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ECONOMIC TALKING POINTS

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An Inflation That Stems From Abroad.
Can the Fed Do Anything?

Much like Don Juan flailed away hopelessly at windmills, the Fed's hawkish interest rate policy will achieve little to bring down inflation. That because more than 80% of the forces driving prices higher stem from a series of exogenous events outside the US, and thus mostly out of the Fed's control.

The reality is inflation is not just a US problem, it's a global phenomenon that may be inextricable given current geopolitical tensions and related supply chain woes. And that is what makes current monetary policy so exasperating. Inflation pressures are building. But I worry that all Jerome Powell's aggressive rate policy will accomplish is doom the US economy to stagflation later this year and next.

The Fed chairman and others on the monetary policy committee have ramped up their tough talk lately to demonstrate their commitment to bring inflation back to their 2% target. The traditional approach to accomplish that is to "gently" depress demand enough to ease inflation pressures and, ideally, achieve a soft landing for the economy. Whether they succeed in that goal remains to be seen, but it looks increasingly unlikely.

May's 1% jump in headline CPI was the second fastest of the past 12 months. And we can't pin the blame on gasoline alone, which nevertheless leaped 4.1% last month and more than 48% over the year. The war between Ukraine and Russia devastated food exports from these regions to such an

extent that other countries, like India, Indonesia, Argentina and Egypt, are now restricting or banning exports of food to protect their own domestic supplies. As a result, food prices jumped 1.2% for the month, the biggest single hike since April 2020, when consumers rushed to clean out supermarkets in preparation for Covid lockdowns. Food inflation is now racing up at its fastest annual clip since 1981.

And in an unusual twist of modern day economics, the cost to eat at home is rising twice as fast as the cost to eat out! Prices paid for food to be consumed at home jumped 1.4% last month (11.9% over the year), while the price to eat out rose 0.7% (7.4% YOY). A few reasons may account for that. Restaurants can lower prices at will (and accept thinner margins) to attract customers, or simply offer less expensive meal options on their menu.

While annual core inflation did slip the last two months to a 6% rate, let's not kid ourselves. It's an irrelevant statistics to households. Consumers react to top line price pressures since food and energy are necessary expenses. Moreover, so long as headline inflation remains high, core prices will also move up over time as energy and commodity inflation get further embedded into broader economy.

What will be most interesting to watch in the weeks ahead is less how the Fed responds. We already know they will hike rates next week another 50 bps, or perhaps even 75 bps in light of this latest CPI report, and a similar increase in July. No real surprise here. What is worth monitoring now is to what extent households will change their behavior. We have already seen some demand destruction both in purchases of discretionary items and of gasoline.

However, as inflation expectations build, shoppers could also choose to advance their future purchases simply to avoid paying higher prices later. But by accelerating spending now, consumers are drawing down future consumption and that can cause the economy to limp from stagnation into outright recession

What the latest CPI tells us is that the Fed is no longer walking a tightrope. It has already lost its balance, stumbled and is now barely holding on.

From our perspective, stagflation will be nearly impossible to avoid. While the Fed can dull economic activity in an effort to curb US inflation pressures, it's difficult to see how weaker domestic demand will materially reign in prices in this crisis-prone global economy.

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United States

	I 2021	II 2021	III 2021	IV 2021	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023	I 2024	II 2024	III 2024	IV 2024
Real Gross Domestic Product (GDP):																
%	6.3	6.7	2.3	6.9	-1.5	2.8	2.3	2.0	1.4	1.9	2.7	2.3	2.1	3.3	2.4	2.8
Personal Consumption Expenditures:																
PCE %	11.4	12.0	2.0	2.5	3.1	3.3	2.4	2.0	1.4	2.4	2.8	2.0	2.7	3.8	2.7	2.2
Inflation, end of period, year-over-year:																
CPI %	2.6	5.3	5.4	7.0	8.5	8.7	7.8	6.9	6.6	6.5	6.2	4.5	3.0	2.5	2.5	2.5
Unemployment Rate (end of period):																
%	6.0	5.9	4.7	3.9	3.6	3.8	4.0	4.3	4.6	4.9	4.5	4.1	3.8	3.6	3.6	3.5
Non-farm Payrolls, monthly avg. thousand:																
	513	615	651	365	562	385	265	260	225	235	240	255	275	310	315	325
Treasury 10-yr Note Yield % (end of period):																
	1.75	1.44	1.52	1.51	2.32	3.11	3.01	2.88	2.85	2.78	2.70	2.60	2.75	2.85	2.85	3.10
Federal funds rate % (end of period):																
	0.13	0.13	0.13	0.13	0.38	1.38	2.38	2.88	2.88	2.38	2.38	2.38	2.38	2.38	2.38	2.38

GDP Growth - Global Economy - Year over Year

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
US	2.6	1.6	2.2	1.8	2.3	2.7	1.7	2.3	2.9	2.3	-3.4	5.7	2.0	2.3	2.6
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.9	1.2	-6.7	5.2	1.8	2.2	2.5
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.3	1.5	-9.8	7.5	2.9	1.4	2.0
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.2	-4.5	1.7	2.1	2.0	1.9
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.0	1.6	-5.3	4.5	2.8	2.5	2.6
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.8	4.8	-7.5	9.2	6.2	6.5	6.8
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.6	6.1	2.2	8.1	4.3	5.2	5.6
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.1	-3.9	4.5	0.9	2.2	2.5
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.1	-0.1	-8.5	5.0	1.2	2.4	2.8
Australia	2.8	2.6	3.6	2.4	2.6	2.5	2.4	2.4	2.7	1.8	-1.1	4.7	3.8	2.7	2.9
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.5	1.2	-2.9	4.5	-12.0	-2.6	1.9
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.7	–3.1	5.9	2.8	3.1	4.4