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Alan Blinder on Landings Hard and Soft: The Fed, 1965-2020

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Webinar Transcript

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Markus Brunnermeier: So welcome back everybody to another webinar organized by Princeton for everyone worldwide. We're very happy to have Alan Blinder with us today. Hi Alan.

Alan Blinder:
Hello.

Markus Brunnermeier: Great to have you, and Alan will talk about hard and soft landings today and describe what the Fed did from 1965 onwards. His presentation is based on his book, which is forthcoming, describing monetary and fiscal policy in the United States from the 60s onwards as well. So the big question–I think it's one of the biggest questions of our times, how to orchestrate a soft landing, given the high inflation numbers we are observing. And the question is soft in what–soft landing in what? Do we want to have a soft landing in GDP numbers and unemployment numbers or soft in inflation? Should the landing be soft in lending, so in a sense that you know, we want to make sure that credit lending is going down softly, and to what extent should be also soft for the financial conditions and asset prices, so that we will not have some havocs in the financial markets, so that's the first thing we have to answer: what should it be soft in? And then the second question is, to what extent is there a financial dominance, if you think there is an issue that there might be some potential difficulties in the financial markets. How should we consider that, is it like removing the “Fed put”? Is this actually causing some difficulties? Or should we not worry about the financial sector at all, and if you have to worry should be going more about the bond market or the housing market or the equity markets? And if there are some spillover effects from the financial markets back to the real sector, so if there is a hard landing and it leads to some difficulties in the financial sector, will it spill over to the real sector and cause some problems with GDP unemployment? And is it different between economies which are more bank dependent versus economies, which are much more dependent on financial markets like the U.S.? Do we have to think differently? And are conclusions from this, if you have this financial dominance, that we should move only in small steps? And what lessons have you learned and I think Yellen will tell us from the early 1990s bond crash and from the taper tantrum in 2013? So what lessons can be learned, and how should we behave differently and have a different strategy this time around? So how to soft land and how to do this, how to get some you know unconventional lending, given that we have so much unconventional measures still? That's the other questions, so how to create or orchestrate a soft landing? So we have (it seems like) forgotten the “Taylor Principle” which says that when the interest rate goes up or when inflation goes up, you should increase the interest rates more than one to one in order to satisfy the Taylor Principle. But the question is what inflation do you look at–the current inflation or the forward projection of the inflation? So that's one question but what about the Taylor Principle, should we just ignore it? Should we move in small steps, 25 basis points, or also in jumps, and if we move in jumps, how should we communicate it? Should we prepare the market for it? Should we move at the short end of the yield curve or the long end of the yield curve? There's this argument that we have actually a “Bear Flattening” that essentially we move the short end of the yield curve, but what matters is the five year or ten year interest rate, and there's no movement at the five or ten years, so should we do or undo some QE? Or just stop QE and then start quantitative tightening essentially, selling off some of the positions the Fed has. So that’s the short term versus long end of the yield curve, I think it's a very critical point. And how should we remove the “Fed put”, where the “Fed put” is some conditional promise that if something were to go wrong, the Fed will step in and help it up. So is the “Fed put” on the bond market, on a corporate bond market, on the stock market–is there such a “Fed put” and, if so, how to remove it? And how should this soft landing interact with other policies like this macro potential regulation? Should we make sure the banking sector and the financial sector is ready for such a big move? And how should they interact with fiscal policy? So these are all interesting questions. I think it's very exciting research topics coming up here and we dive into it with Alan in these dimensions. And then there's a totally other dimension, on top of it. How to make soft landing for the U.S., could it be implying hard landing for the rest of the economy, the world economy, the emerging economies, developing economies. There might be reversals in capital flows, it might be soft for the U.S., but not soft for especially the emerging economies, how to make sure that emerging economies also get a soft landing. What role will the BIS play, what role will the IMF play in order to capture that? So these are all interesting questions we're looking forward to looking back in history in the last 60-70 years: what happened in the U.S. and what can we learn from the past experiences so that you know we can better achieve a better soft landing this time around, and Alan proposed r some questions, the poll questions and let me just highlight a few of the answers you gave and, unlike other poll questions, most of the time, there is now correct answer or not. So it's more like a test, it is test questions. So how many soft landings has the Fed engineered since 1965: none, one, three, or it depends how you count. And Alan will tell us which answer is the correct one. I won't give it away, but just to give the answers you gave us, about 25% said none, then about 20% said one of them, three of them said about 9%, and the big majority is that actually 50% that it depends how you count, and the second question was: the Fed refused to raise interest rates aggressively as inflation arose in 1978, ‘77 to ‘79, changing only after Paul Volcker became the chairman of the Fed in August 1979. Is this true or false? And the maturity, more than 70%, 71% that it's true, the statement is true, and 29% that's false, and Alan will tell us whether the majority is right or not. And the final question is: the Fed actually reduced interest rates in 1980 because: inflation was already going down to 4%; the White House was not happy with that and that's why they decreased interest rates or credit controls caused recessions or Volcker was outvoted by the FOMC, and the answers were 22%, 20%, 33%, and 23%, so the majority got the most votes went to C, and so we will also see what happened. So with these opening remarks I pass it back on to Alan. He now will give us his perspective and also look back in history and explain what happened and the various tightening measures over the last 60 years. Thanks, Alan, glad to have you with us.

