The risks of prolonged higher inflation

With consumer prices rising at the fastest pace for three decades, what are the risks of prolonged higher inflation as a result of the current stance of fiscal and monetary policy, and what is the likely impact of an easing of supply bottlenecks? **Romesh Vaitilingam** *sums up the views of a panel of US economists on these two issues. The experts were asked whether they agreed or disagreed with two statements, and, if so, how strongly and with what degree of confidence.*

Statement 1: The supply bottlenecks that are currently contributing to rising prices can be reasonably expected to abate without causing inflation over the longer term to be above the Fed's target.

Of our 43 experts, 41 participated in this survey. On the first statement, weighted by each expert's confidence in their response, 55% agree, 34% are uncertain, and 11% disagree. The short comments that the panellists are able to include when they participate in the survey provide a variety of perspectives on the potential effects of current supply bottlenecks on inflation over the longer term.

Among those who agree that inflationary pressures can be expected to abate, Austan Goolsbee at Chicago remarks: 'The steady state for a manufactured good is not shortage.' Carl Shapiro at Berkeley says: 'Temporary supply constraints cannot cause long-term inflation. People should indicate a time frame when they say "long term".' Darrell Duffie at Stanford comments: 'I agree because (a) the supply-chain disruptions are not permanent and (b) the Fed will eventually act.' Robert Hall at Stanford adds: 'That is the Fed's job.'

Pete Klenow at Stanford directs us to some further reading with a consensus view on inflation prospects: 'In the latest Survey of Professional Forecasters, PCE inflation is expected to average 2.3% from 2021-2030.' David Autor at MIT also agrees but with a caveat: 'The supply bottlenecks will likely abate, but I doubt that this alone will resolve the inflation threat.' And William Nordhaus at Yale, who disagrees, explains why: 'Depends upon the wage response and expectations, as well as Fed timing.

Several participants who say that they are uncertain make reference to inflation expectations. Larry Samuelson at Yale notes: 'The supply bottlenecks will abate, but expectations or other adaptations to inflation may then cause inflation to persist.' Richard Schmalensee at Yale concurs: 'Bottlenecks can reasonably be expected to abate in the near term, but longer-term impacts on expectations are uncertain.' And Anil Kashyap at Chicago states: 'The inflation is here, future expectations could shift, indexing could re-emerge (see John Deere union contract), no way to be certain.'

Similarly, Robert Shimer at Chicago warns: 'Supply bottlenecks will abate unless new barriers are created. But current adverse supply shocks may still lead to persistent inflation.' And Aaron Edlin at Berkeley concludes: 'Inflation might be temporary if its causes are temporary. But inflation does tend to cause inflation.'

Statement 2: The current combination of US fiscal and monetary policy poses a serious risk of prolonged higher inflation.

The second statement concerns the potential inflationary effects of the current stance of fiscal and monetary policy. Weighted by each expert's confidence in their response, 5% strongly agree with the statement, 48% agree, 35% are uncertain, 8% disagree, and 5% strongly disagree (the totals don't always sum to 100 because of rounding).

We asked the same question in June this year: at that time, 33% agreed with the statement, 36% were uncertain, 26% disagreed, and 4% strongly disagreed. So while the share that is uncertain has remained at just over a third, the share that agree has gone from a third to over a half; and the share that disagree has gone from just under a third to less than an eighth.

Several panellists who agree with the statement comment on the role of the Fed. Markus Brunnermeier at Princeton says: 'The outcome will depend on the Fed reaction function and future fiscal policy.' And David Autor notes: 'The Fed erred correctly on the side of labour market recovery over inflation risk. Inflation risk is now inflation reality. Recalculating…'

Ray Fair at Yale points us to his own analysis of the issue: 'I have a recent paper, "What Do Price Equations Say About Future Inflation?", which has higher inflation predictions than the Fed expects.' Pete Klenow adds: 'This is why markets expect the Fed to eventually tighten', providing us with a link to the Atlanta Fed's market probability tracker.' And Eric Maskin at Harvard refers to fiscal policy: 'There are indeed inflationary risks, but the infrastructure act and the Build Back Better bill may help ease long-term inflation.'

Others who agree with the statement are concerned about our collective lack of experience of inflation in recent times. Robert Shimer notes: 'We have no recent experience in an environment with unanchored inflation expectations.' Michael Greenstone at Chicago comments: 'Source of inflation is uncertain but current policy mix seems to assume too low probability that monetary/fiscal policy can make it worse.'

Among experts who say that they are uncertain, Jose Scheinkman at Columbia says: 'Would agree, if current fed funds rate and rate of asset purchases are maintained even if inflation fails to abate, but not otherwise.' Richard Schmalensee observes: 'I agree that current policy is too expansionary, but the Fed is shifting, and the statement seems way too strong.'

Kenneth Judd at Stanford, who is also uncertain, notes: 'Inflation dropped as deficits rose in the 1980s. Increases in money did not ignite inflation after 2008.' In a related comment, Larry Samuelson, who agrees with the statement, adds: 'Our old models suggest that massive deficits eventually beget inflation. But, this has not happened yet, so perhaps we need new models.'

Finally, William Nordhaus, who strongly disagrees with the statement, explains: 'The Fed has the tools and the will, but it may take time because of inertia coming out of years of low inflation.'

- *The survey is conducted regularly on different topics by The Initiative on Global Markets, of the University of Chicago Booth School of Business. All comments made by the experts are in the full survey results.*
- *This blog post first appeared at LSE Business Review.*
- *Featured image by engin akyurt on Unsplash*

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Note: The post gives the views of its authors, not the position USAPP– American Politics and Policy, nor of the London School of Economics.

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About the author

Romesh Vaitilingam – *Economics Observatory.*
Romesh Vaitilingam is an economics writer and communications consultant and editor-in-chief of the Economics Observatory. He is also a member of the editorial board of VoxEU and manages the IGM Forum surveys of economic experts. Romesh is the author of numerous articles and several successful books, including The Financial Times Guide to Using the Financial Pages (FT-Prentice Hall). As a specialist in translating economic and financial concepts into everyday language, Romesh has advised a number of institutions, including the Royal Economic Society, the Centre for Economic Performance at LSE and the Centre for Economic Policy Research. In 2003, he was awarded an MBE for services to economic and social science.