The Economic Club of New York

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The Economic Club of New York

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Managing Director, Morgan Stanley

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Moderator: Kenneth E. Bentsen, Jr.
President and Chief Executive Officer
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Introduction

Good afternoon. Thank you for joining us. This is Barbara Van Allen, President of The Economic Club, and we will get started in exactly a minute and a half. Thank you.

Vice Chairman Michael O'Neill: Good afternoon, and welcome to the 541st meeting of The Economic Club of New York in our 113th year. I'm Mike O'Neill, Vice Chairman of The Economic Club of New York and retired Chairman of Citigroup. The Economic Club of New York is the nation's leading nonpartisan forum for discussions on economic, social and political issues. The mission is as important today as it ever was as we continue to bring people together as a catalyst for conversation and innovation. We proudly stand with all communities seeking inclusion and mutual understanding.

A special welcome to guests of our members and members of The Economic Clubs of Chicago and Washington, D.C. and members of SIFMA, whom we have also invited to join the webinar today. Delighted to also have joining us members of the ECNY 2020 Class of Fellows. Before we begin, I'd like to thank our healthcare workers and our frontline workers for all that they do, particularly during these challenging times, to keep us healthy and safe.

It's a pleasure for me today to introduce our guest today, Ellen Zentner. Ellen is the Chief U.S. Economist and Managing Director of Morgan Stanley, which she joined in

2013 from Nomura Securities International. Ellen serves on the Treasury Borrowing Advisory Committee, the Economic Advisory Panel for the Federal Reserve Bank of New York as well as the American Bankers' Association and is Chair of SIFMA's Economic Advisory Roundtable. She's a Director of the National Association for Business Economics as well as the NABE Foundation where she was a former president. Ellen holds a Bachelor of Business Administration and a master's degree in Economics from the University of Colorado.

Today's format will be a conversation, which we are fortunate to have ECNY Club Member Kenneth Bentsen, Jr. doing the honors. Ken is President and CEO of SIFMA. He is also the CEO of the Global Financial Markets Association, SIFMA's global affiliate, and Chair of Engage China, a coalition of 12 U.S. financial services trade associations united in support of high-level engagement with China. Previously, he served as President and earlier as the Executive Vice President of the Public Policy and Advocacy for SIFMA where he was responsible for SIFMA's legal, regulatory and legislative affairs and advocacy initiatives. From 1995 to 2003, he served as a Member of the United States House of Representatives from Texas, where he sat on the House Financial Services Committee and separately on the House Budget Committee.

We will end promptly at 2:45 and any questions that were sent to the Club from members in advance were shared with Ken. As a reminder, this conversation is on the record as we do have media on the line. So Ellen, over to you. Good luck on what I suspect is a difficult task of predicting the next six months.

Conversation with Ellen Zentner

ELLEN ZENTNER: Thank you.

KENNETH BENTSEN, JR.: Great. So Mike, thank you as well for having us. And I might say at the outset, we did – to your point – we did receive some questions that were sent in beforehand and I think, working with Ellen, we've wrapped those into the conversation that we'll have. So hopefully we'll hit the mark for those who were kind enough to submit questions.

MICHAEL O'NEILL: Terrific.

KENNETH BENTSEN, JR.: So maybe to get started, as you pointed out, Ellen is going to talk about both her own views and her forecasting – as difficult as that is in the current environment for every type of economic forecast – but also, we'll touch on SIFMA's Economic Advisory Roundtable's midyear report that we just released last week.

So Ellen and I had a chance to talk this week as we prepared for this event and notwithstanding the report that our roundtable put out last week, subsequently we also had a jobs report that came out last week, a report that was far different than pretty much every analyst or forecaster had thought it was going to be where May unemployment went down to 13.3% from 14.7% in April as the U.S. added 2.5 million jobs. And so we thought we'd start with that. And maybe, Ellen, how was it that so many analysts missed the mark on that?

