



Economic Perspectives

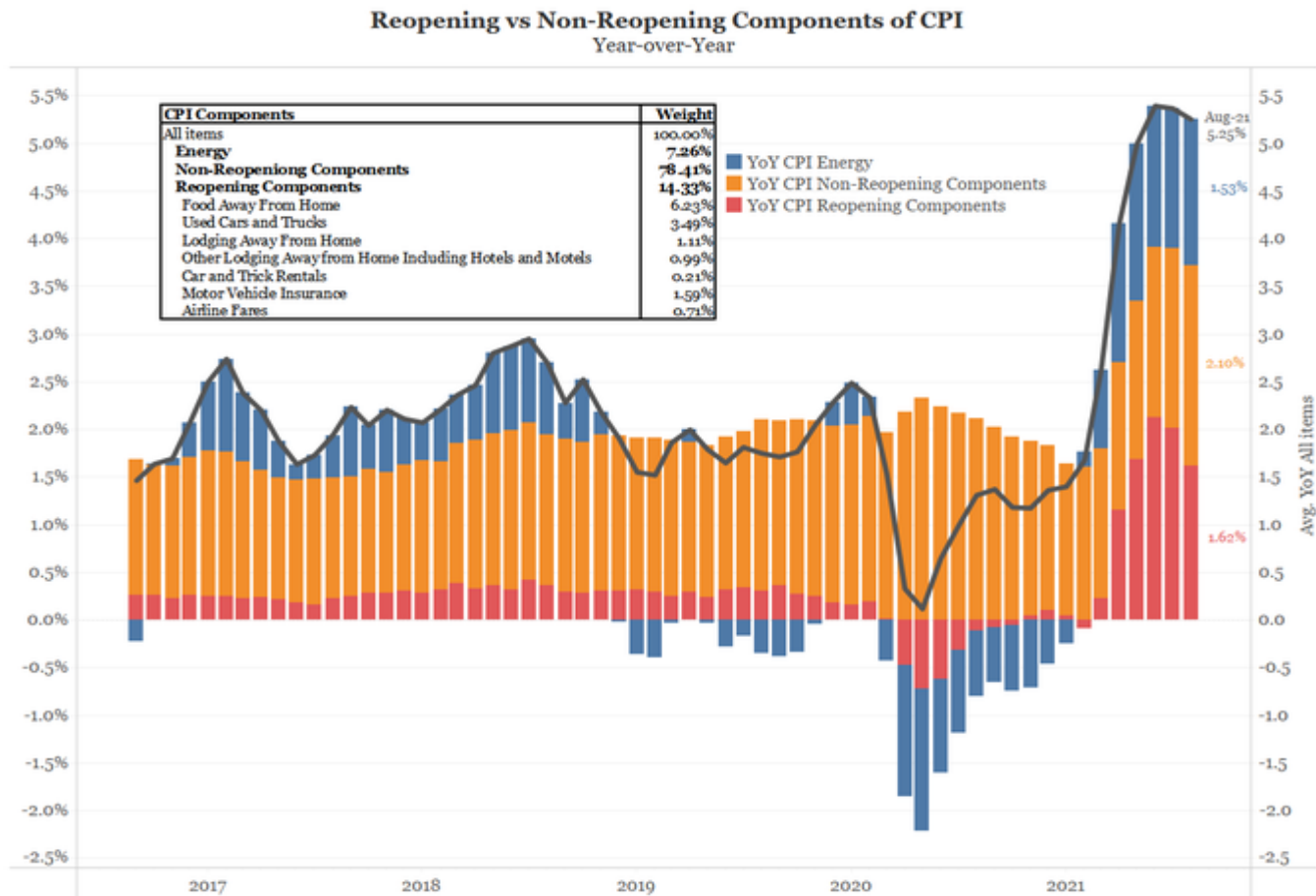
***The inflationary resurgence:  
passing or persistent?***

Peter Warburton

September 2021

# US CPI inflation: transitory components are softening

- But non-transitory items are hardening

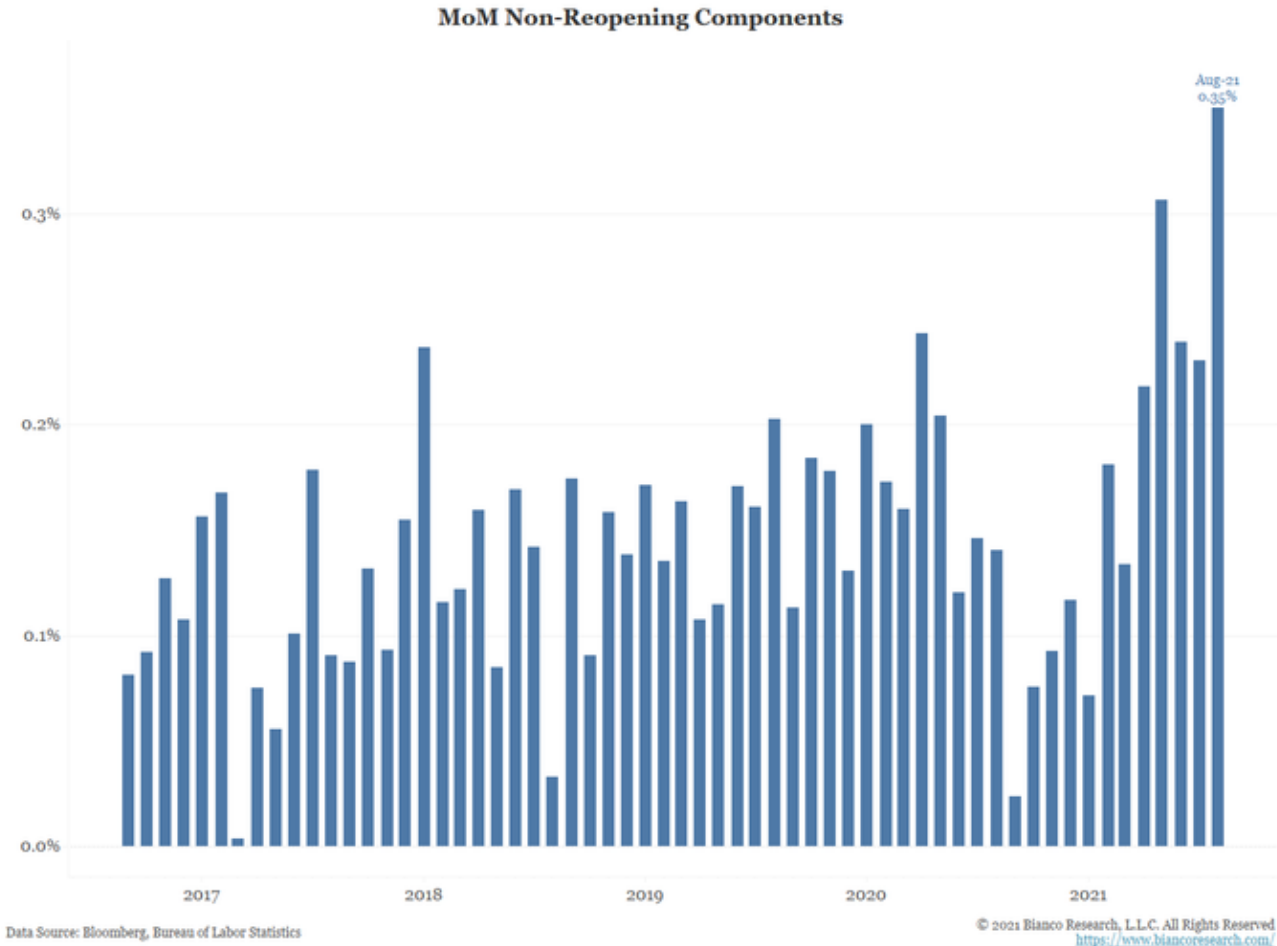


Data Source: Bloomberg, Bureau of Labor Statistics

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## Contribution from non-reopening components ...

- ...representing 78% of August rise



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## *Inflation: the shifting landscape*

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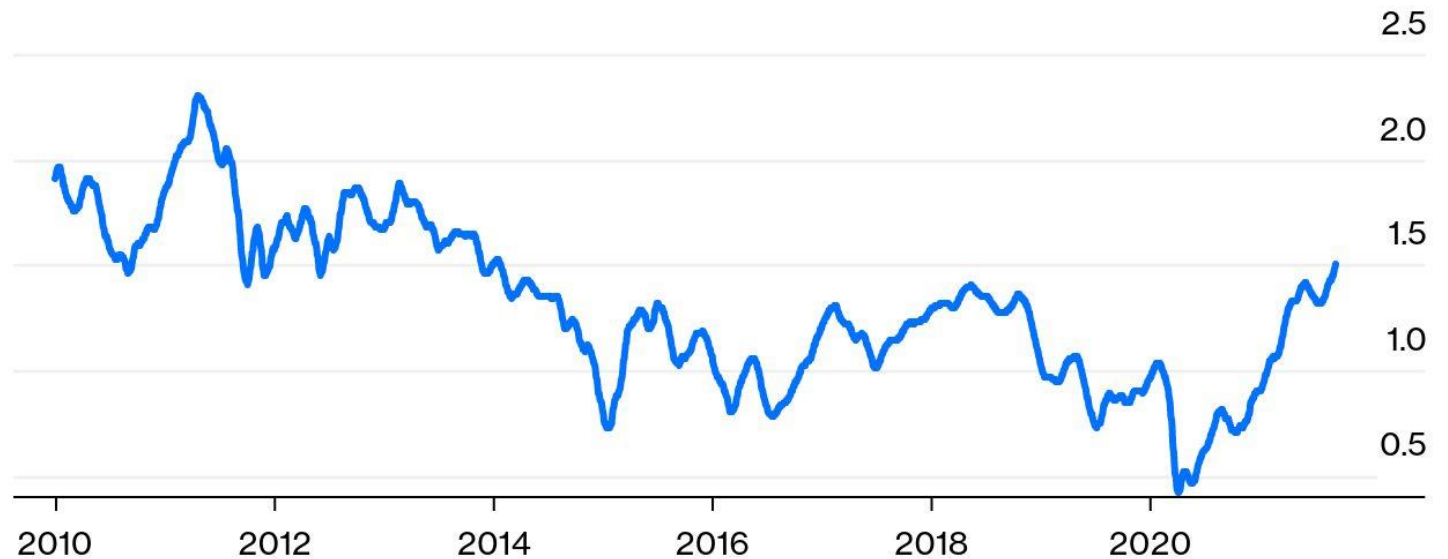
- Many more commentators willing to contemplate future inflation
- Diehard Keynesians insist inflation is impossible because they assert a negative output gap
- Many more refuse to believe that rapid broad money supply growth carries inflation risks
- Living through the melt-up scenario: explosive demand pressure overwhelms supply capabilities
- However, consensus sees inflation scarcely higher in 2022 than 2019, and only above target in US, UK and Canada. Is consensus complacent?

## Pricing in the coming inflation – even in Germany

- Market-implied inflation compensation

### 10-Year German Inflation Breakeven (20DMA)

Long-term expectations are their highest in more than seven years



Bloomberg

BloombergOpinion

## US inflation compensation and Brent oil price

- A contrived correlation ! Both series express the strength of desire to hedge against future inflation

Exhibit 11: Brent crude oil price and US 5-year 5-year inflation expectation rate