7:30
Alan Blinder: Thank you very much. I've been in the audience for a bunch of these things, I hope I can at least live up to the average of–I don't know what n is, it's a large number by now. And I should also thank Marcus for pushing me to do this. This talk is based very loosely on a book that I mostly finished up and just got into the hands of the Princeton University Press, I hope it will be published late this year. You may recognize the title, if you just blink you'll think Friedman and Schwartz know if you look carefully it's monetary and fiscal –I'm not going to talk

about that today– history of the United States over the last 60 years. If you've forgotten, Friedman and Schwartz ended in 1960 so this book has nothing to do with taking issue with Friedman and Schwartz; I guess, I could do that in some instances, but I'm not. And nor is it focused on the question of today: I said Marcus kind of pushed me into this. These episodes that I will speak of today are in the book. Tightening monetary policy, but not too much, so to speak, but so are many episodes of easing monetary policy and fiscal and monetary policy either acting together or across purposes, and so on. It's a history of the 60 year period of macro history (macro policy history) of these 60 years and I've just pulled a few episodes out of that that are germane to this question of hard versus soft landings. I should say right at the outset, I think the received wisdom is that the Fed has only done this, once in the mid 1990s. It's really, really hard to have a soft landing. On my multiple choice test, the answer I intended to be the right answer was the last: depends what you mean by soft and I'm going to elaborate on that a great deal. I should say this also reminded me about why I never put multiple choice questions on economics exams: I hate them. There's usually no right answer or they're all half right or all half wrong or something like that. The one by the way that you all…never mind i'll come back to that. So, here's the punch line or the elevator pitch for today's talk and for the question which is this… so that's a picture of an airplane landing, we've all been passengers in events like that. I don't know about you, but it's quite rare in my experience to experience a perfect soft landing by which I'll mean that you can barely tell when those wheels hit the runway. That the one second before, and the one second after are almost indistinguishable. This is like the envelope theorem: you just touch it exactly correctly. That's very rare. On the other hand, we probably all experienced hardish kind of hard landings, where the plane hits hard enough that, well, that explains why the flight attendants took the coffee away before it landed, because otherwise it would have splashed, and you wonder whether they just blew a tire because we hit so hard and are we going to skid? That happens now and again. It's not common; the modal event is just calling it here a soft-ish landing to remind us that soft is not a 0-1 variable in this context, or in the context I'm going to speak about, monetary policy tightenings, but it comes in degrees, and in the case of landing aircraft, at least in on with good pilots, what is this American airlines? The softest landings are common. They're not 100% of the cases, but they're common and what I'm going to argue with you going over case by case is that. If you're not too fussy about definitions, don't insist that it be an absolutely perfect soft landing, the Federal Reserve has pulled off a number of kind of soft landings and I'm gonna go episode by episode over the details.

12:37
So first here's a visual overview. I'm going to focus the attention of monetary policy on the effect of Federal Funds rate, this graph comes from FRED. I'm sure you've all used FRED, and the effect is kind of a continuous variable right we think of the fed funds rate us on a particular date moving up or down 25 basis points or something. That does happen to the target but there's some drifting and some bouncing around in the fed funds rate. I only mentioned this, because that sometimes makes it unclear exactly when to date the beginning and end of tightening you're going to see my datings shortly. And I picked out 11 Fed tightening out of this graph. The next one will make you see them more easily. Those stars are inserted by me, not by FRED. At the peak of the Fed tightening, so you can see why I started this, in 1965 with the first of them that first star on the far left and finished in 20– well, it says 2020 but the last tightening ended in 2019. What you can also see from–so I'm going to go over these 11 episodes– what you can also see from this graph is a lot of action in here you're seeing the cursor right that shows. Up down up down a lot of things are going, mostly got some down and a lot of action, the next slide I think just spreads out and focuses on the period from the late 70s, through the early 80s which included three of those 11 stars, so this gives you a better view. It's not so tight, you can see why I call this the end of a tightening because the Fed eased tremendously, that was one of your multiple choice questions, and the answer is, as a number of you knew and the rest of you

