Coyote Economist

News from the Department of Economics, CSUSB

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Whither Inflation? The Political Economy of a Rate Hike

By Daniel MacDonald

The Federal Open Market Committee decided in mid-December to raise the target for its federal funds rate by 25 basis points, or a quarter of a percent, to between 0.25% and 0.5%. The decision to raise the target for the federal funds rate usually signals that the Federal Reserve (or "Fed" for short) is concerned about underlying inflationary pressures in the economy. The federal funds rate has broader effects on interest rates in the economy, and higher interest rates mean an increase in the cost of borrowing money that should lower investment spending and reduce inflation. It is widely believed that the Fed should raise rates when the economy is expected to see price growth above and beyond its implicit target of about 2%. However, the Fed is also charged with ensuring full employment – this "dual mandate" of price stability and full employment is one of the signal features of central bank policy in the United States.

The reason why some were surprised by the FOMC's decision to raise rates boils down to the fact that according to most measures, inflation is still quite low. According to the Consumer Price Index, yearly inflation was only about 0.4% before the December meeting. Taking out the price indexes for food and energy (both of which have recently been volatile, especially oil prices) puts CPI growth at a higher 2.1%. But the Fed's preferred measure of inflation is the Personal Consumption Expenditures index, not the CPI. Taking out food and energy from this index (shown on page 3), price growth in December came in at about 1.3%, with no signs of a significant upward trend.

If there are few reliable signs of inflationary pressures, why did the Fed raise rates? Official statements from the FOMC, as well as the minutes of the FOMC meeting released weeks afterward, rarely contain specific language about the reasoning behind

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Economics Alumni Reunion

The CSUSB Department of Economics will be hosting a reunion of its alumni on Thursday, March 3, 2016. The reunion will take place at CSUSB's Robert and Frances Fullerton Museum of Art (RAFFMA) from 6 to 8 p.m.

There will be a brief program with Professor Tom Pierce welcoming the alumni and department chair Mayo Toruño providing an update on what's been going on in the Department.

The highlight of the gathering will be catching-up with other alums, reconnecting with "old professors", and enjoying three exhibits RAFFMA currently has on display: "Empire," "Intimate Landscapes," and "C.ASH_4_GOLD." Wine and refreshments will be served, and campus tours (by tram) will be available.

Economics Scholarships!
Application Deadline–April 22

Each spring the Economics Department invites applications for its scholarships. Scholarship winners are announced in early June; recipients receive their awards around October 1, after they have enrolled in fall quarter classes. The dollar amount of each scholarship award will be approximately $1,500. This spring the department plans to award five scholarships, so please apply!

To be eligible to apply for an Economics scholarship, students must:

1. Attend CSUSB as a declared economics major (any track);
2. Have completed a minimum of 9 semester, or 12 quarter, units of economics course work with at least a 3.00 grade point average (2.75 for the Economics Alumni Scholarship and the Sean Brunske Economics Scholarships);
3. Have an overall grade point average of at least 2.75 (2.50 for the Sean Brunske Economics Scholarships);
4. Have completed at least 30 semester, or 45 quarter, units of college course work;
5. Be enrolled at CSUSB on at least a one-half-time basis during fall quarter 2016.

In addition to information about your grades and the economics courses you have completed, you'll need one letter of recommendation from an economics professor and a 250-word, typewritten, statement of purpose. When asking for a letter of recommendation, be sure to request it from your professor at least two weeks prior to the application deadline. Also your statement of purpose must discuss your post-graduation career/educational plans. The overall quality of these submitted materials determines the scholarship recipients.

Scholarship application forms will be available at the Economics Department website (http://economics.csusb.edu/) and in the Department office (SB-451) by the week of April 4. Completed applications are due Friday, April 22.

OMICRON DELTA EPSILON (ODE):
Application deadline–April 22

ODE, an International Honor Society in Economics, encourages devotion to the advancement of economics and to the scholarly effort to make freedom from want and deprivation a reality for all mankind. ODE is one of the world's largest academic honor societies and currently has 652 chapters throughout the world.

ODE was established in 1963 as a result of a merger of two honor societies, Omicron Delta Gamma and Omicron Chi Epsilon. Omicron Delta Gamma was founded in 1915 by John Roger Commons and Frank W. Taussig, and Omicron Chi Epsilon was founded in 1956 by Alan A. Brown.

