WHAT'S INSIDE

Dean, Sykes College of Business

> Tampa Bay Forecast: A Tale of Two Tampa

Is the U.S. Economy Headed for a "Hotter but Shorter" Expansionary Cycle?

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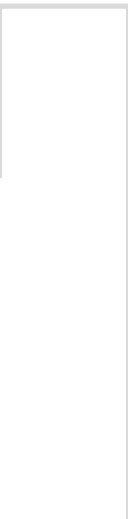
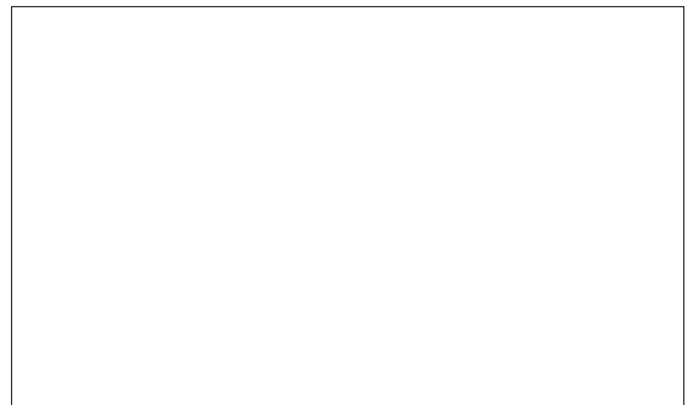
financial sector and a rapidly improving labor market.

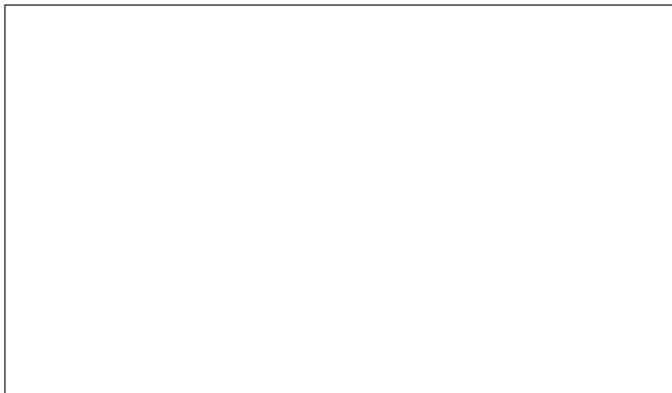
While economists wait for an official confirmation of the end date for the pandemic recession from the National Bureau of Economic Research (NBER), it is quite apparent that the U.S. economy entered a new expansionary phase sometime in the third quarter of 2020. The pandemic recession was clearly a deep but very brief recession. As the U.S. embarks on a new expansion phase, it is necessary to highlight a few crucial distinctions between the previous business cycle and the current one. While the post-financial crisis recovery was notable for its duration (the expansion was the longest on record – it lasted 128 months (June 2009-February 2020)) as well as for its sub-par growth performance (real GDP growth rate averaged around 2.2% during the period), there is a distinct possibility that the current business cycle expansion phase is likely to be shorter but hotter (average GDP growth rate is expected to be higher).

Following a year of curtailed spending options due to the pandemic (and associated social distancing measures and government lockdowns), the saving rate rose sharply amongst upper-income households. The largest fiscal stimulus measures outside of war times led to unprecedented levels of transfers to low and middle-income households. Consequently, overall U.S. personal saving spiked and remains elevated (**2**). The Federal Reserve's ultra-accommodative monetary policy stance helped engineer a rapid recovery in equity and real estate values and bolstered the balance sheet of American households ( ). Excess savings and healthy consumer balance sheets imply a faster recovery, and the recent surge in U.S. retail sales ( ) does indicate robust consumer demand. In contrast to the 2007-09 financial crisis and its aftermath, when households were engaged in an extended period of deleveraging, the post-pandemic recovery phase is likely to be characterized by a much faster turnaround in aggregate demand.

Another critical difference between the current recovery and the one experienced in the aftermath of the financial crisis is the scale and nature of policy interventions. Fiscal policy response to the pandemic shock was notable both for its alacrity and its sheer magnitude (which stands in sharp contrast to the response observed during and after the 2007-09 financial crisis). The major stimulus measures undertaken so far include: the $2.2 trillion CARES Act (2020), the $483 billion Paycheck Protection Program and Health Care Enhancement Act (2020), the $920 billion Consolidated Appropriations Act (2020)







and the $1.9 trillion American Rescue Plan (2021). The dramatic increase in federal government expenditure ( ) not only put a floor under the U.S. economy during the initial phase of the pandemic shock but also set the stage for a rapid recovery. If the Biden administration's infrastructure spending plan and proposals to rework the social compact were to pass (even in limited form) later this year, it may add further fuel to the already red-hot U.S. economy.

