

A Question for the Fed

It's not a surprise. Inflation is running hot. But, is it transitory and temporary, or is it real and here for the longer term. How hot will the Federal Reserve let it run, and for how long? When does transitory and cyclical become “secular” and “serious”? These are important questions and only the Fed has the answers.

In April, the consumer price index was up 4.2% from a year ago; producer prices were up 6.2%. The “core” measures for each of these indexes are running at 3.0% and 4.6%, respectively. The Federal Reserve focuses on the inflation measure for personal consumption expenditures (PCE), which should be up about 3.4% versus a year ago once we get the April data, which is scheduled to arrive this Friday.

The Fed has said it thinks the inflation surge, at least when looked at on a year-over-year basis, is overstated because it is built on comparisons to a period when prices were falling during the onset of the COVID-19 crisis. They also think any recent pressures are “transitory,” caused by supply-chain issues that should go away as the economy continues to recover.

Meanwhile, it has discounted extremely rapid growth in the M2 measure of the money supply. Because central banks around the world have introduced Quantitative Easing in the past decade, with no pick-up in inflation, the Fed thinks any link between money and prices has been broken...Jerome Powell even said we should “unlearn” this idea that money growth causes inflation.

Clearly, the Fed is dismissing the surge in inflation this year. And Fed forecasts show that it expects inflation to fall back down to its 2.0% target in 2022 and beyond.

But back in mid-March, the last time the Fed released an economic forecast, it projected PCE inflation of 2.4% this

year. We estimate a 0.5% increase for the month of April and, if we're right, we could easily end up getting PCE inflation of 3.0% or more for 2021, well above the Fed's forecast.

So, what we would like to know from the Fed is whether 2021 inflation matters at all. What if PCE inflation for 2021 ends up at 3.5% rather than 2.4%? How about 4.5%? Does the intensity of this year's inflation carry any weight?

Maybe the Fed should say directly or at least signal cryptically (or maybe just leak through its favorite journalists), that it is handing out a one-year dispensation for inflation in 2021. Inflation can skip curfew and stay out to all hours, eat meat on Fridays, party like it's 1999, pretty much do whatever it wants through the stroke of midnight on New Year's Eve, but then has to get back into 2.0% compliance in 2022. And, if inflation behaves like that...gets back to its 2% target next year, then all is forgiven.

We would love the Fed to be right about this. But this is not the first time in history the Fed has dismissed an increase in inflation as temporary or unworthy of serious policy attention. The Fed sat back and watched as inflation crept upward in the 1960s and 1970s. They blamed OPEC, the value of the dollar, and a stream of one-off events for temporarily lifting prices. The Fed also thought that persistent unemployment needed to be fixed with more money printing.

The problem is that a lot of inflation always starts with a little bit of inflation. And once the Fed gets into the habit of blaming it on “transitory” events, it runs the risk of becoming more of a long-term issue.

The Fed will next release a policy statement on June 16, followed by the usual press conference. We think it's time to let everyone know how high inflation can go, and for how long, before the Fed would adjust its policies.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
5-25 / 9:00 am	New Home Sales – Apr	0.950 Mil	0.955 Mil		1.021 Mil
5-27 / 7:30 am	Initial Claims May 22	425K	432K		444K
7:30 am	Q1 GDP Preliminary Report	6.5%	6.5%		6.4%
7:30 am	Q1 GDP Chain Price Index	4.1%	4.1%		4.1%
7:30 am	Durable Goods – Apr	+0.8%	+1.4%		+0.8%
7:30 am	Durable Goods (Ex-Trans) – Apr	+0.8%	0.2%		+1.9%
5-28 /7:30 am	Personal Income – Apr	-14.3%	-14.3%		+21.1%
7:30 am	Personal Spending – Apr	+0.5%	+0.3%		+4.2%
8:45 am	Chicago PMI	68.0	68.0		72.1
9:00 am	U. Mich Consumer Sentiment- May	83.0	83.0		82.8