THE ECONOMIC OUTLOOK GROUP

475 Wall Street
PRINCETON, NEW JERSEY 08540 Tel: 609 - 529 - 1300
www.EconomicOutlookGroup.com

ECONOMIC TALKING POINTS

Bernard Baumohl
Chief Global Economist

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August CPI and the Geopolitics of Oil

The Federal Reserve's greatest obstacle to tame inflation nowadays is not an overheated economy or surging wages or the profligacy of consumers. No, what has frustrated their efforts to cool prices this time is the artificial scarcity of one critical commodity, oil.

When the Covid-19 crisis erupted, it led to a paralytic shutdown in global supply chains and ultimately drove inflation to a 40-year high! But those supply chain pressures have since largely disappeared and the movement of goods has returned to pre-Covid levels, according to the Federal Reserve Bank of New York. As a result, inflation transitioned into retreat mode, with the CPI falling from 9% a year ago and edging close to a 2% handle this summer.

But geopolitics has a way of becoming a spoiler and we got a taste of that again in August. This time, it was OPEC Plus that tripped up the progress made on disinflation in the US.

Consumer prices significantly rebounded on a month-to-month basis in August, driven mostly by the jump in energy prices. The cost of gasoline shot up 10.5%, the biggest one-month leap since March 2022, and fuel oil prices leaped 9.1% in four weeks. Both helped push headline's annual inflation up from 3.3% to 3.7%.

While core CPI, which excludes energy and food, dropped to a 4.3% rate in August, from July's 4.7%, it's a good bet rising oil and gasoline prices will soon feed their way through other sectors of the economy as businesses raise prices to offset higher production costs and shipping expenses. Indeed, airlines have already responded by jacking up fares 4.9% last month (though to be fair, ticket prices have fallen in July and June by more than 8% each).

So what will the Fed do next week in light of this latest reversal in inflation's course?

To begin with I suspect there is a feeling of exasperation with those who have to decide on the next step in monetary policy. The desire of OPEC+ to maximize revenue by cutting production 1.3 million barrels per day the rest of the year may lift Brent toward $100 a barrel and likely do more damage to already struggling economies in Europe and emerging countries.

The oil/price dynamic in the US is more complicated because the economic recovery here is much further along than the rest of the industrial world. The Atlanta Fed's GDPNOW estimates 3Q growth is on a 5.6% track. We expect that figure to drop back in the coming weeks, with our own projection showing a still hefty 3.2% pace this quarter. As a result, WTI oil will probably exceed $90 barrel in the coming weeks and push the average national price of retail gasoline to $4.00 or higher.

Why so high? Well, first of all, don't expect the White House to tap the SPR this time and sell close to 200 million barrels of crude, as they did last year. That step did arrest the rise in oil and gasoline prices, but it's not an option this time since oil reserves in the SPR are at a 40-year low. Secondly, I don't see the major US shale producers rushing in to ramp up that oil-rich sector have recently been pulling back on rig use at the fastest pace in three years. They are either under pressure to preserve their capital, or return it to shareholders.

Clearly, the Saudis know precisely which buttons to press to maximize oil revenues these days and it also highlights the Kingdom's foreign policy ties shift away from the US and towards Russia and China. Such geopolitical transitions, of course, are outside the purview of the Federal Reserve and they are now left to deal with the fallout of higher domestic energy prices.

I do not expect Fed policymakers will act next week. Despite the economy's strength this quarter, there are already emerging signs of a significant slowdown in business activity. Households and companies are not impervious to high interest rates. In fact, consumer confidence and spending appear to be cracking. Delinquency rates on credit cards have bounced sharply higher this year. Employers have also slashed the pace of hiring in recent months as businesses turn more cautious. Simply put, the economy is starting to lose steam from the lagging effects of high interest rates.

