID crisis, part of that was relief. Part of it was getting money to the unemployed, helping businesses stay open. But there always is an aspect of it that, what we call stabilization. Blunting the recession so it's not as severe and getting the recovery going.

And macro economists tend to live in that space. And now things have been changing. So, I don't want to, like there are more ducks now than there used to be. But the type of data we have it's aggregate data, GDP, inflation, you run these models. Macro economists tend to have this view of a representative agent. It doesn't mean that we believe that. But it's more of a modeling technique, so that you can think about the macro economy, and you only have to think about one person that kind of sums it all up.

The problem is when you use, you -- sometimes it's easy to forget, like, and I try very hard in my work, and also like the writing I do, and like today, speaking, to recognize that GDP is the reflection of hundreds of millions of families and millions of businesses. That's what's under there. Inflation, we don't have a lump of inflation. People buy different things. And we need the aggregate numbers, like they're a good -- I mean, I was a macro forecaster, right? Like, we wrote down the numbers. It's just I was taught at the Fed, and that shows up in my research. I mean, you tell the story. And the story often gets told with the macro, the big picture, I try very hard to tell the story with the people. And certainly some of my work at the Fed. There's a lot of people that inform their forecasting with micro data.

But that's particularly important to me in the macro debates, which often, I think, could use more of the people perspective. But things are changing. There are more macro models that break away from this idea that we can represent it all with, like one kind of person standing in. And those are some really exciting distributional macro models. And you can -- I've been working with them, you can learn a lot about fiscal and monetary policy. So, I think it's something people understand that we need to recognize those differences across people. But in the macro debates that you hear, like the talking heads, you know, good luck hearing too much of that.

Adam: 00:07:52

Yeah, I have this impression, maybe you can shed more light on this or more nuance. But I have this impression that many, if not most of the economists that are relied upon for informing policy, either at think tanks or at the institutions that actually guide policy, do focus primarily on aggregates, right? And the aggregates are, for the most part, averages, right? Like GDP is an average, or consumption is an average, or home price growth is an average, etc. But that an enormous amount is lost under the surface there because of, as you say, sort of distributional effects. And also, that -- I mean, this wouldn't be such a problem if the underlying distributions that matter most, at least to my interpretation, were not so highly skewed.

So, for example, wealth distribution, income distribution, consumption distribution, those sorts of items, by virtue of the fact GDP, right, by virtue of the fact that we're looking at averages of a distribution that is so highly skewed, and that has changed in composition, so dramatically over time, in both directions. I mean, obviously, laterally, it has been in the direction of concentrated income and concentrated wealth, etc. But it has gone in the other direction in different epochs.

So, I mean, how do you think about the impact of these distributional effects and how does economic policy as it's currently conceived by the majority of policymakers go wrong by not considering these distributional effects? And then how might -- what kind of changes would you advocate for to better take into account some of these distributional effects?

Claudia: 00:10:12

Wow. There's a lot there. So, first, I would qualify that numbers like GDP, consumption, inflation, they're not averages. And the problem goes to exactly what you were talking about with the inequality. So, with inflation, for example, basically what that is, is, at one period, you take the shopping cart for the entire United States. You tally it all up. How much does this cost, and then you go get the shopping cart a month later, do the same exercise. The thing is, is people like Jeff Bezos put a lot more in the shopping cart than say the mother with, you know, the single mom with three kids. Or frankly, he puts more in than almost anybody.

And so that means that certain people, they mean more to the inflation,. They're spending more, they're causing more of the inflation. And so that's in there.

The unemployment rate is one that it is an average, right? Everybody counts the same, what percent of you know, are unemployed. But it doesn't mean -- like the aggregates can be totally useful, as long as these differences stay pretty stable. Wealth inequality has been increasing, but it's relatively stable. So, and that's why macro economists, or at the Fed, we'd have these conversations much more recently into the recovery, that it's like, well, the aggregate is fine. Like you can place hold for all these differences in the economy. One example that the Fed was really called out on, both internally and externally, is not looking at the black unemployment rate, the Hispanic unemployment rate. We just look at the national average. And the defense is well, the black unemployment rate is always about twice the white unemployment rate. The Hispanics, about one and half. So, like the national unemployment rate says enough.

Unfortunately, if you as a policymaker stare at a chart, every six to eight weeks when the FOMC gets together, and you see three lines. And you see, black workers live in what would be considered recessionary, always, because their unemployment rates are that much higher. Though right now, they're in a pretty good place that is low. So, that's a problem. It's not that the aggregates don't capture what's going on, it's just that they don't really tell the story. They don't remind us of like how desperate the effects in the economy are. So to me, there's just an aspect of putting it in front of your face, and like making you aware, like, and again, this is about unpacking GDP. So, you're like, there are people under this, and they're living different experiences.

So, in terms of what do we do about it? So, the Fed now looks at all three lines. I mean, they're very clear that it's not like they're going to go from targeting, thinking about national measures of employment. I mean, maximum employment is one of their mandates. That's a national. So, they're not going to start targeting the black unemployment rate or the high school dropout unemployment rate, but they are trying to think of, and now, in their last framework, we're very clear that maximum employment is a broad based and inclusive concept. Right. So, that really underscores that they need to think about the employment labor market for lots of people. And the only way you do that is if you look at the data. They're a data driven group.

And so what we can do is have more data. One of my favorite new data products is what's called the *distributional financial accounts*. It's at the Federal Reserve. And you can look at wealth by different groups. So, you can look at wealth by wealth and wealth, and by income and by race and age. And that's a great way to unpack and keep track of quarter by quarter the national wealth. What does it look like across households, and that's actually been a data source important in the past few years because that's where we can look and see there are lower income households, bottom 50% of household and they are -- they have really put away some savings. And that could be very important weathering the months ahead. But you know, you need data to have a firm read on what's happening. So, more of that would be great.

The Role of Data

Adam: 00:15:09

Right. And then it's amazing and you need data as a first step to be able to make better decisions. And then are you observing shifts in perception and objectives at the institutions that are creating policy, that take into account what is emerging from this more granular data?

Claudia: 00:15:41

So, like I said, I think the Fed is integrating it in its thinking more. I think they have done a lot to elevate maximum employment on par with price stability. I don't think in any way they've gone past their mandate. I mean, it is the Fed, right? They held off on inflation not because labor. I mean, they supply, they thought supply chains, COVID, all of these things. But that's really good. That's a big step forward for the Fed, to make very clear that maximum employment is their job. You know, they've had it since the late 70s. It's nice that we're getting on board.