ELLEN ZENTNER: Yes, thanks Ken. So, a lot of the data is fraught with measurement issues at this time. And, of course, we're going to talk about inflation a little later on, also measurement issues there. For instance, how do you get a handle on hotel prices when hotels are closed? And so the employment report is no different in that the BLS advised its survey takers to count those that are unemployed due to Covid in a specific way and many of them have been counting them as unemployed for other reasons. And so what that has done is resulted in a much lower unemployment rate than probably the true underlying rate. Now while the unemployment rate came down in April, we estimate that it's still running around 19% rather than the as-reported number closer to 13%. But still, even that, sort of what we call shadow unemployment rate, it's still lower than it was.

Now, on the jobs number, we have to remember that this is net jobs created. So economists are trying to forecast first and foremost the number of job separations over the month and, in fact, about 9.3 million workers were separated from their jobs in May and that broadly is in line with what we were getting in the weekly jobless claims data. But we also have to forecast the other side of the coin and that is how many workers did we bring back? That is more uncertain because we don't have high frequency data that we can use to point to how many are coming back. We know that the states were opening up. We know that businesses opening would have to bring some amount of workers back. And it turns out that we did, we brought back 13.1 million of them. So that resulted in that net job gains of a couple of million jobs which was surprising but ultimately good news.

So, here's where I come in as an economist. We're the dismal scientists and any good news we're supposed to throw water on. So here's the water. We're still about 19.5 million jobs below the level that we were in February. And so we've got a long way to go, but the economy is opening up. We'll continue to bring jobs back. And I think the risks that we're watching beyond how many jobs we bring back when we're all opening up is that, you know, the only way to see this play out if we're right and the unemployment rate comes down as people come back is if that unemployment rate decline starts to stall at some point. And that's where we would then become concerned that we're just not going to bring back as many workers as we thought. But so far, we're off to a good start.

KENNETH BENTSEN, JR.: And you sort of underscore the difficulty in forecasting. Forecasting is difficult in more benign environments. Obviously, this is far from a benign environment and some have even been skipping their forecasts, right?

ELLEN ZENTNER: Sure. Some have definitely been skipping their forecasts. The most well-known is the Fed who skipped its own forecast back in March. So they needed to focus on developments at hand, injecting liquidity into the economy, getting these extraordinary measures put in place, and battling the very sharp drop in demand and closing of the economy. And frankly, if they had put out forecasts at that time, they wouldn't have been very credible and so the Fed would have been spinning its wheels.

From about mid-March, which is when I began working from home, until about mid-April, I revised our forecast at Morgan Stanley no less than three times, which is just incredible when these tend to be – you know, forecast updates are few and far between. And that's because each time I would put out a forecast, there would be a greater number of states that would shut down than I had built into my assumptions. And it was really, only once it was clear that all 50 states were going to shut down, that we finally were hitting the mark on just how deep the downturn would be and were able to slow down the pace of forecast updates. So it's been, these are nail-biting moments for sure. And while things appear to be relatively more calm now, there is still a considerable amount of uncertainty around the outlook.

KENNETH BENTSEN, JR.: So, and again looking at the May numbers, are there any – and obviously, you know, it's hard to predict what June will be, but were there any green shoots in the May numbers that maybe gives us an inkling towards June?

ELLEN ZENTNER: Yes, I think that, well, we're going to continue to see jobs coming back because states are moving through their phases of reopening – albeit to different degrees. And so we're going to see a lift in activity just because a lot of pent-up demand is going to come through. So we shut the economy down for two months and we plugged the hole in income with fiscal support for all those that have lose a job. So a lot of pent-up demand will be coming through, and I suspect we'll continue to see that pent-up demand come through all the way through July.

So, one good example of that pent-up demand is motor vehicle sales. Dealers are telling us that they're having difficulty finding enough vehicles because not only did demand drop off but so did production. So it's not like we had some big inventory overhang. Used cars, very difficult to find enough used cars because there's not enough new vehicles.

