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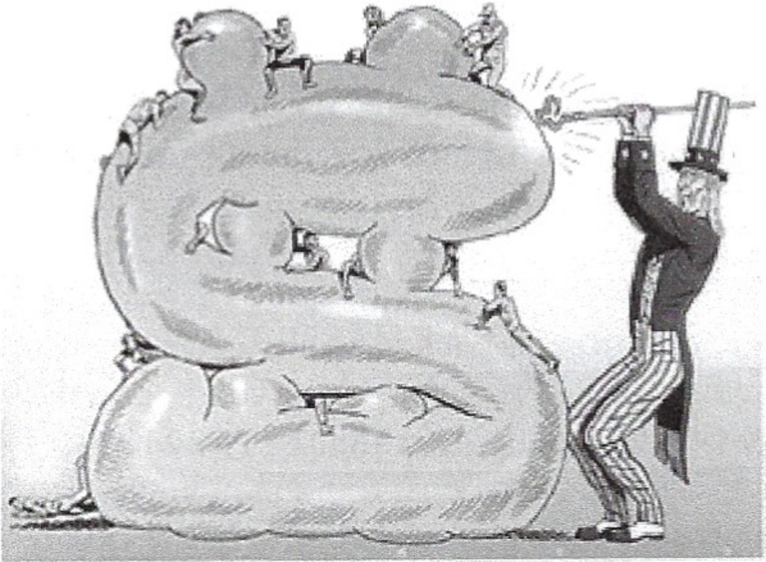
Biden-era high prices persist even as the Fed slows the rate of increase. Trump should take note.



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The Economy Is Still Inflated

By Mickey D. Levy And Michael D. Bordo

The Federal Reserve has slowed inflation, but many Americans continue to pay a high price for the cumulative inflationary consequences of excessive monetary and fiscal stimulus.

We wrote in these pages in February 2021 that, based on history, high deficits combined with expansive monetary policy would trigger accelerating inflation. Joe Biden's $1.9 trillion American Rescue Plan was close to being enacted, but we never imagined that the Fed would maintain zero interest rates and continue its massive purchases of assets until March 2022, almost a year after inflation first began to surge. Today's economy is still suffering from these policy excesses.

There's a big difference between the rate of inflation, which measures the percentage change in the prices of all goods and services, and the actual price level consumers currently pay, which is the accumulation of

past inflation. The Fed focuses its attention on achieving its dual mandate of 2% inflation and maximum employment. Meanwhile, it has no strategy to address the fact that the compounding of past inflation has raised consumer prices dramatically: The consumer-price index is about 22% higher than its pre-pandemic level. This is higher than the 19% rise in the Fed's favored personalconsumption- expenditure price index, but the latter measure understates the increases in consumers' out-of-pocket expenses by including items financed by third-party payers, such as Medicare, Medicaid and employer- provided health insurance.

Research by Fed staffers and other economists attributes the high inflation primarily to transitory supply shocks during the pandemic. But supply bottlenecks have now disappeared, and price levels remain well above the level that would be consistent with their pre-pandemic trajectory. It's clear that excess demand generated by pandemic-era stimulus checks and extended monetary easing contributed significantly to the high inflation. Continued strong demand has led to healthy economic growth that exceeds the Fed's estimates and sticky inflation that remains above the Fed's target. Ironically, while the Fed characterizes its monetary policy as restrictive, the Federal Reserve Bank of Chicago's Financial Conditions Index shows " looser-than-average" financial conditions.

Even as economic growth creates new jobs and workers' wage gains begin to exceed inflation modestly, many middle- and lower-income earners have fallen behind as higher prices eat up larger shares of their incomes. According to the Bureau of Labor Statistics, the costs of shelter, food and energy are up about 25%, 27% and 25%, respectively, since the

onset of the pandemic. The 34% of Americans who rent their homes take little solace in new alternative measures of "core inflation" that omit the cost of housing.

The Case-Shiller National Home Price Index reports that house prices have risen more than 50% since year-end 2019, making homeowners wealthier. Besides driving up rental costs, this increase, along with the normalization of bond yields and mortgage rates, has set back a generation of prospective home buyers. Even as economic growth creates new jobs, higher prices lower Americans' living standards.

Would different policies have made a difference? Definitely. Imagine if a trimmed-down American Rescue Plan had efficiently targeted financial support to the unemployed and those who really needed it, rather than issuing up-to-$1,400 checks to 165 million eligible Americans, most of whom were employed. After all, by April 2021, robust economic recovery had lowered the un--employment rate to 6.1% from a high of 14.8% the previous year.

Also imagine that the Fed had ended its massive purchases of U.S. Treasurys and mortgage-backed securities and started raising rates in mid-2021, when inflation and inflationary expectations first started rising well above 2% and the housing market was booming. Mortgage and consumer interest rates would have adjusted up accordingly. Growth in demand would have moderated, limiting inflation, halting the surge in home prices and rental costs, and slowing the rapid rise in consumer prices. Even with relatively slower economic growth, America would have been far better off.

Chalk the surge in deficit spending up to the exuberance of the newly elected Mr. Biden, who interpreted his victory as a mandate to transform America. Even as the American Rescue Plan checks were being distributed, Mr. Biden proposed further dramatic increases in spending, taxes and federal debt as part of his Build Back Better agenda. These expansions would have likely gone through had Sen. Joe Manchin not vigorously opposed them.

We hope these lessons aren't lost on President-elect Trump, who, like most new presidents, reads his electoral victory as a mandate for radical change. We urge him to take a cautious approach on tariffs, spending, taxes, regulations and immigration. Misguided policies with unintended outcomes can quickly lose public support.

We understand that revisionist history is speculative. But such an exercise is nevertheless instructive for future economic and monetary policies.

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