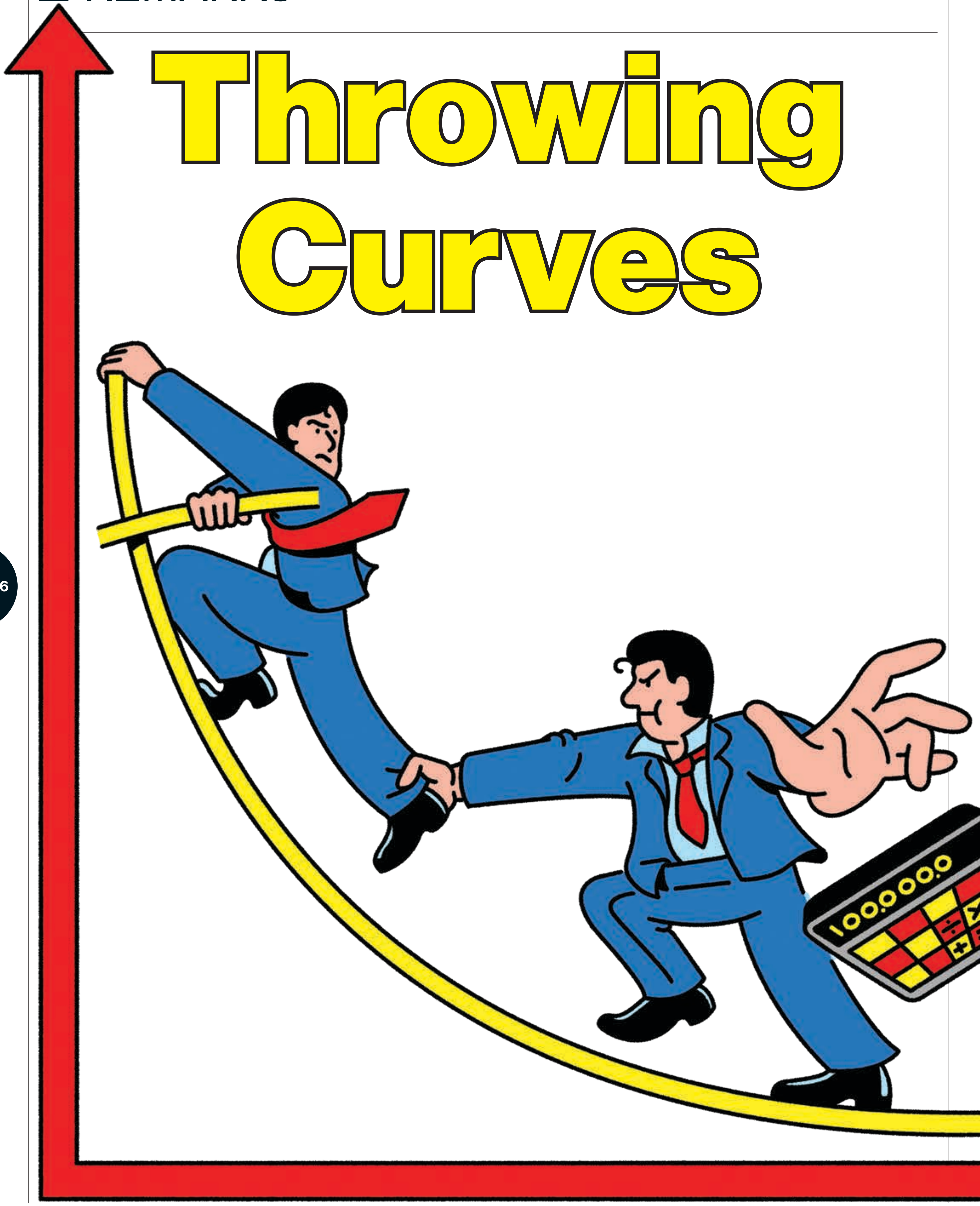
Throwing Curves



● The real winner in a tussle over an 80-year-old theoretical model is the US economy

● By Enda Curran

What weapon does an economist take to a street fight? A curve, of course.

A staple of economic models, curves can also be repurposed as cudgels. Over the past 18 months, two groups of distinguished economists have sparred publicly over the shape of the Beveridge curve, drawing commentary from the sidelines. Named after William Beveridge, the economist who's been dubbed the father of Britain's welfare state, the Beveridge curve maps the level of job vacancies in an economy against the level of employment. The relationship is simple, with the two generally rising or falling in tandem.

