

Weekly Commentary with Professor Jeremy J. Siegel

Richmond Fed President Tom Barkin on the Economy ***Tuesday, 26/5/2020***



Jeremy Schwartz, Executive Vice President, Global Head of Research for WisdomTree, hosts a weekly discussion with Professor Siegel, typically on the Wharton Business Radio podcast. The notes below summarize their conversation along with further commentary and context.

We had the great pleasure of hosting Richmond Fed President Tom Barkin with Wharton Professor Jeremy Siegel on our Behind the Markets podcast on Friday. Professor Siegel commented how health care and frontline emergency workers are the first in line for praise during this pandemic—but the Federal Reserve (Fed) is perhaps 2nd in line to those we all should be thankful for, given all of the steps they've taken to support the health and functioning of our economy.

The operational elements of re-opening businesses have commenced in all 50 states, some even accelerating the opening under growing pressures. But many consumers are still scared. Businesses operating below capacity will lose money, not only from lack of customers, but also from the additional costs of opening. But they hope to preserve their customers and thrive as confidence returns.

Barkin is watching China and South Korea retail activity closely for signals of what to expect here—both countries have been open for 3 months and retail activity, he claimed, is still 25% below pre-virus levels.

Professor Siegel discussed the 25% increase in money supply since March 9th—and he asked Barkin how the Fed would respond to inflation pressures that might be anticipated as the economy re-opens.

While it is hard to see inflation 'now,' with the April Consumer Prices Index (CPI) being negative and other deflationary signs, Barkin agrees that the Fed should always be looking out to the horizon. Barkin commented that it is instructive to look back at the last 10 years when a lot of liquidity was also put into the system. The increased money supply just sat as excess reserves and did not find its way into the real economy. But Barkin admitted that this time might be different.

Barkin claimed that since the Fed pays interest on excess reserves, banks will keep all the QE on bank balance sheets and prevent it from being lent out to the real economy. Barkin noted the Fed could very well let its balance sheet roll off and bring it back down if there are these inflation pressures over time.

Jerome Powell emphasizes a symmetric 2% inflation target, so Professor Siegel inquired whether Barkin thinks inflation will run hot if the Fed would keep rates low.

Barkin has a hard time seeing economic growth returning and the Fed keeping real interest rates at zero—he thinks there is a natural rate of real interest and that it should be above zero. Barkin is also worried about keeping rates at zero lower bound for extended periods of time and thinks other pernicious impacts may come from keeping rates at zero too long. Professor Siegel believes that the Fed will be forced to raise rates, but keep those rates below the rate of inflation.

If the Fed has to raise rates to 2-3%, right now the Fed is buying a portfolio of bonds that have much lower interest rates. The Fed has generally been a source of healthy 'profits' to the Treasury given the interest earning on their balance sheet and a low cost of funds. This spread paid back to the Treasury may come down and put some more pressure on our deficit.

How much is temporary vs. permanent damage due to the economic shutdown?

Right now the pandemic is most impacting the lower wage workers in retail, hospitality, and travel related industries. Barkin sees the economy opening fairly slowly—so he is focused on how to retrain workers. He does not see infrastructure projects being a solution here. Rather we are likely to need more help in home health care and contact tracing and new online learning practices will hopefully help.

Barkin wants to see certificate training programs made available to more people. As an example of what we can do there—Pell grants are not available for certificate programs and he would like to see that.

The employment to population ratio last month was the lowest it has been since 1973—which is when women increasingly entered the workforce. We've also had rising labour force participation from people over age 55.

With daycare shut down and camps closed—and the virus leaving a greater toll on the elderly—Barkin sees pressures on the labour force which will decrease the productive capacity of our economy.

On the positive side, Barkin claims there are new productivity enhancers coming from technology—like telehealth programs that are being tried now and proving to be quite effective.

We are thankful to President Barkin for taking his time ahead of the memorial day weekend holiday to share his thoughts with our program and thank him for all the Fed is doing. To listen to our full conversation, you can go here: <https://soundcloud.com/user-20931378/behind-the-markets-podcast-president-ceo-of-the-bank-of-richmond-tom-barkin>

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