If you have taken a minimum of 20 units in economics and have an overall GPA of 3.0 and an economics GPA of 3.0, then you can join ODE. The name of the CSUSB chapter of ODE is Alpha Delta. Applications to join ODE are available from Professor Mayo Toruño or the Economics Department Office (SB-451). The initiation fee of $35 covers a membership scroll and a one-year subscription to the American Economist. The deadline to join ODE for this academic year is April 22.

Staying Informed of CSUSB Department of Economics Events and News

If you're receiving the *Coyote Economist*, then you're on our mailing list and everything is as it should be. But, if you know of an Economics Major, or an Econ Fellow Traveler, who is not receiving the *Coyote Economist* through email, then please have him/her inform our Administrative Support Coordinator, Ms. Jacqueline Carrillo, or the Chair of the Economics Department, Professor Mayo Toruño. Our phone number is 909-537-5511.

You can stay informed by consulting:

Our Website - http://economics.csusb.edu/

Our Facebook Page- http://www.facebook.com/pages/CSUSB-Department-of-Economics/109500729082841

Chair of the Economics Department – mtoruno@csusb.edu

Inflation

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a particular decision. The Fed does publish a few charts that show their analysis of forecasts of inflation, real GDP, and unemployment in the short-, medium-, and long-run, and these provide some answers as to the Fed's reasoning (see the figure below for an example of one of these charts).

The FOMC's analysis suggests that while the Fed's preferred measure of PCE inflation dipped in 2015, forecasters are expecting a strong upward trend in 2016 and afterward, with long run inflation eventually returning to about 2%. (The Fed is also thinking about the need to normalize interest rates – keep them at a higher level – so that it can lower them again in the future if economic conditions start to sour.) The source of the upward trend is based on continued improvements in the labor market, as unemployment continues to stay low for the foreseeable future and job growth remains strong (according to the latest data from the BLS, the official national unemployment rate is now below 5%). Low unemployment means higher bargaining power (and thus, higher security) for workers, which should translate into wage growth. Higher wages mean higher costs for employers, which will eventually get passed on in the form of higher prices.

…"Low Unemployment means higher bargaining power for workers"….

Notice the underlying logical chain here: inflation itself is not a worry at this time, but continued strength in the labor market suggests greater risks of inflation in the future. The real reason behind the rate hike, then, is not that there are any real signs of inflationary pressures, but rather that labor markets are being perceived as healthy enough to possibly generate inflationary pressures in the future ("perceived" being a key word).

This policy stance is not an unfamiliar one. As Dean Baker observes in his book Getting Back to Full Employment, after the country's bad experiences with inflation in the mid-to-late 1970s, the Fed has consistently been more concerned with price stability than with full employment – despite its official "dual mandate" to promote both price stability and full employment. According to Baker's analysis, between 1949 and 1979, the economy was (on average) operating above full employment. In October 1979 and continuing through 1980, Paul Volcker began instituting contractionary monetary policy, raising interest rates to combat excessive inflation rates of