The Federal Reserve acted promptly and aggressively in March and April of 2020 to stabilize the financial system and it ensured the availability of sufficient liquidity. The central bank was aided in its efforts by the fact that leading U.S. financial institutions, unlike the scenario in the leadup to the 2007-09 financial crisis, had much healthier balance sheets this time around. The Federal Reserve also restarted its large-scale asset purchase program in response to the pandemic shock (see). During the 2007-09 financial crisis and the subdued recovery that followed, the Federal Reserve engaged in large scale asset purchases that saw its balance sheet expand from $870 billion in August 2007 to $4.5 trillion in early 2015. This time around the speed of the central bank's balance sheet expansion was truly extraordinary – it rose from around $4.2 trillion in February 2020 to around $7 trillion in September 2020. The Federal Reserve has also stated that it intends to keep policy rates near zero until the end of 2023 despite projections for robust economic growth in 2021 and 2022.

In the aftermath of the 2007-09 financial crisis, household and financial sector deleveraging hindered the pace of economic recovery. Furthermore, inadequate fiscal support and its premature withdrawal also adversely affected recovery prospects. Equity and, especially, real estate prices took a relatively long time to recover in the crisis aftermath. The underwhelming post-financial crisis recovery led Harvard economist, Lawrence Summers, to famously suggest that the U.S. had entered an era of secular stagnation characterized by sluggish growth, persistently low interest rates and absence of inflationary pressures.

This time around, with strong household and bank balance sheets, record levels of fiscal stimulus, and a rapid recovery in asset prices, the key debate is regarding the possible overheating of the economy. Many are wondering if the expected surge in consumer spending will lead to a positive aggregate demand shock that, at least, temporarily overwhelms supply. Concerns are also being expressed about a potential inflationary spike that, instead of being transitory, may in fact signal a new era in which inflation remains at elevated levels. This stands in sharp contrast to fears of deflation that was widespread amongst central bankers in the aftermath of the 2007-09 financial crisis.

In the current context, Federal Reserve officials and many in the Biden administration are willing to risk temporarily overheating the economy in order to generate a substantial improvement in the labor market. The avowed goal being to aid the labor force reentry of underprivileged and marginalized sections of society. The underlying assumption is that a high-pressure economy will boost economic mobility. High-pressure economy refers to the scenario where output is maintained above its potential level in order to push capacity utilization rates temporarily above their long-run sustainable levels. In the early 1970s, Arthur Okun contended that a high-pressure economy with a low unemployment rate would trigger skill-upgrading, boost labor productivity and raise wages and force firms to expand their labor search pool (Okun, 1973). Surging inflation in the 1970s forced advocates to abandon their pursuit of a high-pressure economy, as curtailing rapidly surging inflation took precedence over stoking aggregate demand. Starting in the 1980s, consensus regarding macroeconomic policy goals shifted dramatically: emphasis was placed on achieving and maintaining price stability, and monetary policy was given top billing (and fiscal policy effectiveness was downplayed) when it came to undertaking policy interventions aimed at moderating business cycle fluctuations.

Recently, however, Okun's high-pressure economy hypothesis has regained some prominence. The failure of substantial Federal Reserve support to reinvigorate growth in the aftermath of the financial crisis and the apparent (albeit short-lived) success of Trump's aggressively expansionary fiscal policy in 2017-18 led many to reconsider the efficacy of fiscal policy vis-à-vis monetary policy. Furthermore, just prior to the March 2020 pandemic shock, the decline in U.S. unemployment rate to a near fifty-year low of 3.5 percent failed to generate inflationary pressures. Importantly, there

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was a noticeable improvement in the employment prospects of less-advantaged groups. The U.S. experience of 2019 and early 2020 has led many

revenue contractions following the COVID-19 outbreak, suggest that debt overhang during the COVID-recession could lead to an up to 10 percent decrease in growth for firms in industries most affected by the economic repercussions of the battle against the outbreak."

The Federal Reserve bears primary responsibility for some of the structural and financial distortions.

