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Economy

# Prices climbed 7.5% in January, compared with last year, continuing inflation's fastest pace in 40 years

## High inflation is undermining a robust recovery, testing policymakers at the Federal Reserve and White House

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Prices continued their upward march in January, rising at an annual rate of 7.5 percent, the fastest pace in 40 years, as pandemic inflation continues to defy expectations, climbing faster and lasting longer than nearly anyone would have guessed.

Inflation had been expected to climb relative to last January, when the economy reeled from a winter coronavirus surge before widespread availability of vaccines. The cumulative price increases of a chaotic 2021 also were evident.

But Thursday's release from the Bureau of Labor Statistics also hit new and surprising high notes: Electricity bills saw their fastest monthly increase in 16 years, and a rapid rise in the cost of baked goods, including cupcakes and cookies, led most food prices higher.

The January inflation report reflects an economy still wracked by virus variants and supply chain upheaval, a stark contrast to the promises from the White House, Federal Reserve and economists that 2022 would ring in a new era of normalcy, throwing off the shackles of transient price gains.

However, as the omicron variant subsides and vaccination rates rise, the hope is that inflation will begin to drift downward. Many economists and business leaders predict price growth will peak in the next few months and inflation will begin what could be a long descent back to normal, assuming new variants of the coronavirus don't jolt the recovery's overall trajectory.

“Inflation is still hot, and obviously uncomfortably high, but it’s at its peak, and as the pandemic winds down, as supply chains iron themselves out, inflation will moderate,” said Mark Zandi, chief economist at Moody’s Analytics.

Zandi said “it’s not going to be a straight line back” to more sustainable levels of inflation. But his prediction is that “each new wave is less disruptive than the previous one, and as that continues, it’s very encouraging.”

Annual inflation numbers are likely to slow in coming months. That’s in part because the yearly comparisons will no longer include the effect of all the supply chain disruptions and massive stimulus of early 2021. Still, monthly price growth remains unsustainably high — prices jumped 0.6 percent from December to January — although many hope that the Fed’s plans to raise interest rates in March could begin to cool prices down.

The January inflation report raised fears that the Federal Reserve would move aggressively to hike interest rates at its next meeting, driving major financial markets lower Thursday and pushing up bond yields. Higher interest rates make it more expensive for households and businesses to borrow money, which slows spending and can cool off a hot economy and curb price growth.

Indeed, increases in the cost of food, electricity and shelter helped drive inflation higher in January with household furnishings, clothing and medical care becoming costlier, while used-car costs continued to spiral upward, albeit at a slower pace than in prior months.

“I’m worried,” said Diane Swonk, chief economist at Grant Thornton. She agrees that inflation could slow in the next few months but warns that it might be difficult to bring price growth down to pre-pandemic levels.

“The Fed is counting on inflation abating somewhat on its own,” Swonk said. “The problem is that even as inflation abates, it may not cool enough not to burn. Some of the inflation we are seeing is becoming more entrenched in the service sector. There is no playbook for derailing inflation in this environment.”
The White House has touted its efforts to lower prices, including targeting corporate consolidation to help create more competitive markets. On Thursday, President Biden pointed to the economy’s bright spots — historic economic growth, a drop in weekly unemployment claims, wage increases — as successes amid such high inflation.

“We have seen historic success on the first priority, with the greatest year of job growth in history, Americans finding better jobs, better wages, and better benefits, along with the fastest economic growth in decades,” Biden said in a statement. “On higher prices, we have been using every tool at our disposal, and while today is a reminder that Americans’ budgets are being stretched in ways that create real stress at the kitchen table, there are also signs that we will make it through this challenge.”

But inflation has proved to be a blistering political handicap for Biden and a litmus test for the way many Americans judge the economy. Republicans largely blame Democrats' $1.9 trillion American Rescue Plan for overheating the economy, and the GOP is set to hammer on inflation going into the midterm elections this fall.

"Joe Biden's economy has Americans drowning in record-high inflation," said Sen. John Barrasso (R-Wyo.). "People in Wyoming are now paying sky-high prices for gas, groceries, heating bills and rent. As a result, they are having to change how they live while Democrat-driven inflation keeps eating away at their paychecks."

Despite inflation, there are signs that strong wage growth and generous federal aid have helped workers stay ahead of rising prices since the pandemic began. And while workers have fallen behind in recent months, some economists expect workers to come out ahead, again, as inflation falls.