Source: Bloomberg, Federal Reserve Bank of St. Louis

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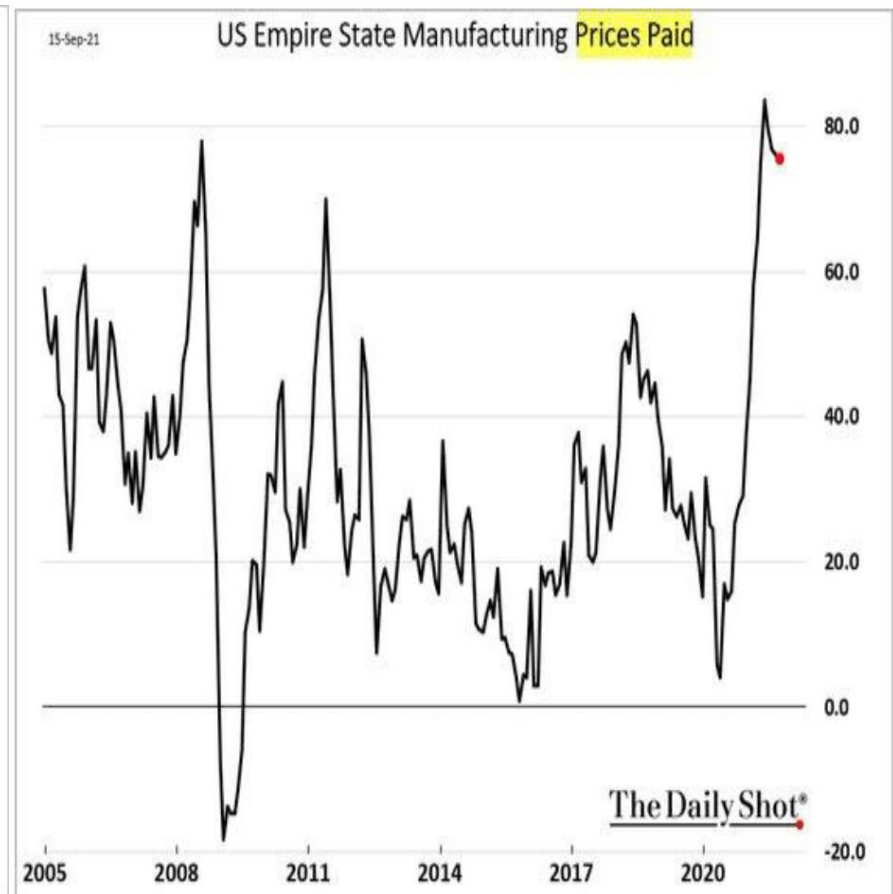
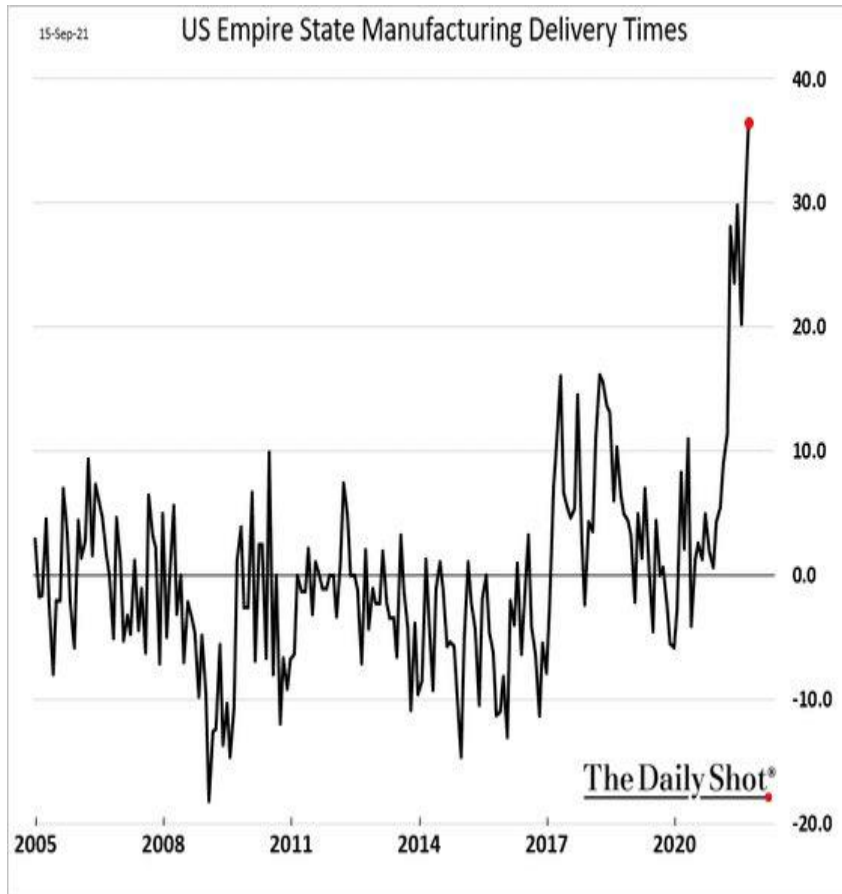
## *Inflation: a richer narrative (1)*

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- Melt-up scenario is the credible inflationary trigger
- Public sector budget deficit reduction will squeeze the private market sector – lurch toward a command economy and smaller SME sector
- Public sector pricing of labour and materials is driving up the aggregate price level
- Impending market-led credit tightening will weaken private sector activity but raise costs
- Semi-permanent contraction of supply will keep inflation strong even when the sugar-high is over

# Global goods supply chains are creaking

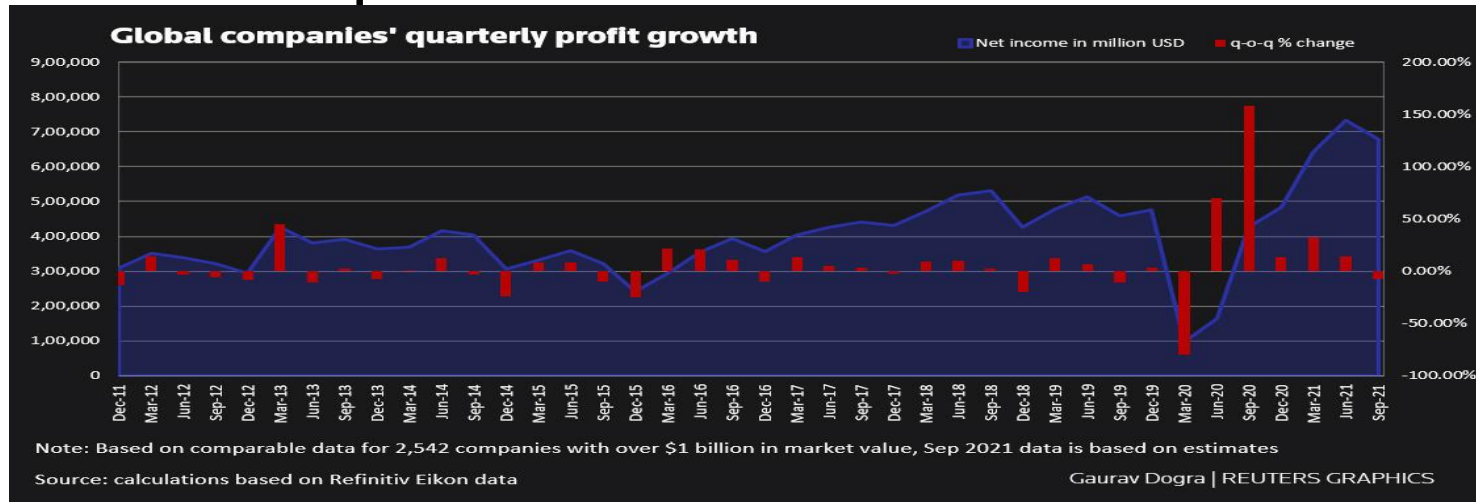
- Delivery times are lengthening, prices rising





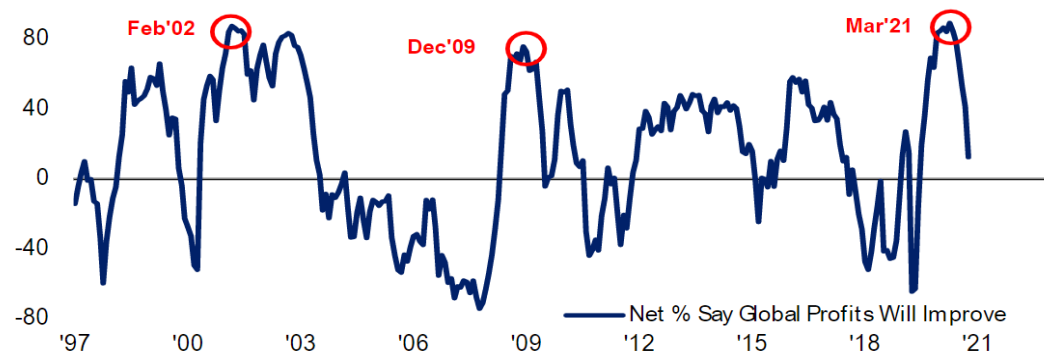
# Large profitable businesses are cleaning up ...