But in terms of -- I find it is still a missing piece in macro fiscal policy. Right? There's a lot of fiscal policy that's like social programs that emphasize the inequality. As one recent example, I worked a lot on the new Child Tax Credit that was in the *rescue plan*, sent money every month to families, no strings attached, the poorest of the poor got this money. It cut the poverty rate, it cut food insecurity… and there was just lots of good things. This program, one of the most common things that comes up against is, it's inflationary. And it's like, I mean, first of all, it's not true. But you know, we could have a debate about it because it is a cash transfer.

But it's like, if macro doesn't have a tool to really think about the poorest of the poor, the benefits that are happening at the very bottom by a program like that, and frankly, they were supporting children up through the middle class. If all they have are these aggregate lenses, like inflation, I think it becomes hard to put like them on an apples to apples and really have a conversation. I mean, there's always costs and benefits and tradeoffs. But the lenses are just so different. People that work on social policy, and I've worked with a lot of them, don't do macro, and macro doesn't tend to do social policy. So, there's almost this missing link. And we're advising.

So, then it becomes harder, I think, for policy makers to have a coherent discussion, a coherent set of advice that takes the macro into account and the micro, and puts it all together. Yeah. So, that piece is missing. But again, the people that work with the distributional macro models, you can tell, bringing up the bottom because they're the worst off, like that does the most in terms of improving the social good. You can show that in a very technical way that are tools in the past -- I mean, it's kind of intuitive. But in terms of bringing it into the debate. So, we're pointed in the right direction, it's just we're not there yet. But more tools are coming online and more theories and thinking and we'll get there.

Adam: 00:19:17

Yeah, fair. I think your example about Jeff Bezos and how the CPI basket is constructed is an interesting case study. So, if we're focused on CPI inflation, or let's say PCE inflation, some combination of inflation metrics, and each of those inflation metrics is by composition over-representing the consumption basket of those who consume more, which are obviously people in higher income and wealth brackets. But the people that are most impacted by inflation are people in the lowest income and wealth brackets, then to me that seems like the kind of fundamental disconnect that can do a lot of harm. Is that a fair statement? And like, how do we get around that challenge?

Claudia: 00:20:18

Yeah. One of the other issues and I don't -- I'm not trying to undercut the CPI, because again, as long as these inequities are relatively stable, then looking one month to one month, like, you can do the price changes and get inflation and we -- so, I have -- the CPI is like a real thing, and it's telling us something. Now, what -- in fighting on this back on the lump of inflation, people buy different things. Right? So, there, I mean, it'd be probably hard to find someone that looks at the CPI and is like, oh, yeah, that's exactly what I experienced last month. And particularly now, there's a lot of discussion about *who's getting hit the hardest by inflation*? And it's pretty clear from the data, that there's a big negative impact on people who have lower incomes.

I mean, part of that is just they don't have as much of a buffer. Other money to pull out, although they have -- many have more now than they have in many years. But when you look at how they spend their money, for the lowest quintile of households by income, they spend about 60% of their -- 60% of their spending is on gas, food and housing, and those are all necessities. So, that means they only have about 40% of their spending that could potentially be non-discretionary, like things you could give up. And probably there's some of that 40 that is also what we call discretionary. Whereas if you get to the highest quintile, it's more like, around 40% is gas, food and housing.

Adam: 00:22:14

It's that high in the top quintile.

The Housing Mess

Claudia: 00:22:18

Yeah, housing is expensive.

Adam: 00:22:20 Well, yeah housing, because housing scales with wealth and income, right? People tend to just continue to buy bigger houses in nicer neighborhoods, etc. Yeah.

Claudia: 00:22:30 Yeah. No. And that's the thing to like in terms of the shares, it's the lowest income spent the most on these things. But obviously, the dollar amounts are much bigger as you go up in income. Like, I don't …

Adam: 00:22:43 I think you could make an argument that once you sort of move away from, let's call it, I'm going to just use a hand wavy term here and call it kind of basic shelter, right? Like, moving from kind of basic shelter, whatever hand wavy thing that means to nicer, larger homes and nicer neighborhoods, including cottages in the Hamptons, etc., all of that excess is discretionary spending.

Claudia: 00:23:16 Yeah. It's squishy in terms of what's discretionary and non-discretionary. But these are things that at least would be harder to adjust, when all of a sudden, Putin invades Ukraine and gas prices jumped by a buck 50. There are things that would also be -- housing would be hard to adjust. But yeah, I mean, it's -- Yeah, there's …

Adam: 00:23:45 Well, housing, I raise housing, because to me housing, or shelter in general, may be at the top of the list in terms of challenges to especially people in kind of the lower quintiles of the income distribution. And it also seems to me to be the component of the CPI, for example, over which policymakers have much more control than for example, over the cost of gasoline or the cost of food in the short and intermediate term.

But it also has been the component of the consumption basket that policymakers seem to have completely ignored or at least allowed to run vastly out of control over the last, certainly over the last couple of years, and arguably over the last decade or so, so that the bottom couple of quintiles by income and wealth are now effectively priced out of the housing and rental markets. So, how does that happen?

Claudia: 00:25:12 How does it happen?

Adam: 00:25:15 Yeah. How does it happen that policymakers are, either turn a blind eye to the impact that they're having, or what are the things that they are balancing between where they're saying, I acknowledge that this is a major challenge and a major problem, but these other things are a larger problem. And that we're going to prioritize that and sacrifice the cost of shelter, as an example.

Claudia: 00:25:39 So, there's many, many things that go in to why is housing such a mess. Well, okay, first, the policymakers, fiscal policymakers, so Congress in particular, I mean, this is an area that they could do a lot of good in terms of money for building affordable housing. Like just straight up like we're going to build. There was money set aside in *Build Back Better* for exactly that purpose, building affordable housing. When we see something not being produced, we ought to step back and say, why, why is this not happening?

And, one of the things it's pointed to with housing is housing is very much a local, the zoning, the permitting, like it happens at a local level. There has over time been an increasing amount of what is referred to as exclusionary zoning. People that, nice homes, nice neighborhood, don't want anybody else there. You know, they'll put a Black Lives Matter sign in their yards, but they won't let anyone move -- I mean, like, it's -- ...

Adam: 00:27:09 Oh, no. This is a well-documented phenomena. Yeah, absolutely. Yes, of course.