Given the size and speed of the central bank's balance sheet expansion, some distortions in asset markets were inevitable. The problem, however, is being compounded by the central bank's insistence on continuing with further liquidity injections (the Federal Reserve is still buying U.S. Treasury Securities and Mortgage-backed Securities at a rate of around $120 billion per month) even as the economic rebound gains momentum and as equity and home prices surge towards all-time record highs. Emergence of micro-bubbles involving crypto-currencies and non-fungible tokens (NFTs) and the explosive growth of SPACs (blank check companies that raise funds through initial public offerings (IPOs) in order to purchase private firms) offer clear evidence of excess liquidity in the system.

Furthermore, under its recently adopted Average Inflation Targeting (AIT) framework, the Federal Reserve has committed to keeping rates near zero (the Effective Lower Bound (ELB)) for an extended period of time even if inflation exceeds its target level. In a recent speech (*"The Federal Reserve's New Framework and Outcome-Based Forward Guidance,"* April 14, 2021), Vice-Chairman Richard Clarida summarized the Federal Reserve's new approach: *"First, the Committee expects to delay liftoff from the ELB until PCE inflation has risen to 2 percent and other complementary conditions, consistent with achieving this goal on a sustained basis, have also been met. Second, with inflation having run persistently below 2 percent, the Committee will aim to achieve inflation moderately above 2 percent for some time in the service of keeping longer-term inflation expectations well anchored at the 2 percent longer-run goal. Third, the Committee expects that appropriate monetary policy will remain accommodative for some time after the conditions to commence policy normalization have been met."*

The unprecedented increase in M2 money supply (see) during the past year has the potential to provide a large upside surprise on the inflation front. A decline in the velocity of money (the turnover of money), driven by a spike in precautionary money demand during the initial pandemic phase, has so far limited the impact of the dramatic increase in broad money supply (Jayakumar, 2021). There is, however, a possibility that the velocity of money will spike during the second half of this year as the unleashing of pent-up demand leads to a surge in transactions volume.

The former chief economist of the IMF, Olivier Blanchard, recently highlighted the risk posed by Federal Reserve's current inflation stance: *"If inflation were to take off, there would be two scenarios: one in which the Fed would let inflation increase, perhaps substantially, and another—more likely—in which the Fed would tighten monetary policy, perhaps again substantially. Neither of these two scenarios is ideal. In the first, inflation expectations would likely become de-anchored, cancelling one of the major accomplishments of monetary policy in the last 20 years and making monetary policy more difficult to use in the future. In the second, the increase in interest rates might have to be very large, leading to problems in financial markets"* (Blanchard, 2021).

While the Federal Reserve and the Biden Administration are to be commended for taking a proac (-ruelyuspie toideading withractial)-9.9 ( )]TJ T*[and

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How does the current pandemic recession compare with the financial crisis or Great Recession of 2007-2009? In this update, we will compare the recessionary impacts on the Tampa Bay metropolitan area (consisting of Hernando, Hillsborough, Pasco and Pinellas counties combined) from the current recession to that of the Great Recession. We will compare the impacts of each on local employment, housing and aggregate spending. With almost a year of pandemic data, we see a very sharp though short decline in these markets and what appears to be an impressive economic recovery well underway in Tampa Bay.

Consider the labor market. **2.1** shows the unemployment rate for both the U.S. and the Tampa Bay economy (TBE). In March 2020, the U.S. rate peaked at 14.8 and the TBE at 13.5. They dropped a year later to 6.0 and 4.6, respectively, in March 2021. The unemployment rate peaks from the Great Recession were lower at 9.9 and 11.9 and occurred in early 2010, well after the recession had ended. An after-recession unemployment peak had also occurred in the 2001 recession. As such, both recessions were given the appellation "jobless recovery." The sudden spike and subsequent decline in unemployment during the pandemic bodes well for a relatively quick job market recovery. But how far are we into a recovery? We gain additional insight into the jobs market by examining employment. Figure 2.2 shows the percentage difference in total nonfarm jobs compared to the month prior to the recession – that is, 1.4 million nonfarm jobs in January 2020. While the Great Recession took nearly 82 months to regain its pre 1.4 million noed. Alillion no( )]n3the T

The differences in the labor market impacts for the two recessions is evident in retail sales.
2. shows the monthly gross sales (seasonally adjusted) in Tampa Bay from March 2006 to March 2021. Gross sales serve as our measure of aggregate demand in the TBE. The steady increases in unemployment during the Great Recession are mirrored by persistent Great

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