



Inflation and the COVID-19 Pandemic Economic Recovery

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The views expressed here are those of the presenter and not necessarily those of the Federal Reserve Bank of Richmond or of the Federal Reserve System.



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Poll #1

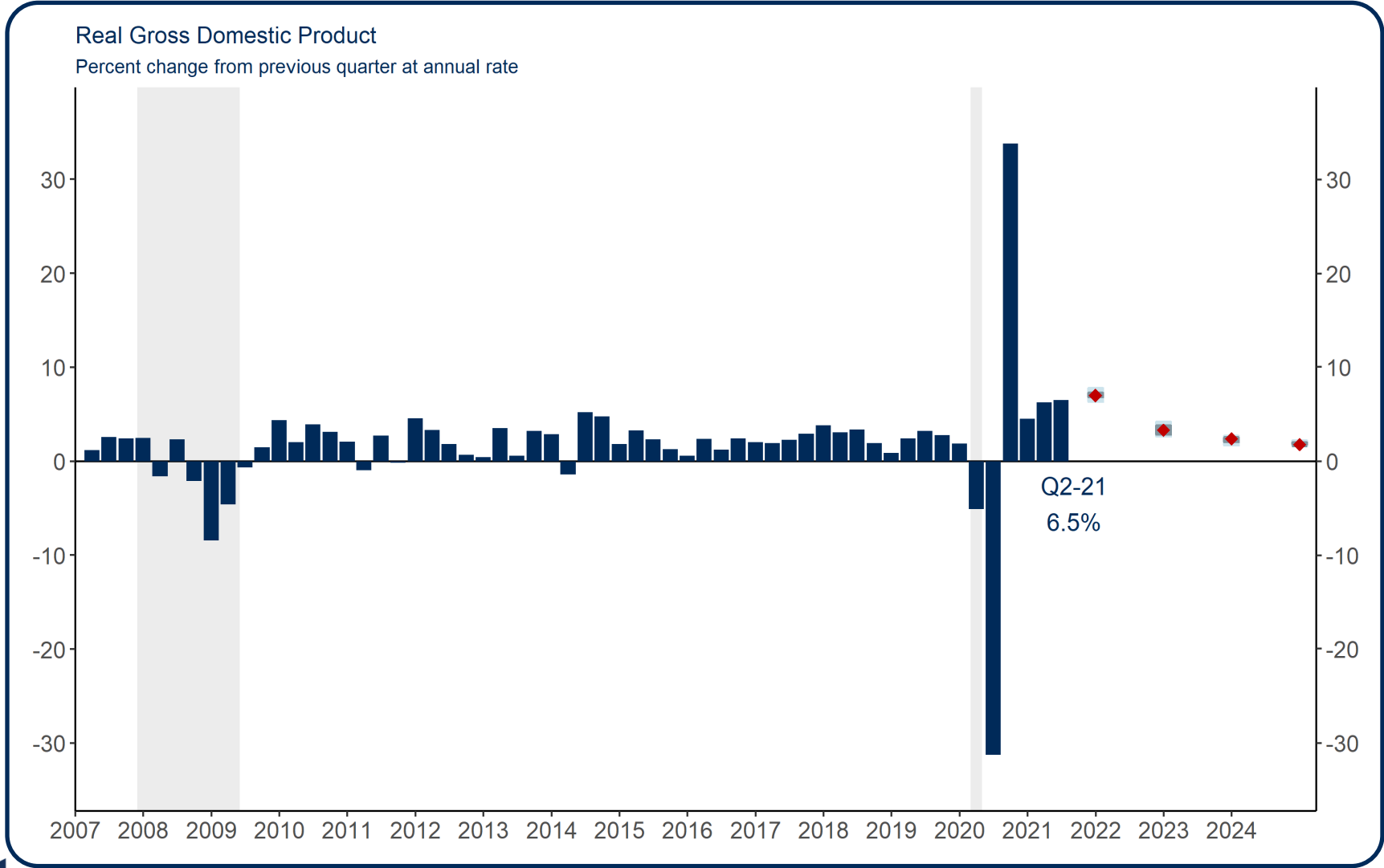
What is your work status?