Claudia: 00:27:12 Yeah. And so that's a big problem. But that's not the only problem. Even if you were to fix that, there isn't an argument to be made that these types of homes are not profitable for builders to build. Part of it's going through the permitting process, other part, cost of labor and materials, and frankly, it's just more profitable to build a lot nicer homes. And right now, the Fed is raising rates to cool off inflation, housing is going down. Well, builders aren't going to build right now. I mean, this will bring prices down, but it's not going to get supply up.

Fundamentally, we need more homes. There is no way to solve this without more homes. And even if there's not a zoning issue, if the builders don't find it profitable to build, we do live in a capitalist economy, right, then it means that the government can step in, should step in, and get the stuff built. Make it profitable for the companies to build. But the fiscal policy, the economic fiscal policy, more or less has happened in crises and at no other time. So, the government is really good at sending out money. Basically, that was the only thing that was like well executed in the three big relief packages, was getting checks in people's hands. Like, that's basically it. And the Child Tax Credit went out too.

But I mean, if the IRS is doing it, they're printing checks off it goes, they're electronic, that works really well. We don't have the like state capacity to do a lot of other things well. There were some really creative programs in the past three years, but it's like when the world is on fire, Congress will act. And it just hasn't done it. And the thing is -- and the other, because housing has been a lot in discussion because of inflation, right? Like it's a piece of inflation that has come on. And they're talking with another economist, well, in rent prices, or housing costs, so families is, housing is procyclical.

And that just means when times are good, the prices go up, inflation is higher. But I was like, you know, and this is a particular person that was concerned about the *rescue plan*, and it's created too hot of a labor market and blah, blah, blah. And it's like you know what, it's a really sad statement on our housing market, that when people get jobs, when people at the bottom get some raises, and they go, they want to move out, they want to start a family, that it creates inflation, because there isn't enough for them to move into. Like that, to me, that's a really sad statement.

But the reaction to it is, the Fed needs to raise rates and get inflation down. And it's like, no, the reaction to this should be, build housing. But we just don't, you know, the fiscal policy has not been effective, the Fed has always looked to at times like this, and we always kind of look at it through the lens of too much demand. And yet, it should be so obvious when we look at -- like the crisis, it's so big, that it kind of amplifies problems that have always kind of been there, and you ought to like not be able to look past -- like, it just should be so obvious. And yet I think we're just stuck in this lens of it's all about demand, the Fed does inflation, house prices always go up. I mean, like, it's just the, like, the supply solutions that only Congress can do. Or maybe state and local governments. It's just like, they're not even talking about them. It's really sad.

Adam: 00:31:29 Yeah. I mean, there's this, just this is related, but maybe slightly parenthetical. But I've heard an argument articulated that the Fed should, in fact, aggressively lower rates, because lower rates will stimulate private sector supply. And I can certainly see how that's true in certain segments of the economy. But what I struggle with, and housing is a perfect example of this, is that when you lower rates, you immediately make credit available to -- more credit available to more people. That's an immediate effect. But the supply that could even conceivably come on, as a result of lower rates, first of all, even if the supply/demand equation would eventually find an equilibrium, which I'm not suggesting it would.

But even if it would, there would be a substantial lag. There'd be one to two or three year lag between when potential purchasers of homes would have the ability to buy a home, and the time when new homes would come on the market to meet that demand. So, in segments of the economy where credit plays a larger role in demand, it seems to me that that supply argument fails on its face. Would you concur with that, or what am I missing?

Claudia: 00:33:36 Yeah, I mean, the Fed's only tool in terms of stabilizing for the recovery is pushing around interest rates, setting aside lender of last resort in the absolute crisis, but when you're fighting inflation or trying to push the labor market, its interest rates, whether it's the federal funds rate. I mean, quantitative easing is just about pushing around interest rates. That is primarily though not exclusively, about demand. The interest rate's a price just like anything else, they're making the price of buying right now higher, encouraging saving, but you know, to cool off the economy.

Now it is true and I think this is a good point that is Skanda Amarnath who's at Employ America, he's been pushing a lot on the supply angle. And one of the things he said and I mean there's I mean clear examples, I think housing is definitely one of them, as they push up interest rates they'll cool off demand. It might take a while, but they will cool off demand, but they're potentially going to lower supply too.

Adam: 00:34:56 Oh, they're definitely going to lower supply. Absolutely.

Claudia: 00:35:57 Yeah, and it's you know, but the damage in the sense of like, when we get to the other side, there's actually less supply than we went into it. But if you think about which effect is bigger, I think the general understanding is that the demand effect is bigger. And it's like the demand effect is all they got to fight inflation. So, it's kind of like, the best thing that we can do for supply or demand is heavy, fast and sustained expansion, or fast recovery, sustained expansion, like, that's good. We've seen a lot of business investment being done and the recovery's, we're seeing a lot of consumer spending. Keeping this going, even if it kind of cools off a little bit, is the best thing that we can do. What the Fed is doing is not going to raise supply, right, and it's going to decrease demand.

So, I think just that demand argument stands in that issue, like that's what the Fed is doing. Now, this and I've been really pushing on this, the Fed is not the only game in town on fighting inflation. That is the conventional thinking, but it totally breaks my heart to see the President or leaders in Congress being like, the Fed's got this. They do inflation, and it's like, oh, my gosh. Because if policymakers did things to increase supply, that is the low pain way of getting inflation down. And frankly, there are places, particularly food, energy, gasoline, the Fed can't fix those problems. And you know, it's one …

Adam: 00:36:49 Well, they can but it's such a blunt instrument that you kill the patient by trying to alleviate the symptoms.

Claudia: 00:36:53 Right. Well, there's been a lot of, yay, gas prices are down. Yay. And it's like, okay, a big reason for that is fears of a global downturn. We don't want to trade one problem for an even bigger problem. But the thing is, it will provide temporary -- because I was asking, I was like, what supply came online? What refinery did we just build? You know, more oil. So, it's like the recession will push down demand not so much for gasoline, but like for other production stuff, it'll show up in gasoline. But you haven't fixed the problem, the underlying problem, and we will come out of the recession.

And if the Fed has done it alone, they might actually have pushed another refinery to go out of business, or they sure didn't encourage people to do more fracking or whatever. So, when you come out of the recession, not only do you still have the problem, it could be a little bit worse than when you went into it. If the Fed has to go it alone on inflation, it will be much worse, like there'll be much more hardship. Even if we avoid a recession, it will create more hardship than if there were efforts to increase the supply. And like, Congress has a lot of levers to increase supply. But, they're not pulling any of them right now.

