Narrator 00:00

At the Annual Federal Reserve Symposium in 2022, just a few months after the Federal Reserve began to raise interest rates to fight inflation, Chairman Jay Powell was clear about what those actions might do to the economy.

Jerome Powell 00:14

While higher interest rates, slower growth, and softer labor market conditions will bring down inflation, they will also bring some pain to households and businesses. These are the unfortunate costs of reducing inflation.

Diane Swonk 00:26

He didn't mince any words. He was quite blunt in the fact that the Fed was willing to take a recession if that's what it took to derail inflation, and there was a sense that that's what they believed was necessary.

Narrator 00:38

Of course, the Fed is trying for--

Jerome Powell 00:41

A soft or soft-ish landing. It’s a soft landing with inflation coming down and unemployment holding steady.

Narrator 00:47

But by fall, more than 60% of economists surveyed by the Wall Street Journal including Diane Swonk predicted a recession in the coming year. But now, almost a year later, it still hasn't come.

Diane Swonk 00:59

I am more than happy to eat crow on this one. When you're wrong and the economy is more resilient, that's a wonderful thing.

Narrator 01:05

So where did the recession go? A recession starts in one of these three areas. Either people spend less money, leading businesses to make less money and lay people off or they start when people get laid off, giving them less spending power and businesses fewer profits. Or an industry may start to do poorly, and the cycle flows from there. But all of these areas were strong back in 2022 when the rate hike started, and they still are. There's a few reasons why. Let's start with spending. Simply put, there's a lot of money out there. People had a lot in savings coming out of the pandemic, thanks to the stimulus and generally just not spending money in 2020, which meant that when they started spending again, they had that cash despite inflation.

Diane Swonk 01:48

We also had the lingering effects of the stimulus, which ramped up at the state and local level on infrastructure spending.

Narrator 01:56

Money is also there because people still have jobs. The unemployment rate continues to hold at pre-pandemic levels. That reflects two things, a lower percentage of Americans working or looking for work, thanks to a wave of baby boomer retirements, and there are still jobs, a lot of jobs. The number of vacancies is still far higher than it was pre-pandemic which also keeps wages growing. July 2023 was the first time in two years where wages grew faster than inflation. So people were spending money and working, and businesses were in a strong position. Not only did corporate profits rise, they had less debt to be affected by the Fed's rising interest rates.

Diane Swonk 02:37

Large corporations either locked into low rates or carried much less debt. And that's really important because that also acted as yet another buffer against higher rates and the implications for employment.

Narrator 02:51

A major way this cycle is often set off, especially when the Fed raises interest rates, is the housing market. But this one is different. Normally, when the Fed raises rates, that increases mortgage rates, which slows the number of new houses sold, slowing construction and furnishing and all the spending and jobs that come from a robust housing market. Blue goes up, red goes down, and usually a recession follows. But that's not really happening now. The number of new houses being sold has slowed, but it was already slowing, thanks to a really limited supply and what happened here. More than 90% of all homeowners have a rate below 6%. More than 60% have a rate below 4%.

Diane Swonk 03:34

It caused what we called a mortgage winter where people were literally locked in place because they couldn't afford to now buy a house at a higher interest rate and much higher prices. However, they were also hedged against both inflation and those interest rate hikes.

Narrator 03:50

Now, here's where we must put in the disclaimer. Just because there hasn't been a recession in 2022 or the first half of 2023, doesn't mean there won't be one.

Diane Swonk 03:59

There are headwinds that are building that I think are quite substantial.

Narrator 04:04

Sure, people had money to spend coming out of the pandemic, but today, people have way less saved. And they're more in debt. Economists are still unsure how major Hollywood strikes will affect unemployment numbers or the economy as a whole. And don't forget inflation, which is still not down to the Federal Reserve's target. Now, most economists still predict a recession, but fewer of them.

Diane Swonk 04:26

I am much more optimistic than I was that we can weather the storm. I think it's very important that at the press conference that Chairman Powell was careful to not use the word optimism.

Jerome Powell 4:37

I wouldn't use the term optimism about this yet.

Diane Swonk 04:40

He said there is a path to a soft landing, and I think there is a wider path to a soft landing than we once thought.

Jerome Powell 04:48

It's a long way from a short and, you know, we have a lot left to go to see that happen.