- A. 100% in-person
- B. 100% remote
- C. Majority remote
- D. Majority in-person

What's the story?

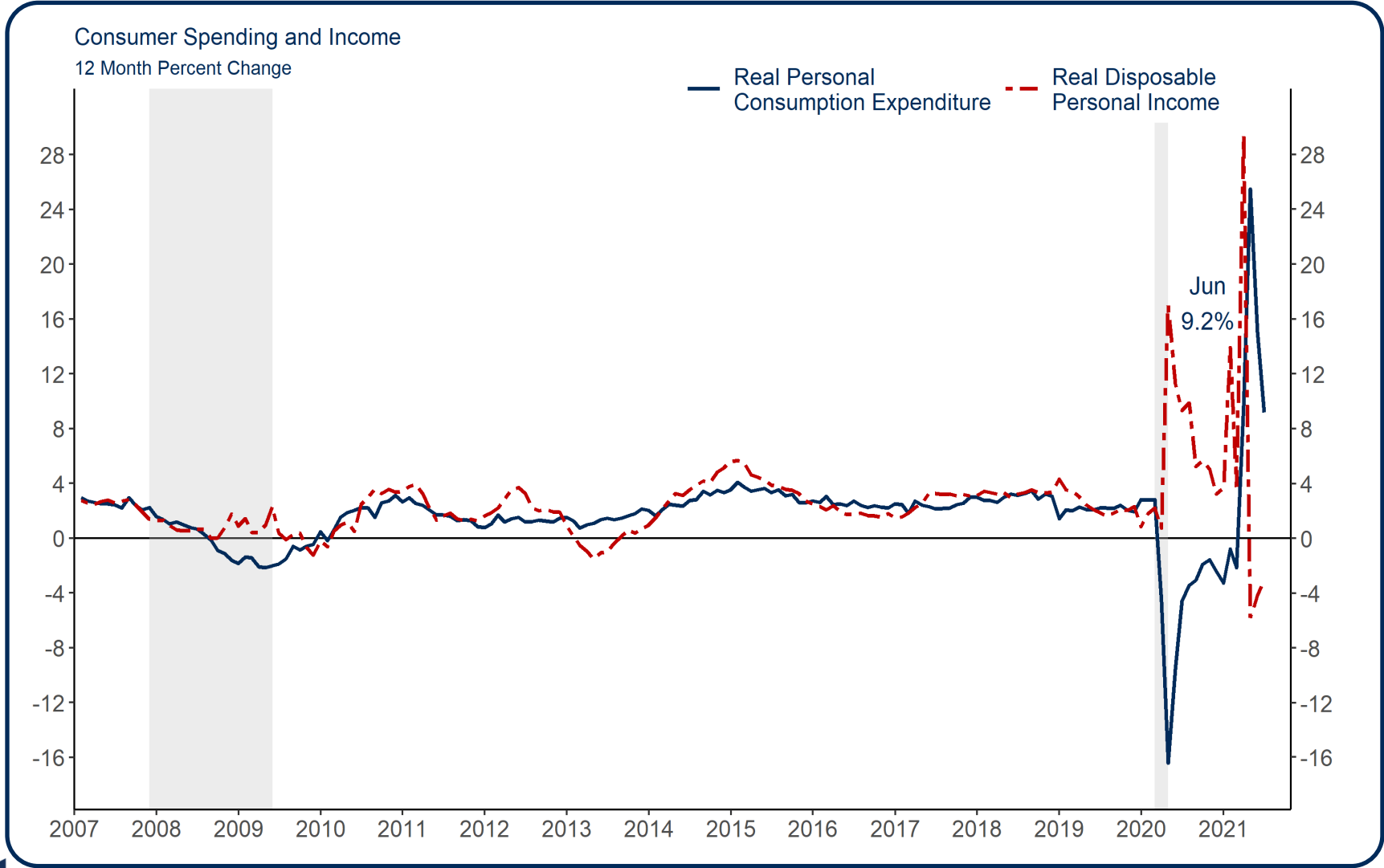
- Overall economic activity is strong on the heels of the COVID-19 pandemic.
- Vaccinations and savings accrued during the pandemic are helping to boost consumer spending. Sectors heavily affected by the pandemic have not fully recovered, though.
- We are from pre-pandemic employment and labor force participation. However, job openings are at record levels and businesses are struggling to find workers.
- Inflation is above the 2% target, reflecting high demand, supply chain frictions, and moving past low inflation readings from last spring in year-over-year inflation calculations.
- Risks remain to the outlook, especially the impact of business closures due to the Delta variant.