Restaurant sales have picked up. And, to me, that speaks to the degree of trust that households already have in businesses to provide safe service. So there are some states that already have restaurants open. And so it's really some of the hardest hit sectors during the shutdown that are going to show the biggest rebound. The outlier to all that is, of course, the high-density services which are the obvious outlier and those are going to be the last to come back because it may not be until after a vaccine that some governments allow those high-density events, let's say, to occur. So that will be lagging.

But I want to keep drawing back to, you know, rather than being so focused on what's going on now because this is really a structural factor of opening up the economy and allowing more activity to take place, I'm more focused on what the labor market confidence, incomes look like six months from now, especially as government support is fading. And at a time when the unemployment rate is still elevated, and I know we'll talk about this a little bit later on, or I'll touch on it, but the possible second wave of infection.

So, Chair Powell and the FOMC are also focused on what the economy looks like, say six months from now, as opposed to the data unfolding today. And, you know, given these uncertainties, the Fed has communicated that it continues to be willing to use its tools to an unlimited extent as necessary and it sees rates remaining where they are today for a few years. Yesterday, we got the FOMC meeting, and probably my favorite quote from any Fed Chair ever was Jay Powell's quote, "We're not even thinking, we're not thinking about raising interest rates, we're not even thinking about thinking about raising interest rates." I mean there's no more powerful forward guidance than that.

KENNETH BENTSEN, JR.: Yes, that's certainly a departure from the famous Alan Greenspan Fed speak, it probably couldn't be more clear in what you were trying to communicate than that. Maybe shifting gears for a second, well, really two things. One is, well, shifting gears, let's go to this. On global economic growth, obviously there's also been, you know, we focus a lot on the U.S., but what's happening in Europe, what's happening in Asia? Are there things that you're seeing globally that we should be concerned about or that could have a spillover effect on the U.S.?

ELLEN ZENTNER: Well, I think what we're seeing is that actually the pickup in activity that we're seeing in the U.S., of course, has already been going on in parts like China, where it's a first-in, first-out, around the impacts of the virus. And over the last few weeks, if I split it up into developed market economies and emerging market economies, you know, we've seen significant improvement in mobility across developed market economies and emerging markets' mobility is also improving too, though not as strong as developed economies.

China's economy continues to recover in a very broad-based manner so that's good news. It's not just heavily loaded in one sector or another. And it's on track for its GDP to start growing again already year over year in June. We have our first year on year growth in GDP in the U.S. in the second quarter of next year. So quite a big lagged behind. If we lump together U.S., China, and the Euro area, it's improvement in the services sector that's been better than manufacturing. And, of course, the services sector is what's been hit the hardest here. And, so, you know, broadly in those developed markets we're seeing the same dynamics in the U.S. where the sectors that were lagging or were the most impacted due to Covid are those that are showing signs of improvement now.

And I'd just finally note that if we're looking at emerging markets outside of China, the improvement in the manufacturing sector is really what's driving that rather than services. You know emerging markets outside of China, particularly Latin America, are in the very early stages here of Covid-19 so they're going to see improvement from that quite a bit later than these other areas of the globe.

KENNETH BENTSEN, JR.: So, in terms of, you know, you talked about you're sort of thinking six months out, you know what's going to happen there in terms of labor market behavior, where we'll be in the cycle. I mean there are a lot of unknowns out there, right? How do you figure that out? How do you quantify it?

ELLEN ZENTNER: So, where do I start? It is a long list of unknowns. And so for instance, and this is the case for all of our economists that participate on SIFMA's

Roundtable Survey, you know, in terms of all of us, what were our assumptions for further policy support we get from Congress this year or from the Fed this year? How large will the Fed's balance sheet get? That matters for an economic outlook. How will the election affect sentiment? Remember, we have a presidential election this year which has sort of gotten overshadowed. Will U.S.-China trade tensions come back to the fore? Will that be enough to roil markets? Will a second wave of infections occur in the fall? And to what extent do we see a return of shutdowns because of that? And then, how many folks will come back to work?