- ... but the profits bonanza will soon be over



**Chart 3: FMS profit expectations have fallen drastically since March**

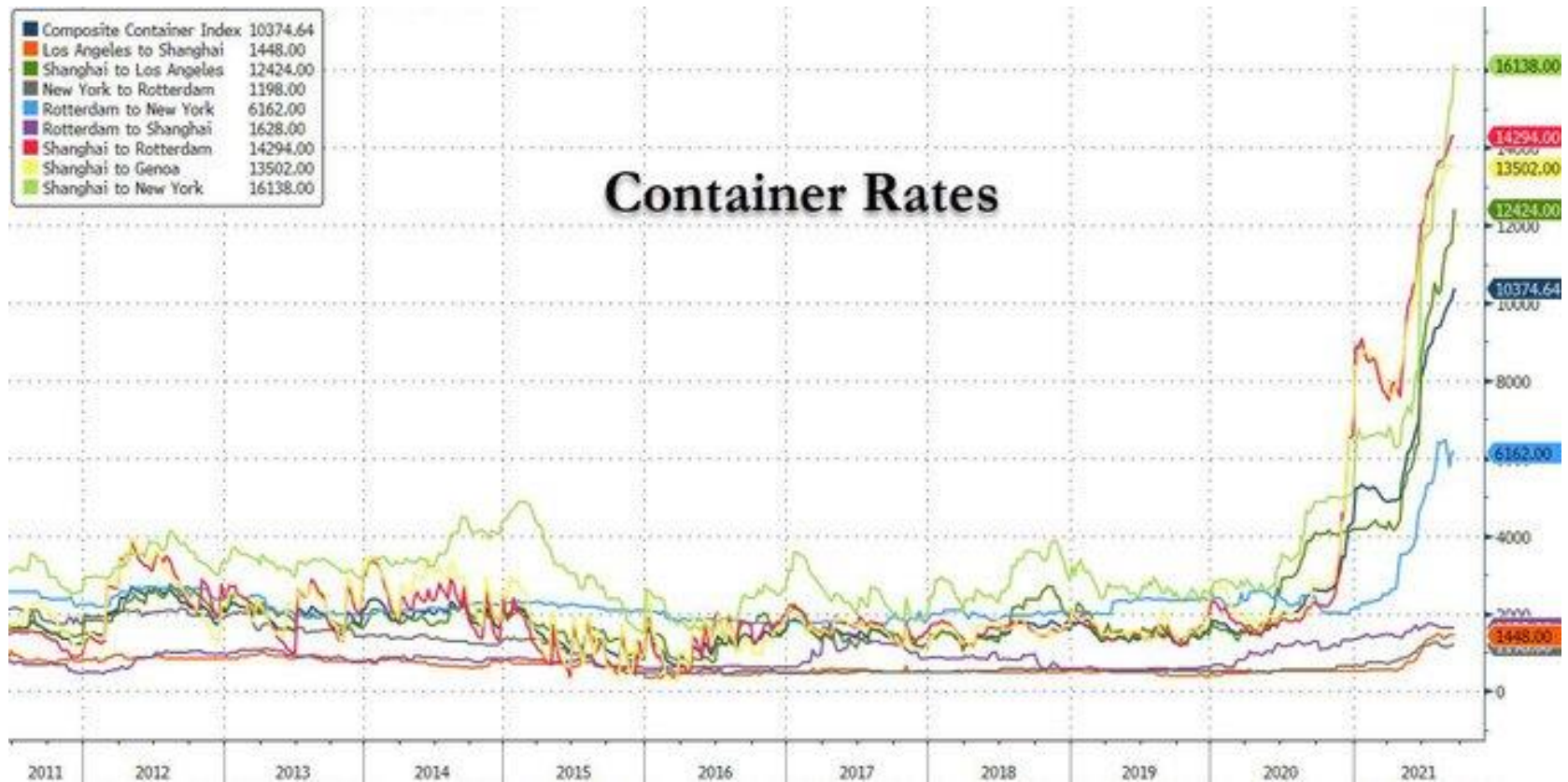
Net % Say Global Profits Will Improve



Source: BofA Global Fund Manager Survey

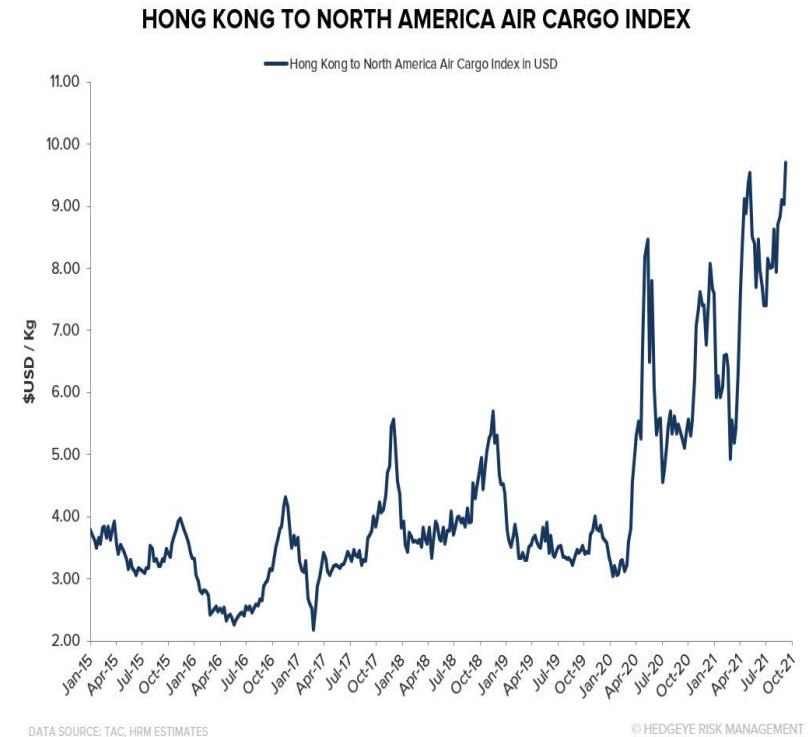
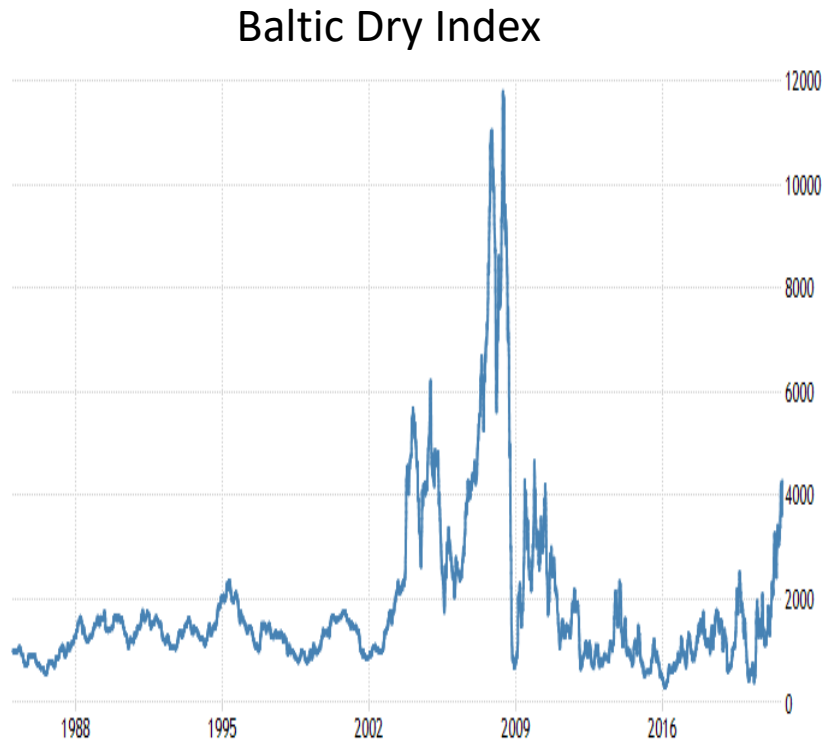
## Spiralling container rates

- Strong demand, ships in the wrong place!



# Signs of supply bottlenecks in shipping and air freight

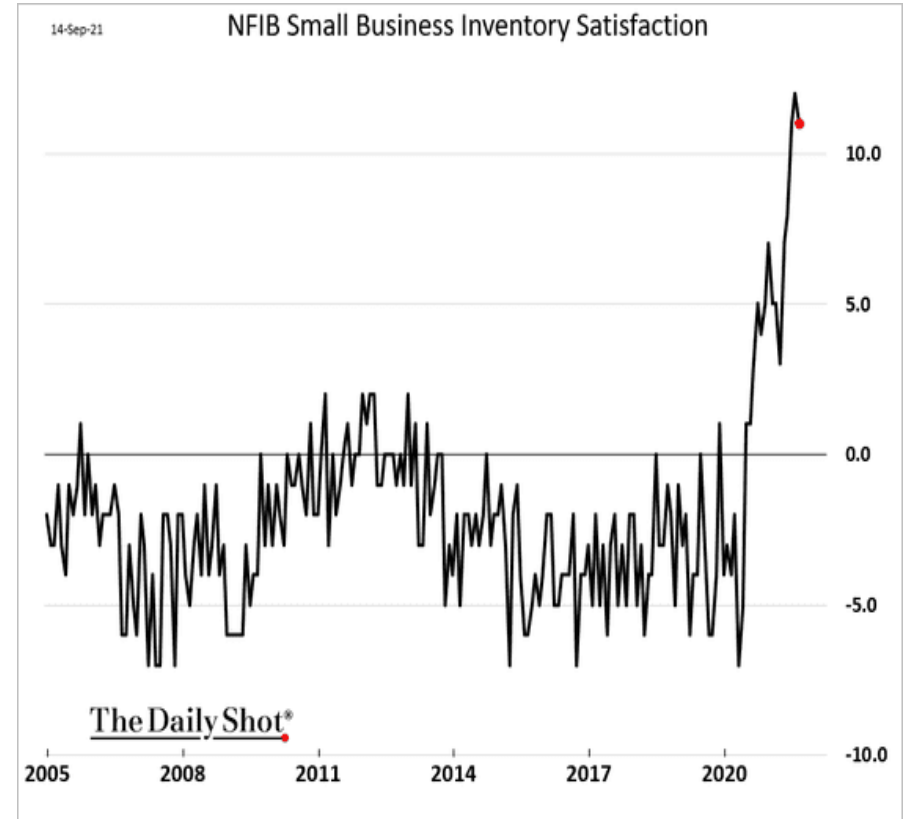
- Baltic Dry Index: cost of moving raw materials



Source: Baltic Exchange

# Tight inventory conditions unalleviated as ...

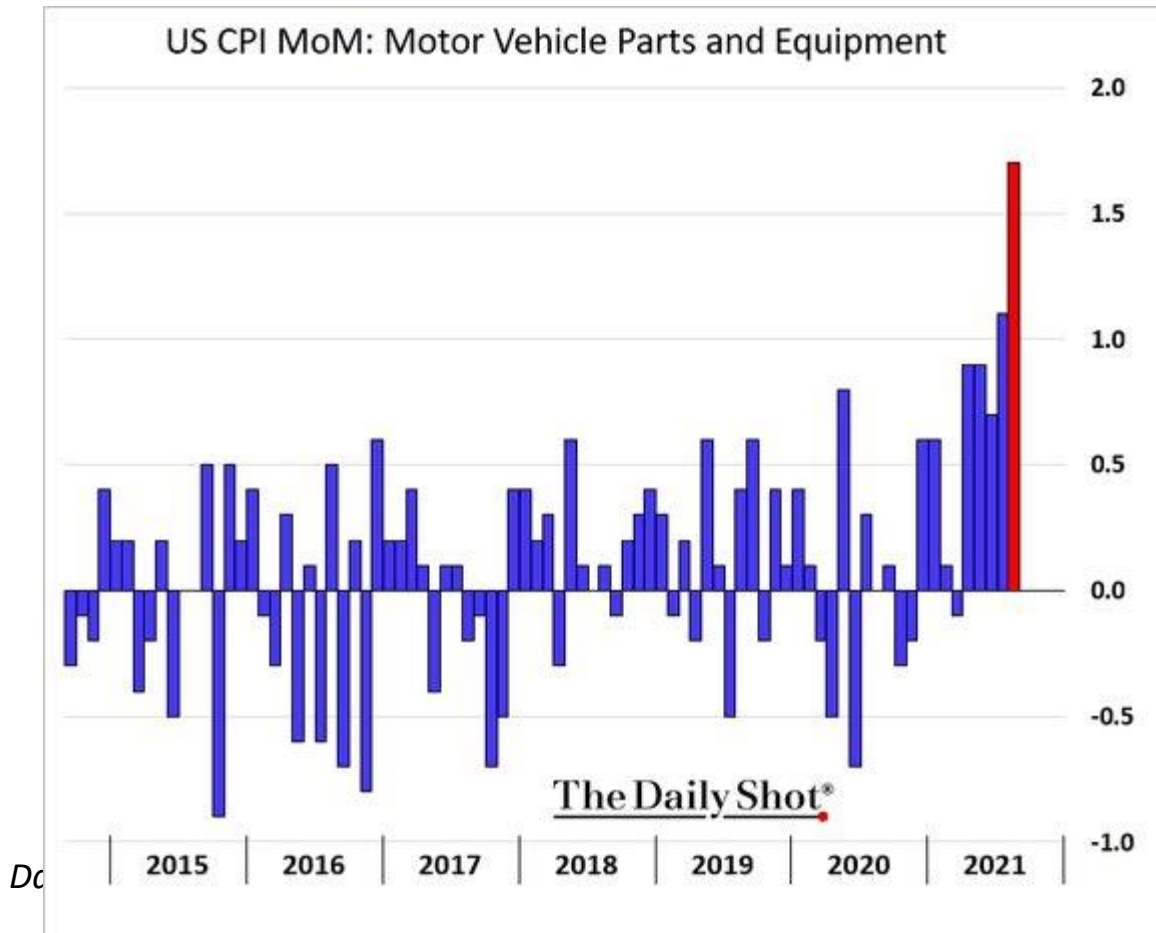
- ... consumer demands remain intense



Data sources: FRED, NFIB

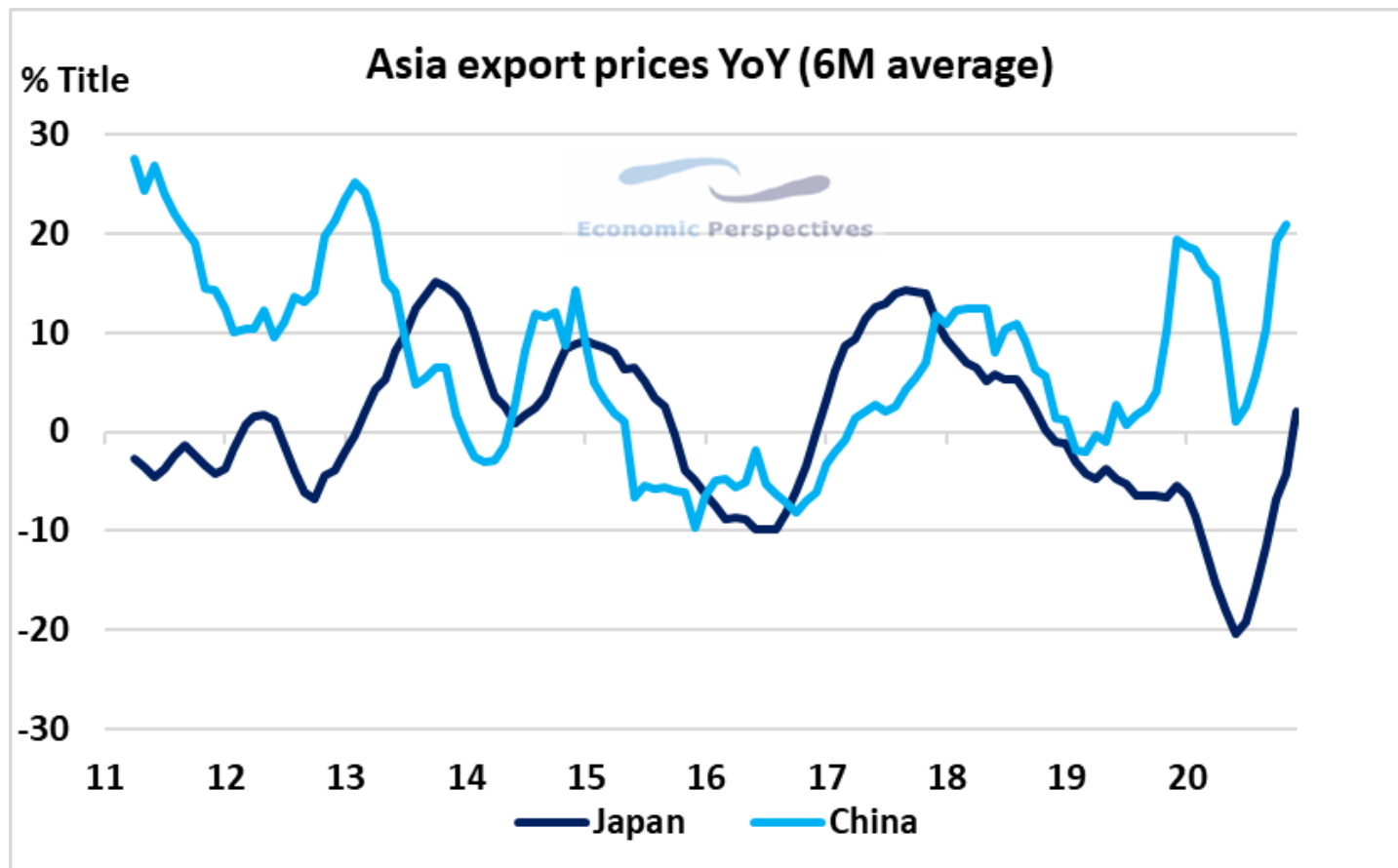
## *Surge in demand for consumer durables in lockdown ...*

