# A Shift in the Inflation Winds?

At the Fed, a lot of work has gone into anchoring inflation expectations in recent decades. As a result, our economy has seen, from the early 1980s until last year, an era of remarkably low and stable inflation — sometimes called "the Great Moderation."

During this period, the wind may have been at our backs when it came to containing inflation. Globalization, especially the rise of India and China, gave producers more access to lower-cost labor and gave consumers more access to lower-cost products. The explosive growth of e-commerce made price comparisons easier for consumers and cut costs for retailers. Fracking provided additional supplies of natural gas and oil. The labor force grew strongly, both from rising population numbers — via the baby boom and high levels of immigration — and from more women entering the workforce. And the federal government during this era ran relatively low deficits, meaning lower inflationary fiscal impulses.

Still another factor, usually unsung, is the rise of professional purchasing organizations in large firms, especially big-box retailers and large manufacturers. These exerted continual year-over-year pressure on costs, and consequently on prices. If you were a purchasing agent at, say, a major home improvement chain, your job every year was to grind out another few percent in expense savings. That's disinflationary.

These forces particularly influenced pricing for goods. Goods inflation for the 20 years ending in 2019 was low at 0.4 percent per year, while services grew at 2.6 percent a year, leaving core inflation near target at 1.7 percent.

But the Fed's success wasn't simply a matter of circumstance; it depended on recognizing those factors and adjusting. The best known such moment was probably in the late 1990s, when the Fed deferred interest rate increases, recognizing that productivity gains from technology would limit inflationary pressure.

Now, of course, the wind seems to have shifted. We've seen tariffs, the pandemic, and the Russian invasion of Ukraine lay bare the vulnerabilities associated with offshoring and a complex global supply chain. We are likely to see some deglobalization, as countries rethink their trading relationships. And firms may redesign their supply chains to prioritize resiliency, not just efficiency. All other things equal, these changes will likely mean higher costs over time.

We may also see long-term tightness in the supply of labor. Offshore labor may prove less available. At the same time, our population is aging. Birth rates are declining. We missed out on millions of immigrants during the pandemic. Unless we can find a way to reduce labor demand (for example, through automation) or increase participation (as Japan has done with older workers), a tighter labor market could also pressure wages, and in turn, prices.

Fiscal policy may also contribute to the headwinds. Government deficits have run at historic levels, and entitlement spending looks to grow further as the population ages. Climate transition could increase energy costs.

Should these trends persist, real forces will be more likely to create near-term inflationary pressure. As a consequence, our efforts to stabilize inflation expectations could require periods where we tighten monetary policy more than has been our recent pattern. You might think of this as leaning against the wind. Doing so would be consistent with our flexible average inflation targeting framework.

But it's a little early to make these judgments. Fed policymakers will watch for persistent headwinds and adjust how we navigate. Our target — 2 percent inflation — wouldn't change, nor would our longer-run ability to meet that goal. But we will remain open to altering the appropriate path to achieve it.

*A longer version of this essay was delivered as an address to the Money Marketeers of New York University on April 12, 2022.*