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ECONOMIC TALKING POINTS

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Producer Prices Jumped in March. Expect CPI To Do the Same. But Ignore Alarms of Rampant Inflation Ahead.

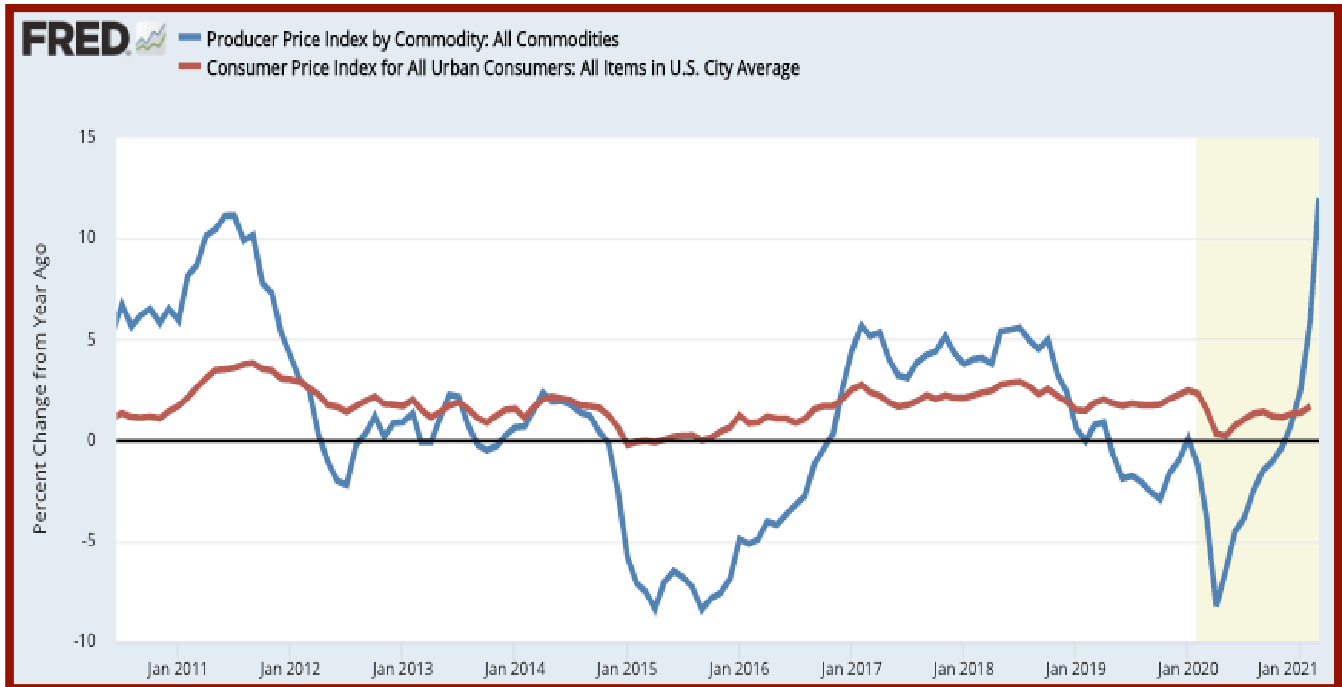
Two events were certain to happen today. The first was a report showing producer prices (PPI) had shot up in March. The second well anticipated event was the hyperventilation that would follow by analysts who say it is a foreboding sign the US is on the cusp of the worst inflation in 40 years.

Our recommendation on the latter group is to breath…breath…breath.

A computer glitch at the BLS initially delayed the release of the PPI by more than half an hour. But this seemingly innocent complication only fired up more speculation that the inflation numbers would be worse than forecast.

That turned out to be the true. Final demand producer prices jumped 1% in March, double that of February. It was, however, the annual change that startled most. PPI surged 4.2% over the past 12 months, the biggest increase in nearly 10 years. And if you took out the volatile components of food and energy, producer prices rose 0.6% for the month and 3.1% over the year, the latter being the fastest since 2018.

All these numbers were larger than consensus expectations, in some cases double what was forecast. The outlook now is for PPI and CPI (consumer price inflation to be released next week) to accelerate further.



Should we be fearful that the US economy is entering a new era of chronic and corrosive inflation? Absolutely not!

Here's why. Let's try to keep current conditions in perspective. It was a year ago when the pandemic began to pulverize the US and international economy, causing prices to plummet. So any upward movement in inflation now would be exaggerated on an annual basis since it was 12 months ago when the economy and prices collapsed. I suspect many will nevertheless proclaim it as evidence that the days of low and stable prices are behind us and that the Federal Reserve is already dangerously behind the curve. And they have additional evidence to back up this view. The latest report by the Institute for Supply Management showed that prices paid by manufacturers in March was the most in 10 year and for the service industry the highest since 2008.

So why are we so placid about the path of inflation?

Look, we have no disagreement about where it is headed in the short run. Prices are increasing for raw material, intermediate goods and

finished products. But this does not represent the start of a secular climb with inflation spiraling skyward.

What's important to appreciate here is the context. The economy is recovering from a destructive, exogenous shock (Covid-19) that threw the world into a deep freeze. Factories, malls, transportation, restaurants, hotels were all shutting down on a scale never seen in modern history.

But that is now dramatically changing --- and at hyper speed. The economy is transitioning into a phase where consumers, businesses and governments are ramping up spending all at the same time.