"It's very likely that the prices will come down faster than wages," said **Bernard Baumohl, chief global economist of the Economic Outlook Group**. "And what that means, of course, is that companies will suffer narrower profit margins than they did last year."

As inflation spread throughout the economy, several categories posted their largest monthly price increases ever, including tires, vending machines and frozen foods.

Compared with 2021, the energy index rose 27 percent, and food rose 7 percent. The cost of food rose in January, compared with December, with cereals and baked goods increasing the most. Fruits and vegetables also edged up.

John Sayles, chief executive of the Vermont Foodbank, said that before the pandemic, the group's produce distribution program helped about 250 families in a part of rural Vermont. That has grown to around 600 families, many of whom are also struggling with higher heating oil and propane costs in the winter.

"Food insecurity is really financial insecurity," Sayles said. "Of all the families we see, very few have zero income. It's really a matter of where that income goes. … People are looking for any strategy that's out there to be able to tie those ends together at the end of the month."

Rent prices jumped again in January, climbing at a slightly faster pace than in the previous two months. Economists have been especially worried about rising home and rent costs, which can get locked in through long-term contracts and may not improve after supply chains clear up.

The overall sharp price growth has undermined an otherwise robust recovery. Even after accounting for inflation, the economy in 2021 recorded its fastest growth since 1984. Over the past 12 months, the U.S. economy has added nearly 7 million jobs, and average hourly earnings have climbed 5.7 percent.

Yet high inflation has left an indelible mark on the economy, including the highest price increases for housing, food and energy that many workers have ever seen. And questions loom about how or whether policymakers will be able to rein prices back in without slowing the recovery or even causing another recession. The answers will have enormous implications for policymakers at the Federal Reserve and in the Biden administration.

All signs suggest that the Federal Reserve, which is in charge of keeping prices stable, will raise interest rates at its next policy meeting in March. On Thursday, St. Louis Federal Reserve President James Bullard told Bloomberg News that he would like to see rates increase a full percentage point by July, which would be considered aggressive.

Momentum in the job market, combined with soaring inflation, has pushed Fed officials to suggest they plan to raise interest rates higher and faster than officials previously anticipated. The Fed is expected to end its sprawling asset purchase program next month and to raise rates multiple times in 2022, with some analysts predicting as many as five hikes.

Fed officials maintain they expect inflation will fall later this year, especially if supply chains clear their backlogs and consumer demand eases to more normal levels.

“There are multiple forces which should be working over the course of the year for inflation to come down,” Fed Chair Jerome H. Powell said last month. “We do realize that the timing and pace of that are, are highly uncertain and that inflation has persisted longer than we thought. And, of course, we’re prepared to use our tools to assure that higher inflation does not become entrenched.”

Swonk, the economist, said she is worried it might already be too late. “The Fed doesn’t have a good record of derailing an actual surge in inflation without rate hikes bleeding into the unemployment,” she said.

As wages rise, inflation may already be getting entrenched into the economy. Colgate-Palmolive, which sells toothpaste, pet food, soap and more, recently announced price hikes to cover soaring costs.

Chief executive Noel Wallace said on a recent earnings call that he expected the price of raw materials to peak in the first three months of the year and that the company would be able to increase profits later in the year as recent price hikes took effect and raw-material costs began to fall. Because prices are rising everywhere, Wallace said, there is a lower risk of customers switching to a cheaper competitor.

Houston-based Sysco, a major supplier of food for restaurants, hospitals and other institutions, has stayed in strong financial shape despite double-digit growth in food prices. It has been able to charge customers more while winning significant new business with its lower-cost products. On a recent earnings call, Aaron Alt, the firm’s chief financial officer, was asked whether inflation had peaked. He demurred.

“We are continuing to see elevated levels of inflation. And as much as I would like to call when the down point will be,” Alt said, it’s “impossible for us to do.” At the very least, he said, he expects inflation to remain elevated through June.

Economists say the economy has a long way to go before prices settle back to what’s considered typical inflation. The pandemic economy has been anything but predictable, and new coronavirus variants have weighed on supply chains, raised workers’ exposure risk to the virus and complicated households’ ability to find child care.

“It doesn’t happen this year, it just doesn’t, and I think everyone needs to be honest about that,” said Douglas Holtz-Eakin, a former economic adviser to George W. Bush and John McCain. “[The Fed] is talking a big game, but they’ve had the foot on the accelerator for years now, and they haven’t done anything yet.”

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