So these are all, you know, unknowns that we have to make heroic assumptions around when putting together economic outlooks that lead to that considerable uncertainty. You know all of those present a downside risk to already dismal forecasts. But, you know, I would add, though, that it's not unusual around cycle turns to have a laundry list of unknowns in the outlook. These just appear to be particularly big unknowns.

KENNETH BENTSEN, JR.: So given all of that, what you know and what you don't know – the known knowns, the known unknowns, and the like – what's your forecast for economic outlook in the U.S.?

ELLEN ZENTNER: Yes, so I think what first will be helpful is we provide a little bit of context for the situation we find ourselves in today. So let me do a little bit of comparison to where we were in SIGMA's Roundtable Survey released in December. So, in December, you know, we saw that GDP growth estimates were at 1.8% for consensus for this year and the probably of recession in the next 12 months was 25% on average. I mean it spanned, we spanned 10% probability to 65% probability so there was a lot of uncertainty.

But, at that time, economists expected the unemployment rate to tick up only slightly to 3.7% in 2020. We're in the double digits instead as you noted at the beginning. And the economy had been suffering because of the U.S.-China trade uncertainties and the supply chain disruptions emanating from that. But we signed a Phase 1 China trade deal in December. There was work going on around a Phase 2. At that time, manufacturing indices across the globe had bounced upward and it looked like we were coming out of that self-induced hit to growth.

And, of course, we weren't without concerns, because at that point the expansion had been extremely long. But the typical signs of overheating that precede economic downturns just weren't there. So, all together, the U.S. economy was holding up quite well.

KENNETH BENTSEN, JR.: And then Covid-19 hit.

ELLEN ZENTNER: Yes, so Covid-19 hit. You can pretty much take that December survey and rip it up, except for being able to make these helpful comparisons that I just went through because we woke up in a completely new world. So, we've had the sharpest drop into recession on record. We think we're declining more than 30% in the second quarter on an annualized basis. But we also think that it's proving to be the shortest recession on record.

Now, some of this is just the structural nature of the downturn and how we grow out of it. The National Bureau of Economic Research has just determined that February was the start of the recession. And, you know, from the data that we're seeing, the economy has begun growing again. So, from a technical standpoint, and because we believe this growth will be sustained, the recession might have ended as early as May, May or June as an official end. So very short-lived, but very sharp.

And so the, you know, Morgan Stanley's biotech analysts expect a second wave of infections in the fall so we've adopted that as part of our baseline. And, you know, during that time you can imagine as media reports are giving case counts, it's rising, there's worry over the second wave and what does it mean, households may turn a bit more cautious at that time. So after we come out of this with pent-up demand driving growth, you could see a bit of a flattening out in spending later in the year as we go through that second wave of infections.

Now we've assumed that lockdowns are not as severe around that second wave that we've just gone through because we'll have expanded hospital capacity at that time. So to us it's more of a confidence event at that time. And so, and then we have an inflection in growth next year after we get a vaccine which we're assuming comes in the spring and we sort of shake off the last vestige of Covid-19 impact. So that's the general shape of growth that we're looking for.

We've got GDP returning to the pre-Covid levels by the end of next year. And while that's two years of lost growth in the economy, that's a much faster return than say the return to, of how long it took us to climb out of the hole after the financial crisis.

KENNETH BENTSEN, JR.: How does that compare or is that consistent with the consensus of the Roundtable Survey? Granted that that was, you know, conducted in the April 30 to May 28 range and, you know, things change on a daily basis?

ELLEN ZENTNER: Yes, so I think, you know, needless to say the bulk of economists do believe that it's going to take quite some time to climb out of the hole that we've fallen into. There was a wide range of views of how long it would take us to climb out of that hole. The consensus believes, are in line with our thinking that by the end of next year we'll have seen real GDP climb back to a level with where we were before Covid. But certainly there was a wide range of views that go all the way out, well into 2022, as to how long it would take us to climb back to those pre-Covid levels. And, in fact, after hearing from Chair Powell yesterday, that view, that it takes even longer is certainly more in line with what we saw out of the committee consensus expectations.