The Power of Fiscal Policy

Adam: 00:38:25

Yeah. So, I think that's the crux of the issue. As you say, fiscal policy has the capacity to solve a wide variety of the biggest supply challenges in the economy and in relatively short order, at least on the order of several quarters, maybe, substantially create a sustainable solution to many of the problems. Like, as you say, a federal home building, like the Affordable Housing Act. Drug costs are a major source of inflation and hardship for the bottom one or two quintiles of society. Single buyer or single payer health care, single buyer economies of scale, negotiating power on drug prices.

You know, I've been advocating for a national nursing corps, right, where you train nurses and their sideline but they're trained and you know, they go work in other related or unrelated positions. But then they can be called upon, for example, in the event of another pandemic, or some other type of health crisis. Like there's all of these different types of infrastructure plans. I think I was just reading that the US Society of Engineers has said that there's a $2.1 trillion infrastructure gap by 2029. If you're going to implement a housing plan, and you can't build downtown in cities, it means you kind of have to build in suburbs and exurbs. Well, that doesn't really totally solve the problem either. Because all you're doing is kind of building in these really large commutes.

So, if you're going to have a national housing plan or housing act, then shouldn't you also introduce intra urban high speed transport? Like, it seems to me that there's a lot of different interconnected policy tools and opportunities to very substantially improve the situation for a huge swath of society. The problem is, there seems to be no confidence that any of these things can be hammered out by legislators. So, how can we move forward?

Claudia: 00:41:18

So, I think there's -- oh, and I'd add one thing to what you were saying about these programs, and you'll notice it from the examples you gave. One thing that Congress can do that the Federal Reserve cannot do is Congress can target its policies. Like the Fed is using a very blunt instrument. It's going to have an effect on the housing market because it's an interest sensitive market, but it has an effect on a lot of other things in ways that sometimes are surprising, right? Whereas Congress, if they send out money to build housing, we would expect houses to be built? So like, they can do things that are much more targeted.

Now, I think the macro economists, we don't always help in this debate, because once it starts getting into all of these small programs, investment or social policy, that's not our lane. And so you'll see fiscal debates turn into, when economists come in and try to help, how much does it add to the deficit, the deficit spending.

Like, when Senator Joe Manchin said he wasn't comfortable going forward with the legislation that they were looking at, and inflation, he wants to see the next CPI. I mean, I really about lost it, because by this time …

Adam: 00:42:47 Me too.

Claudia: 00:42:48 We probably weren't alone. But in particular, him calling it inflationary, it's like there were four things left in this package. The prescription drugs, which lower the price of prescription drugs, the ACA health premiums, not resetting to a higher level. Clearly, that's inflation. That actually is going to show up here soon, if they don't get that fixed. Energy legislation. A lot of that was green energy. But I mean, Joe Manchin is the deciding vote, there's going to be things in there for the fossil fuel industry.

Not having an energy plan has been extremely destructive, both in terms of sustainable life on this planet, sustainable growth, but also this has created problems for like, we're going to need fossil fuels and our traditional energy sources for a while. The transition is going to take a while. But we've seen this year, even though they've got these huge profits, they're not building supply. Because I mean, come on shareholders a couple years of profits, that's not enough to convince you to do a decade long capital investment.

Adam: 00:43:59 Especially when it's clear policy at the administration level, but also in the financial spheres now to be punitive against companies that are not ESG compliant. So, the ESG mandates, while well intentioned, are raising the cost of capital substantially, and lowering the visibility of prices and the flexibility of these companies to implement future plans. So, it definitely complicates the plan.

Claudia: 00:44:40 Yeah. I mean, we just -- we got to have a plan that's like a coherent plan. What we have right now is very chaotic, and we've had these kinds of energy cycles now every like, six-seven years, multiple times. I mean, this is one where you could fix future inflation. Like this is coming again. We cannot be so dependent on a global oil market that's supplied largely by dictators. This is not a good setup. So, anyway, so if that was in there, that would be good.

And then like he had this big tax increase on the rich. I mean, that right there that is like sucking a lot of demand out. Every single piece of it was something that Congress could do to actually fight back against inflation. Now, not all of it would take an effect right now. But I mean, like, these are some areas that there's for many reasons, we need to be doing them. But like in terms of inflation, like, at some point, they're going to have to…

Adam: 00:45:39 Direct impact to …

Claudia: 00:45:41 -- all of that. Yeah. And so -- but if you have this lens of debt is bad. The package wasn't completely paid for. I think, like half of it was or something. And there's a lot of discussions you'll hear about fiscal spending that are just what's the top line number. What is it do to the deficit, and it's really important to look under the hood. The program itself would determine largely, if it causes inflation or not. Like things that are investments pay off, and they actually build our supply, our capacity. And then that gives us some breathing room.

But there could be a lot of reasons that Senator Manchin opposes the legislation. I mean, inflation was one that he's pointed out. But I mean, that one just really pains me because of that, that is just bad advice. And frankly, I don't think as macro economic policy adviser, I'm not sure we do a great job of explaining that difference.

Adam: 00:46:54 Yeah. You're giving the benefit of the doubt to these decision makers. That's very graceful of you. I'm curious whether you feel that if the administration did formulate a constructive energy policy, that part of which provides for a loosening of regulations or perhaps incentives for companies to increase the supply of energy in the most environmentally sustainable ways, for example, do you think it would make it easier to pass these sort of broader infrastructure or *Build Back Better* type bills, because it would be easier to get a consensus with representatives that are more sensitive to energy policy? Do you think they're using this, the fact that they're not getting constructive movement on energy as kind of, they're holding policy hostage to that, in a way? And if we could move towards something constructive then we could get a lot more done in general?

Claudia: 00:48:27 So I'm not an expert on energy. So, I don't want to -- there are a couple of things that I understand. We do have these price spikes, we have to have more supply, we have to have more independence from the global markets. Like just being the largest oil producer in the world doesn't cut it, because it's still a global market. Anyway, so we've got to have more supply that's reliable, sustainable, and we've got to have less demand. And it could be less demand for fossil fuels and electricity, but just like energy efficiency.