will all know now was credit controls caused the sharp recession. This is not GDP, this is the Fed funds rate and the Fed reacted to that and then went back to tightening. There was kind of this double peak here, I might have put the star here, instead of here, that's slightly arbitrary. And then another tightening leading into the great moderation right here. I will talk about all of these in detail, but that was just to unpack the crowded part of the graph. Of course, all of these tightenings were related to the behavior of inflation, so we see basically in this history of this period in the United States (by the way this is core CPI inflation) three big hills and a couple of hillocks so there's this big hill here, the Vietnam inflation, and then there's the OPEC one etc, etc, inflation. I'm going to talk about all these, the OPEC 2 etc, etc, inflation, these are the two big stagflationary episodes. A bit of an uprising and inflation here at the very end of the '90s, not huge but noticeable, went over 5%. Another little one here, but that was mainly recovery from the downdrift in inflation, that of course what we're living through now. So the Fed is reacting to this and other things. So you're going to see this chart multiple times. I'm going to bring it back for each episode, but if I just go over the content and philosophy of this table, these are the 11 tightening periods as defined by me. What I was saying before about the effective rate, and sometimes there's a little bouncing around, is the exact dating could be disputed by a month or two. Sometimes– if I go back, I can show you. Well, this is a graphic example I could have said, the tightening ended here or here and there are many other episodes like that, not quite as dramatic as that. So someone could quibble with the exact datings but I'm showing you the ones I used. The next column is the change in the federal funds rate in basis points over that period, rounded. Yeah, by the way, if you don't know this, if you go back in history, it wasn't always 25 basis points. The Fed sometimes moved the funds rate 18 basis points or seven basis points or 42 basis points. They weren't always 25s and 50s, so I rounded them here and so these are the episodes that I'm calling tightenings. Three of them are pretty small, 175 basis points, 190 basis points, 225 basis points. I'll come to each of these. The next column is not the NBER peak, there's this habit that I've never loved. If you remember our business cycle peak is when the activity is at its highest, so if you think that's a good thing that's like the best. And then you get a recession and things start coming down, so this is the month after the NBER that is the first month that according to the NBER the economy was in recession. That's what this column is, and you already get a hint of one of those multiple choice questions, that three of them have nothing, there was no recession, according to the NBER and commensurately if you move over one column– this address is Marcus's first question: how are you defining soft, with respect to what? To me it's soft with respect to output employment looks more or less the same output in unemployment and those dash dash dash no recession was no decline in GDP. The last thing I want to point out, as a general fact (which if you spend time staring at quarterly GDP numbers, you know, but if you don't, you don't know), inside recessions there are typically some up quarters inside recessions. So, in the first episode, there was no recession, but there was a slow down. In the second episode, there was a five quarter recession, according to the NBER but two of them were up, three of them were down, simply five of seven, two of two and so on. That's what this column talks about and I highlighted here what's known as the perfect soft landing, as I said. I think the conventional wisdom in many quarters is that the Fed has only pulled off one perfect soft landing and this was it in '94 but actually because of the wiggles in the effect of fed funds rate started the last month of 93 into early 1995. I was Vice Chairman of the Fed for this. I'm not going to claim causation there; it happened on my watch but I'm not going to claim credit for doing it, but I will confess that there were two doves on the committee then named Yellen and Blinder and we were trying to hold the committee back from overdoing it so that that's been documented, a number of places that's not a secret.

21:20
So those are the 11 episodes I want to now take them one by one, starting with the first, which some people wouldn't call a tightening at all, it went up–the Fed raised the funds raised about

175 basis points, there was no recession in those days, people talked about a growth recession and there was a growth recession, there was a considerable slowdown in GDP growth in 1966 which had something to do with the Fed easing up so here's the commentary. In 1965, you go back, so the Fed started raising interest rates in September '65. I don't remember the month Lyndon Johnson, President, "invited" William McChesney Martin to come down to Texas, while he was doing to Barbecue him. More figuratively than literally, Johnson was famous for these barbecues on his ranch and he really led into Martin and he'd berated him as being unpatriotic as American soldiers were dying in Vietnam and so on. Johnson was the President before Trump who inquired to his lawyers whether he could fire the Fed chief and they told him, as Trump's lawyers told him, "no you can't do that, except for cause you can't do that because you disagree with the policy." So he really tried hard to browbeat Martin. It didn't work, the Fed tightened enough to produce this growth recession but not an actual recession, but then it backed off of tightening. I saw Ricardo was on next week: Ricardo's Brookings paper in the last meeting which I discussed, was very critical of Martin in this episode for backing off before he should have and I was more defending Martin in the discussion. Especially– first of all, because it's a little hard to resist the President of the United States when you're having a growth recession. But mostly because of this last line: the Fed returned very soon to tightening. So let's look at the next episode, notice the dates. So this first tightening episode ends in November '66, second already starts in July '67 so it wasn't a very long pause. And this time the Fed embarked on a tightening cycle of over two years, 540 basis points. Put this into perspective, the inflation rate was not 12% then. You were talking about four or five, maybe a peak 6% inflation rate, so this was big stuff compared to an inflation rate like that. A recession followed the NBER peak in December '69, but this is an interesting number. This is the total drop in GDP in that recession, not very much. This comes to the point of it depends how you count. So what was happening in this episode? The Fed then got serious about the Vietnam inflation, so it started fighting it and '65-6, it stopped for a while, and then it really went back into battle. Fiscal policy also tightened in the middle of '68 when Johnson finally got this tech surcharge that he asked for long before through Congress. Here is a quotation that I put on here, because I know I've got a lot of PhD economists that specialize in monetary and fiscal policy here. This is unbelievable from a modern point of view. I'll read it. "It has been and remains the conviction of both the Administration and the Federal Reserve system that the nation should depend on fiscal policy, not monetary policy, to carry the main burden of the additional restraint on the growth of demand that now appears necessary…" Just think about that; can you imagine Jerome Powell or Janet Yellen, before him or Ben Bernanke he before her or Alan Greenspan before him, not to mention Paul Volcker saying the job of restraining the economy to fight inflation is fiscal, belongs in the realm of fiscal policy, not monetary policy. But I just want to put that into to try to help you wrap your mind is a little bit about the way people thought about policy, anti-inflation policy back in the '60s and notice that this is a joint statement of the administration and the Federal Reserve in the CEA report (that also never, never happens in recent years). And then, by the way, I don't have that inflation graph you saw earlier. In the wake of this tightening, inflation tumbled from about 6% to about 3%.

