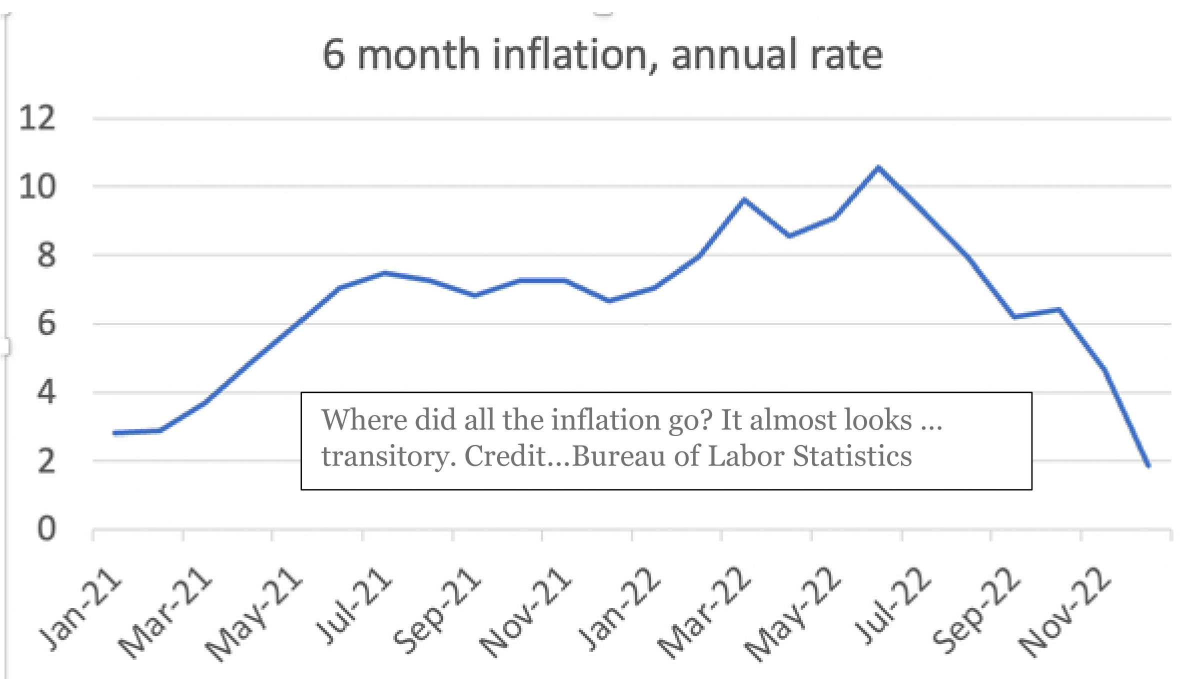
Stagflation or Soft Landing? It Depends Who You Ask.

By Paul Krugman
Opinion Columnist

Let me start with a picture, which will help frame the debate I'm about to describe. Here's official consumer price inflation, measured over the previous six months but converted to an annual rate, since the beginning of the Biden administration:



Where did all the inflation go? It almost looks … transitory. Credit...Bureau of Labor Statistics