We also wanted to know from our roundtable of economists, though, you know, what might be the longer-term impacts, longer term implications for the U.S. economy coming out of this? And in speaking with the participants of the survey, at this point where we're still in the midst of coronavirus, and we're not quite sure what the other side of it will look like, you know, many questions do remain. And this is going to look like a laundry list like we gave at the beginning.

What is the timing of a vaccine? You know, the longer it takes to get a vaccine in place, we could see longer term impacts to the economy via a crisis of confidence among households. How much of the work-from-home arrangements will be more durable? You know, will the efficiencies that we see drive gains in productivity and employment lower? How will inflation be affected? And so answers to all of these questions matter when we think about the longer run implications for potential GDP.

And so essentially, you know, it's just too early to tell. The bulk of our economists said that their estimates of longer run potential GDP had not changed since they gave their assessment pre-Covid. But it's more a factor of it's just way too early to tell when we're trying to look at the economy five years out, ten years out, and what kind of fundamental way it will be impacted.

KENNETH BENTSEN, JR.: Yes, and I would note that three-quarters predicted, I guess what's now become known as a swoosh-shaped recovery. I think you used the term lazy J which I kind of like a little bit better. But, you know, is that, do you think that's still consistent, you know, particularly given what Fed Chairman Powell said yesterday?

ELLEN ZENTNER: Yes, I think it's certainly consistent with what Chair Powell is expecting, what we saw in the committee's forecast as well. Just the very lengthy return to any, you know, even near a semblance of full employment, how long inflation will be running below their estimate, what a sizable output gap will have grown during that time, which is that economic slack that they look to reduce?

So I would say that's consensus. I mean, in terms of the forecast coming out of our committee, we have a pretty strong consensus around about a 5 ½% drop in GDP for this year. So, again the sharpest that we've seen on record. And we're getting pretty, at this point, now that things are relatively calm, it's been easier to get a more centered consensus view. Next year, though, the dispersion in forecast grows again. And so we're looking for a 4.7% increase in growth next year but that is a much wider range of views of where we could be and mostly how we grow around Covid and what the path of Covid could look like.

KENNETH BENTSEN, JR.: You know in your own discussion of your own forecast and, you know, what January and February looked like, until you got to mid-March and then, you know, also looking back at the roundtable's year-end report that was released in December of 2019, which seems like more than, you know, six months ago, but a dramatically different view of economic growth, both in '20 and '21. Do you think that Covid perhaps revealed any underlying or fundamental issues or flaws with the economy that weren't otherwise picked up? Or do you think that this is just a real shock, just a black swan event type?

ELLEN ZENTNER: Yes, so I'm in the black swan camp, but I will touch on something else. So it is an exogenous demand shock of profound magnitude that no one could have seen coming. So, yes, very much a black swan event. You know if we think about the business cycle prior to Covid-19, there really was little sign of the traditional type of overheating that we would look for leading up to a recession.

Households weren't over-levered. Inflation was low. The unemployment rate was very low but wage growth was tame. And certainly there were spots that economists were watching. For example, commercial real estate valuations, non-financial – or what we call shadow lending – you know those were risks to the outlook as opposed to a certainty. But, in general, there was really nothing out there glaringly obvious that told us that we would be headed for a recession. And that's why we saw as a recession probability, in that December survey, it was still at 25%. So, one in four chances.

What Covid-19 has underscored, however, is that we never addressed income inequality in the aftermath of the global financial crisis in the way that we should have. And given the disproportionate effects of Covid-19 across income groups, it further widens that gap. And so we're seeing fiscal policy tackle that now. We think that it will continue in the future and we think fiscal policy activism is something that we should be paying close attention to.