- ... aggravated by semiconductor shortage



## Asian consumer goods deflation has reversed

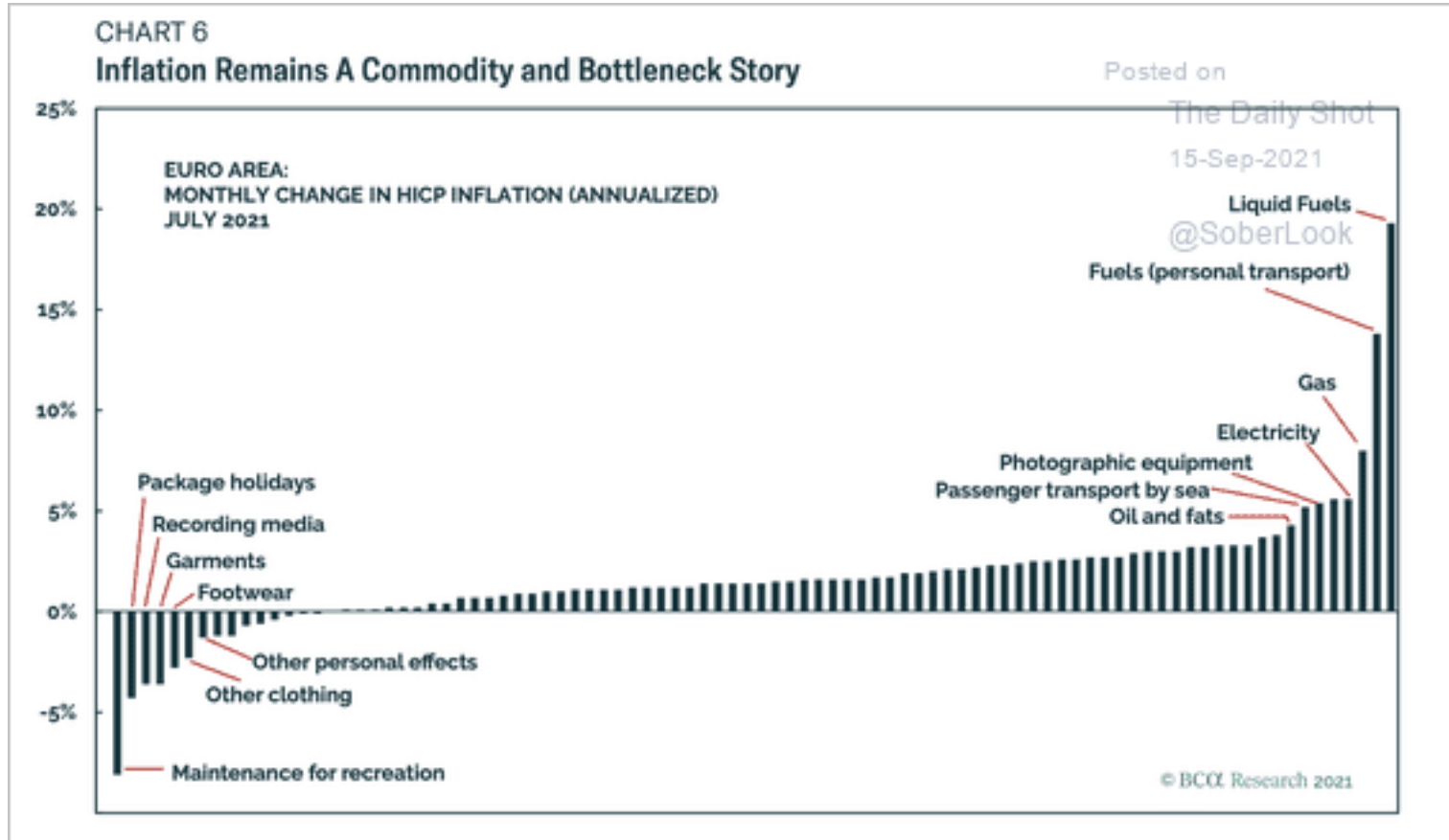
- Aided by a falling USD



Data source: Eikon Reuters

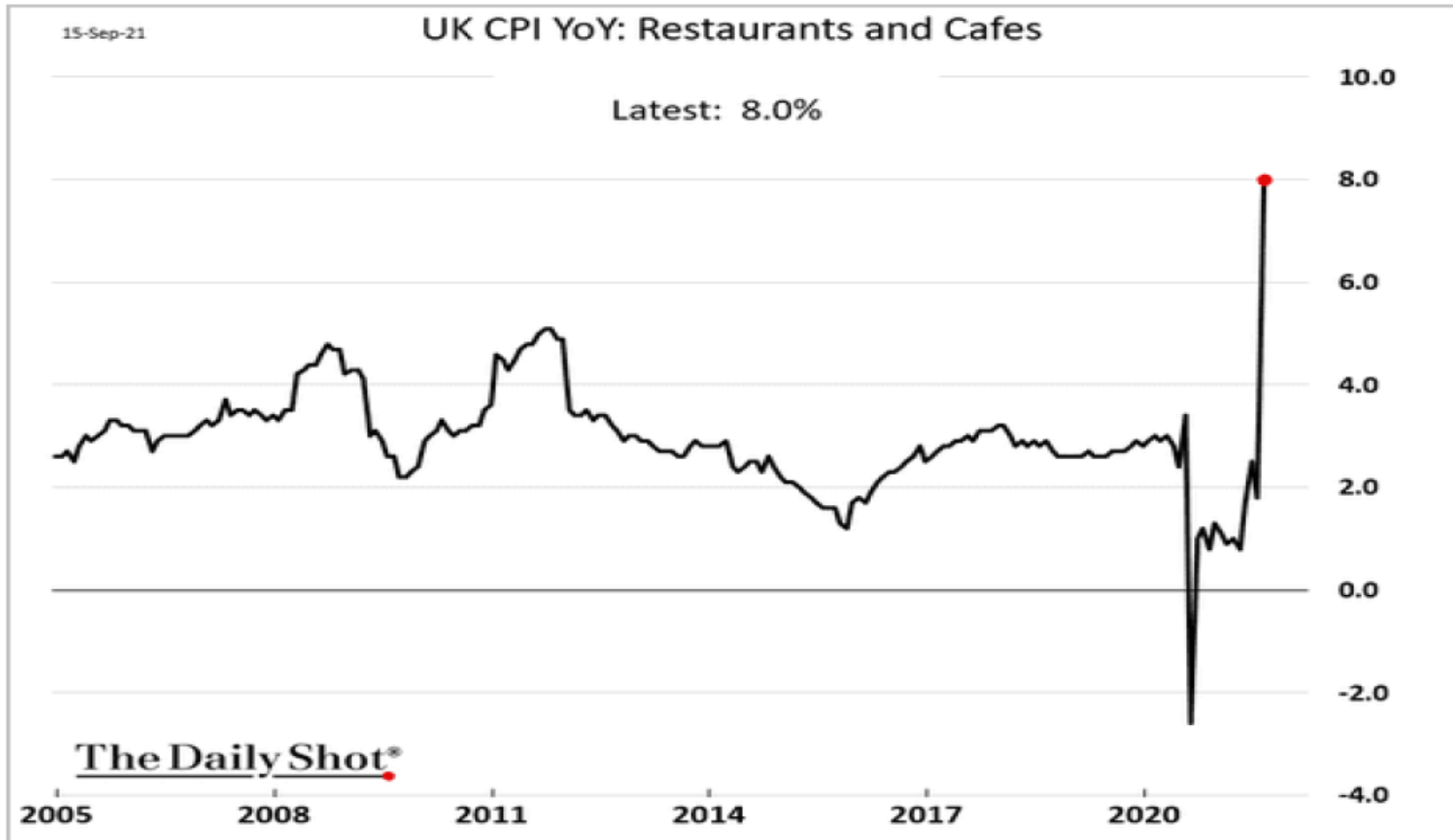
# Eurozone is in a deflationary hole but ...

- ... is not immune from global bottlenecks



## *Withdrawal of services capacity remains an issue*

- Survivors face a firmer pricing environment





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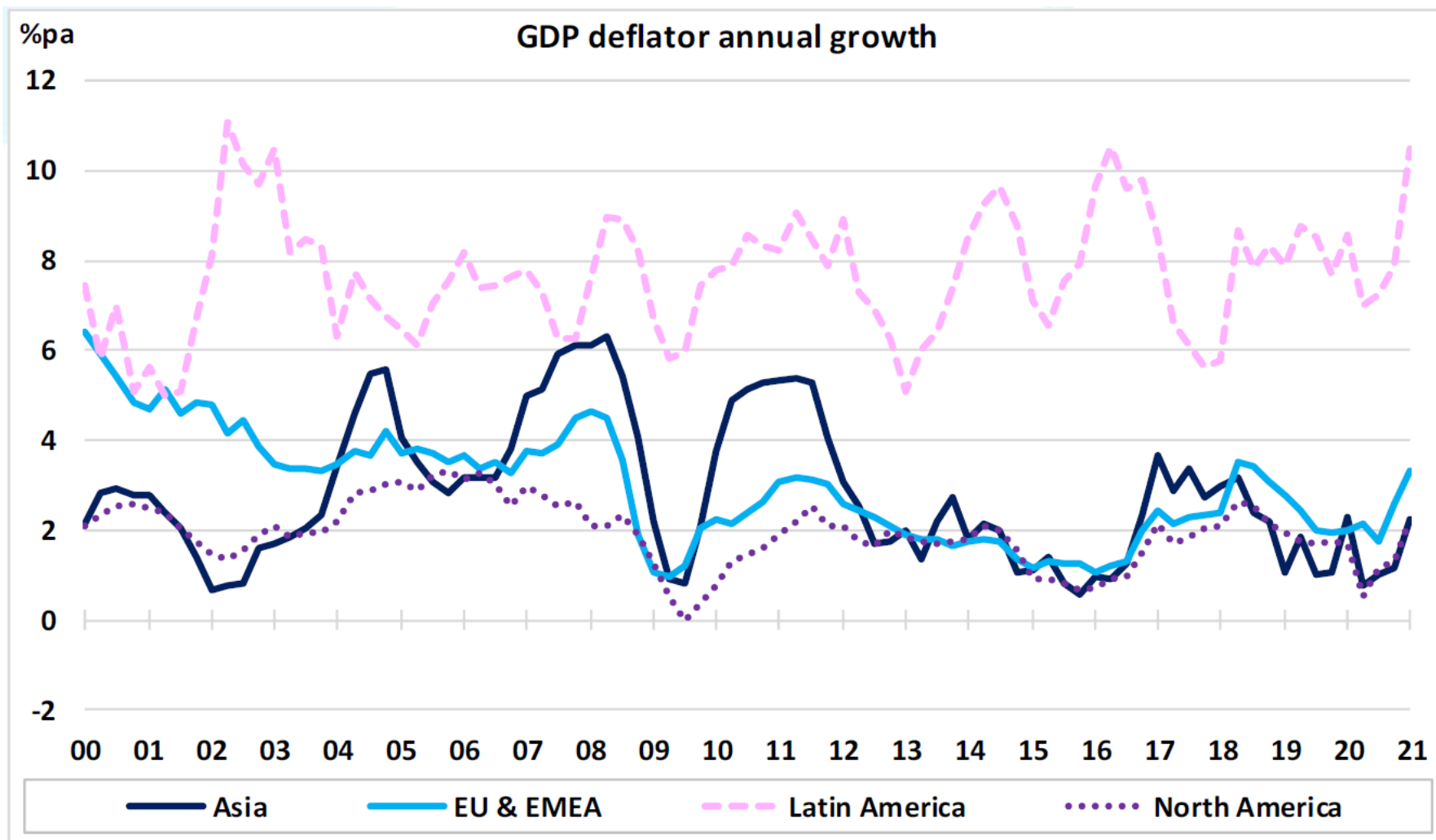
## *Inflation: a richer narrative (2)*

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- GDP inflation is faster than CPI inflation
- Home-working revolution will dominate the rise in unemployment as a driver of housing inflation
- FAO food price index at its highest since 2014. Covid-19 limited the planting of crops in 2020 and has impacted harvests
- Non-food commodity price increases are driving up construction and industrial costs. Natural resource 'nationalism' becoming more evident
- E&D expenditures have plummeted since 2014, meaning curtailment of new sources of supply