Let me be clear. I am not saying we're headed for recession — and frankly neither is the Fed. But it's more likely policymakers will wait until November to better assess whether the latest spike in oil prices will be sustained, and what impact it will have on inflation and on overall demand in the economy.

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Key Economic Forecasts

- Actual
- Forecast

United States

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	I 2022	II 2022	III 2022	IV 2022	I 2023	II 2023	III 2023	IV 2023	I 2024	II 2024	III 2024	IV 2024	I 2025	II 2025	III 2025	IV 2025
Real Gross Domestic Product (GDP):																
%	-1.6	-0.6	3.2	2.6	2.0	2.1	3.2	1.9	0.9	1.6	2.2	2.9	1.7	2.5	3.0	2.6
Personal Consumption Expenditures:																
PCE %	1.3	2.0	2.3	1.0	4.2	1.7	3.7	2.0	1.0	1.9	2.7	2.6	1.7	2.8	3.1	2.9
Inflation, end of period, year-over-year:																
CPI %	8.5	9.1	8.2	6.5	5.0	3.0	3.5	3.1	2.8	2.6	2.5	2.8	2.6	2.7	2.8	2.8
Unemployment Rate (end of period):																
%	3.6	3.6	3.5	3.5	3.5	3.6	3.7	3.8	3.9	4.0	4.1	3.8	3.8	3.7	3.5	3.5
Non-farm Payrolls, monthly avg. thousand:																
	561	329	423	291	297	201	165	180	155	185	235	230	200	235	240	240
Treasury 10-yr Note Yield % (end of period):																
	2.32	2.97	3.80	3.83	3.47	3.82	4.20	3.95	3.70	3.70	3.60	3.65	3.70	3.75	3.80	3.80
Federal funds rate % (end of period):																
	0.38	1.63	3.13	4.38	4.88	5.13	5.38	5.38	5.38	5.38	4.88	4.38	3.88	3.63	3.13	3.38

GDP Growth - Global Economy - Year over Year

Country	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025
US	2.6	1.6	2.2	1.8	2.3	2.7	1.7	2.2	2.9	2.3	-2.8	5.9	2.1	2.2	1.8	2.5
Eurozone	1.7	1.4	-0.9	-0.2	1.4	2.1	1.9	2.5	1.8	1.6	-6.2	5.3	3.5	0.8	1.3	1.7
United Kingdom	1.7	0.7	0.3	1.8	2.9	2.2	1.9	1.9	1.7	1.7	-9.3	7.6	4.1	0.3	1.0	1.3
Japan	4.6	-0.4	1.6	1.5	-0.1	1.1	0.5	1.7	0.6	-0.2	-4.6	1.7	1.0	1.2	0.9	1.6
Canada	3.1	3.1	1.8	2.3	2.9	0.7	1.0	3.2	2.8	1.9	-5.1	5.0	3.4	1.6	1.4	1.8
India	8.4	8.6	6.7	4.9	7.4	8.0	8.1	7.2	6.4	3.8	-6.6	8.7	6.7	5.6	6.1	6.6
China	10.5	9.5	7.8	7.7	7.3	6.9	6.7	6.8	6.7	6.0	2.2	8.1	3.0	5.0	4.6	4.8
Brazil	7.5	2.7	0.9	2.3	0.1	-3.5	-3.5	1.2	1.2	1.7	-3.6	5.3	3.0	2.3	2.2	3.1
Mexico	5.2	4.0	3.9	1.4	2.3	2.7	2.7	2.4	2.2	-0.2	-8.2	4.9	3.0	2.5	2.2	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	4.7	3.7	1.3	1.7	2.8
Russia	4.0	4.3	3.4	1.3	0.6	-2.8	-0.2	1.6	2.8	2.2	-2.7	5.6	-2.1	0.9	1.2	1.7
World	4.2	3.1	2.5	2.6	2.8	2.8	2.6	3.4	3.2	2.6	--3.1	6.0	3.1	2.3	2.0	2.9