GDP has recovered to pre-pandemic levels



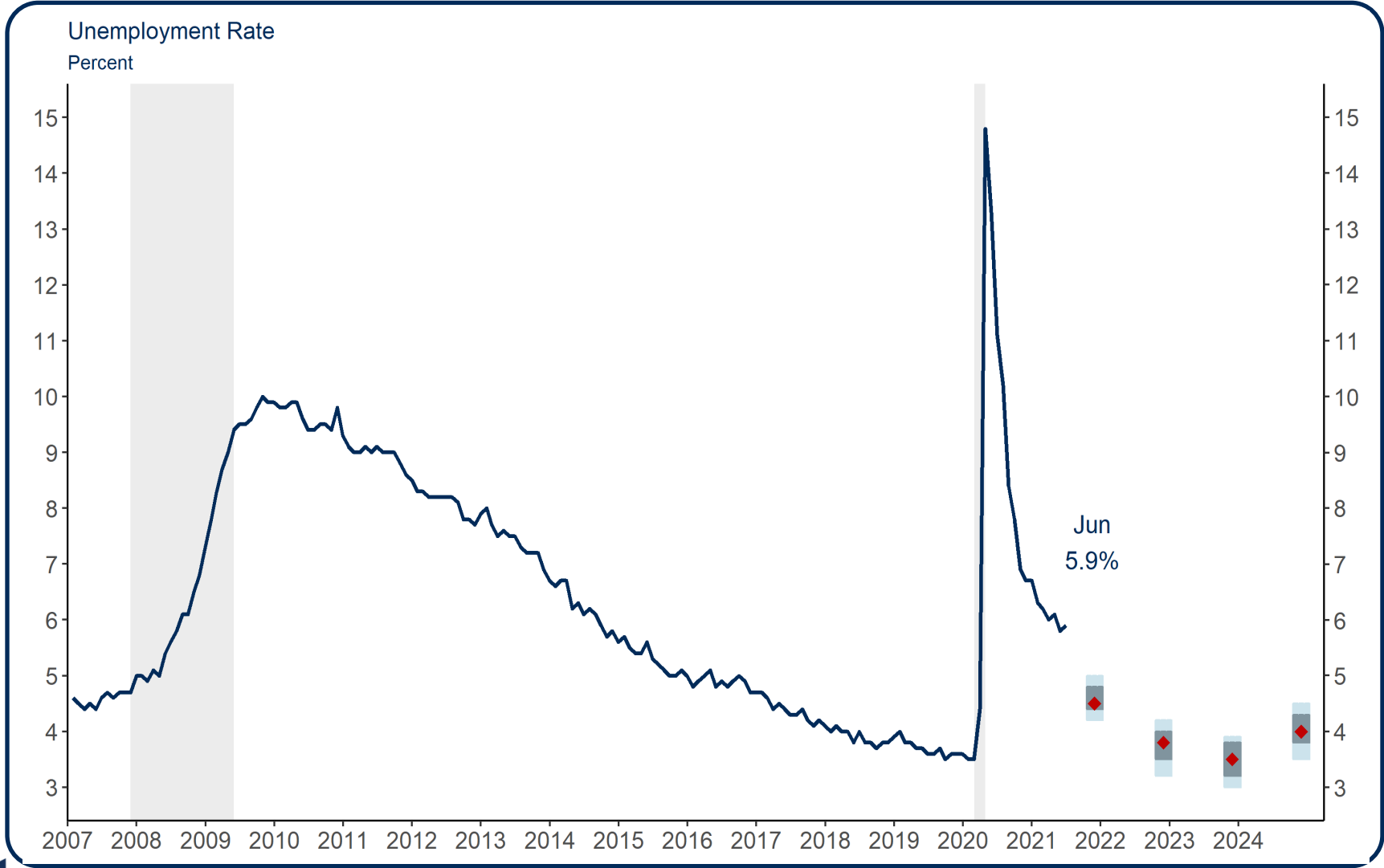
Note: Projection is the median, central tendency, and range from the March 2021 Summary of Economic Projections. Red dots indicate median projections. Projections of change in real gross domestic product (GDP) are from the fourth quarter of the previous year to the fourth quarter of the year indicated.