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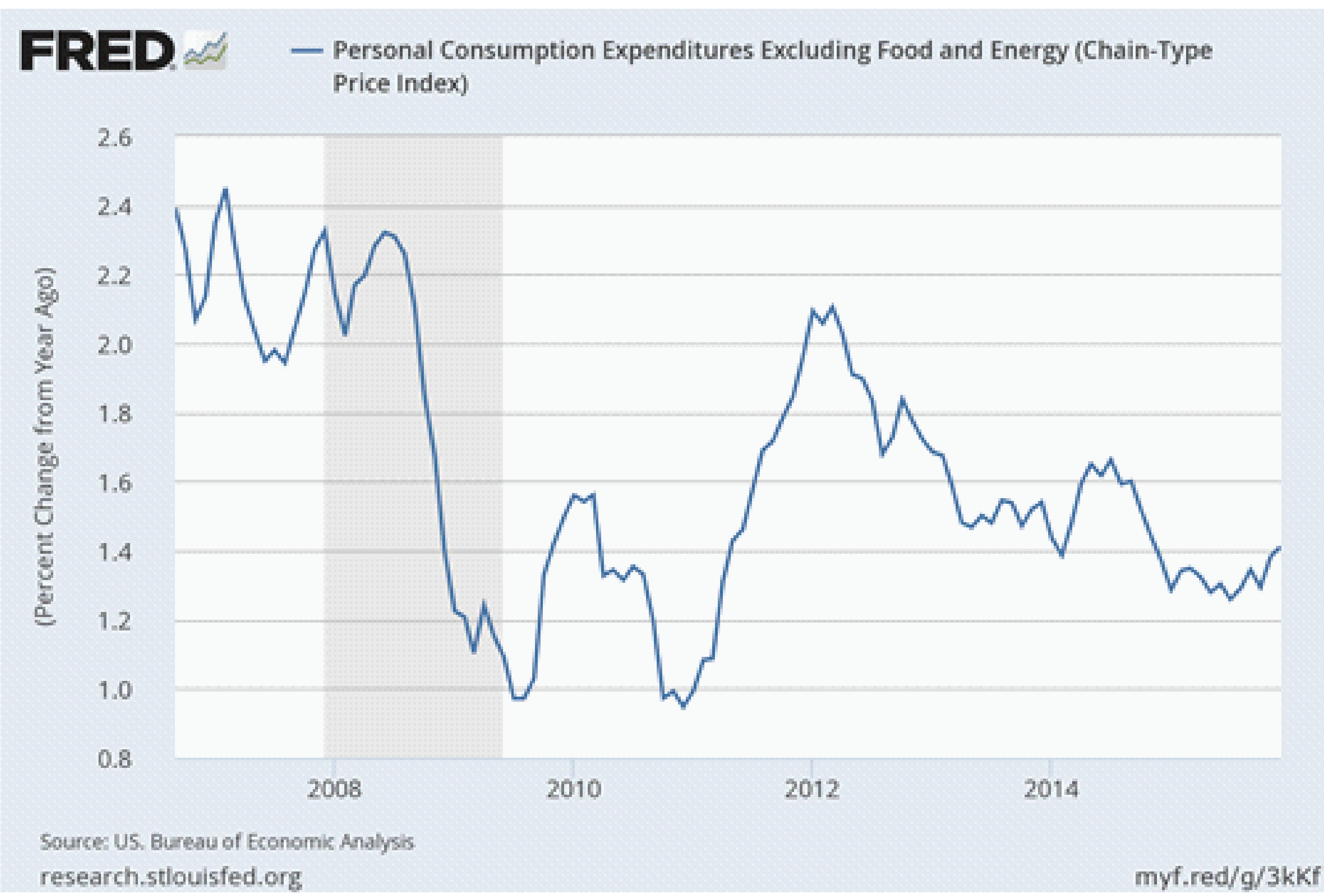

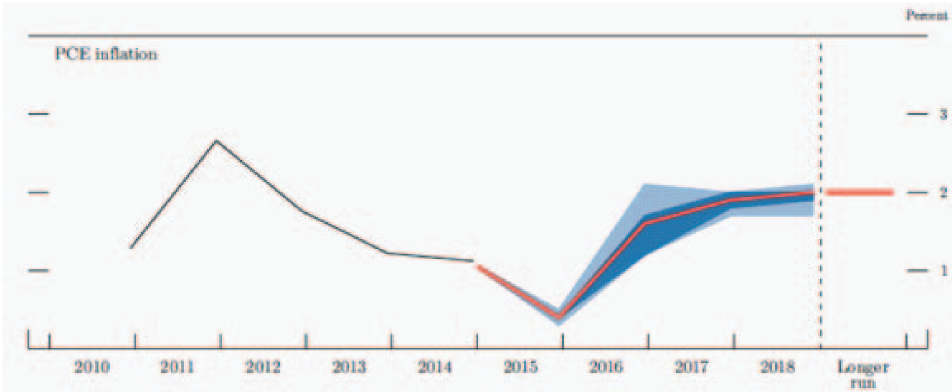

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over 10%. By 1981 inflation began to tame down, at the expense of higher unemployment that continued through 1982 before falling through the rest of the 1980s. But the inflation scare had contributed to broader concerns with maintaining price stability, and since the 1980s the economy has (on average) operated below full employment rather than above it – again according to Baker's analysis of the data. Aside from the late 1990s when the economy did operate above full employment, the Fed now pays more attention to taming inflation than to making sure the labor market has a clean bill of health before setting out to raise rates.

