The Daily Dish

The Inflation Outlook

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Eakinomics: The Inflation Outlook

Yesterday the Bureau of Labor Statistics (BLS) released its report on consumer prices in May. Releases of the Consumer Price Index (CPI) have become much-anticipated events since the passage of the American Rescue Plan (ARP) – the administration's $1.9 trillion over-stimulus of the U.S. economy – and the repeated commitments by the Federal Reserve to maintain its extremely loose monetary policy raises the specter of a return to sustained high inflation.

I don't think sustained high inflation is by any means automatic. In the late 1960s policymakers ran the economy very hot – averaging gross domestic product (GDP) 3 percent above potential GDP – for 24 straight quarters, and the result was 15 years of inflation that the Fed ultimately tamed. The ARP is a big mistake, but (thus far) a one-time error. Nevertheless, the data are giving me pause.

The headlines (see, e.g., the *Wall Street Journal* report) are that year-over-year CPI inflation was 5 percent, the highest in 13 years, while year-over-year core (non-food, non-energy) inflation was 3.8 percent, the highest since 1992. Unfortunately, looking over the full years masks the recent, sharp moves in inflation since the $900 billion stimulus in December and the ARP. Core CPI inflation has averaged 6.0 percent in 2021, and much more recently: It rose at an annual rate of 10.4 percent in April and 8.8 percent in May. Things are heating up.

That said, the only way for inflation to become sustained is for wages to start rising as well, producing a wage-price spiral. There is nascent evidence of this as well. Average hourly earnings (for non-supervisory and production) workers averaged 5.5 percent growth in 2020, but rose 9.4 percent and 6.8 percent in April and May, respectively.

So, there are early signs of rising inflation. What would it take to transform it into a lasting phenomenon? Well, for starters, sustained overheating would be one element. Not all of the fiscal stimulus from the $1.9 trillion ARP has kicked in, and there is roughly an additional $2 trillion in household savings available to spend. On top of that, there is no evidence of any fiscal restraint in DC, so who knows what might happen next.

Second, the Fed's new strategy essentially precludes pre-emptive moves. As a result, it is poorly equipped to deal with an inflation surprise, and inflation will have more time to take hold. On top of that, there is no constituency for the low-inflation-centric policy stance of the near past. As a result, expect overly easy fiscal and monetary policies in the years to come.

Finally, inflation expectations have to rise, so that people start asking for wage increases in advance to cover anticipated inflation.

The data so far don't confirm that these elements are in place. But they do not rule them out either.