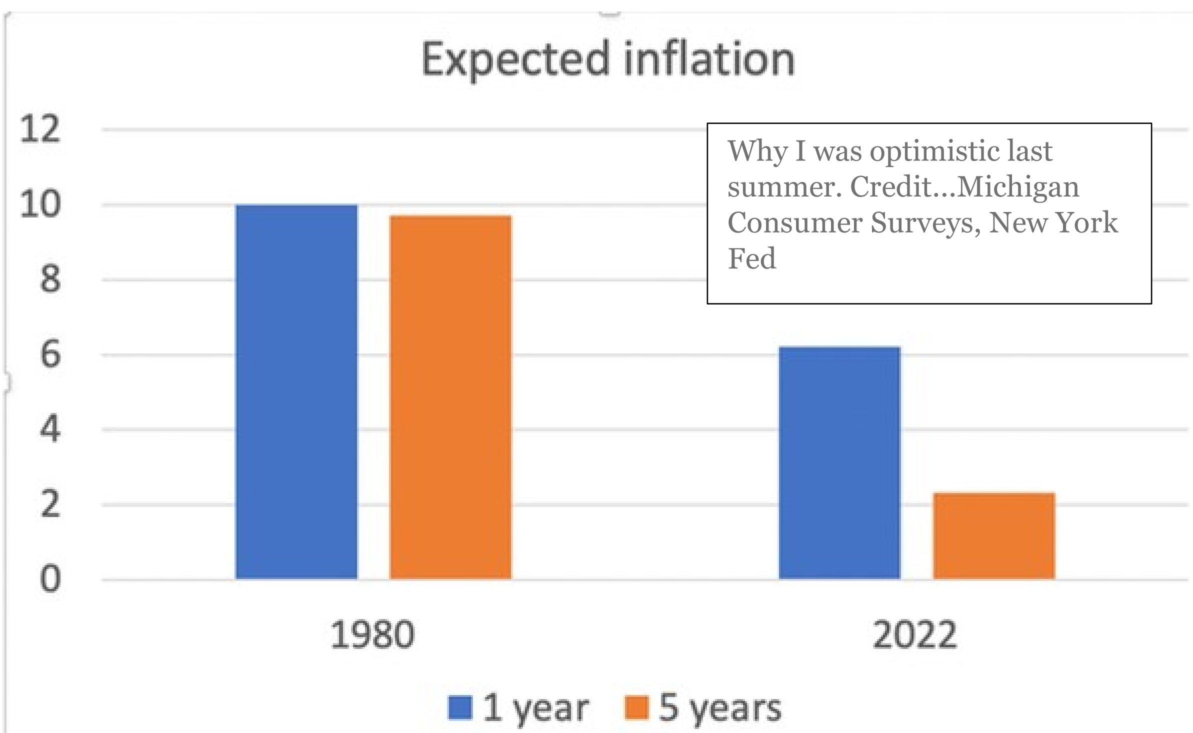
Why six months? It's a compromise. Monthly numbers are too noisy: Official inflation was actually negative in December, but everyone considers that a blip. On the other hand, while news reports often cite price changes over the previous year, those numbers seem to lag too far behind a rapidly changing economy.

So, about that debate: In early 2021 some economists, most famously Larry Summers, warned that the Biden administration's big spending package would be highly inflationary. Others — myself included, unfortunately — downplayed that risk. And as inflation accelerated over the course of 2021, we initially argued that a large part of the story involved “transitory” factors, like a shortage of shipping capacity as the world recovered from the economic effects of the Covid-19 pandemic, and that inflation would soon reverse.

But inflation just kept rising. Team Transitory was proved wrong, and I admitted as much.

At that point, however, the debate shifted. High inflation had happened, but how hard would it be to get it down again? Again, economists took sides.

One side — call it Team Stagflation — argued that it would take years of pain and high unemployment to restore price stability, which is what happened after the high inflation of the 1970s.
The other side, call it Team Soft Landing, argued that the situation was very different this time. The conventional view among economists is that disinflation was so hard in the 1980s because high inflation had become entrenched in expectations, with companies setting prices and wages based on the belief that inflation would stay around 10 percent for the foreseeable future. In mid-2022, however, both surveys and prices in financial markets showed a widespread expectation that inflation would soon fall back to normal levels. Here’s a graph I put in my newsletter last summer:



Why I was optimistic last summer. Credit...Michigan Consumer Surveys, New York Fed

So Team Soft Landing argued that disinflation wouldn’t actually be that difficult and needn’t involve a huge surge in unemployment.

Well, as you can see from the first picture in this newsletter, official inflation rolled over in the middle of 2022, and has fallen even faster than it rose. Notably, this has happened without any significant rise in unemployment, at least so far.

This good news has led to a big role reversal in how economists talk about the situation. At this point, pessimists are arguing that the rapid decline in inflation reflects, well, transitory factors, rather than a fundamental reduction in inflation pressures. And to be fair, recent inflation numbers have been held down in part by one-time events that probably won't continue, like falling gasoline prices and the plunging price of used cars.

On the other hand, a huge factor in recent inflation data has been high rates of increase in the official cost of shelter, which in turn mainly reflects rental rates. But this official measure lags around a year behind rents paid by new tenants — which surged in 2021-22 but have been falling in recent months.

So where does that leave us? I'd say that these various temporary factors are more or less a wash, and that underlying inflation really has come down a lot; the inflation surge may not be completely behind us, but there's good reason to believe that we can restore price stability without huge economic pain.