## Global GDP deflator rising faster than CPI

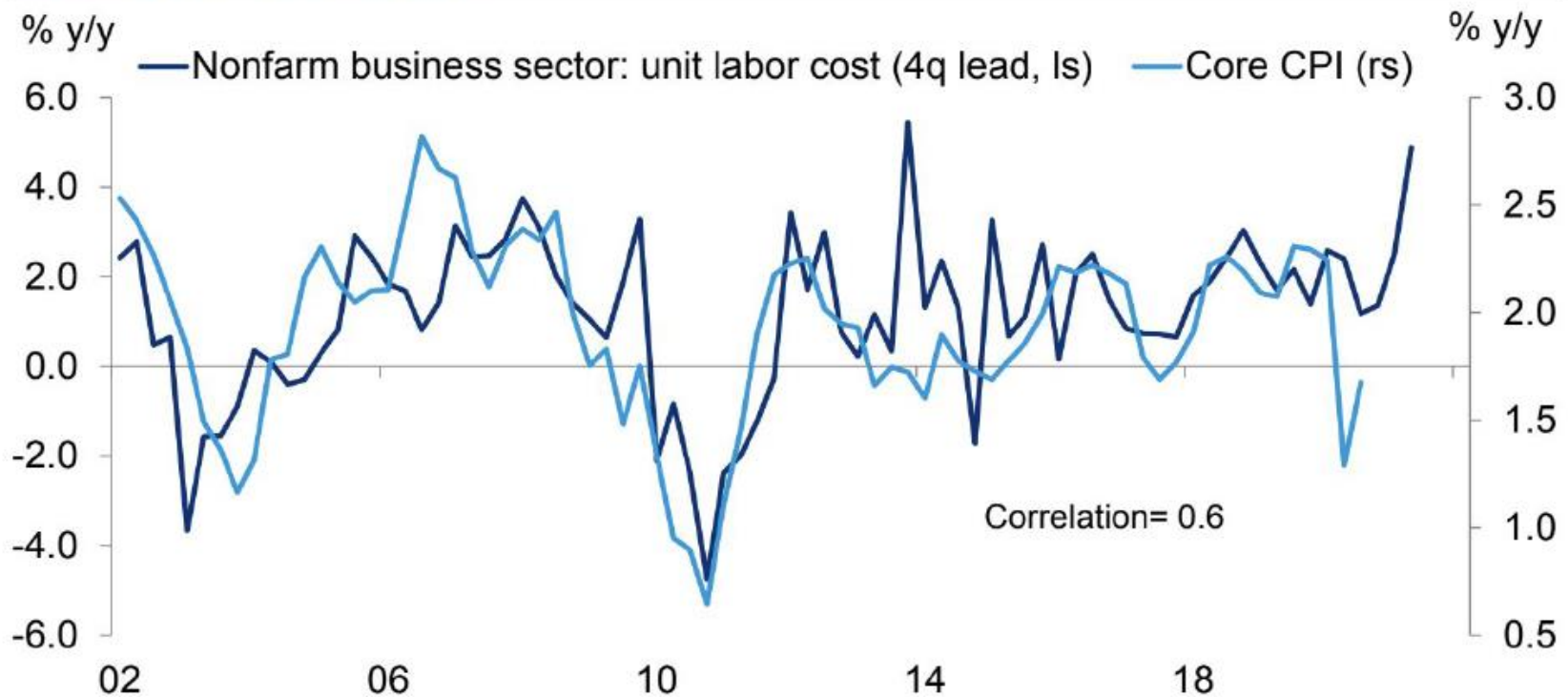
- Q2 rebound in all regions



## *Lockdowns have lowered productivity per person ...*

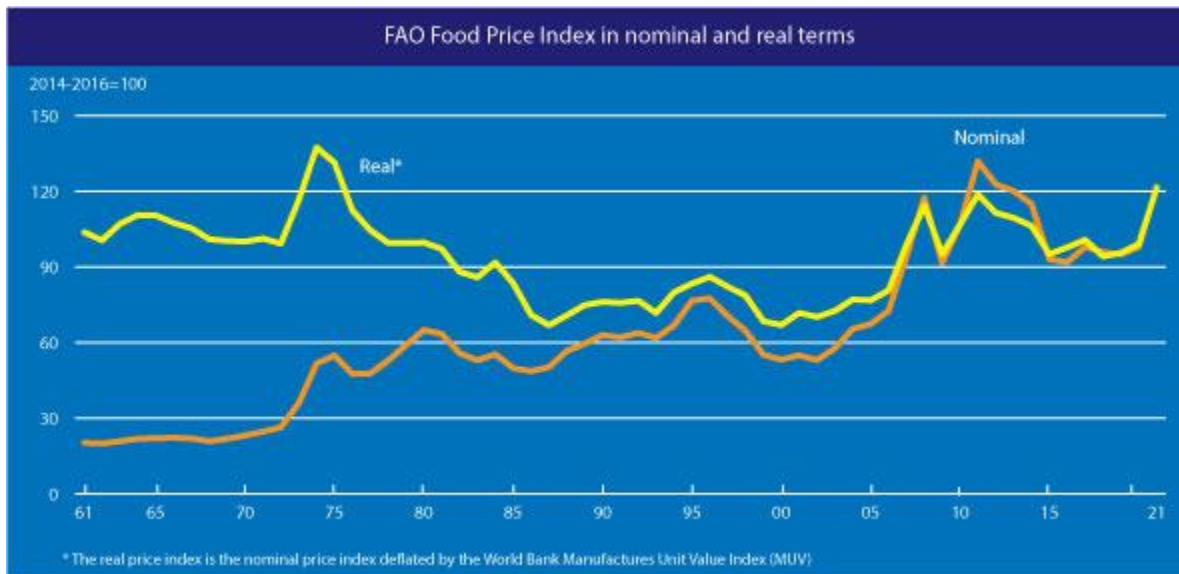
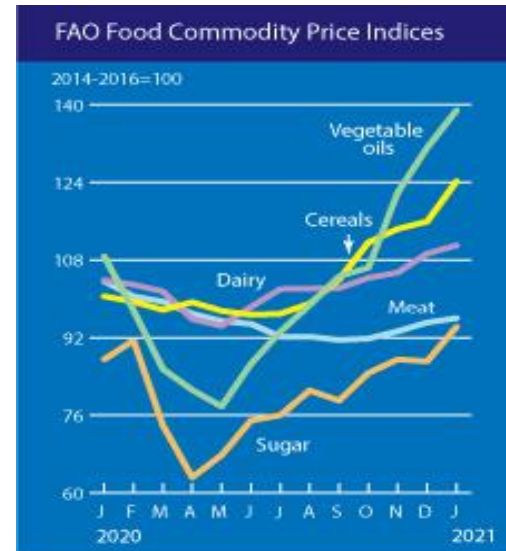
- ... and boosted unit labour cost inflation

### Labor costs lead inflation



Source: BLS, Haver Analytics, Deutsche Bank

# World food prices are soaring again



## Commodity price pressures permeating the economy

# The UK's Cost of Construction is Soaring

Material prices index for all construction work in the UK from January 2016 to July 2021 (2015=100)



May-July 2021=provisional

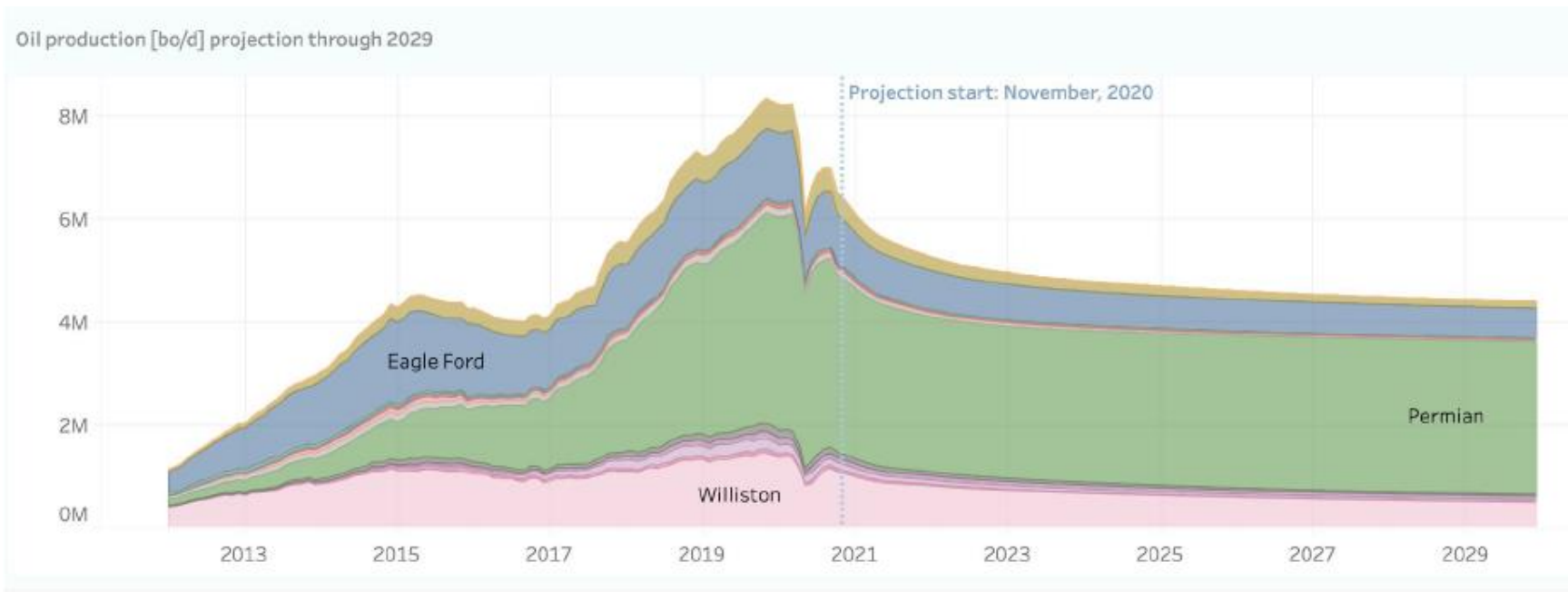
Source: Department for Business, Energy & Industrial Strategy



statista

## Crude oil: permanent supply shock

- Lost US shale output maybe gone for good



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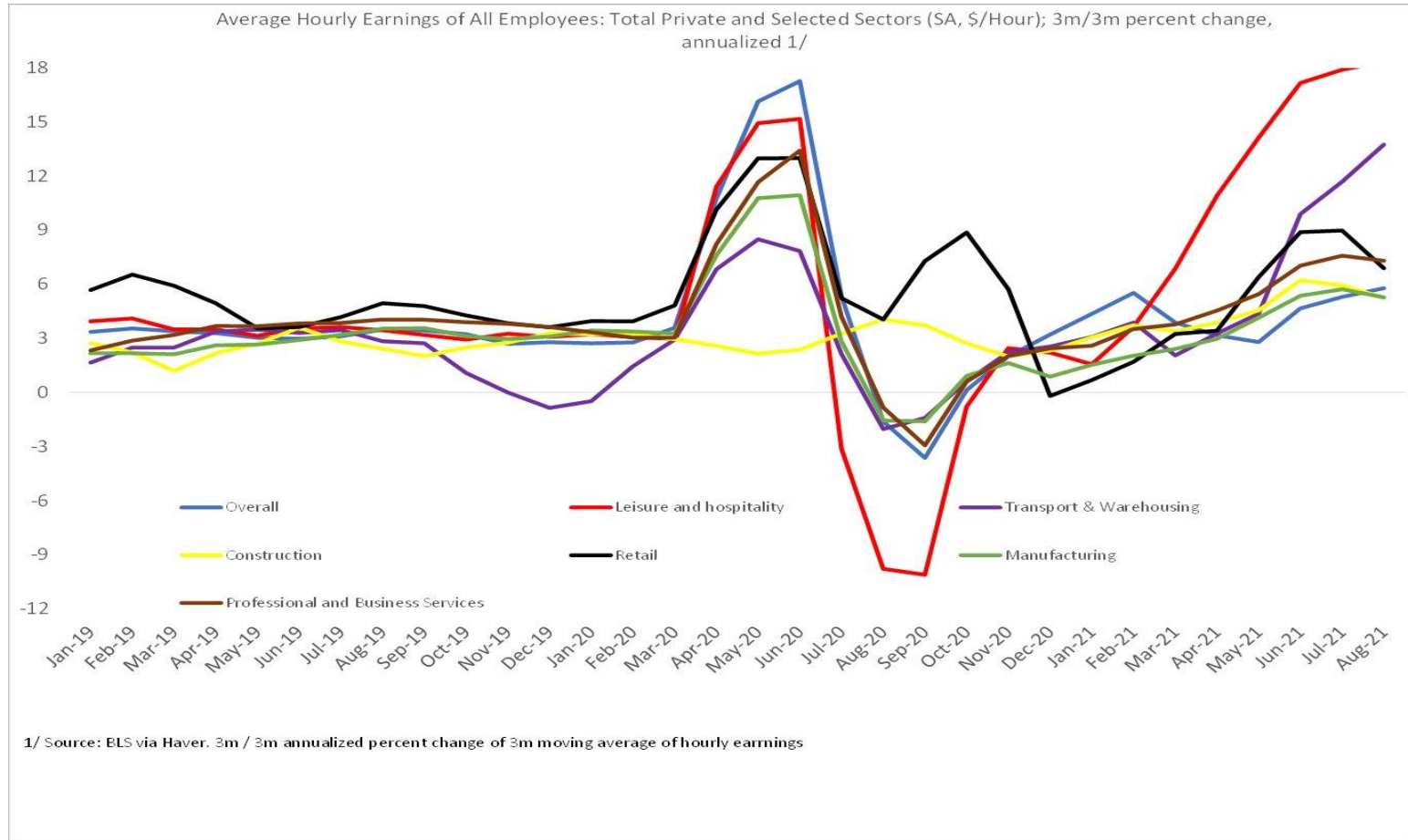
## *Inflation: a richer narrative (3)*

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- Labour and housing markets are key transmission mechanisms of inflationary pressure
- Pandemic-related public spending has shifted upwards the cost structures of many economies, including US, UK and Canada
- Surging corporate profits have triggered a bidding war for competent staff, leaving large gaps in pre-pandemic workforces and motivating higher wage offers. Quit rates are soaring.
- Wages are accelerating, especially in service sectors, but productivity will not keep pace

