Federal Financial Analytics, Inc.

MEMORANDUM

TO: Federal Financial Analytics Clients

FROM: Karen Petrou

DATE: August 1 2022

As seems increasingly the case, I spent more time last week than hoped with airport personnel. In the course of the economic-inequality discussion that prompted my travels, I mentioned that I had little confidence in the general-public inflation expectation data in which economists put such stock. So, I asked my aide what she thought and was told that her biggest fear is the "rising price of the dollar" and whether she will thus be able to afford her apartment and get her kids ready for school. The airport was packed and she is turning down overtime, but she has to take care of her kids and day care costs are higher than even more pay can manage. Pressing on, I got only a blank stare following mention of the Federal Reserve but then heard a diatribe about useless politicians including those she no longer thinks care for anyone but themselves. I think this lady's views are emblematic of lower-wage workers who once were active voters and thus also an important warning signs not only of how unequal economies work at odds with the Fed's macro models, but also of the outcome of the election this year and, should things only get worse, then in 2024.

I decided not to waste time by asking Kisha (not her real name) to agree that the recession is just an illusion because all the data boxes have yet to be checked as the President, Treasury Secretary, and Fed chairman insist. It's hard to think of a greater disconnect between economic policy and economic reality than when public officials assure Americans everything will be fine even as household with employed individuals are cutting back essential purchases, going even more deeply into debt, and hearing more and more about shorter hours and even layoffs.

When the Fed's models-based approach failed to function during the 2010s, the central bank announced that its would henceforth be "data driven." This seemingly "just-the-facts-ma'am" construct might have worked in the 2020s but for the fact that the Fed is driven only by the data is malfunctioning models like the best. See for example how the Fed measures inflation without regard to food and energy prices or meaningful housing costs even though these determine what people and companies decide to do each day they wake up and head out into the real economy. See also the Fed's preferred measure of employment, which makes it look good because high rates of labor non-participation and stagnant real wages are conveniently omitted. See my book for many vital distributional data points that the Fed finally collects but still ignores. And, now, see even the arcana of matters such as the neutral rate, set principally and perhaps even instrumentally as the Fed thinks best suit public communication.

In 2014, the Obama Administration and its central bank believed with some justice that they brought the financial system back from the brink and salvaged the real economy. However, as ultra-low rates and QE grew long in the tooth, voters saw the slowest recovery since the Second World War, fast-rising financial markets, a growing number of plutocrats, and a shrinking number of jobs paying

2101 L Street, N.W. – Suite 300
Washington, DC 20037
Phone: 202.589.0880

E-mail: info@fedfin.com
Website: www.fedfin.com

anything close to living wages. In that year's midterm, they voted out Senate Democrats, giving the GOP control over the Congress.

In 2016, Hillary Clinton adopted the Fed's macroeconomic mantra that the economy was a "good place," again echoing the "look what we did for you theme" the White House and its Treasury also lauded. Of course, she lost – narrowly, but still. Black people whose economic lives were as bad as they had been before the civil-rights era stayed at home and lower-income white voters rocked to Donald Trump's "they done-you wrong" serenade.

Joe Biden triumphed in 2020 in part because he ran a campaign acknowledging economic inequality. Now, the White House and Treasury talk a lot about racial equity, social justice, and other equitable ideals, but the economy itself has made the United States the least equal it's been in decades. Nominal wages are up and middle-class wealth grew thanks to house-price increases and fiscal stimulus, but inflation robbed households of much of that short-lived financial security even as it ripped the Fed's omniscient mantle away to reveal a central bank in a state of acute confusion.

Expecting voters to reward the team that brought them to this frightening predicament is like believing you'll to thanked after you've just spilled ketchup all over the diner seated next to you. Perhaps with just a little ketchup and a lot of charm you might get away with a gracious apology or – the usual political tactic – you could blame the server. But, telling your companion that her dress looks even better than when she walked in is a losing strategy not just in terms of what the Biden Administration hopes in November, but also what the Fed is trying to achieve still more quickly.