Will President Biden’s economic stimulus cause inflation? Economists are unsure

Amid fierce public debates about the size of the Biden administration’s coronavirus protection and stimulus package, the Initiative on Global Markets Forum (the University of Chicago Booth School of Business) invited a panel of US experts to express their views on the likelihood of the economy ‘overheating’ and causing inflation as a result. ***Romesh Vaitilingam*** *writes that the survey indicates considerable uncertainty and differences in views.*

The survey asked the experts whether they agreed or disagreed with the following statement: “The current combination of US fiscal and monetary policy poses a serious risk of prolonged higher inflation.” If so, how strongly and with what degree of confidence.

Of the panel’s 43 experts, 38 participated in this survey, and the results indicate considerable uncertainty and differences in views. Weighted by each expert’s confidence in their response, 33% agree with the statement, 36% are uncertain, 26% disagree, and 4% strongly disagree. The short comments that the experts are able to include when they participate in the survey provide more details on different perspectives.

Among those who agree that there are risks of prolonged higher inflation, Steven Kaplan at Chicago states: ‘Poses a risk, but much uncertainty about whether that risk will be realised’; while his colleague Anil Kashyap comments: ‘Poses for sure. We don’t know much about how inflation expectations are formed; if they become unhinged, watch out.’ Markus Brunnermeier at Princeton adds: ‘While sharp price spikes might be transitory, they can translate into lasting higher inflation if one isn’t watchful.’

Ray Fair at Yale points to his own analysis of the issue: ‘I have a recent paper on this, “What Do Price Equations Say About Future Inflation?” using an econometric approach.’ Pete Klenow at Stanford also directs us to some further reading with a consensus view on inflation prospects: ‘Modest in magnitude: ~20 bps over the next 5 years [from 2.20% to 2.40% annual rate] and ~10 bps over the next 10 years [from 2.20% to 2.30%],, according to the Survey of Professional Forecasters.’

Darrell Duffie at Stanford remarks: ‘A bit higher inflation would be good. The risk of much higher inflation involves a tradeoff. Better infrastructure, for instance, is needed.’ Similarly, Abhijit Banerjee at MIT, who says he is uncertain, notes: ‘I am not sure that slightly higher inflation would be a bad thing by the way. The question seems to lean that way.’

Among other panellists who express uncertainty, Judith Chevalier at Yale notes: ‘The TIP-Treasury spread does not suggest extreme inflation expectations at the moment.’ And Austan Goolsbee at Chicago comments: ‘There wasn’t prolonged inflation with unemployment at 3.5%. Why would it be prolonged when, apples-to-apples, it is double that?’

Kenneth Judd at Stanford points to a source of uncertainty: ‘It is unclear if current conditions indicating overheating, such as the so-called labour shortage, are temporary or important beyond summer.’ And Larry Samuelson at Yale returns to the issue of uncertainty about expectations: ‘It is remarkable that inflation has hitherto been mild. It might be temporary, but inflationary expectations are hard to dampen.’

Richard Thaler at Chicago cautions: ‘Any strong opinion is misplaced.’ And Eric Maskin at Harvard concludes: ‘There appears to be significant disagreement among experts on this point. I don’t know enough myself to say one way or the other.’

Daron Acemoglu at MIT is uncertain about how the statement describes potential inflationary dangers: ‘Inflation is undoubtedly more likely now than it has been for 20 years. But the qualifiers “serious” and “prolonged” are too strong.’ This perspective is shared by Richard Schmalensee at Yale, who disagrees with the statement, arguing: ‘“Serious” and “prolonged” seem a reach.’

Several others who disagree suggest that monetary policy can react effectively should the need arise. Aaron Edlin at Berkeley says: 'Current policy does not by itself pose that risk because future monetary policy can be changed swiftly.' William Nordhaus at Yale concurs: 'Fed can and will react to prevent this syndrome were it to threaten.' And Robert Hall at Stanford, the only panellist to vote 'strongly disagree', states: 'Monetary policy is firmly committed to keeping inflation under control and has the means to do it.'

Similarly, Jose Scheinkman at Columbia notes: 'Prolonged higher inflation would require a very inattentive Fed.' And Barry Eichengreen at Berkeley comments: 'If "current combination" means accommodating monetary policy now but higher interest rates if higher inflation materialises, then why "sustained"?

Finally, James Stock at Harvard looks to potential risks further down the road: 'The risk is more at long horizons with our unsustainable debt path, than at one-two years.'

Notes:

- *All comments made by the experts are in the full survey results.*
- *This blog post expresses the views of its author(s), and do not necessarily represent those of LSE Business Review or the London School of Economics.*
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