

Lead Left Interview – Mickey D. Levy (Part 2)

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This week we continue our conversation with Mickey D. Levy, chief economist of the Americas and Asia, Berenberg Capital Markets. Mickey is a long-standing member of the Shadow Open Market Committee and conducts research on a wide range of global economic, financial and policy issues. *Second of two parts* – [View part one](#)

The Lead Left: Separate from the Fed, what should our domestic policy priorities be?

Mickey Levy: I'd love to see our elected official set aside partisan politics and achieve reforms in tax policy (both corporate and individual), energy policy and education policy. Also, with the Federal budget process effectively dysfunctional, policymakers have enacted a web of regulatory policies that has become so burdensome that it unnecessarily raises operating costs and dampens productive activity. Addressing these policy initiatives, rather than relying on more and more monetary stimulus, would be the right vehicle to lift growth. I recommend a starting point for each policy reform initiative: set aside polemics and identify initiatives that reasonable people on both sides of the political aisle agree upon. With purpose and calmer heads, there would be much agreement. Corporate tax reform is a good example.

TLL: Let's talk about the dollar. Do we need a weaker dollar to help exports?

ML: No. Attempts to manipulate the dollar would be misguided and only lead to unintended consequences. The stronger US dollar is constraining exports, but pushing down the prices of imports and increasing consumer purchasing power. When the Fed does raise interest rates, history suggests that whether the dollar will appreciate further is uncertain. Think of the dollar as a relative price in global markets; let it float and focus on policies that will generate stronger long-run growth and higher standards of living.

TLL: There seems to be confusion about whether inflation risk is present. What's your view?

ML: Inflation is modest. There's no threat of deflation—that is, a persistent decline in the overall prices of goods and services—nor is there a threat of significant rises in inflation in the near term. Following all of the Fed's massive quantitative easing that has bloated its balance sheet, it's important to remember that excess money is a necessary but not a sufficient condition for persistently higher inflation. The Fed's stimulus has failed to stimulate an acceleration in nominal spending, and the associated modest growth in business product demand has influenced the willingness of businesses to grant higher wages and how they set prices of the products they sell. Could higher inflation unfold? Yes, but that would take an acceleration in current dollar spending—that would create the environment for higher wages and inflation.

TLL: The Fed has a \$4 trillion balance sheet now. What risks does that carry?

ML: As long as the Fed's balance sheet is stuck as excess reserves (currently, \$2.5 trillion) and not put to work by banks, overall economic activity will not accelerate and inflation will remain modest. If economic activity does accelerate, as it has following past episodes of monetary stimulus—and this always occurs with a lag—then watch out for higher inflation. But even with low inflation, the Fed's policies are distorting economic and

financial behavior. Consider two domestic examples: by suppressing bond yields, interest income of retirees is severely squeezed—and keep in mind there are 63 million Americans 60 years old and older—and the Fed's policies are greatly accentuating income and wealth inequalities by boosting the stock market and home values that benefit higher income people while raising rental costs for lower income people who tend to be renters.

TLL: The US has a 5.1% unemployment rate. Does the underemployment rate concern you?

ML: I'm not concerned about the unemployment rate, but I am concerned about the fall in the labor force participation rate and the large number of unemployment and under-employment of youth, low-skilled and some minority cohorts. What's striking is the sharp decline in the labor force participation rate among younger people (aged 16-30) than among older people. Job and wage prospects for people lacking skills are dim. All of these pockets of under-performance in labor markets has to do with skills, educational attainment and incentives. There's no question but that the trends are affected by internationalization and technological innovations that are raising demand for skilled workers and lowering the demand for semi-skilled people; but that's the environment that we have to deal with.

TLL: Will job creation come up against structural or cyclical headwinds?

ML: With the unemployment rate below its longer-run average following 6 ½ years of economic expansion, these problems are structural and cannot be addressed by more "counter-cyclical" monetary stimulus. Simply put, these challenges are way beyond the scope of the Fed. What's critically important is identifying the true sources of labor market distress, and addressing them with the proper policy tools. There's a lot that could be accomplished. Unfortunately I see our elected officials in Washington grandstanding and passing laws that address the symptoms of the problems, often in ways that are either counterproductive or have unintended effects, and really don't address their causes.

TLL: Lastly, Mickey, what's been your biggest economic surprise so far this year?

ML: I have had two disappointments. First, I had expected the US economy to perk up. We have all this monetary stimulus, lower oil prices, improved balance sheets and consumers borrowing again, etc. I just don't buy into the dour secular stagnations' view that the US is mired in sustained low growth. There's just too much innovation, entrepreneurship and a history of progress. I think strong leadership in Washington and some meaningful reform efforts could lift the gray cloud hanging over the economy. Second, I'm surprised the Fed hasn't begun to raise rates. I think it's worries about the economic and financial responses to a rate increase are unwarranted and inconsistent with historical experiences, and it is too caught up in its forward guidance language. If the Fed just relied a bit more on economic sense, it would have raised rates—this would boost confidence in the economy and help economic and financial markets achieve a better balance.

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