I mean, like, there are a lot of ways, and this was one outcome from the world oil shocks in the 1970s, we just have to have less demand. And that's it. Like you either increase supply or you decrease demand. And, frankly, for the globe, we ought to be decreasing demand. So, but the thing is, is this is, as with other things, like COVID has been tragically politicized. So, I don't -- I mean, this needs to happen in terms of some kind of an energy legislation. There's got to be a way. And I really thought with Senator Manchin leading the charge, you'd have something that would put various pieces together, like fossil fuel and green energy. But it's not looking real good.

Congress did pass the infrastructure bill. I mean, that was straight up bridges and roads, it really wasn't much more than the typical spending. But I mean, they did come together and pass -- But like, if you -- if you can't do anything, for people, any kind of social program, whether it's Child Tax Credit or affordable housing, and you can't do anything for the planet, right, like bridges and roads, and they're not doing enough, right, the engineers and we still need more of the -- that's -- I mean, there's just a sign of a deep dysfunction that goes way beyond one particular plan. It's just, it's sad.

But there are private, I mean, there's a lot of technology, there's been a lot of change. I mean, the lot of energy producers are finding more sustainable ways. But it's a lot to bank on the private sector and like ESGs. Those are not entities that put together overarching plans of where we want to go as a country. You just get this hodgepodge and some bad decisions. So, this is, yeah, it's just hard to watch. But I don't you know, they know -- I mean, this is a high profile issue. So, it's just, I mean, if -- I think if they can thread the needle, they will. I mean, they're trying but, yeah.

Adam: 00:51:40

Right. So, shifting gears just a little bit. I know you mentioned earlier, and I know you've mentioned elsewhere, that you were instrumental in bringing about that Child Tax Credit. And so I want to talk a little bit about how you perceive the differences, the strengths and weaknesses of actions that drive cash directly to individuals and families for them to use how they see fit. Like, what happened with the Child Tax Credit, which I'm a supporter of, by the way, maybe -- not that it matters to this conversation, but I am. Versus building, investing in childcare, or pre K, or child health and dental care, you know where I'm going, right?

There's this idea that you give people money and let them spend it how they want versus you build, you invest in resources that everybody in this cohort can use and has the potential to improve their lives and future outcomes. Right. How do you think about the difference there? And how do politicians think about it in terms of how they're implementing policy?

Claudia: 00:53:20

Yeah. And I should say, I have been a big advocate, and I've worked on a lot of issues related to Child Tax Credit, but I don't get credit for getting that on to the … I did do a lot of work on the stimulus check. So, I have the cash relief, I'm in that space. Well, first, I'd just say the cash relief, whether it's in a recession, or these regular payments to families with children, there are several advantages to them. But one, there's something that the government's actually capable of doing. And we talked about, they can get money out. And they give the families a lot of agency.

So, with the stimulus checks, for example, I mean, I did surveys both on the 2020 and the 2021 checks. And actually, since the 2008, I've done a lot of research on ways we support families in recessions. And about you know, 30% will spend it, again, these are the stimulus checks, let's say on the Child Tax Credit. And then you know, another 20% or something will save it, and then the rest pay down debt with it. And we actually saw in our results from the COVID -- I mean, people were paying down payday loans, auto title loans, I mean, the credit card was the most prevalent.

Like families have a lot of different financial situations. You give them money, they know best what their family needs. They might not always make a decision that the policy maker would say, oh, that's what we intended you to do. But it gives them the space to live their lives with just a little bit more breathing room. And the Child Tax Credit, there has been a lot of good research that's been done on what did the families use it for? Well, they used it on like clothes for their kids and food and rent. I mean, like they -- and other spending for children. I mean, they did exactly what we would have expected them to do with extra money.

The thing with the Child Tax Credit, with a lot of government programs that do exist, there's this big push to target. This has like economics, again, has some credit for this, whereas you want it to go to exactly the right person, and it's the most efficient use of the money. The problem is, we're not very good at that. Like, we're not very good at figuring out exactly who needs it. And then a lot of times people will fall through the cracks. So, a big push back on the Child Tax Credit and part of the reason that it expired and hopes of its revival are not great is, for the first time it was a social program, a cash program that went to the poorest of the poor. It did not have a work requirement, it did not have an income phase-in, and unlike the Earned Income Tax Credit, it had a massive reduction in the poverty rate.

And I had a lot of discussions with economists, and they're like, oh the work disincentive and they'll drop out. And some studies were like, and people will choose to go back into poverty. And I was just like, it's not that much money. It's like 300 bucks a month. But I was talking with one and I said, look, I said, I'm really open-minded. You know, but the idea that we have children living in deep poverty in the richest country in the world, I mean, that is like, morally wrong. So, I'm like, you don't like the Child Tax Credit? Fine. What's your idea to solve child poverty? Because what we've been doing for the last decades, hasn't solved the problem. I mean, and it's not trivial. This is a big problem. So, the Child Tax Credit moved the needle, it existed, it really helped people.

So, I guess one of the reasons I like these programs, they work. The help gets to the people, and they can do what they want with it, which to me, should raise the probability that it works. Now, because the United States has been derelict in its social programs for a very long time now, like, the list is long. If we can only have one thing, and it's got to be universal pre K, great. There's so many things in the choice set that like, I love all my children. Like, there's a lot of good stuff in there. It's just I've done more work with the cash policies. I feel more comfortable that the research shows these happen, and they can be implemented really fast.

Passing Legislation

Adam: 00:58:43

Right. I guess one of the challenges, certainly much less so with the Child Tax Credit than the stimulus checks is that it ends up in the pockets of people that weren't the intended recipients, right? I mean, I forget what proportion of all of the PPP payments was it that ended up on corporate balance sheets instead of in the hands of the employees that it was meant to support, that sort of thing. Yeah. I mean, I guess it's one of these things where you can kind of look at the needs, if the idea is you want to eliminate or not eliminate it, you'll never eliminate it, but like, dramatically impact lower -- the rates of child poverty, then what are the impacts of child poverty?

Malnutrition, neglect, poor child care, poor exposure to education, not making it to school, etc. But these are all items that can be addressed through investment in social programs, I would argue more effectively than leaving each individual to try to solve this problem themselves. But I hear you say, and they're not mutually exclusive either. I mean, there's a role probably for both. And I hear you say that it's just vastly easier to pass legislation that distributes cash than it is to pass legislation that deals with these major social investments.

Claudia: 01:00:39

Yeah. And I would say it's not just about getting them passed. I mean, there are simple. The legislative text is really simple. But it's about administering them. We have a real problem with state capacity. Like the unemployment insurance system, like our bedrock automatic stabilizer is a mess. Like it's run at the state level, some states actively tried to limit the benefits are like, not as generous. Many of the states have their administrative systems written in a computer language that only some retired coders know.