# Increasing signs of US wage acceleration ...

- ... cannot be explained by furlough distortions





# US labour supply crisis

- Record vacancies and a record-high quit rate

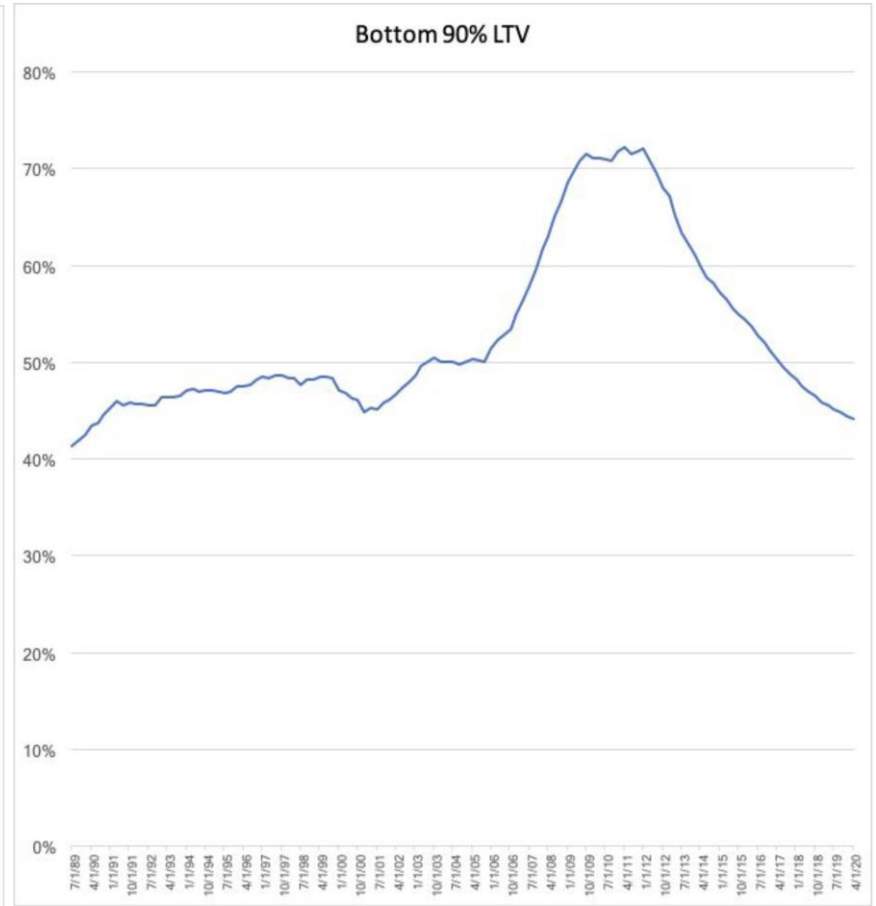
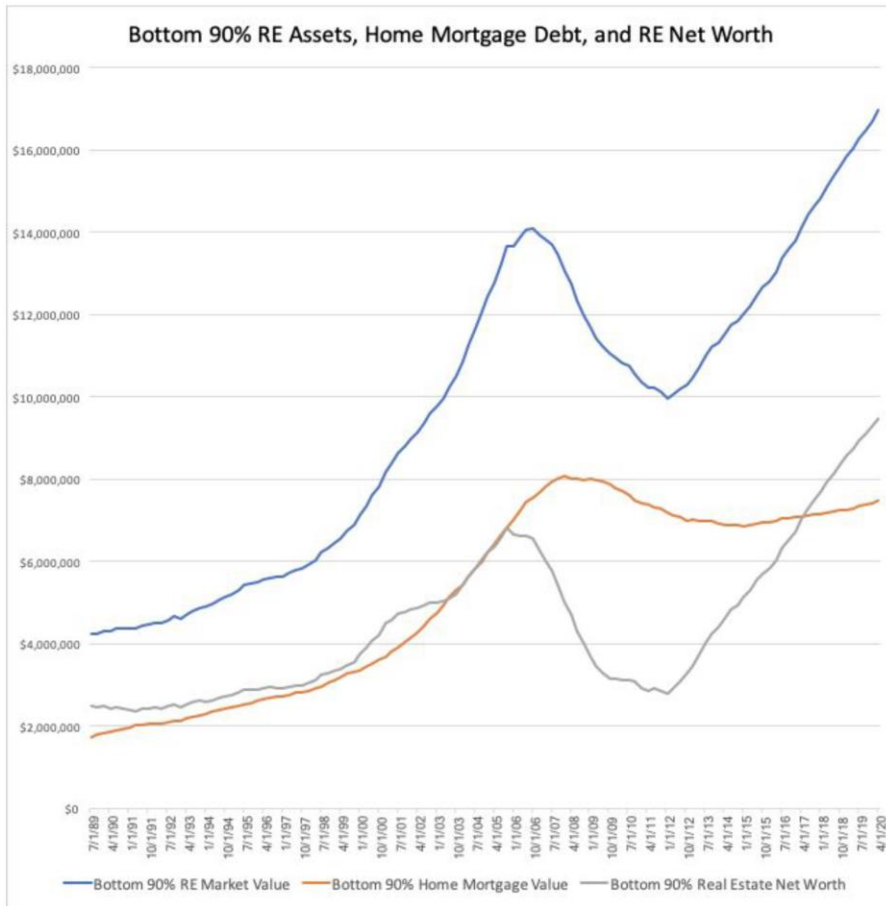
Percentage of US non-farm payroll employees



Source: JOLTS

# Lower leverage ratio creates space for refinancing boom

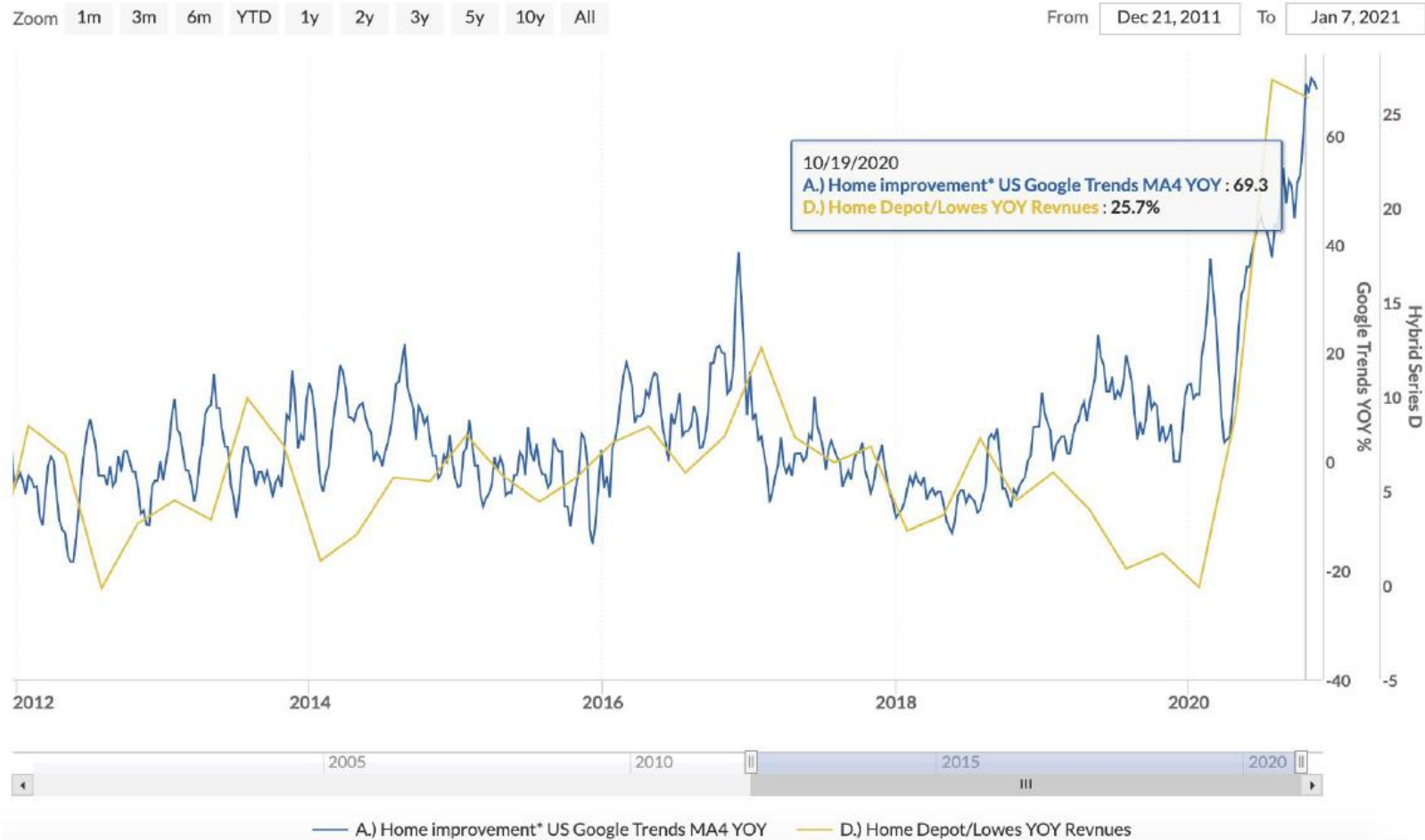
- Home price revaluation brings a wealth effect



Source: FRED

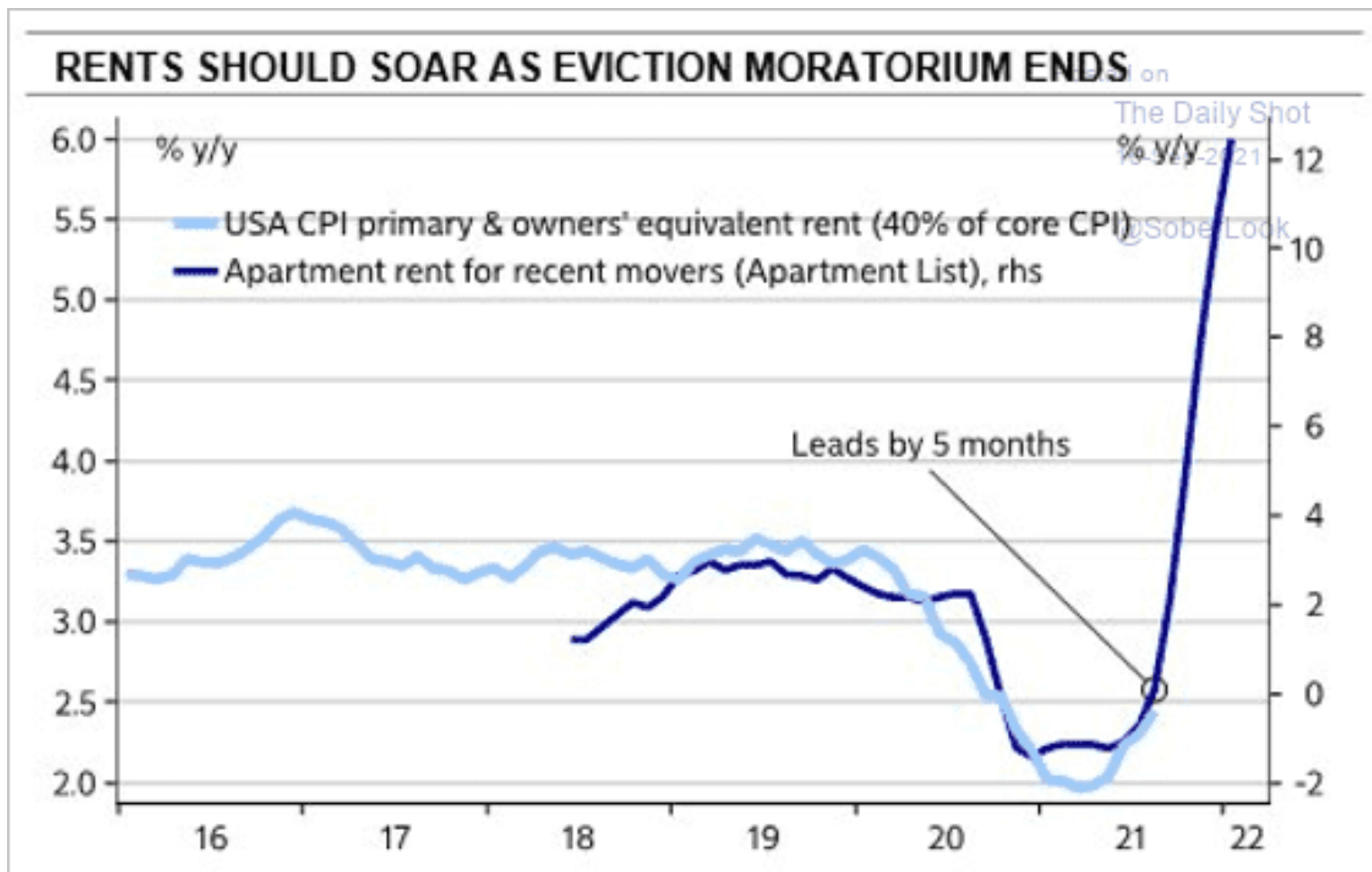
# US home improvement searches are up 70% yoy