26:56
Next episode is the early '70s, dated here '72 to '74. The Fed, in stages, raised the funds rate 960 basis points, and then we had a serious recession. I wouldn't put 100% of the blame for the recession on the Fed, we had a stagflationary shock from OPEC in the fall of '73, the GDP drop was notable if you just scan these numbers here. 2.7% was a big one, by the way, I'm old enough to remember this was called (at the time) the Great Recession. We now don't call it the Great Recession anymore, but in real time it was long and it was deep and there were five negative quarters. What's the story about the Fed? 1972 is Nixon's re-election year and you may remember that Arthur Burns was very interested in getting Richard Nixon re-elected. There

was a big fiscal stimulus that year price controls had started the previous year, in preparation for the election. Nixon and Burns–well let's just say Nixon, but I think Burns– to have the idea, you could push aggregate demand very hard and further the inflationary implications until after the price controls were listed which happened in the ‘73-4 period in stages of that, plus the huge supply shocks food price shocks and OPEC one drove the inflation rate very, very high. That was one of the big mountains we saw in that early picture of inflation, and inflation rose through, even right through the recession, but then cratered down to 6.5. So when I say crater, inflation went up to like 12-13%. So that falling to 6.5, which is still a high rate, was a big decline because this was not a soft landing. Yeah, go ahead.

Markus Brunnermeier: So some people argue that we overemphasize OPEC because inflation went up before the big shock during exactly that period, can you elaborate a little bit on that too. Without that there might have been high inflation too.

Alan Blinder: Yeah, let me go back to the inflation graph here. So what you see is inflation starts coming up here, that's not so far before OPEC, but OPEC was preceded by–the food price shock was very large in 1972; people forget about that completely. But it was very large and food is a much bigger part of the CPI than energy is. So we had that and we had, as I said, the overstimulation of the economy, to help Richard Nixon get reelected so those were two factors other than OPEC that accounted for this tremendous rising inflation.

Markus Brunnermeier: And why food, in particular because it's…

Alan Blinder: There were crop failures, there was a famous (at the time) disappearance of the Peruvian anchovies which I learned, we all learned, at that point was used to feed livestock, chickens I think. Are chickens livestock? I think it was used to feed chickens anyway. Because of weather events and whatever moved the anchovies and some other stuff, things having nothing to do with monetary or fiscal policy, food prices soared, I didn't put a graph of that here. But I have in some other work. We're already here, I said yeah, we're right here, next episode. I thought nobody would remember–I don't know the age of everybody on here–would remember the credit controls of 1980 that's why I put that down there, and also, I put on this question about the Fed not raising interest rates in 1977-78. That's false. This cycle of raising rates lasted more than three years before Volker eased up; that was that other question. The funds rate went up 1300 basis points, that's a lot. The NBER was dated to start in February, the peak was January. It was short, but sharp, so 2.2% in only two quarters, is a sharp annualized rate of decline, and it was caused, believe it or not, by Jimmy Carter urging people to tear up their credit cards and stop using them because “don't spend so much money” and that's how we as Americans are going to tackle the inflation problem. Amazingly, a lot of people listened, and we have this deep recession, so if you look at this whole period, the identity of the Fed chair changed from Burns to Miller to Volcker. Inflation was rising throughout this period beginning, especially in ‘78, reaching a peak for the core about 13.5% in June 1980. There was a big measurement issue having to do with mortgage interest rates which if anybody wants to come back to it, we come back to it, but i'll just skip over that. Now, and this was your multiple choice question: Miller, in fact, raised rates, much more than history gives him credit for. The historical images Miller was like asleep at the wheel and not caring about inflation and not paying attention to what you should do and then Volker came in and saved the day. The last part about Volker saving the day is accurate, but the part that not Miller not doing anything is not; if I go back to the beginning of the–Miller is first at the beginning, Burns, but mostly Miller is the chairman of the Fed as all of this is happening and Volker is becoming Chairman around here, something like that so it's just not true that Miller was looking out the window and not seeing that he should–that the Fed should raise interest rates, but Volcker, was the one that really hammered the funds rate, and is it said on the chart, he did this with the so-called monetarist (that's why I put this in quotations) experiment, where he could say well we're just stabilizing the money growth rate, which they weren't, and interest rates are set by the market rather than by us.

34:19
Next one is a short episode. July ‘80 to January ‘81, but 1000 basis point increase, a serious recession. So this recession came in two pieces, the first stage, the second stage of the recession was more serious and lasted six quarters. Credit controls, as I mentioned, created the real economy, briefly, and that induced Volcker to back off. That was one of your multiple choice questions, but then as growth snapped back, Carter said forget about credit cards don't worry about that wish I never said that, whatever he said, and people started spending again and the economy started going uphill again, and 1982 was the year in which the inflation rate really plummeted from about 9.5 to about 4.5.

Markus Brunnermeier: So, Alan, can you describe these credit controls, a little bit further just to get a better idea of what went on, and did the underlying theory, the monetarist theory, make a big difference in how the market perceive things and helped or was it abstract, it can be abstracted away from it.