Adam: 01:01:19

COBOL. Yeah.

Claudia: 01:01:20

Yeah, CO-- I mean, this is ridiculous. We live in the country with the tech center of the world. So, that system, and you know, a lot of people talk about, oh the unemployed got benefits that were larger than what they earned before and blah, blah, blah. That was a direct consequence of a poor administered system, because what they wanted to do is go in and say, hey, let's just have it be a full replacement rate. Usually, the unemployment benefit's around 70 or 80%, of your prior pay. Government was like, oh, it's the Cares Act, we want to take it up to 100%. And the state agency said, we can't do that. We can't actually change our programs to make that happen. What we can do is just add a dollar amount on top.

So, the $600 was the median benefit for the worker. So, that's where that number came from. And that's not what they wanted to do. And maybe they wanted to make it like 110%, just to you know, but like, it was not possible. So, something that that program was attacked for, and frankly, was probably a design flaw, had nothing to do with the intentions of the lawmakers. It was a bottleneck in the program. I often say if the unemployment system actually worked in this country, we'd never need another stimulus check.

Adam: 01:02:46 That's a really good point.

Claudia: 01:02:47 But it doesn't work. And you gave the example of the payroll protection program. If that thing worked, we wouldn't need much of the unemployment insurance system, because it's so much better to keep workers attached to their employers. And other countries manage this. That's like the core of Germany's stabilizer in recession. So, it was a really well intended program. But it was wildly, badly administered, but we could do better. But that's the thing the US just doesn't have. We have not demonstrated a lot of state capacity. And so that's what makes me very skeptical of these more targeted, we're going to build schools, we're going to have child care. Like, I just don't trust the process.

Adam: 01:03:36 Well, I mean, it sounds like that's a bottleneck that could be addressed by a Federal/State Administration Act, where you're going to invest in tech and capacity for better state administration. And that would enable a whole slew of more effective programs in a wide variety of different areas.

The Great Resignation

Adam: 01:04:35 *The Great Resignation*, so to speak. It's kind of a curious thing. So, my kind of -- my thesis is and I know that reductionism, I think is one of the great sort of meta problems in society. But I do think that one of the contributing factors, perhaps a major contributing factor is that many people withdrew from the workforce because they could afford to, because investment portfolios and home prices rose so dramatically that they were looking at a job that they probably didn't like that much in the first place, or were tired of or whatever, and decided I don't need this anymore. I'm wealthy enough to retire. And perhaps among young people, the gains in crypto markets or through stock speculation, etc., over the 2020-2021 period may have contributed. I'm wondering, do you credit that as a source at all, and if not, what other factors do you think are major contributors, and how might we be able to address it?

Claudia: 01:06:02 Yeah. So, first, I'd say that at this point, among the prime age workers, so that's people the 25 to 54 years old, so kind of in their working ages. Before the crisis, about 80% of them were employed, were self-employed, or employed at a firm.

And we are back to about 80%. Right. So, in terms of the prime age workers, could talk about it being a slow recovery. You know, there definitely were issues with like childcare, caregiving. I mean, there were reasons, it took longer for some groups of individuals to come back in. But at this point, basically, we're back. And I mean, these are people who we expect to be working. Full-time work is at an all-time high. Full-time jobs are what's come back. It's the part time jobs are lagging way behind, which isn't that bad. These are bad jobs.

So, then, but if you look at the overall population, like you said, we are missing workers relative to before the crisis. It was so unusual. I mean, there's a long list of unusual things with this recession and recovery. But we had people at the beginning just like walk away. Like, they just left their jobs, they quit and left the labor force. And it's been a big question as to when they come back. Right? And that gap has been important you're saying with the labor shortages and other issues in the labor market. So, but it is a big question, who are these people and why have they left?

Adam: 01:07:53 It sounds like they're mostly people over the age of 50, what was it, 55 was the --

Claudia: 01:07:57 Yeah, 54. Yeah, no, they're older. So, a big piece of it right now are older individuals, ones who say they're retired. Now, it's a little tricky, because yes, some of them had more money, a little bit more of a nest egg. Maybe they were close to retiring anyways, and we're just like, ugh. But they also were the most at risk group from COVID, like having problems. So, you see in the surveys, COVID health concerns does come up as an issue more broadly. I mean, there are aspects of the pandemic that are at play.

But I hear you, I mean, there were definitely people who had enough, like they could cash out and had a little bit of money. And they were close to retirement. Maybe somewhere past retirement age, and we're like, now's the time. Like, this is the sign. Some have, we have had movement back in to the labor force from some people who have called themselves retired. I mean, that's also a very socially palatable way for the -- if you're retired, or if you're unemployed and you're older, retired. And inflation is high, that extra money runs down. Like, so you can see people coming back in. But yeah, I mean, I don't -- it's hard to parse out how much of it's an effect of extra money, the extra wealth, but that certainly has to be the case for some of the retirees. I don't think there's a lot of these crypto, GameStop…

Adam: 01:09:48 No, I didn't mean to interrupt. I'm sorry.

Claudia: 01:09:50 No, no, you're fine. I was just saying I don't think it's a lot of these crypto people GameStop there doesn't seem.

Adam: 01:09:57

No. Especially since, and I didn't realize that, that most of the prime working age population were or we've returned to the same population employment ratio from that age cohort. I do feel like it plays even more to my thesis that it's early Gen Xers and boomers who are the ones that have withdrawn from the workforce. I do hear you that illness may play or fear or concern about illness from COVID may play a role. But to me, that strengthens my thesis, that wealth effects have played a very large or may have played an outsized role in people withdrawing from the labor force because of unearned shock higher to wealth. And in order to alleviate the labor shortages, there may need to be a normalization of asset prices in order to draw people back into the labor force.

My thesis has been that that is actually at least peripherally on the radar at the Fed, that one of their explicit objectives here is to lower asset prices, because it is, first of all, it's causing a lot of trouble for new household formation in the household sector, but it's also a tertiary factor in labor shortage. Is that on their radar at all, do you think? Or would that be very peripheral, if at all?

Claudia: 01:11:50

Yeah. So, I think with the Fed in terms of its goals, it's important to center it on its mandate. So, the stable prices and the maximum employment. So, what the Fed is really focused on is moving the needle on things in the real economy. So, not in financial markets. Now, that said, they watch all of this because, and in particular, the Fed moves through financial markets, right, like it can move interest rates around. So, that's its primary, it talks, it looks to see if interest rates move, right. Like, that's its big thing.