Consumer spending strong

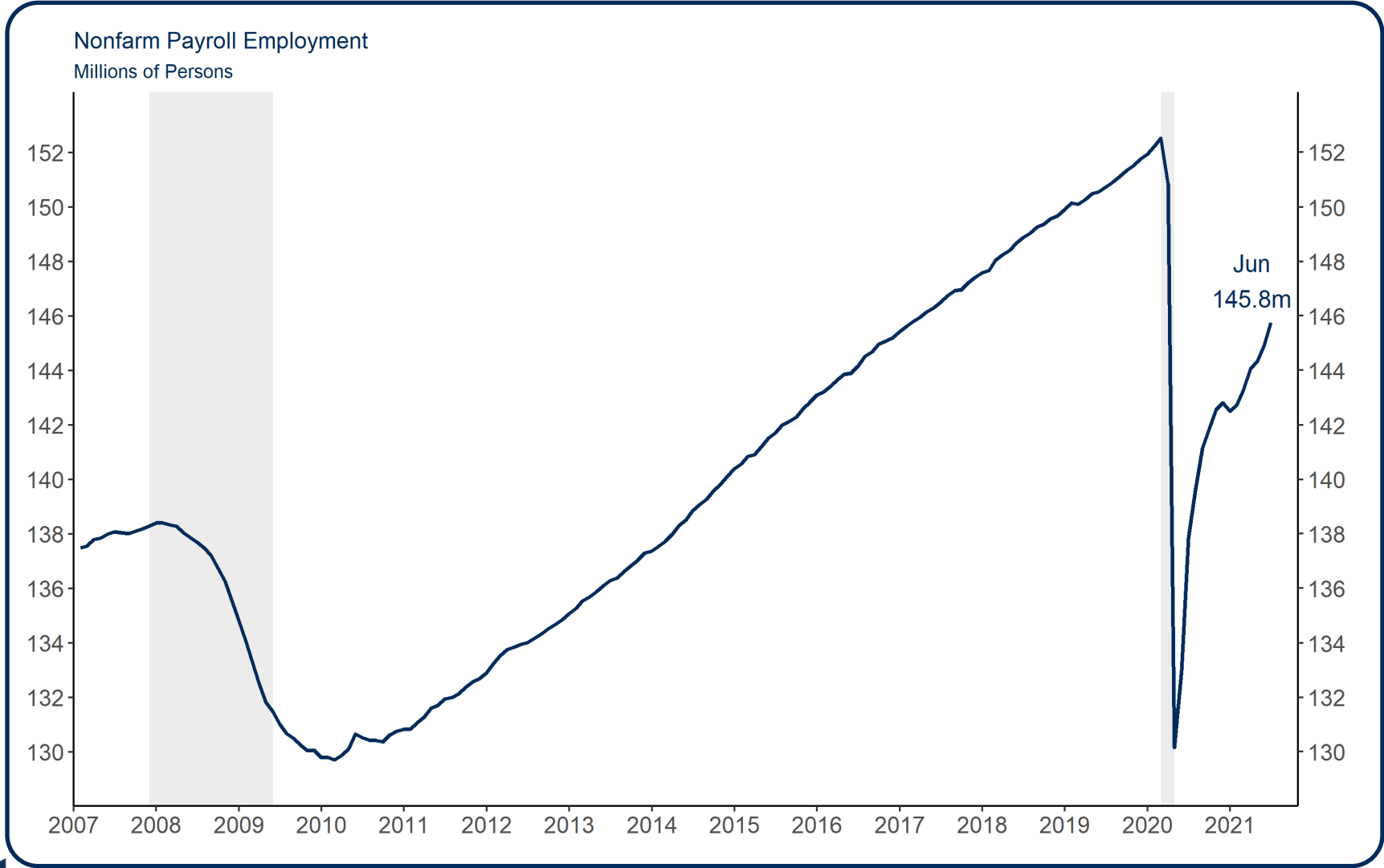


Note: Income has been adjusted to account for temporary fiscal actions in 2008 and 2012-2013.