KENNETH BENTSEN, JR.: So maybe that's a good segue into sort of the fiscal and monetary response, you know, the struggles, I mean the economic impact is beyond real. The Federal Reserve, the Treasury, the Congress have undertaken, you know, unprecedented actions to stimulate the economy, bring stability to markets, you know, it's like a flotilla of helicopters throwing out money – to use the Bernanke term I guess – to some extent. What do you see here and what's your impression so far of how this has gone? And is this enough?

ELLEN ZENTNER: Yes, so, yes, we have thrown a lot at this, a nearly unprecedented amount. I mean certainly the coordination we've seen between the Fed and Treasury we've not seen since World War II. And deficit to GDP ratio is approaching World War II-like levels, but even more support is needed. And so Morgan Stanley's U.S. Public Policy Strategists are looking for an additional trillion package to be passed by July 1. That is something that we're seeing move actively in Congress now. And that would extend important lifelines to small businesses and households as well as provide support for state and local governments whose revenues have just been decimated in this.

Now, as an economist, that latter element, the aid for state and local governments is something that we hadn't received yet. And, you know, when I think about what could be something that would have a notable impact on the outlook and make it take even longer to get back to any semblance of normal, it would be if come July state and local governments have to go to the table to start negotiating their budget and they have to run a balanced budget – unlike the Federal government that can run unlimited deficits. So when they go to balance that budget, 80% of the budget is labor.

Now, state and local governments represent about 13% of the total labor market in the U.S. and so they're going to have to make tough choices. In any downturn they're going to have to make tough choices and we're going to go through layoffs at the state and local level that have not yet occurred. So we're going to have to absorb those. But there would be draconian cuts to labor if they didn't get help to shore up state and local coffers. So that's part of that package as well. So more needs to be done there. If you were not to get that help for state and local governments, then you would start to see the unemployment rate move higher again when those layoffs begin occurring. So we think Congress is moving toward that package.

You know, in our survey, 67% of respondents expect no major non-Covid-19-related legislation. And we would agree, this would be the last major legislation before the election. And our respondents believe that if further major legislation were passed, it would be around fiscal stimulus that would include health care and items related to Covid-19.

So I think generally speaking the economics community sees that more is needed, but also sees that there's a limit to that. Things are getting better and that this would be the last bit of Covid-related stimulus we would get.

KENNETH BENTSEN, JR.: Yes, and I would note, I mean the programs that the Fed and the Treasury set up in the market space have certainly provided a fair amount of stability and then I think you noted some of the forbearance also that's been out there.

ELLEN ZENTNER: Yes, so we've seen a lot of preemptive programs, especially if we compare it to our response after the financial crisis. So, credit makes the world go ‘round and credit spreads are the most important component of the financial condition. I mean when they widen, it runs the risk of pulling the credit rug out from under the economy. And so that tends to have an immediate up-front impact with long tails on the economic outlook. So keeping credit flowing is extremely important and this tends to be where we see the Fed put a lot of its focus when it’s designing the programs.

The forbearance, as you mentioned, have also been put in place much faster than they were after the financial crisis and those are also helping to keep household balance sheets healthy. We’ve seen a tremendous take-up rate among households for the 12-month forbearance programs for mortgage payments for example. This has been put in place at a time when mortgage delinquency rates are at a record low compared with after the financial crisis when these same programs went into place in 2010, after we had passed the peak for delinquencies on mortgages and foreclosures and many households had already lost their homes. So this is a substantial difference, not just in the size of the response from Congress and the Fed, but in the speed of which they’ve responded. And it’s an important distinguishing factor between the recovery we think we’ll see this time and the recovery post-‘08, ‘09's financial crisis.

Just to give you a quick look at the household balance sheet, in 2007 going into the financial crisis, we hit about 136% debt to disposable income ratio for households. We were extremely indebted. And when the financial crisis hit, we needed to shed a lot of debt. And when we are focused, as households, on shedding debt, we take the focus away from other things – spending and driving that economic recovery. And so that deleveraging cycle took five years to get through. And so for five years we had extremely sub-par growth in the U.S. economy because of it.