This burst of economic activity is the result of an impressive roll out of the vaccine, some $5 trillion in fiscal stimulus pumped into the economy over the last year, very low interest rates and of shoppers that are eager to unload that boatload of cash they have accumulated during a year of hibernation.

Here's the problem. Satisfying this explosion in aggregate demand has become problematic. The pandemic severely disrupted supply chain networks around the world. Certainly the cargo ship blocking the Suez Canal could not have come at a worse time. Ports on the east and west coasts of the US are also unable to unload fast enough. Dozens of container vessels ladened with goods now rest idly off shore in a queue that can take as long as two weeks for their turn to port.

Adding to these woes is the fact that many US factories pursued "just-in-time" inventory strategies, which led to a severe shortage of key commodities. If you can't replenish your stock rooms, then production slows or ceases altogether. The most severe shortages are in semiconductors, graphite, copper, cobalt, steel (both hot and cold roll), plywood, soft lumber, corrugated boxes, rebar, reinforcing mesh, resins and even balsa wood, which is used for blades in wind turbines.

Retailers are waiting longer than usual for shipments of electronic goods, appliances and furniture. If you don't have them, you can't make a sale. The lead times between ordering goods and deliveries is now the slowest in 47 years, according to the ISM.

It is this scarcity, this temporary imbalance between demand and supply that has pushed prices higher.

Such bottlenecks, however, will resolve themselves over the course of the year and that should decompress the inflation pressures now building.

So, yes, it is likely prices will continue to accelerate as the economy "burns red hot" in the short run.

But let's not ignore the next chapter in this recovery.
- **Much of that pent-up demand will be satiated by 2022.**
- **The enormous fiscal stimulus will replaced by fiscal restraint.**
- **Corporate and individual taxes are destined to increase.**
- **The gummed up supply chains will soon clear.**
- **With economic activity and market interest rates higher in the US than the rest of the industrial world, the dollar should maintain its strength and limit import inflation.**

Finally, there's one other historical lesson we shouldn't dismiss. Prior to the outbreak of Covid-19, business conditions were robust, yet inflation was nowhere to be found. Let's recall some specifics of that time:

(1) The world economy was humming along at a 3% rate.
(2) President Trump's massive tax cuts provided considerable stimulus to the US economy.
(3) Monetary policy was anything but tight. The "real" effective federal funds rate was less 1% in 2019 —– and in the immediate years before that it was negative.
(4) Labor markets were incredibly tight! The number of job openings greatly exceeded those who were unemployed. Companies were thus aggressively competing to find suitable workers.

And yet despite these trends, both CPI and PCE prices remained stubbornly below the Fed's target of 2%. The lesson here is clear. In the perennial tug of war between forces that push inflation higher versus those that seek to depress it, the latter has ruled in recent years. Precisely why is a debate that has consumed economists. But we are STILL living in one of the greatest deflationary periods in modern economic history due to the ubiquitous use of productivity-improving technology, eCommerce, globalization, changing demographics, and a decline in union membership.

So for those who warn of rampant inflation ahead, I say relax, keep breathing. The inflationary scare will fade the next 12 months. There's no reason to fear its shadow.

United States

	I 2020	II 2020	III 2020	IV 2020	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023
Real Gross Domestic Product (GDP):																
%	-5.0	--31.4	33.4	4.3	5.2	5.8	5.3	6.7	3.8	4.9	5.5	4.2	2.8	3.5	3.1	2.9
Personal Consumption Expenditures:																
PCE %	-6.9	-33.2	41.0	2.3	5.5	6.6	5.1	6.0	2.4	5.2	4.2	3.6	3.1	4.1	2.8	3.5
Inflation, end of period, year-over-year:																
CPI %	1.5	0.6	1.4	1.4	1.5	2.4	2.5	2.7	2.5	2.5	2.3	2.2	2.5	2.6	2.6	2.7
Unemployment Rate (end of period):																
%	4.4	11.1	7.8	6.7	6.0	5.8	5.7	5.6	5.4	5.5	5.6	5.4	5.4	4.9	4.4	4.1
Non-farm Payrolls, monthly avg. thousand:																
	-303	-4,427	1,322	213	539	455	510	620	424	325	265	240	185	225	235	250
Treasury 10-yr Note Yield % (end of period):																
	0.63	0.65	0.68	0.91	1.75	1.71	1.65	1.79	1.77	2.05	2.00	1.94	1.90	2.05	2.00	2.10
Federal funds rate % (end of period):																
	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.13	0.38	0.88	1.13

GDP Growth - Global Economy

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
US	2.6	1.6	2.2	1.8	2.5	3.1	1.7	2.3	3.0	2.2	-3.5	5.8	4.6	3.1
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.9	1.2	-6.8	3.3	2.5	2.0
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.5	-9.9	4.4	4.6	3.1
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	2.2	0.3	0.7	-4.8	2.4	2.8	2.2
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.0	1.6	-5.1	5.4	3.4	2.9
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	4.8	-8.2	9.1	6.4	5.7
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.3	6.9	5.7	5.6
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.1	-4.1	2.9	2.7	2.4
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-8.3	3.3	2.8	2.7
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	2.5	3.0	2.7
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.2	-3.1	2.4	3.3	2.0
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.9	-4.2	4.4	4.2	3.9

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