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Opinion **Global inflation**

Is a recession worse than inflation?

Economists have been asking people what they think

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People really hate inflation. (You've probably heard.) They see it as stressful and unfair. Whereas economists think a little inflation is a good thing, and a lot can be a sign that the economy is doing too well, about half of recently surveyed Americans couldn't think of a single positive effect. Recently, Neel Kashkari, the governor of the Federal Reserve Bank of Minneapolis, suggested that some might hate it even more than a recession. Really?

Unemployment might seem preferable to inflation for the kind souls who assume that job losses would fall elsewhere. But Kashkari's point was different. He had heard of some low-paid service workers who were used to managing recessions. If they lost their job they could rely on friends and family for help. But inflation hammered their whole network, making it harder to cope.

It's a little tricky to find evidence that high inflation made it harder to get support. The share of people saying that they would rely on friends or family to cover a $400 emergency expense fell steadily from 10 per cent in 2019 to 8 per cent in 2021, but recovered even while inflation was still high. It is possible that people are remembering the more recent recession when savings were plentiful, and not the grimmer one starting in 2007.

The broader question is how to balance trade-offs between unemployment and inflation. Although so far US inflation has fallen quickly without much visible damage to the labour market, the Fed could have to confront tricky trade-offs in getting it all the way back down to its 2 per cent target.

Economists have tried to quantify people's preferences between inflation and unemployment. A study by David Blanchflower of Dartmouth College and co-authors looked at how unemployment and inflation affected happiness in Europe between 1975 and 2013. It found that an extra percentage point of unemployment was five times worse for life satisfaction than an extra percentage point of inflation.

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Three much more recent studies try to capture preferences around the more recent inflationary episode. Unsurprisingly, given that inflation has been so high and the labour market so tight, people are more exercised about the former. Stefanie Stantcheva of Harvard University conducted a survey between December 2023 and January 2024 and found that around two in five respondents think inflation and unemployment should take equal priority, while another two in five think managing inflation should come first.

The two other studies try to pin down people's preferences more precisely, by asking them to rank specific scenarios. The results are a little mixed. The first one by two economists at the Federal Reserve Board finds that people would only tolerate a 0.6 percentage point increase in unemployment to reduce inflation by a percentage point. The other, by Stantcheva and co-authors, finds more than three times as much distaste for inflation.

It is a bit weird to find such different results from such similar exercises. The gap doesn't seem to be explained by the different circumstances at the time of the survey; the study showing greater hatred for inflation surveyed people later, when actual inflation was lower. (Though it could be that the cumulative experience of inflation makes people more miffed about it.)

The economists from the Fed suggest that if the other study found greater distaste for inflation, it could be because its scenarios were a bit more extreme. Perhaps at very high levels of inflation trade-offs change, and people are more willing to suffer through a bit of unemployment to get it down.

What does this mean for policy? Generally, the surveys suggest that while people will state their preferences when pushed, overall they are not at all keen to accept trade-offs. Optimistic consumers tend to think both low unemployment and low inflation are coming. Even those who dislike inflation are not prepared to pay the price of the higher interest rates that would bring it down. (Over half of respondents thought higher interest rates would raise inflation.)

The Fed authors compare people's preferences as recorded in their survey with those an economist might typically assume in a standard macroeconomic model. They find that in fact people hate unemployment more in reality, which holds whichever of the recent studies you believe. The prescription seems to be that policymakers should not interpret anger regarding the recent inflationary bout as evidence of a desperation to get inflation from 3 per cent down to 2. So policymakers' patience is justified. For now.

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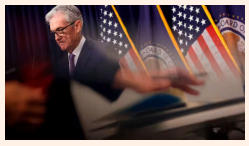

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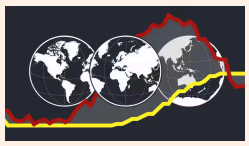

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duncombe 32 MINUTES AGO

Not really much choice at the moment - we have stagnation in GDP.
We did have stagflation from Spring 2021 to Spring 2023 but since then monthly CPI inflation has levelled off - just have to hope a second wave of wage-price inflation doesn't occur - apart from any externally driven inflation.
Parties can talk about renewed growth but it seems darned hard to get it going again.

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1298 24 MINUTES AGO

In reply to **duncombe**

When you have the world's most expensive energy, the world's most dysfunctional planning system, and the world's greediest, most obdurate NIMBYS then growth isn't going to drop into your lap.

If I were Labour I would tax the NIMBYS until they beg to be allowed to have some pylons or a new housing development placed within fairly close proximity.

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