Alan Blinder: On the ladder, I think not. Only in the sense that all economists were against credit controls, then, as they would be now, that included Paul Volcker. But Volker thought he owed…so Volker didn't initiate this, Carter did, he just came to the White House, Volker thought he owed being polite to the President who after all had just appointed him and was supporting him as he crunched the economy, as many Presidents might not have. So he instructed the staff to try to design credit controls that wouldn't work. That would be you know fig leaves and wouldn't really affect the economy. Well, they didn't quite succeed. Between that lack of that absence of success and Jimmy Carter's exhortations from the White House like turn your heat down, don't use your credit card, and so on, had a remarkably strong effect at the time, but you shouldn't think that Volcker or the Fed or economists were favoring this. By the way, what I could have shown you at the beginning, this was left over from the Nixon period. Congress had given the White House the authority to do price controls and credit controls on a dare. Thinking they’d never do it. So Nixon surprised them in ‘71 by doing price controls, he didn't have to go back to Congress, he already had the authority; ditto for Carter.

Markus Brunnermeier: And these controls were targeting certain sectors or particularly only the household sector? Or was it across the board, because then you're subject to huge volume.

Alan Blinder: It was not quite across the board, but it was set, it was “across the board with many exceptions” and Volker thought the exceptions would be fine. The financial system would kind of just shrug it off. But it didn't, so it was a deeper sense of that 1980 2nd quarter, if I remember correctly, the annualized GDP growth was -8, so until some of the recent catastrophes, that was the worst quarter in the whole postwar history. So, not a soft landing. Now I come to this, which you can argue does or doesn't belong on the list of tightenings. Between February ‘83 and the summer of ‘84, the funds rate was raised by 315 basis points; there was no recession and in fact, unlike in ‘66, there was no growth recession. The economy just powered right through this as if nothing happened this was 315 basis points, remember, at a point when the inflation rate is in the 4 range. So this is not trivial compared to a 4% inflation rate and, by the way, the inflationary rate wasn't changing very much in this period so quite a lot of the 315 was real. So, as I say here, it's not saying we should call this a tightening at all, you could argue against it. It was more like a readjustment. The Fed had come through this monitarest episode, tempted to say monetarist disaster, where nothing worked very well; the M's were growing at erratic rates, the interest rates were bouncing all over the place and the economy slowed down a little in the third quarter of 84, but that was kind of like a glide path to the Great Moderation. So if you want to call this a tightening, maybe you don't, you could call it a soft landing also. Certainly nothing real, real employment, output, etc. was damaged by this 315 basis points of tightening.

40:00
Episode seven is the one if I had taken my own test before doing all of this, I think I might have answered two, with this being the other one. This is a close call. So you see the Fed raised interest rates over a year by about 325 basis points, a recession followed but a year, a year and a half later, a year and a half after the Fed stopped raising interest rates, it was kind of a modest recession, short only two negative quarters.

Markus Brunnermeier: Alan can I ask you another question?

Alan Blinder: Yes, I go back?

Markus Brunnermeier: During the mid '80s, it was always the case that the dollar appreciated tremendously.

Alan Blinder: Yes, the dollar was going up from '81 to '85.

Markus Brunnermeier: Did it have any implications for the U.S. inflation? Or maybe the U.S. is too large and it doesn't matter so much…

Alan Blinder: Yeah I think for the U.S. you could mostly–I think it's an exaggeration to call a rounding error but it's not as big a deal as it would be for a European country. For example, yeah it was there, yes okay so where was I…so this was a close call, the Greenspan Fed almost achieved the soft landing. What happened is the growth was averaging 2.8% from the third quarter of '88 through the third quarter of '90, a 2 year period. 2.8 in those days was a below trend number, not horribly below trend, but below trend, the trend growth rate would've been up in the three someplace. So it was a bit of a slow down, not much, and it looked like we were coming through it very nicely until August 1990 when there was a tremendous spike–it didn't last long–in the oil price. So you really want to blame this recession, not on Alan Greenspan, but on Saddam Hussein and I've thought for years, and I still do that this would have been pretty close to a perfect soft landing had the oil spike not happened and ruined it. And notice again the time gap, the Fed finished its tightening in April '89, the recession didn't start until August '90 when the oil spike happened. Okay, next episode, we're getting near the end, this is what history records is the perfect soft landing. From the end of '93 until April '95 the funds rate went up 310 basis points the inflation rate throughout this period was 3% plus or minus almost nothing, it was really flat as a board at 3%, so this is basically all real, the real fed funds rate went up from zero to three basically. The GDP did not drop at all, and this goes down in history as a perfect soft landing. Here are some numbers, the growth from '93 fourth quarter for the next year was four and a half percent, almost, and then it slowed down to only 1.3% in '95. I was on the Fed then, and I remember we were a little worried about this, you know 1.3 is not a great growth number, but then, then it picked up again. It was kind of a blip. The Fed looked at that weakness in the first half and backed off a little from the 6% fund rate to a 5.5% fund rate. We had the unemployment rate about five and a half, which was believed to be the natural rate at the time. If you took a poll of economists, I think that's what you would have found. By the way, as the history progressed into the later ‘90s it looked like it, we then saw we could go below five and a half percent without inflation. So maybe this soft landing was not as perfect as history makes it out to be, that is, the Fed could have given the economy even more running room than it did, but it looked pretty perfect at the time.

44:17
Markus Brunnermeier: Can you elaborate a little bit? This was also the period where this huge bond crash happened.