And so this time we fast-forward, we never quite took on debt levels faster than growth in income. And we've gone into this downturn with, in the aggregate, incredibly healthy balance sheets where debt to income ratios were about on par and at 20-year lows. And with all of these forbearance programs and the government shoring up income during this difficult time, we think that balance sheets will come out of this in a much healthier way than we came out of the financial crisis and that alone can be a big factor in quickening this recovery.

KENNETH BENTSEN, JR.: That's a positive comment in terms of not having to get into a deleveraging type situation. But do you see any other structural, lasting structural impacts of Covid-19?

ELLEN ZENTNER: Yes, I think that, so near-term, long-term, so post-vaccine we see the greatest chance for an inflection in growth as we shake the last vestige of Covid-19 off. But, you know, we don't fool ourselves, I mean make no mistake life after Covid is going to be far from the pre-virus norm so consumer and business behavior will change. Certainly some of the change in activity will be temporary, the restriction of movement and operating capacity dictated by state governments.

But if we think about, you know, across the board we could see more durable work-from-home arrangements so moving some people away from urban centers and acceleration of existing trends such as e-commerce taking share. We'll see how that impacts overall economy. Last year we, at Morgan Stanley, we studied the generational effects of millennials and Generation Z. So in a large-scale survey, they told us they want to remain mobile, want quality of life. They want to be homeowners. And so we've identified at that time single-family rentals as a clear beneficiary. Covid-19 will accelerate that trend.

So we will see a lot of acceleration of existing trends. And you and I have talked a lot about, before this, about our own work-from-home arrangements and how they may be more durable. My husband and I live in New York City and so I have to remind myself every day that life takes place outside of this bubble. And most households in the U.S. had never ordered groceries online for delivery, but many have tried it now and that means that they may continue to do so to some extent.

So, you know, on the work-from-home, making significant investments to enable working from home. Business continuity plans are going to fold in work-from-home arrangements. You know, we've removed the stigma to working from home. We've shown that productivity rates – I don't know about you, but in my case, productivity rates have gone through the roof since I've been working from home. And so those more durable work-from-home arrangements are likely to remain.

So, think about it if you're a behavioral economist and you're thinking about, you know, how do we spend differently when we're working from home? Taking healthcare spending out of it because that is dictated more by age, but when we work from home our spending patterns are more like when we're in retirement. So these are the kinds of things, the framework we're going to have to build around forecasting going forward as we try to capture these changes.

KENNETH BENTSEN, JR.: So turn Modigliani on its head a little bit perhaps on some of his trends. But maybe in the time we have left, two things to talk about. One, maybe let's talk a little bit about the Treasury market and interest rates and then inflation. The first is that, you know, the survey found that 100% of the respondents did not believe interest rates would go negative or that the Fed would let interest rates go negative in the U.S. Why so strongly, why such a strong feeling on that? And what might happen in the Treasury markets?

ELLEN ZENTNER: Well, you know, I think, again going back to communication, Chair Powell and the FOMC have been extremely clear on where they stand on negative rates. Our money markets are structured differently than other countries. It would be detrimental to the U.S. has been their conclusion. They did very carefully study other countries' experiences with negative rates and have continued to drive that message home over and over again that it's just not for the U.S.

You know, 86% of the economists in our survey, if we think about where could the Fed go with rates from here, believe that they won't begin to normalize rates until after 2021. And we certainly saw this reinforced with the Fed's own dot plot yesterday where they showed an expectation in their forecast even out to 2022 where they're not likely to raise rates. So the Fed would certainly agree with that assessment.

So when the Fed does decide to begin raising rates, we asked our economists, you know, what would be the top factors that they would take into account in that decision making? The impact of Covid? A large-scale return to work? Whether there's a second wave of Covid or not? So in the view of our economists, you know, Covid-19 – at least in the near-term here – is determining the path for monetary policy.

