The Washington Post
Democracy Dies in Darkness

ECONOMIC POLICY

As recession fears rise, Washington begins to weigh how to respond

White House and Federal Reserve officials remain focused on inflation and confident in the economy's trajectory

By Jeff Stein

Updated October 20, 2022 at 4:34 p.m. EDT | Published October 20, 2022 at 4:32 p.m. EDT

Amid intensifying forecasts of a U.S. recession, Washington policymakers are beginning to confront their limited options for easing the effects of a slowdown accompanied by high inflation – a confounding set of economic conditions that would present starkly different challenges from recent downturns.

Officials at the White House and the Federal Reserve say that they continue to believe a recession can be avoided and that they remain focused on fighting inflation, which is rising at rates not seen in four decades. But with Wall Street trembling, and many private forecasters warning that recession is likely, preliminary talks about policy options are underway around town.

On Capitol Hill, congressional officials have begun discussing the challenge of intervening to alleviate the pain of a recession in ways that do not exacerbate inflation. At the White House, aides have informally begun weighing hypothetical options, such as unemployment benefits and food stamp assistance. And at the Federal Reserve, staffers have discussed with outside analysts how monetary policy could simultaneously respond to an economic contraction and high prices — a dual challenge it has not faced in decades.

"I'm asked a lot by policymakers what we should do during the next recession if inflation is still high — this is very much on their minds right now, including inside the Biden administration," said Wendy Edelberg, director of the Hamilton Project and a senior fellow in economic studies at the Brookings Institution, a center-left D.C.-based think tank. "I have talked to them about it."

Experts generally agree that a downturn now is unlikely to cause the kind of deep rupture in the labor market seen during the Great Recession of 2008-2009 or the 2020 collapse in the face of the pandemic. Many analysts predict that any downturn is likely to be "mild," with unemployment staying below 5 or 6 percent. The current unemployment rate is 3.5 percent.

But Washington's options for providing relief could be constrained by the effort to fight inflation. During the pandemic and the Great Recession, Washington flooded the economy with aid to the unemployed and other cash supports. If enacted now, such policies would risk pushing inflation higher. Meanwhile, with the Fed hiking interest rates faster than it has in decades as part of its battle against inflation, the new federal spending would require additional borrowing at a time when debt is becoming increasingly expensive.

"Typically in a recession, where inflation is not too high, monetary and fiscal policy try to stimulate demand to stimulate our way out of a recession — which has the effect of bringing up inflation from too low a level," Edelberg added. "But in this case, stimulating our way out of a recession would be counterproductive to the efforts to also fight inflation."

Joe Brusuelas, chief economist at RSM, said Fed staffers had reached out to him to discuss how economic turmoil abroad could weigh on the U.S. economy and how financial markets would respond if a recession happened while inflation was still high, or if there was a more conventional recession that happened in tandem with global economic upheaval. "It was within the context of the current environment, which is more external than U.S.," Brusuelas said.

In a statement, a senior White House official disputed the idea that the administration was preparing for a recession and emphasized aides' focus on inflation. The job market has proven very resilient despite the central bank's rate hikes — unemployment claims fell to a three-week low in mid-October, a report out Thursday showed. Another report next week is expected to show economic growth in the third quarter of this year.

"The White House is not planning for a recession — the economy is showing growth, and the unemployment rate is 3.5 percent, the lowest in 50 years," said Heather Boushey, a member of the White House Council of Economic Advisers. "We are working on bringing down inflation, and focused on lowering the cost of living."

Policymakers around Washington are adamant that they are concentrating on lowering prices in the face of the highest inflation in 40 years. The latest inflation report showed prices continuing to rise again in September, with "core inflation" climbing a worrying 0.6 percent over the month. The labor market has maintained its rapid growth, as well: The United States added 263,000 jobs in September, and the unemployment rate fell to 3.5 percent. In that context, some government officials dismissed the idea of planning for a recession now as premature.

But cracks have emerged that have many policymakers worried. The Federal Reserve's campaign to cool inflation has led to a series of large interest rate hikes aimed at slowing consumer demand and spending. Despite the persistence of inflation and the strength in the job market, there are indications that the Fed's efforts are working: Housing demand is plummeting, and the stock market has fallen precipitously. The average rate for a 30-year fixed mortgage, the most popular U.S. home loan, rose to 6.94 percent in this week's Freddie Mac survey, a huge increase from 3.22 percent in January.

At the White House, some officials recently had informal discussions about potential policy responses to the next recession and the lack of obvious available tools, according to two people familiar with the matter, who spoke on the condition of anonymity to reflect private talks. Those talks touched on improvements to the unemployment system and increased food stamp benefits as potential measures that could buffer vulnerable Americans from a recession without boosting broad-based inflation. White House aides emphasized that such conversation was hypothetical and not a reflection of serious administration policy considerations.

The president has also summoned aides to brief him on the potential for a similar panic in financial markets to the one in the United Kingdom, one person familiar with the matter said. The aides found that such an outcome was highly unlikely. This briefing was first reported by the New York Times.

“We may have to think about this recession in terms of very targeted relief; it’s a much more subtle strategy,” said one person aware of the administration’s “highly preliminary” talks, speaking on the condition of anonymity because they were not authorized to speak to the media. “We are trying to prepare for a recession where there is also inflation, and so the sweeping recovery bills in the style of the American Rescue Plan or the Cares Act or the Recovery Act are off the table — economically and politically.”

Congress is starting to wrestle with similar questions. At a bipartisan briefing for staffers earlier this week, three policy analysts — Edelberg; Michael Strain, director of economic policy studies at the conservative-leaning American Enterprise Institute; and Marc Goldwein, senior vice president of policy for the Committee for a Responsible Federal Budget — fielded questions about how lawmakers should weigh options for responding to a recession. Several Democratic members of Congress have also separately asked about potential policy responses to a recession in the next year, according to Strain.

“They’re asking for the policy options available if we have a recession,” Strain said. “I suspect the administration is concerned about the possibility of a recession in 2023.”

The most difficult challenge in an inflationary recession may be that faced by the Federal Reserve. Typically, when downturns emerge, the central bank lowers interest rates to stimulate demand. But a recession that starts while inflation is still high would complicate that response. Federal Reserve officials at an annual conference in Jackson Hole, Wyo., in August held both formal and informal discussions about the difficulty the central bank would have fighting inflation and a recession at the same time, according to Eswar Prasad, an economist at Cornell University who worked as a lead economist at the International Monetary Fund.

Among the challenges facing the bank is that its balance sheet remains large from its response to covid, limiting the extent to which it can buy assets to prop up spending. Its other major tool — interest rates — would face similar constraints, because any cut to rates to juice economic demand would work against this year’s attempts to contain inflation.

A spokeswoman for the central bank declined to comment.

“This is a real conundrum for both monetary and fiscal policy right now. How can policymakers avoid stoking inflation while still supporting a weakening economy that is heading toward a recession?” Prasad said. “The tools involved are very different.”

Rachel Siegel contributed to this report.