Alan Blinder: Yes, oh yeah. you mentioned that, let's go back. This is the effective funds rate: the official funds rate bumped up for the first time in years, in February 1994 and there was a crack in the bond market and bond market traders got very angry at the Fed, Greenspan in particular. I remember that I became chair, or vice-Chairman of the Fed shortly thereafter, and I remember some of that being directed at me. It wasn't me personally, but “we hate you Fed, how could you do this to us.” They acted as if it just came as a total shock. The Fed learned something there about forming the runway preparing markets, but it was really an unfair accusation, you could trace back statements by Alan Greenspan and others well into 1993 saying we can't keep it– basically saying that we can't keep a zero real funds rate forever. And this is not something that could be sustained, then he said it many, many times before finally pulling the trigger, but the bond traders didn't believe and when the trigger was pulled, there was a sharp reaction to the bond market, that is correct.

Markus Brunnermeier: But why was there a sharp reaction, given all the earlier tightening cycles were even more dramatic?

Alan Blinder: They were ignoring it, I mean that's all I say when I face this hostile audience of bond traders, that's what I said, I said you should’ve been listening. Greenspan was dropping hints of this for months before it happened, but they weren't listening, this–Marcus you if you can put yourself back in that frame–this was back in the time when the Fed basically said next to nothing there was no forward guidance, there was nothing like that, and so people were not used to listening to quasi-forward guidance coming out in subtle ways and they were caught by surprise and they didn't like it.

Alan Blinder: Okay episode nine from the beginning of 1999 through the middle of 2000, 190 basis point increase in rates, the recession started in April 2001; notice there's a big time gap here: July 2008, 2001. Now I said the recession, because the NBER calls it a recession, and who am I to fight the NBER, this is how much GDP declined in three quarters, one of which was positive, so I call this the recessionette, a minuscule recession started April, 2001. If you just look at annual data for 2002–for the year 2000 and the year 2001, you don't see recession, GDP did not decline at all in annual data, so I think that was also pretty close to a soft landing. It doesn't get the applause of 1994-1995 because what happened after was called, at the time, and since the job loss recovery, this is the time when jobs and GDP diverged. GDP did nicely and jobs kept falling. Productivity was doing great and surprisingly jobs did not pick up for quite a while after the economy picked up, but I think this is arguably a soft landing on GDP– this goes back to your very first question Marcus: soft with respect to what? It was a pretty very soft landing with respect to GDP, but not with respect to jobs. Now we come to the more recent episodes, serious recessions. You see this number 3.8 and 10.1 look entirely different from what's above it in that column. The Fed began tightening in June of ‘04, and continued for two years, going up in total by 425 basis points. Look at when the recession happened: January ’08.

This is NBER dating, January ‘08. The Blinder dating, by the way, of this recession is September ‘08 on the day that Lehman crashed, but this is the NBER dating so even that leaves a big time gap between the Fed finishing its tightening cycle and the beginning of a recession, it was a deep recession, it was a long recession I call this the better late than never tightening because the Fed was getting tremendous criticism from conservatives during the years before June 2004 not raising interest rates to try to burst, or at least lean against the House price, above all, that criticism continues to this day. What did happen in that episode is we got a slow-down in growth. The year 2007 was a very low growth year, but it was a growth year, it was not a recession. It was not enough of a slowdown to raise the unemployment rate, which really didn't go up. Inflation crept up a little during that period by about a percentage point, which gives some aid and comfort to those who criticize the Fed for being too late to tighten. But I think blaming the 2007-2009 recession on the Fed's tightening rather than the financial crash is a stretch, a big stretch. And this is a surmise that without the crash happening, if we could imagine a different history where that financial crisis didn't happen, the Fed might have pulled off another soft landing. Here in 2007 and into 2008 it looked pretty soft, and then it looked really hard. Last episode is the recent episode.

51:10
This is a long but very slow normalization of interest rates, you may not want to call it a tightening; 225 basis points in total. The recession, of course, happened when the pandemic struck probably had nothing to do with the Fed’s tightening, which again, you may not want to call that a tightening at all, but if you think back to the first graph I showed you a 425 basis point increase in the funds rate, those show up and looks like tightening. And had it not been for the pandemic, this might have been another successful episode of fine tuning so here's my bottom line. There were 11 episodes called out on that initial chart. Seven of them are arguably pretty soft landings, I put it in bold, the one that was a perfect soft landing, maybe, but these others were pretty soft landings arguably. In three other cases and now we're up to 10 it was a hard landing but that's the way the Fed wanted it, there was never the intention to make it soft in the high inflation periods of ‘74, ‘80 and ‘81, that was deliberately hard. And in two cases, including the recent case, it was clearly not tight money that caused the deep recession, so it's not like the Fed was tightening and overdid it and crashed the economy. So that's it. Oh yeah, sorry, I left out the punch line: so soft landings can't be all that hard to achieve. The last slide I have here is in case anybody wants to ask any questions about these numbers.

Markus Brunnermeier: Yes, so we have a number of questions that I would like to throw at you. One is when you look at the tightening, you always look at the Fed funds rate–did you also look at the long end of the yield curve? The long end of the yield curve might have moved, of course, less than the Fed funds rate. And more generally on the financial conditions measures, or it could be that sometimes people now say you know you move to the short end but nothing happens with the long end and that that doesn't really tighten anything.