Over the past year and a half, Beveridge's economic model has been at the center of a debate that's played out in lecture halls, inside government offices and on social media over whether an overheated US economy can coast to a rare soft landing. In a July 2022 paper titled "Bad News for the Fed From the Beveridge Space," Larry Summers, the former US Secretary of the Treasury, Olivier Blanchard, who was chief economist at the International Monetary Fund, and Alex Domash of Harvard University argued that unemployment would need to increase materially for inflation to cool. Federal Reserve Board member Christopher Waller and Fed staffer Andrew Figura responded in a post on the central bank's website that their own research showed a meaningful decline in job openings—without an accompanying surge in joblessness—would do the trick.

It's too early to declare a winner, but 18 months in, the Waller camp is looking strong. The number of job openings has declined almost 27% from a pandemic peak of more than 12 million in early 2022, without a parallel drop in employment. Meanwhile, inflation as measured by the consumer price index has slowed to 3.4%, from a peak of 9.1% in June 2022.

"We are not quite there, but I would say, using a football analogy, that, at the end of the third quarter, the Waller team is definitely ahead," Blanchard acknowledged in an email. Summers, a Harvard professor and paid contributor to Bloomberg Television, hasn't conceded either, but his public pronouncements indicate a clear softening in his position. "I always said that soft landings were the triumph of hope over experience, but occasionally hope may triumph over experience," he said during a Jan. 11 appearance on Bloomberg TV.

The shift is mirrored among the larger universe of professional forecasters, most of whom have rescinded their recession calls in the face of consistently firm data. Among the latest to do so was Wells Fargo & Co., whose analysts put out a report on Jan. 12 that said "the facts have compelled us to change our minds."

Those facts show American households and businesses continue to fare better than expected in the face of the highest interest rates in more than two decades. Retail sales rose 0.6% in December, defying expectations that this year's holiday shopping season would disappoint. The University of Michigan's consumer sentiment index jumped 9.1 points in January, the biggest monthly advance since 2005. Big employers such as Amazon.com, Google and Macy's have announced job cuts, yet small-business owners list worker shortages as one of their primary concerns in an index compiled by the National Federation of Independent Business.

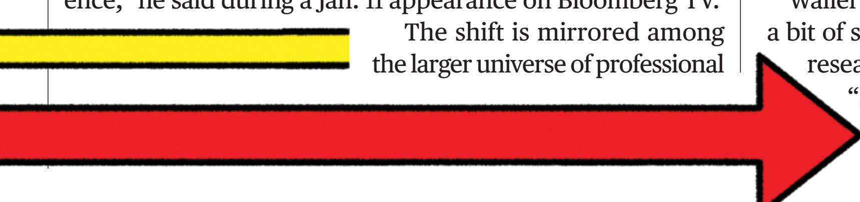
Randy Carr, who runs the biggest maker of emblems and patches in the world for clients including those that need uniforms for their workers, says his order books don't give any sign of weakness in the jobs market. "We don't see a drop-off at all," says Carr, chief executive officer of World Emblem, whose clients include Aramark, Levi Strauss and the NFL. "We know people are hiring when the workwear orders come in and they start putting clothes on new employees. That gives us confidence."

Even as recession worries recede, economists are still struggling to make sense of the last few years. Those who held that price pressures would subside as pandemic-era disruptions to supply chains and the job market faded were dismissively tagged as "Team Transitory" by peers who argued that inflation would prove more pernicious because it was a manifestation of structural shifts in the economy that would continue to drive wages higher.

Vindicated by rapidly cooling inflation, some members of Team Transitory now wear the badge proudly. "The inflation that we had in the last couple of years is supply-driven inflation, not the old 1970s demand-driven inflation," says Dale Rogers of Arizona State University, who's spent decades studying supply lines.

Diane Swonk, chief economist at KPMG LLP, acknowledges that macroeconomists have had their reputations tested over the last few years, but those who made the right calls should refrain from crowing. "I don't know anyone out there who expected the US economy to accelerate in the wake of the most aggressive credit tightening since the 1980s—that is humbling, and it is a wonderful thing," she says. "To see inflation come down at one of its fastest paces outside of a recession or after a major war, those are wonderful things. Take the win, but also do it with humility, because the hubris is where the problems come in."

Waller in a Jan. 16 speech appeared to indulge himself in a bit of self-congratulation. Alluding to the Beveridge curve research he and Figura presented in mid-2022, he said: "How has our prediction fared? Data received since then have supported our argument." In Fed circles, that might be as close as you get to a mic drop. Ⓑ



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