- Home Depot/Lowes sales are 25% higher



## US single family rental market is tightening

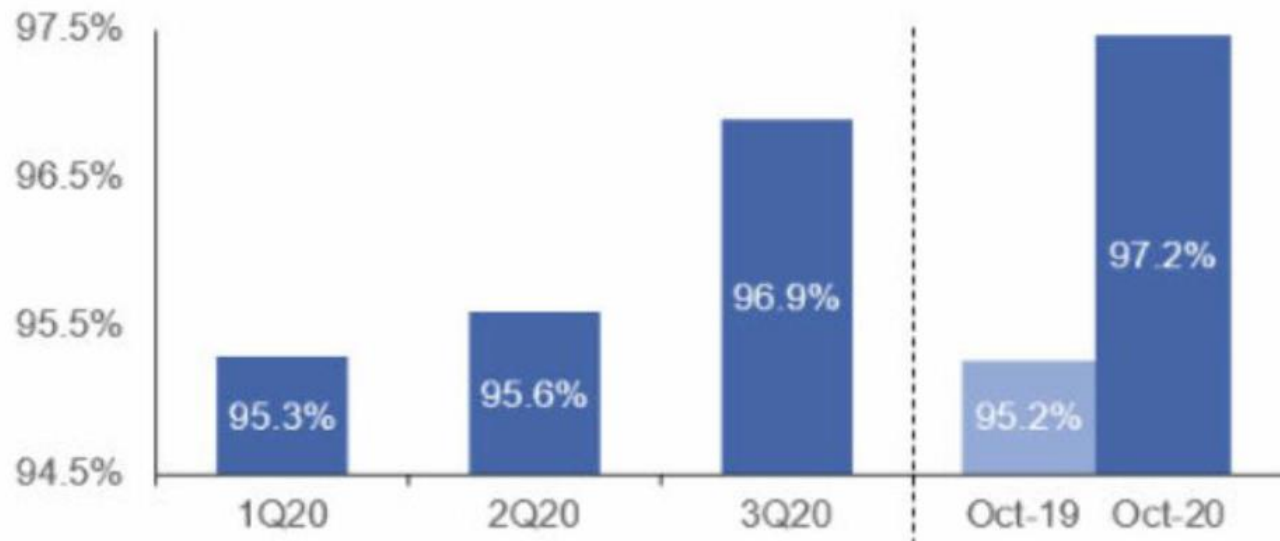
- Scope for rental inflation to set OER on fire



## *Barometer of future OER inflation is surging*

- American Homes 4 Rent reports rent inflation

Same Home Average Occupied Days



Total Portfolio Leasing Spreads	1Q20	2Q20	3Q20	Oct-19	Oct-20
Avg. Change in Rent for Renewals	4.6%	1.3%	1.1%	4.6%	3.5%
Avg. Change in Rent for Re-Leases	3.4%	4.5%	6.1%	2.1%	7.0%
Avg. Blended Change in Rent	4.2%	2.4%	2.8%	3.6%	4.9%

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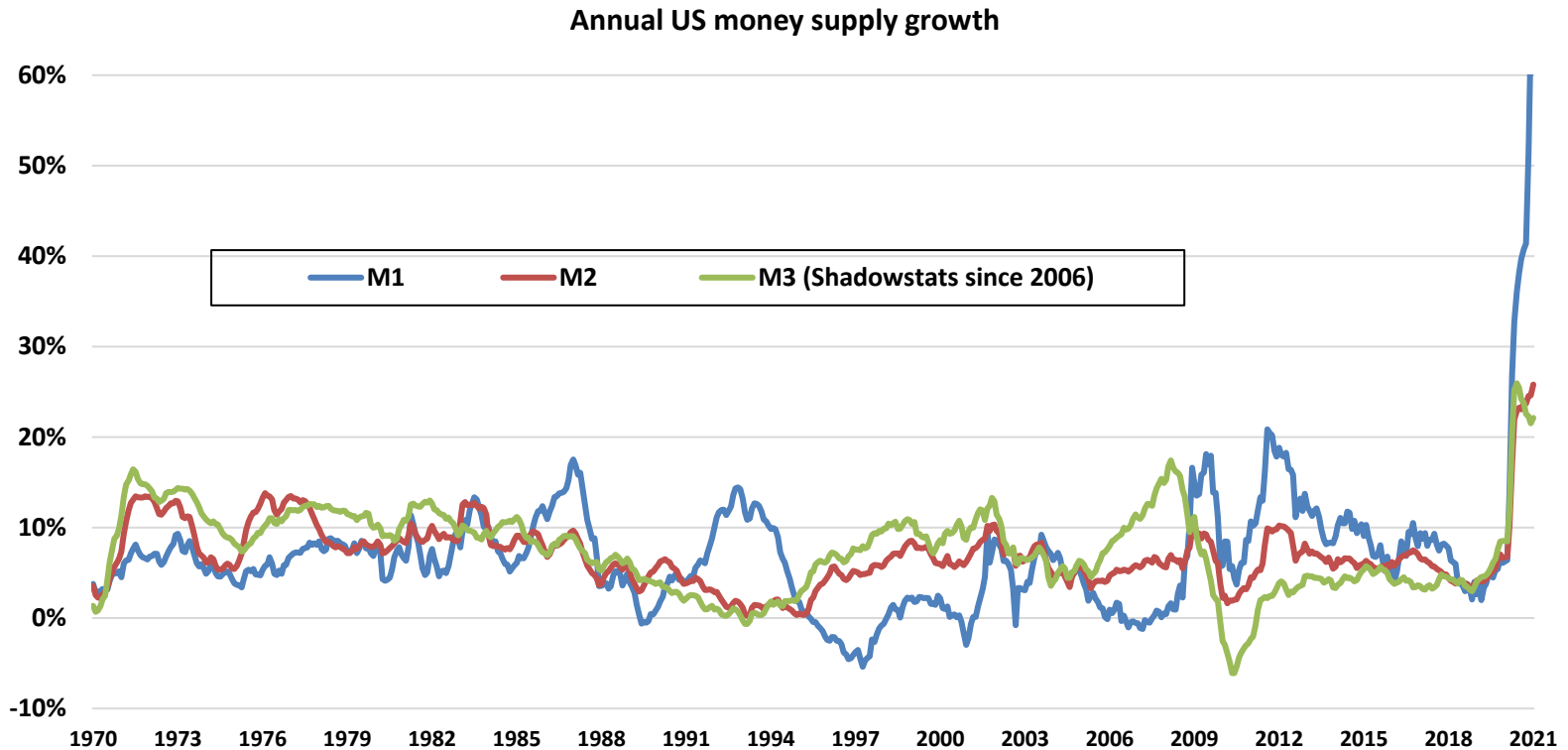
## *Inflation: a richer narrative (4)*

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- Disruption of the public's inflation expectations as frequently-purchased items have risen in price more obviously than the CPI
- Central banks have failed to explain the rationale for significant additions to QE, implying a loss of inflation-objective credibility
- QE has brought a massive acceleration in the growth of the broad money supply (M3/M4)
- Fears of a second 'taper tantrum'
- Fears of a broadening of 'yield curve control', suppressing nominal bond yields