Alan Blinder: Right, I did not, I focused on the Fed's instruments. I thought you were gonna say something slightly different, which is: the Fed wasn't focused on the Fed funds rate as its main instrument through this entire period, which is also true. I was looking for some consistent measure that's why I picked the Fed funds rate, but one thing that has changed over this historical period that you're pointing to Marcus, correctly is that early in the period we–people at the Fed and people that watch the Fed–thought of the long rate as moving sluggishly behind the short rate. So you would move the short rate and the long range would come trudging along in smaller magnitude and with a lag. In the more recent period since the Fed has been more talkative and given forward guidance, to some extent that's been reversed. That long rate sometimes moves before short rates in anticipation that the Fed will be going up later. And that is a difference, so you're quite right. In terms of interest rate affecting the economy, it's not the Fed funds rate that matters most.

Markus Brunnermeier: So coming to another question from Laura Allen, relating to it, of course, right now, we could tighten in different ways: we can actually change the short end of the yield curve, but we can also undo QE and even quantitative tightening. Does history help us in any dimension in this setting as well, because most of our policies were more on the short end of the curve.

Alan Blinder: Yes… not a lot, because these other–we call these other things unconventional monetary policy for a reason, if you look over this history, they really only started with this episode here the penultimate episode on the list, so we don't have a lot of experience with it, but it is true now, as it was true when the Fed started unwinding the easing after the great recession which only–that unwinding only started in October 2015. The Fed had, when it came to unwinding, had a choice then between ending quantitative easing and eventually it went to what we're now calling quantitative tightening, though not a lot of it, and interest rate movements. And it decided that the interest rate movements should come first and then quantitative easing…this was back in 2015. And it's got a similar choice now, but I would add one more element to the choice–I think, this is my personal opinion, it is slightly ridiculous that they haven't– which is all along they've been buying MBS into a housing boom. There was a reason to buy MBS in 2009. I don't think there was a great reason to buy MBS this time around, and if there was, it didn't last very long. So you know if it were up to me, they would stop buying the end they're going to stop very soon, they would have stopped before now.

57:38
Markus Brunnermeier: Coming back to the earlier question about the yield curve: when you go through these episodes, do you know which episodes the yield curve was inverted and downward sloping?

Alan Blinder: Well, the answer is that that's very knowable, but offhand– it certainly happened in the super-Volcker period, the yield curve…let's go back. The alone rates never got this high. These are periods of inverted yield curves, but they were not the only ones, and it's a fair question right? Off hand I don't know. I think the late 60s, which is not on this chart, was. I think this one was an episode that got an inverted yield curve too, but I'm not positive about that.

Markus Brunnermeier: And then I would like to come to the communication of the Fed, you know, now, when we think about central banking we think about all about reaction function, communicating reaction functions, and in the olden days, there was no thing like that, and once you think about the reaction function, you might also think of “fed put” and other things you know, how will the Fed react? Are there any lessons about, you know, generating a reaction function, which is less dovish in a sense, or that's a way in which you don't have to necessarily race interstate now, it has to move a little bit by communicating an actual function, which is…

Alan Blinder: I think this “Fed put” idea is– I understand the origins, but I think it's greatly exaggerated. Let me show you on these two examples. We had a tremendous crash in the stock market in 1987– that's in here– that did not deter, that did not even slow the economy, and did not really affect monetary policy, the Fed just let it happen. Now, what they did is what they should do: they announced to the whole world, to the financial industry that the discount window is wide open. If you get into a liquidity problem, we're here to make sure that it doesn't get worse. So you could call that a “Fed put” but the word comes from a put option. We're going to undergird the drop in the stock market and they were not doing that, and then the other big crash is right in here. In sort of March 2000 or so, and so the ‘87 crash didn't even slow the economy down, the 2000 crash led to what I call the recessionette, an absolutely trivial slowdown in the economy, and the Fed did not react strongly against that. I never liked this idea that there's a “fed put” on the stock market. What there is, and of course they're correlated, is a “fed put” on the economy, call it on GDP. If GDP starts falling, the Fed starts doing things to cushion the drop and those things are going to be good for the stock market. But to me, if that's your definition of the “Fed put” which is not the markets definition, there should be a “Fed put,” that's what they're there for.

1:01:30
Markus Brunnermeier: So let me just summarize the remaining questions in one big block, so one question is essentially when you started out your presentations, and you also cover in your book a lot on the fiscal side, you focus very much on the monetary side perhaps you can say a few words, how the fiscal monetary reaction plays out and should play out in the tightening cycles. And the other thing, which is related to that, was about the political landscape. Some people argue that the political landscape is much more polarized these days. It might make it much more difficult, compared to the old days. On the other hand, you also said at that time it was also not easy, from a political perspective to do this type of tightening.

Alan Blinder: Okay, let me try to take the second one first and quickly. The extreme polarization of American politics now means that nothing could get done so there's not going to be a fiscal contraction, there is not going to be a fiscal expansion of any size, there may be something trivial. You could say that's good or bad, but it is not something the Fed is worried about. The Fed’s not sitting there worrying about big fiscal expansions still to come, or contractions still to come. It's a little contraction, by the way, in case people don't know this. The emergency relief packages either have already worn off or are imminently wearing off, so the fiscal thrust as it is sometimes called is going to go negative. If you look at these episodes, I did mention this episode was largely caused by fiscal policy, with monetary policy pushing against it until fiscal policy turned around. That was that remarkable quote in 1968 that fiscal policy should control inflation. In this episode, fiscal policy was very expansionary to help Richard Nixon get elected. And that was part of the initial surge of inflation, but that was dominated numerically by the supply shocks and the end of price controls. This episode– which is better seen that way– some people accuse fiscal policy of being too expansionary here, so on the graph, and maybe there's a little bit of truth to that, but then of course the credit controls, which are not fiscal policy as we normally say, this is what caused this really steep recession. This is not GDP, this is the funds rate, but this NBER shading is a short, but really steep recession caused on the fiscal side, sort of caused by price controls. This is largely the result of OPEC causing stagflation. What else should I say about fiscal policy? Well, I gotta go back to the other, the rest of this is the great moderation, yes.