There has been and this has been true since the Fed, well, actually may have been true before. But there has been a robust debate at the Fed among Fed officials, and this is something there's disagreement, and not a majority view, but how much their monetary policy should be, responsive is too strong, but should be really thinking hard about the effects in, let's say, asset prices, like stock prices. I mean, this was something that came up … Jeremy Stein, when he was a governor at the Fed, really pushed this that they've been doing quantitative easing, and the recovery after the great recession for so long. He felt like the instabilities were growing, and that this was a reason to start raising rates to get out of this space.

They didn't lift off because of this. In the instability, I mean, like, markets were basically fine, right? It didn't turn out that was a big case. But they're clear about the fact like asset prices, that's not their mandate. The stock market is not their mandate. And the tool that they say is the better tool, which I have, frankly, I agree with, is through their regulatory space. Macro prudential, because again, that's where they can be a little more targeted. I don't know.

Adam: 01:14:14

Can you give me an example?

Claudia: 01:14:18 No. Let's see, the better example of like a wealth issue. So, not the stock market, but we're thinking about house prices. What should have happened before the Great Recession is, the housing bubble was becoming larger, and there were definitely groups inside of the Fed, particularly the ones that worked with communities and we're seeing these subprime -- like it was clear that there was a big problem brewing.

But I mean to the Fed officials and you know, through the lens of like markets are efficient and all that, like it just didn't resonate as this was a problem. But there would have been the case of being like, oh, in 2005, we should have started raising interest rates. Like that wasn't exactly the problem. Like they should have had, using their regulatory policy to get on banks like doing stress tests of like, their subprime portfolio, or, frankly, it's a problem. They don't have supervision of non-banks. But you know, I mean, that's the kind of --

If there was a bubble in the housing market, if there were mortgages -- that isn't something that the Fed funds rate addresses very well. That's something that other, macro prudential tools would work better. But I will say to your point, like this is an active concern, and the Fed watches this, because it is not lost on anyone that quantitative easing has effects in asset markets... I mean, this is one of the reasons the Fed's policies cause more inequality. They do a lot in the labor market. But the wealth inequality, it's clear that they're not helping there, right. And I think the way it manifests itself, and this is just kind of piecing together some Fed officials comments. They haven't said anything like this officially, but like, that's one of the reasons they won't get out of the quantitative, the asset purchases. The asset purchases were working to push down interest rates.

Like it's clearly we're doing something, but they're doing more than what, like with the Fed funds rate, it is an interest rate, it affects an interest rate. These buying the assets, like that it does affect interest rates, but it affects other stuff. Like it's just they're more like, we don't know exactly how they work. It's clear they have some side effects that are more negative than the side effects of just straight up Fed Funds policy. Like the Fed really doesn't like having to use those. It doesn't like being close to the effective lower bound, it doesn't like -- so, you'll see them like it's the first thing they get out of, or try to start getting out of.

So, that's where you see the reflection of concerns about how they're affecting asset prices. They get in that space because it's the best tool they have when they're constrained. But it's not a great tool.

Adam: 01:17:49 Not where they prefer to be.

Claudia: 01:17:50 Yeah, like it's an uncomfortable place.

Adam: 01:17:54 So, I guess, yeah, where I was going, and I think you picked up on it, but just to be ultra-clear, is the idea that, and I agree that maybe stock wealth is more peripheral, but that housing wealth has a very direct impact on inflation and on consumption. So, where are we starting to see inflation pickup, right? Obviously, capital goods, inflation, auto used cars, that kind of stuff, all of that has already begun to roll over pretty dramatically. Where are we seeing inflation start to pick up on the services side where stuff like travel, discretionary health spending, labor costs, shelter costs, owners' equivalent rent, that type of stuff.

And I would argue that the increase in home prices is having a very direct impact on people's budgets for these types of discretionary service spending, for if your home has gone up by 30 or 40% over the last two or three years, you're feeling a lot richer, and you're feeling like you have a lot more latitude to spend on these big discretionary service items. And so, you're going to have a really hard time lowering demand for these service items, and also bringing on new supply of labor to help lower the cost of delivery of some of these services without substantially lowering asset prices and specifically housing prices.

So, this is where I'm sort of directly connecting Fed, the Fed mandates for price stability, with asset prices and in particular housing. But I would also argue that 401Ks are up by twice the compound rate that you that one might have anticipated looking at the very long term returns on equities over the last 10 years. And homes, which are a levered asset on most people's balance sheets are also up by vastly more. And so you want to moderate people's perception of wealth and their tolerance for discretionary spending. The most direct channel to do that is to lower asset prices. In fact, that may be the most direct channel and more effective than the interest rate channel in terms of business investment, and the types of things that are much more sensitive to the Fed funds rate.

Claudia: 01:21:02 Yeah. So, in terms of the asset price, like a portfolio effect, your 401K, like all of that, your house, also like the equity that you have in your home. So, it is the case that when you look at consumer spending, I did this for several years, the wealth is a determiner, at least is associated with spending. But what's referred to as the wealth effect, so like, what fraction of that wealth, what fraction of a change in wealth shows up in a change in consumption, is really small. And I think part of that, and actually, it's become smaller over time. And part of that, likely goes back to the fact that we have such an unequal distribution of wealth. Like, there's so much more wealth at the top. And frankly, at the top, they're going to spend what they're going to spend.

Adam: 01:22:07 Yeah, their marginal propensity to consume is obviously very low.

Claudia: 01:22:10 It's like really close to zero, right? But there's this wealth effect. The strongest piece for lowering consumption, I mean, consumption is like, 70% of the economy. Whether we get inflation down or not like consumers are going to, like, it's the consumer … inflation. So, the biggie is income. So, the extent to which indirectly, the Fed gets income to go down, like hopefully, just maybe grow a little bit less. But in all likelihood, people losing their jobs, So, that's the big one.

Adam: 01:22:55 But that just seems so much more harmful, right? If you're trying to determine, you're trying to lower demand through the income channel, then you are definitionally impacting those who are most vulnerable much more than like -- what we know for a fact is that the household sector, homeowners are, we don't need to worry about them. They're in the best shape in the history of America. These are the people that can afford to be impacted to a much larger degree through the wealth channel, than those at the bottom who are likely to be vastly more impacted by the income channel, because it's going to be largely through job losses.

