
THE ECONOMIC OUTLOOK GROUP



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ECONOMIC TALKING POINTS

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PCE Inflation Spikes in April. More Serene Waters Ahead

Imagine sitting in a raft heading down a serpentine river. The water is fairly calm for now but up ahead you see the violent turbulence of rapids. You brace yourself for the coming rough ride. It will be a wild, bone-shaking experience. But just beyond the whorling white foam, you also see the river turns serene again.

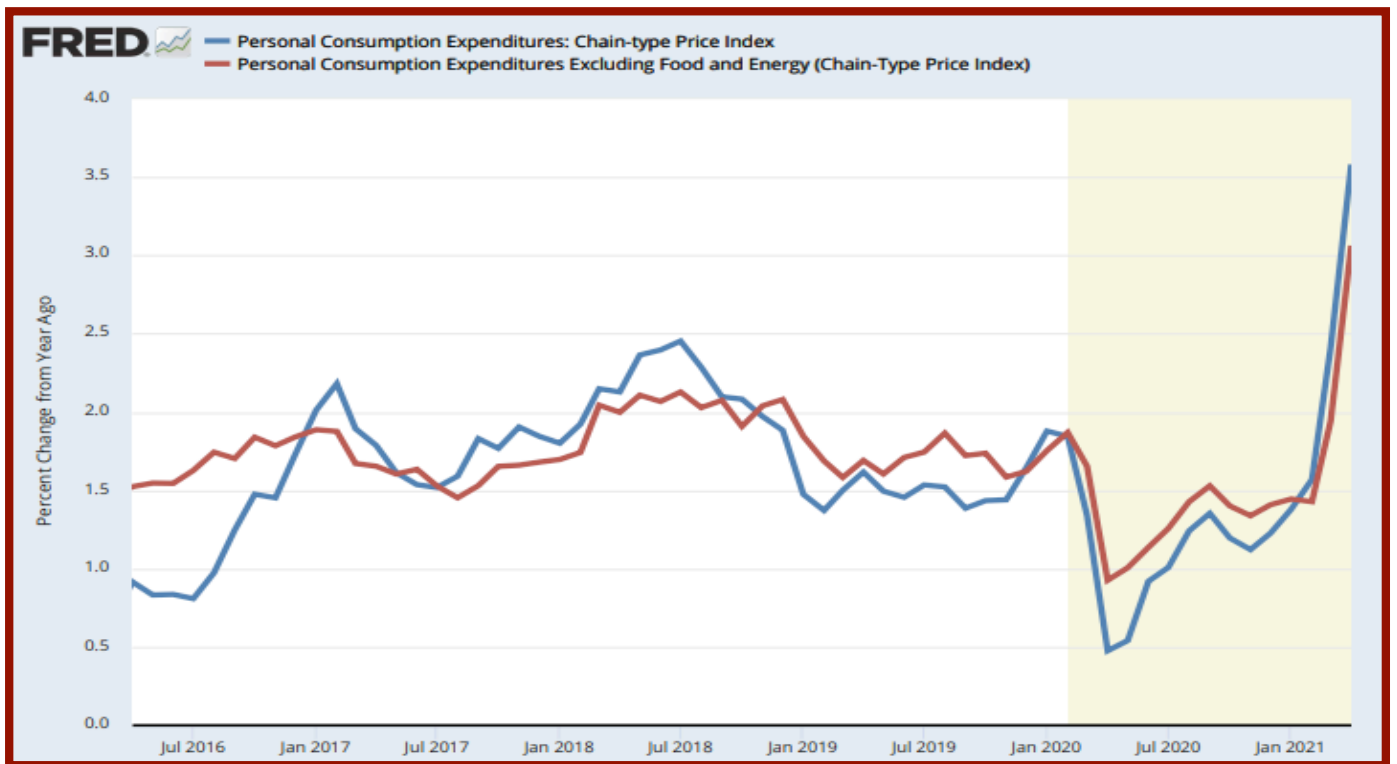
It is a fitful image that can be applied to the behavior of prices. We are now in the midst of a tumultuous inflation ride, one that was fully expected and believed to be short term in duration.