# Money and Credit indicators

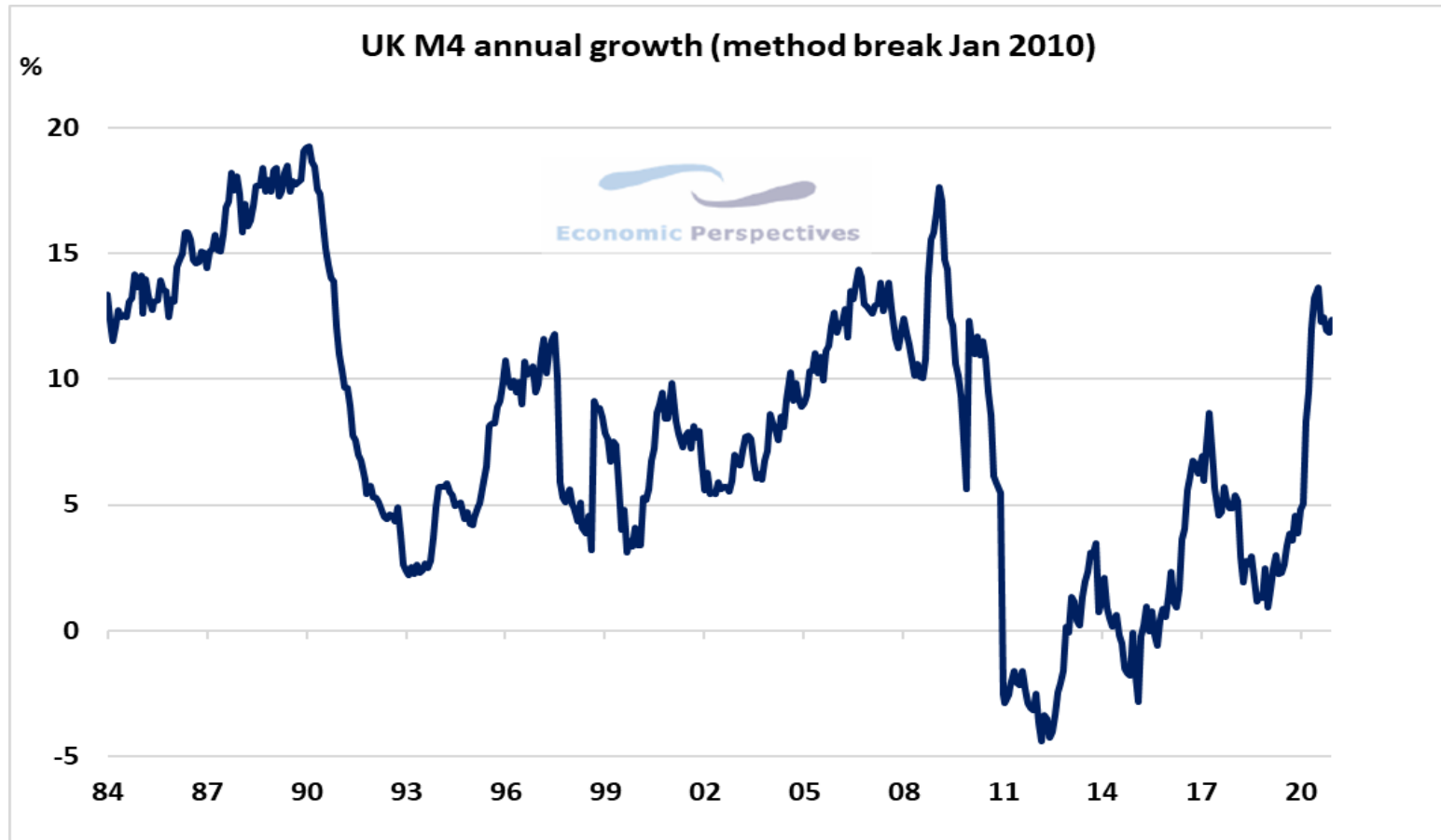
- Explosion of US broad money growth



Data sources: US Federal Reserve and Shadowstats

## UK: spectacular money supply growth

- Caution has been thrown to the wind

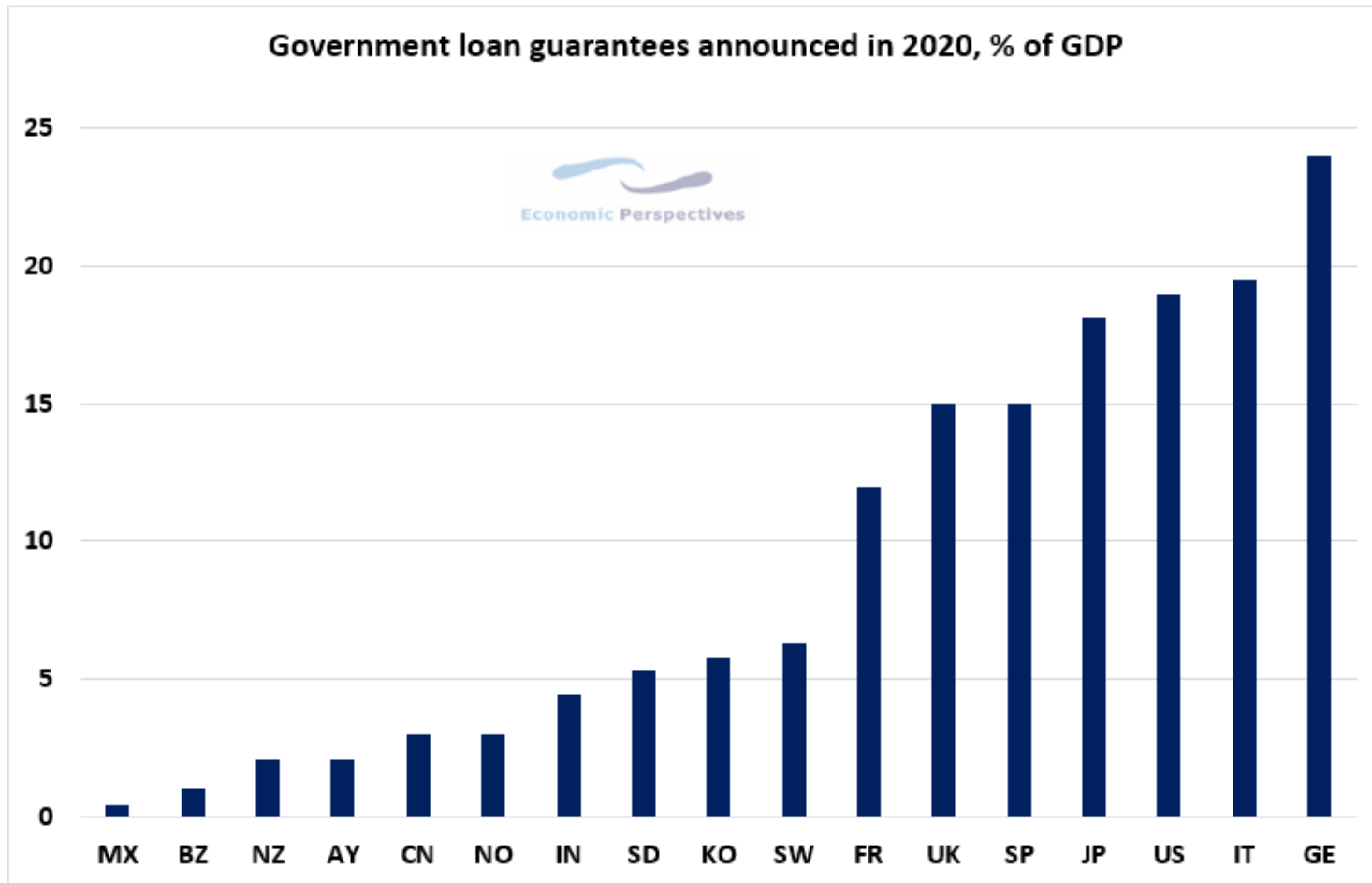


Data source: ONS



# State underwriting of commercial bank lending

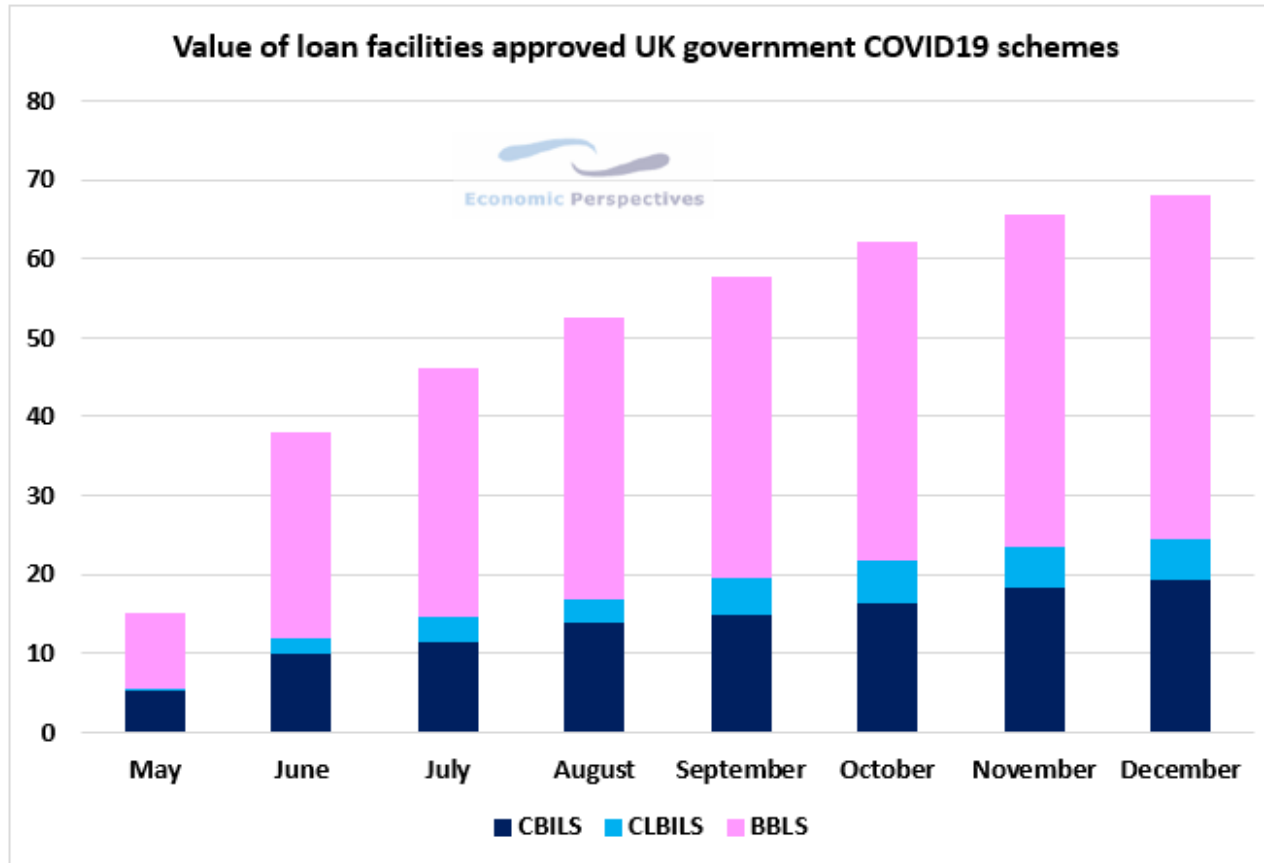
- The eclipse of Maastricht limits



Data source: GS, Bloomberg

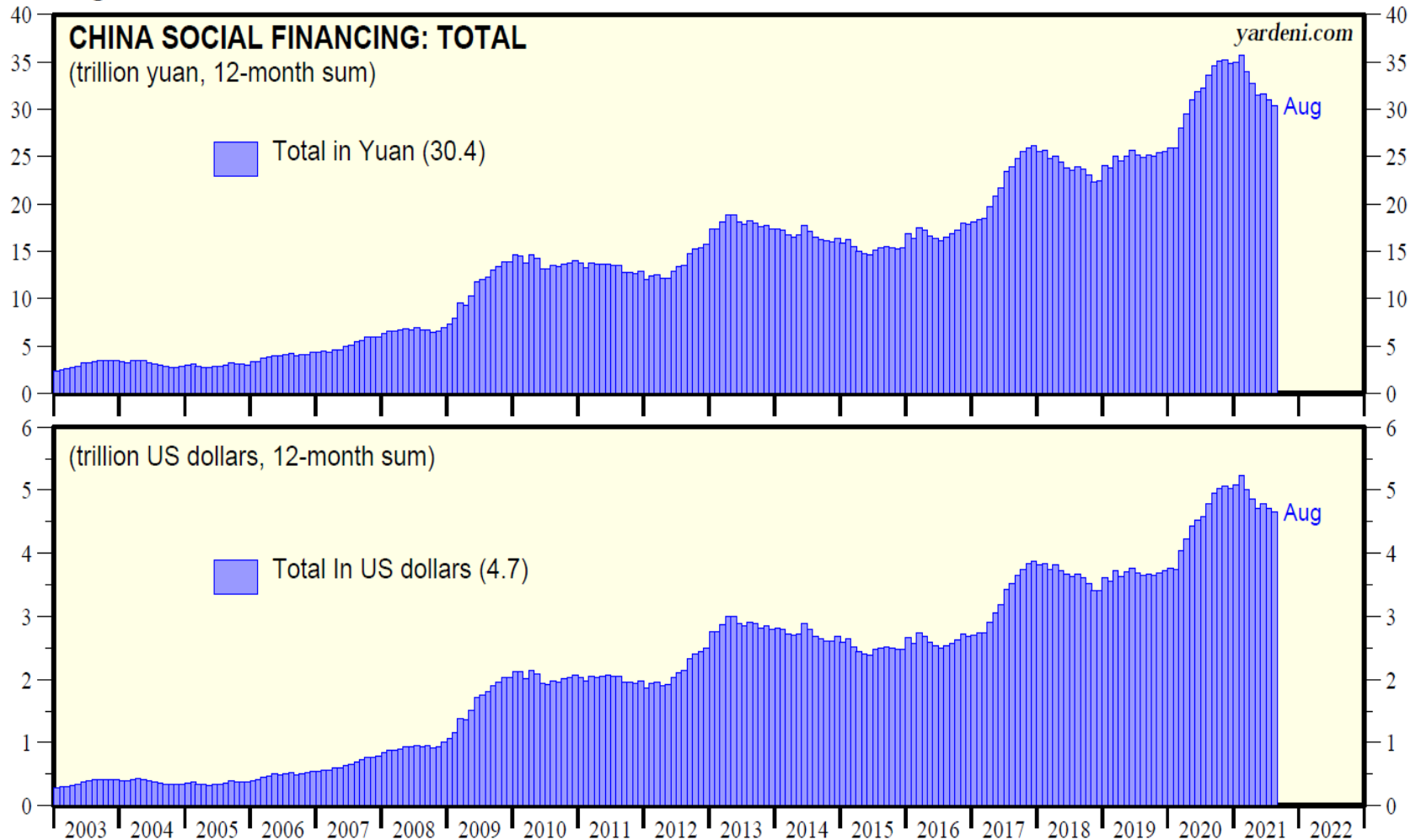
## UK business lending supports are poorly screened

- Presumption that much will be lost
- CBILS and BBLs for UK SMEs, CLBILS for large businesses



Data source: <https://www.gov.uk/government/collections/hm-treasury-coronavirus-covid-19-business-loan-scheme-statistics>

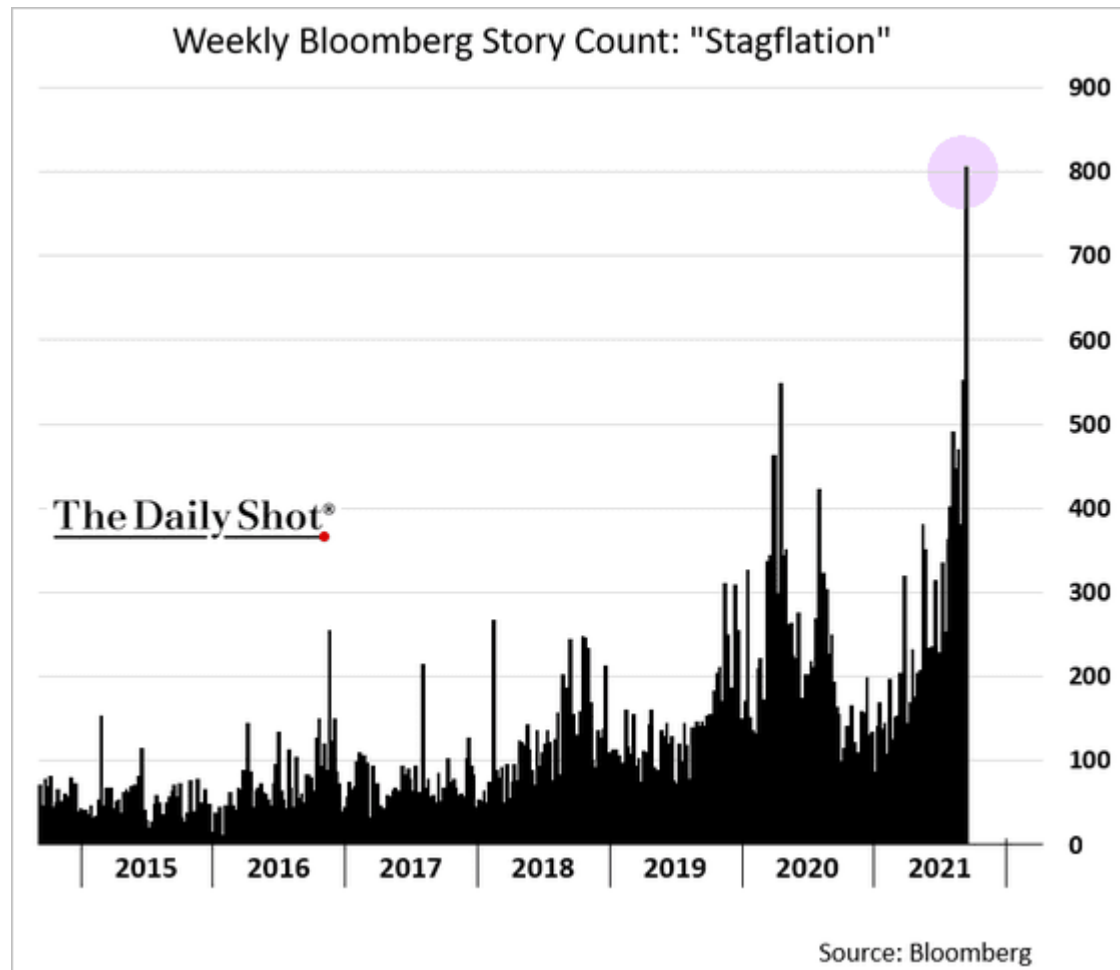
# China's total social financing is slowing



Source: People's Bank of China.

## Keeping the activity and inflation narratives separate

- Stagflation has happened before!



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## *Summary*

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- What evidence do we have that inflationary forces are rising to the surface?
- Surging energy and commodity prices
- Global economy has experienced structural changes since the pandemic struck, bring dislocation and supply chain disruption
- Low inventory/sales, lengthening delivery times
- Increasing signs of wage acceleration
- Extraordinarily rapid credit and money growth
- Beware an inflationary legacy after the re-opening sugar-high: stagflation has happened before



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