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This week in Bidenomics: Uh-oh, reflation

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Is the dragon slain? Or just wounded?

Inflation has been the scourge of the economy for the last three years. It spiked from a benign 1.4% when President Biden took office in 2021 to a searing 9% some 18 months later. The Federal Reserve took aim with speedy interest rate hikes, and it seemed to work. By September, inflation was down to 2.4%, almost in the normal zone.

hen, an upward blip. The latest data shows inflation ticked back up to 2.6% in October. That could be a spot on the X-ray that turns out to be nothing. Or it could signal that inflation is making a comeback, which would scramble the outlook for interest rates, financial markets, and the policies of the incoming Trump administration.

The inflation uptick in October wasn't a fluke based on hurricanes or other one-time anomalies. Most important goods and services categories rose, including food, energy, rent, and vehicles. This came one month after the Fed basically declared victory over inflation. In September, the Fed reversed monetary policy and started cutting interest rates, signaling that the time had come to worry more about keeping growth humming than about getting prices down.

The Fed is staying the course for now. It cut short-term rates again on Nov. 14 and may do so again at its next policy meeting in December. But the odds of more rate cuts are dropping, with policymakers waiting for more lab results in the form of forthcoming inflation data.

"Inflation might soon be front-page news again," Capital Economics announced in a Nov. 13 analysis. The forecasting firm argues that the currently inflationary trend is OK, but the future outlook is more worrisome — in large part because of what Donald Trump plans to do once he takes office next January.

t least two elements of Trump's agenda are inflationary: new tariffs on imports and the mass deportation of undocumented migrants. Tariffs are taxes that raise the cost of imported goods directly. Deporting migrants would reduce the size of the labor force, especially targeting lower-wage workers. Replacing them with workers who might demand higher pay — or with costly machines — would raise costs one way or another, with producers passing as much as they could on to consumers.

A third inflation concern is Trump's desire to cut taxes further, which can have a stimulus effect by putting more money in people's pockets, boosting spending and demand and sometimes leading to higher prices.

"Given all that President-elect Trump has promised to do quickly — such as hike tariffs, cut taxes further and slash immigration — one can easily foresee a re-acceleration of inflation next year," **Bernard Baumohl,** chief global economist at Economic Outlook Group, wrote on Nov. 13. "The Federal Reserve is now in a real quandary."
The stock market has been buoyant since Trump won a second term on Nov. 5. But the bond market is registering concern. Since the Fed started cutting short-term rates in mid-September, long-term rates have gone the other direction, with the 10-year Treasury rising eight-tenths of a percentage point. The rates on mortgages and most consumer and business loans track the 10-year Treasury, so borrowing costs for just about everybody have been going up for the past two months.

Bond investors seem to be betting that inflation is going back up and therefore demanding a higher rate of return to lock in their money. Inflation pushes long-term rates up in two ways: If the Fed must once again start raising short-term rates to fight inflation, that can impact long-term rates. Higher rates are also a hedge against money that loses its value faster when inflation is higher.

If this all plays out, Trump could face a bracing headwind as he takes office. Consumers feel badly burned by inflation, which clearly contributed to voters' rejection of the incumbent Democrats and Kamala Harris's defeat in this year's presidential election. Consumer confidence has been slowly improving as inflation has come down, but it could plunge again if people see another wave of inflation looming.

Many consumers holding out for a more affordable home or car purchase have been waiting, and hoping, for lower rates. That may not happen anytime soon, exacerbating the high cost of housing in particular. If voters transfer their inflation frustrations to Trump, he could end up just as politically weak as President Biden, whose approval rating sank as inflation set in and never recovered.

Trump has some control over the kind of economy he will preside over. He could impose tariff and deportation policies much tamer than he promised as a candidate, which might generate relief in markets, bringing inflation expectations and interest rates down. Reflation is a possibility but not a certainty.

If Trump learns anything from Biden, he'll do just about anything to prevent it.

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