Let's remember it was precisely a year ago when the pandemic pulverized the economy and hammered annual PCE inflation down to near zero! But aggregate demand has since rocketed back. The problem is businesses have been struggling to satisfy the voracious appetite of consumers who are flush with cash.

No one should be surprised that the current large imbalance between demand and supply, especially when viewed against the backdrop of 12 months ago, has driven year-on-year inflation to levels far above the Fed's 2% target. April's PCE price index surged by 3.6% over the year. Take out the volatile food and energy components and it still jumped 3.1%.

Again, this surge was fully anticipated and we can expect the bone-rattling inflation ride to last several more months. What it is *not*, however, is the start of a destructive reflationary spiral that will be embedded in the economy.

We have been arguing all year that deflationary forces will soon regain its momentum to dominate the dynamics of pricing.



Back in March 25th we wrote “no one should be terribly surprised to see a temporary jump in prices during the coming months... In the absence of accelerating wages, inflation cannot thrive. This is especially the case today in an era of technology-driven productivity, eCommerce, globalization, changing demographics and a decline in union membership.”

And when inflation worries led the 10 yr. Treasury yield to approach 1.8% that month, we wrote in the same report that such a yield was not sustainable and would settle back to between 1.4% and 1.7% ---which it subsequently did. Apparently participants in today’s bond market seem to share the same sentiment. Shortly after this morning’s release showing a jump in PCE inflation, the yield actually dropped back to below 1.60%

Look, the Fed is right in its assessment that current inflation trends are transitory. It’s no mystery why we are seeing the current spike. And it’s not a shock why consumers worry any time the cost-of-living rises. Their concern is understandable.

But let’s take a deep breath. We’re now white water rafting in the middle of those inflationary rapids. It’s therefore worth stating again: The structural forces that have kept inflation well behaved prior to the pandemic remain intact. If you dare to look ahead you will see more serene waters around the bend. How far ahead? Inflation pressures will abate during the summer and fall quarters. For now, just hold on as the ride passes these menacing rapids.

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	6.4	8.8	6.4	5.7	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	11.3	13.9	6.5	6.0	3.4	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	2.6	3.2	2.7	2.5	2.4	2.4	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	513	555	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	1.68	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	7.2	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	5.8	6.4	6.7
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.3	6.6	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	3.1	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

Key Economic & Geopolitical Projections for 2021 & 2022

Updated: May 27, 2021

PROBABILITY	U.S.
HIGH	Congress to pass smaller \$1.0 - \$1.5 trillion infrastructure plan late 2021.
HIGH	Pres. Biden's tax increase proposals to be scaled down and is expected to pass the Senate via reconciliation.
HIGH	The fiscal stimulus, vaccinations and consumer spending to produce a "temporary pop" in inflation in 2021.
Moderate	Treasury 10-yr. yields to hover between 1.5% to 1.8% in 2021, with inflation (CPI) in the 1.7% to 2.7% range.
HIGH	The Fed will gradually scale back asset purchases in IVQ 2021 as new economic cycle takes hold.
Moderate	Bottlenecks in US supply chains should begin to clear in second half of 2021.
FOREIGN	
HIGH	Beijing fortifies naval presence in SCS, further erodes autonomy in Hong Kong and increases threats against Taiwan.
HIGH	Biden orders more visible US naval presence in SCS to support allies and defend International Law of the Sea.
HIGH	US - Russian tensions approach cold war levels over Moscow's cyberattacks, extrajudicial killings and Ukraine.
Moderate	Cyber World War underway; may result in periodic disruptions to global financial networks and power grids.
HIGH	Though JCPOA talks resume, Iran secretly committed to produce enough fissile material for nuclear weapon.
Moderate	Europe's 2021 economic outlook improves, but Asia's recovery has been rattled by new outbreaks of Covid variants.
HIGH	Biden to reset trade relations with Europe, but is in no rush to reverse tariffs placed on Chinese imports.