And it seems to me that the way that the Fed has designed its QT program with 35 billion a month coming from their mortgage holdings, if you look at the math of how their balance sheet is going to run off, and depending how the Treasury decides they want to structure their issuance along the duration curve. Most of the Treasury runoff can be managed through just rebalancing into or rolling into new issuance. Whereas about 15 to 20 billion of their mortgage run off looks like it'll need to be financed through direct sales.

So, I'm just wondering whether a very deliberate objective of their balance sheet run off is to increase mortgage spreads against treasuries because they're recognizing that the housing market is a massive source of discretionary spending from wealth effects. So, that's kind of connecting all of the dots to my thesis. And I don't want to beat a dead horse, if you feel like there's not much merit there, or you feel like it's all incidental or coincidental. But I'll let you react and we can move on.

Claudia: 01:25:15 Yeah. I mean, my argument would be, you'd really have to push down on housing wealth to move the needle. Like, these are small effects. I can't speak to the details of the best way to do quantitative easing. This is not like my specialty. But I do know that it is an open and unsettled question as to how one best does that. I don't -- Yeah, particularly how they work the combination of the treasuries and the mortgage backed securities, like I think this will be a much discussed aspect of their toolkit for quite a while. I just don't think they're thinking hard about this transmission through the housing market, to slowing things down.

Adam: 01:26:17 In which case, it's possible that they may have to lean much harder on their tightening policy, in order to see a, the reduction in consumption that they're looking for, in order to reduce core inflation, which is an interesting question. Why don't we wrap up, because I know I'm pushing my limits with your -- where you are in terms of your *recession indicator*, and just your general sort of economic view from here.

A Job-ful Recession

Claudia: 01:26:52

Okay. So, it is a very big question, are we in a recession? Is a recession coming? In some of my earlier work on fiscal stimulus, automatic stabilizers, getting, fight a recession using relief that's tied to economic conditions, not to political whims. In working on that I developed a recession indicator, now referred to as the Sahm Rule. And it's really pretty simple. I mean, that was by design, I wanted something simple. So, what I do is look at the national unemployment rate, take the three-month average, moving average, because you don't want to react to some little bump or wiggle in the data.

So, you take the three month moving average, take the current value and compare it to the lowest value over the previous 12 months. If that difference is a half a percentage point or more, we're in a recession. It doesn't forecast a recession. It is an indicator of a recession. It, since the 1970s was perfectly accurate, no false positives, no false negatives. And it triggered somewhere between two and four months from the recession start, that start being dated later by the MBR.

And the idea of it was once it triggers, send out stimulus checks, or start the enhanced unemployment benefits. Okay. But it's based on the labor market. And we've had a lot of discussion about GDP. Growth was negative in the first quarter, and maybe we'll find out soon that it was negative in the second quarter. That fits the definition of a technical recession. Many countries in the world use that as a definition. Very few people have a recession dating committee, like we do in the US. If that were to happen, it's highly likely, we will have yet another puzzling and never happened before experience of this recovery.

And because two quarters of negative GDP growth and a labor market where the unemployment rate is 3.6%. And we've been adding half a million jobs, that whole period, we've had this negative GDP growth. And like the Sahm Rule right now is zero. Like it's really far. So, I've started calling it just so I have some peace with this, a *job-ful recession.* Which is me thumbing my nose at the idea that it's a recession. I mean, I don't care what we call it. I just want people to have their jobs and keep getting jobs. And that's where we're at right now. There's no guarantee that we stay there.

I am concerned about a recession next year, because the Fed is going really hard right now, I think they should be raising, I'd slice about 25 basis points off of what they're doing, like the rate increases. But because -- and we talked a lot about this, the Fed's direct effects are pretty small. With its interest rate changes, it's going to be its indirect effects through spending in the labor market, and blah, blah, and we aren't going to see those until next year. So, they're lobbing in more and more tightening. And we're not going to know for several months, whether it was too much, not enough, I have a hard time believing it will be not enough, or just right and we stick the landing. And it's just tough, and basically, GDP is the only thing that the MBR looks at, of like, there's kind of eight or nine different -- like it's the only one that looks recessionary.

But there are a lot of strange things in the data and that makes it extremely hard for the Fed. So, I don't know. So, if we were to get some help on supply, whether it's the supply chains, or in the labor market, right, people start coming back. If people get, if we kind of work through and get back to normal, and what we want and what we spend and how fast we do, that'd be good. And then we really need Walmart nation to come back. Like the price sensitivity would be really good.

I was listening, I was talking with some friends who were having a conversation with some CFOs. And they're like, inflation is high. How do we think about that next year? And they're like, we should keep using it as an opportunity to raise prices. And I'm like, good luck with that. Because at some point, like the best cure for inflation is inflation. Because people will finally say, no, and/or they'll switch to some cheaper brand, or they'll do something else. So, it's really those factors that are going to have a huge influence on whether we get inflation down to the extent that the Fed chills out a little bit. And then it's like we need some things to break our way. That has not been the case for two and a half years now, but it is possible.

To me, like sticking the landing, a soft landing, a softish landing is possible still. I guess I'd close with the discourse among macro policy advisors, not so much at the Fed, but like kind of on the outside, is there is a growing drumbeat of *we need a recession*. That it's going to take a recession to get inflation down. Inflation is very bad. We need -- nobody wants one. But like in the thinking of their models, and how we got here. And the Fed doesn't say that. They're not trying to cause a recession, they don't think we need one to get inflation down. But it really makes my blood run cold to have peers really pushing the, we need a recession. Because it's like recessions, and I've been asked in interviews, so is a recession worse than inflation? Yeah, it's a lot worse. So, anyway, so we'll see where this goes.

But in any case, things are going to slow down. We've had a really hot recovery and it's not sustainable. I mean, that was -- I mean, recoveries can often be kind of fast. And this one was particularly, so we needed it to slow down a little bit to be sustainable to go into an expansion. It's just the goal is here to keep this expansion going just at a slower pace, but that's it's really a lot to pull off. And we're definitely seeing signs of slowing.

Adam: <u>01:34:26</u> Right. Right. Okay. Well, you've been extraordinarily generous, more generous than you had anticipated. I know from our …

Claudia: <u>01:34:35</u> Yeah, no, no. This is fine.

Adam: 01:34:36 … expectations. So, I really, really appreciate you giving me the extra time. It has been enormously helpful and fun.

Claudia: 01:34:43 Good.

Adam: 01:34:43 So, thank you.