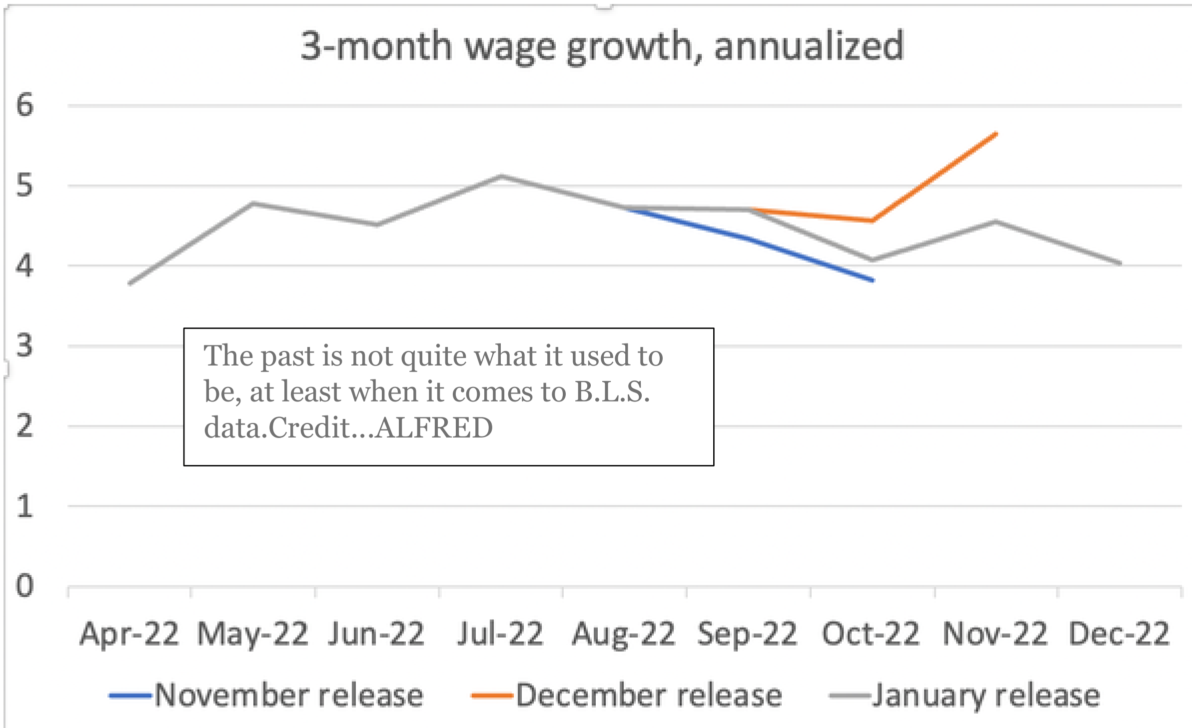
But then I would say that, wouldn't I?

To get meta for a bit here, one disturbing aspect of recent economic debate has been the consistency of many economists' positions despite rapid changes in the economic situation: Optimists are always optimists, pessimists always pessimists. And I have to admit that I personally am part of this pattern.

Given the tendency to choose data that reinforces one's prejudices, I've become nervous about using "artisanal" inflation measures that try to exclude data that may well be misleading. Can we trust people, myself included, not to pick the measures they like?

For a while I thought I could avoid this issue by focusing on growth in wages, a broad measure of how hot the economy is running. But this approach has problems, too. For one thing, the craziness of the post-pandemic economy has reshuffled the mix of high- and low-wage jobs, distorting the averages.

Beyond that (although possibly related), recently the Bureau of Labor Statistics has been making big revisions to past estimates — big enough to cause large changes in the narrative. Here's the three-month change in average hourly earnings, as reported in three successive data releases:



The past is not quite what it used to be, at least when it comes to B.L.S. data.Credit...ALFRED

The November release (the blue line) seemed to show a clear pattern of slowing inflation. Yay! Then, in December, the B.L.S. not only released a higher wage number but revised older numbers up so that the new trajectory (the red line) seemed to show inflation getting worse. Aarrgh! And then, in January, it revised the numbers again — the gray line — and the inflation trajectory looked better again. Um …

So I spent this morning trying not to drink too much coffee, waiting for the release of the Employment Cost Index, which tries to correct for changes in the job mix and is probably the best measure we have of wage pressures. And it was good.

It shows overall wages and salaries rising at a 4 percent rate, only a bit higher than they were prepandemic. Diving into the details, things look a bit better, if anything. As Mike Konczal, a leading member of Team Soft Landing, put it: “The Fed has lost its excuse for a recession.”

No doubt this debate will continue, as economic debates tend to. But I think we’re approaching the point at which Team Stagflation will have to do what Team Transitory did a while back: admit that they got it wrong, and try to figure out why.