One of the earliest signs of Janet Yellen's willingness to support an increase in interest rates came from a speech she gave at the Philip Gamble memorial lecture at UMass Amherst in late-September. At that event, Yellen noted that the labor market at that time still appeared to be operating with a significant amount of "slack", meaning that unemployment and (by extension) worker insecurity were higher than suggested by the current unemployment rate. As the unemployment rate continued to fall, then, she expected the labor market to eventually tighten, spurring inflation as resource utilization further strengthens.

Indeed, in the minutes published 3 weeks after the FOMC's meeting in December, it was remarked that "[a] number of participants [at the FOMC meeting] observed that wage increases had begun to pick up, or that they appeared likely to do so over the coming year... [a]lthough many participants judged that the improvement in labor market conditions had been substantial, some others indicated the further progress in reducing labor market slack would be required before conditions would be consistent with... maximum employment" (emphasis added by the author). These concerns of "some others" clearly did not win out, while the simple appearance of wage increases was enough to set the FOMC on the path to a rate increase.

Instead of letting the labor market continue to improve, the FOMC decided in December that inflation was the bigger concern, and that is why Janet Yellen directed the FOMC to raise rates. In doing so, the FOMC is not deviating from past Fed policy, but it is sending a signal to millions of workers that the Fed does not represent them or their interests.

We're Still on Facebook!

Joining us on Facebook is an important way of keeping up with Departmental news and events, as well as getting information on political economy.

Simply search for The CSUSB Department of Economics on Facebook and you'll find us. We're easy to find. If you've not already done this, do it today!

Economics Department Recruiting Two New Faculty Members

Toward the end of the last academic year, the CSUSB Department of Economics was given the approval to search for two new faculty members. The search was started last summer by developing an ad and placing it in the *Job Opennings for Economists* (JOE) site run by the American Economics Association (AEA). Other economic associations were also informed of our search.

The department received over 520 applications from a wide range of economists scattered throughout the United States as well as the United Kingdom, Spain, Canada, Australia and Latin America. After reviewing the supplied information (curriculum vitae's, letters of recommendation, sample papers, etc.), the departmental recruitment committee selected the top 18 candidates for face-to-face interviews at the AEA meetings held in San Francisco in early January of 2016. After that, the departmental recruitment committee narrowed the list of candidates to the top four, who were then brought to campus to meet the rest of the economics faculty and top administrators. While here, these candidates presented a seminar on their research.

At this point in time, the department is narrowing the search to the top two candidates and getting ready to make offers of employment. We don't know who the two new faculty will be, but you can be assured that the CSUSB Economics Department spared no effort in finding the best candidates. You will be informed of the new faculty in the Spring issue of T*he Coyote Economist.*

SPRING 2016 SCHEDULE OF COURSES					
#	TITLE	DAYS	HOURS	AM/PM	INSTRUCTOR
200	PRIN MICROECON	MW	1000-1150	AM	ASHEGHIAN
200	PRIN MICROECON	MW	0200-0350	PM	ASHEGHIAN
200	PRIN MICROECON	TR	0800-0950	AM	MACDONALD
200	PRIN MICROECON		ONLINE		ALDANA
202	PRIN MACROECON	MWF	0800-0910	AM	HAYES
202	PRIN MACROECON	MWF	1040-1150	AM	NILSSON
202	PRIN MACROECON	TR	0400-0550	PM	KONYAR
202	PRIN MACROECON		ONLINE		ALDANA
300	INTERMEDIATE MACROECON	MW	0200-0350	PM	HAYES
335	TOOLS OF ECON ANALYSIS	TR	1000-1150	AM	MACDONALD
360	ENVIRONMENTAL ECON	TR	0400-0550	PM	DULGEROFF
410	MONEY & BANKING	MW	0600-0750	PM	PIERCE
450	GLOBAL ECONOMY	MW	0400-0550	PM	ASHEGHIAN
490	ECONOMETRICS	TR	0600-0750	PM	KONYAR
500	HIST ECON IDEAS	MW	1000-1150	AM	TORUNO
530	THE GOOD ECONOMY	MWF	1200-0110	PM	NILSSON

SUMMER 2016, 6W1 (June 22 through July 27)					
#	TITLE	DAYS	HOURS	AM/PM	INSTRUCTOR
200	PRIN MICROECON	MW	0100-0450	PM	ASHEGHIAN

SUMMER 2016, 6W2 (August 2 through September 6)					
#	TITLE	DAYS	HOURS		INSTRUCTOR
202	PRIN MACROECON	TR	0100-0450	PM	ASHEGHIAN