Markus Brunnermeier: So let me perhaps throw one more question from the audience. I apologize, but I won't be able to handle all the questions, or pose all the questions. But you covered very much tightening and is there some symmetry to loosening? Would you say it's very different? Where do you see the symmetries and the non symmetries between tightening and loosening monetary policy?

Alan Blinder: I wouldn’t push symmetry. So first of all I concentrated on tightening because what you asked me to talk about was landings, so landings mean tightenings, and you're trying to land the airplane on the runway at full employment. I wouldn't push the symmetry very far– with a few exceptions, so it's good to have this chart up here. This kind of looks symmetric, this kind of looks symmetric, this kind of looks, if you ignore this, sort of symmetric. I have emphasized in other work years ago that the inflation– yeah let me… I think that's coming up– the inflation was very symmetric at this point. This was a big up and then almost as big a down. Not quite, so if you think that the Fed should be tuning its policy to the inflation rate, you get a very symmetric hill here, very symmetrical hill here, not perfectly symmetric and the Fed ought to be commensurately symmetric if it's following the Taylor principle that you mentioned before. But I did not focus on the urgency of it, there are a few episodes in which the Fed has been criticized historically for easing much too much, so this is the obverse of a hard landing, this is a hard take off, we don't have… the fact that we don't have a term for this is an illustration that it hasn't been a big problem but where's my funds rate chart again. The Fed was criticized for some of this, Arthur Burns helping Richard Nixon get reelected. This, I think, not so much Because the supply shack was dissipating and the Taylor rule, the Taylor Principle says when the inflation rate falls, the Fed funds rate should fall even more. Here, everybody was worried about stagflation again although this was one of your multiple choice questions: the Miller Fed, which is a short and not very happy interval at the Federal Reserve is often accused of being way too inflationary, juicing up the economy when it should have been tightening, but I think that's a misreading of history, that's why I showed– it's clearer here, these numbers, this is the Miller episode era in here until Volcker comes in. You could argue, and I think it is right, that they didn't raise interest rates enough, but they raised it a lot, quite a bit. So I'm not sure that the charge of a hard takeoff (I don't know we don't have a terminology), so this really holds. I'm looking for other episodes.

Markus Brunnermeier: But I mean I asked you, focusing on the tightening, because that's what we're facing now but yeah, I think, but it's…

1:09:00
Alan Blinder: Yeah and that's what we faced in a number of points in history, much more than taking off and hitting the ceiling or something like that.

Markus Brunnermeier: So typically we try to end at the positive note, I know your main conclusion is very positive.

Alan Blinder: Yeah, that's my positive note, putting it back up as soon as I find it.

Markus Brunnermeier: So, would you follow the Taylor principle at this point, and what inflation would you take the forecast in the next year or the current inflation, what would be the inflation, you feed into this Taylor rule or the Taylor principle.

Alan Blinder: As your regular listeners know in abundance, there's been for some time now a debate between the team transitory and team permanent or not permanent, but you know team long– I guess what is it's name, team inflation, or whatever you call it, the Larry Summers team and so far… So let me come at a slightly different way: if team transitory is correct, I'll confess to being a member of team transitory and I'll confess that we're not looking so good, so far, but if team transitory is proven to be correct and what I mean by correct in this context is inflation kind of naturally falls by a lot during 2022. The Fed won't have to do very much because the transitory nature of what's pushing inflation up will just dissipate and that shouldn't be hard. Don't make the Fed's job easier. If team inflation is right, and this gets deeply embedded into wages and expectations, the Fed is going to have to push harder and that's where the question of hard versus soft landing is gonna– the rubber on that it's going to hit the road on episode 12.

My chart had 11 episodes, episode 12 is the next line of this which can’t be filled in, but if inflation gets ingrained at 6-7%, the Fed is going to have to clamp down, and it will try to make it a soft landing, and we'll see how well they do the history suggests it's not that super hard to do.

Markus Brunnermeier: And I see that you left a little space there for probably subliminally suggesting we might get there. Some extra white space for the next time

Alan Blinder: Yeah, blank space.

Markus Brunnermeier: So thanks a lot, it was fantastic to get this big picture view and also going back to all the cycles. I think I learned a lot, and so– I think– did the audience, and hope to talk to you soon again over lunch.

Alan Blinder: In person soon.

Markus Brunnermeier: In person soon, I think we are again allowed now since last week. Okay, thanks a lot Alan. I will also forward you the remaining questions which came in and I couldn't pick up.

Alan Blinder: Okay, goodbye everyone, I see by the number counter there are still a lot on, thank you for listening.

Markus Brunnermeier: Thank you to everybody and see you next week with Ricardo Reis, talking about inflation risks as well.