I think, you know, one interesting area I'd like to highlight is our findings pertaining to yield curve caps. Most of our respondents, nearly 80% expect the Fed to embark on some form of yield curve caps. Chair Powell yesterday offered his view that the Fed has reviewed yield curve cap policies. It's ongoing so it does remain an open question and the FOMC will judge what's needed as events unfold and they're going to continue to discuss it in upcoming meetings.

You know, in my view, they would prefer to give, let's say forward guidance the right of first refusal. They can be pretty powerful if they're clear with their forward guidance on how long markets should expect rates to remain low. And to the extent that markets embrace that, yield curve caps would not be needed. But you could certainly grab for that if there came a time when the market starts to pressure the Fed on raising rates earlier than the Fed feels it's ready to. And in that case, yield curve caps would be much more forceful.

KENNETH BENTSEN, JR.: It was interesting, I read that yield curve caps have not been used since the Second World War, in the U.S. at least. It's really fascinating. And then lastly, with our time left, maybe talk about inflation. Obviously, the Fed is well below its inflation target. What was our survey's view? What's your view on where we may be headed? And obviously you had the jobs report from last week that maybe spurred some activity, but how do you see inflation?

ELLEN ZENTNER: Yes, so in our survey the bulk of respondents expect inflation to fall

– and this is core PCE, so the Fed's preferred measure – to fall to just .9% this year. So very much consensus around this being a demand shock that creates near-term disinflationary pressures. The top factor in the forecast is basically the recovery time from Covid, so what does demand look like on the other side of it, and economic slack which, of course, would be more related to how quickly we bring workers back and how we get the unemployment rate down.

In terms of, you know, the probability of outright deflation, so falling headline prices, not just slowing prices, 41% of our economists see a 15 to 25% probably that we could see all-out deflation over the next two years followed by 32% that had a zero to 15% probability. So in most cases, you know, a very strong view around disinflation but a meaningful amount of economists believing that we could actually see outright deflation as well.

But I think, you know, the question really gets at, you know, inflation further out. You know, whether the U.S. will experience structurally higher inflation of the longer term. Forty-five percent of respondents gave this a zero to 15% probability. So very few seeing a significant probability of actually seeing structurally higher inflation. And, you know, that consensus view is quite different than our own expectation at Morgan Stanley where we see a greater chance for structurally higher inflation over the longer run.

So consider this, the rebound in demand will be quicker than in previous recessions and basically because of the lack of overheating going into this as I had noted. We have an extraordinary expansion policy support and will be running structurally higher levels of debt. That's also in our view. These include fiscal policy activism, automation backlash, tougher antitrust policies, trade protectionism, rising wage pressures. And so these are the kinds of things that lead us to believe that we can't just easily assume that the factors holding inflation down for the past 30 years will be the same factors holding inflation down or will still be holding inflation down as we go forward. So that's some good food for thought maybe.

KENNETH BENTSEN, JR.: Ellen, thank you for that. And Michael, I think we're at our point. I would, if I might note for the viewers, SIGMA's Economic Advisory Roundtable midyear report is on our website at SIGMA.org. for those who would be interested in looking at it. And thank The Economic Club of New York for allowing us to present today.

MICHAEL O'NEILL: Well, Ken and Ellen, thank you for sharing your very informative comments. I'm pleased to report that we've got many great speakers coming up this summer and I'd like to remind and encourage you to invite guests to our events. Up next we have Elena Botelho, a partner at ghSMART and Bill McNabb, the former Chairman and CEO of Vanguard. That's on June 18. On June 24, we'll have Larry Summers, Charles W. Eliot University Professor and President Emeritus at Harvard University. On June 29, the Managing Director of the IMF, Kristalina Georgieva. So a good line-up and more to come in the fall. Please continue to monitor our website. We'll also be sending out emails. So thank you again for joining us and thank you again to Ellen and Ken.