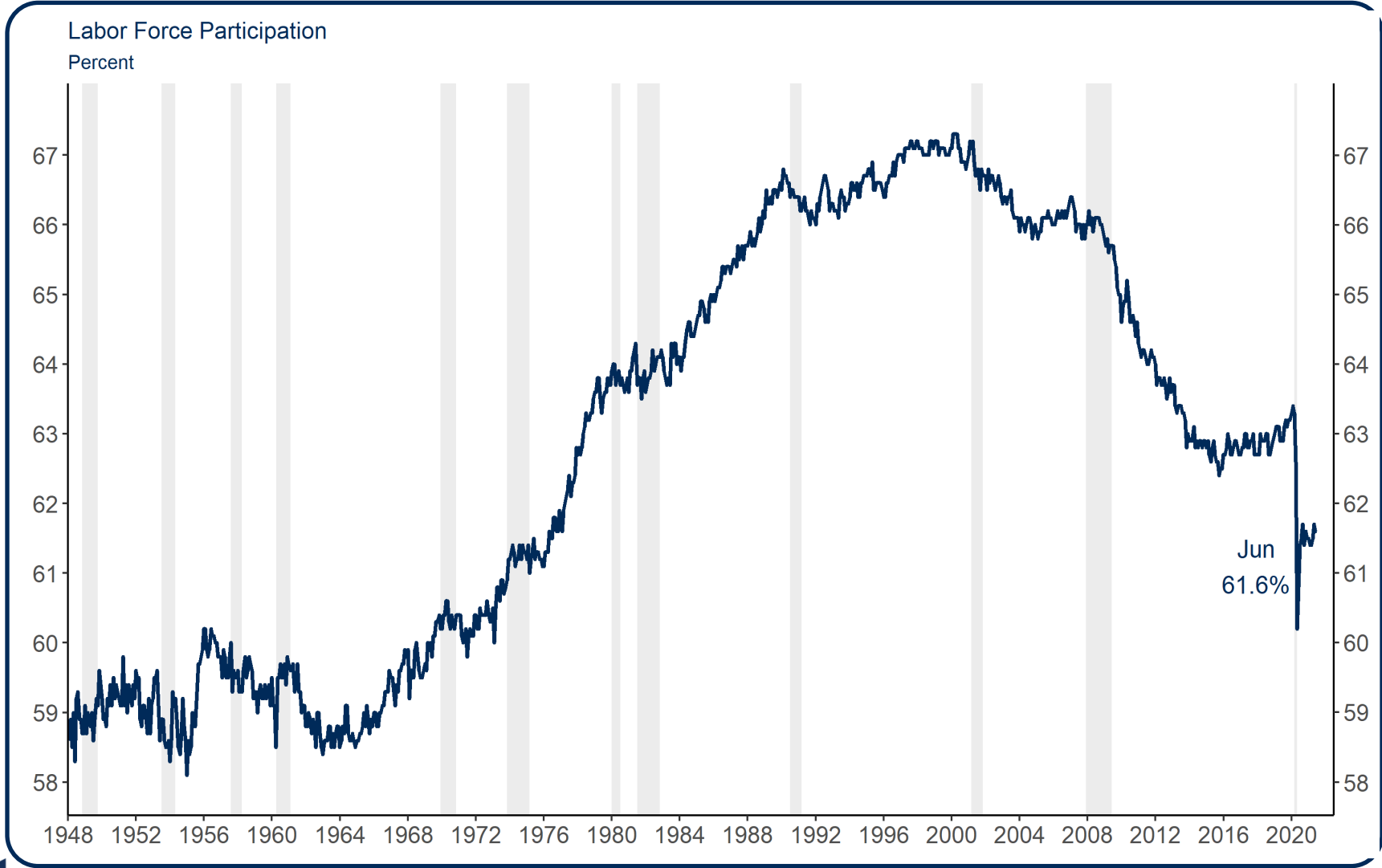
Unemployment rate trending down



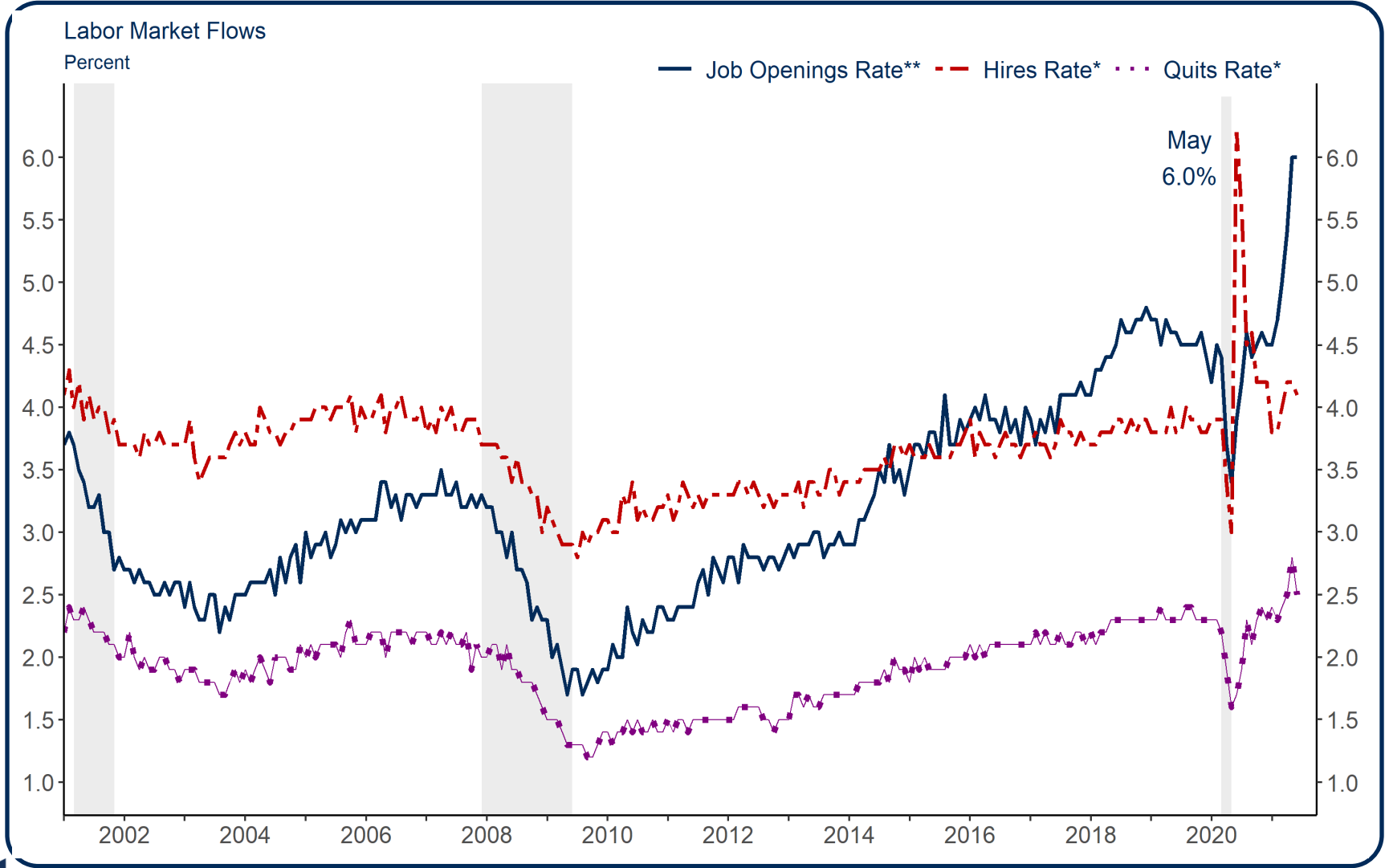
Employment, though, is far from recovered



Labor force participation remains low



Job openings at record levels



Note: *Percent of total employment. **Percent of total employment plus job openings.

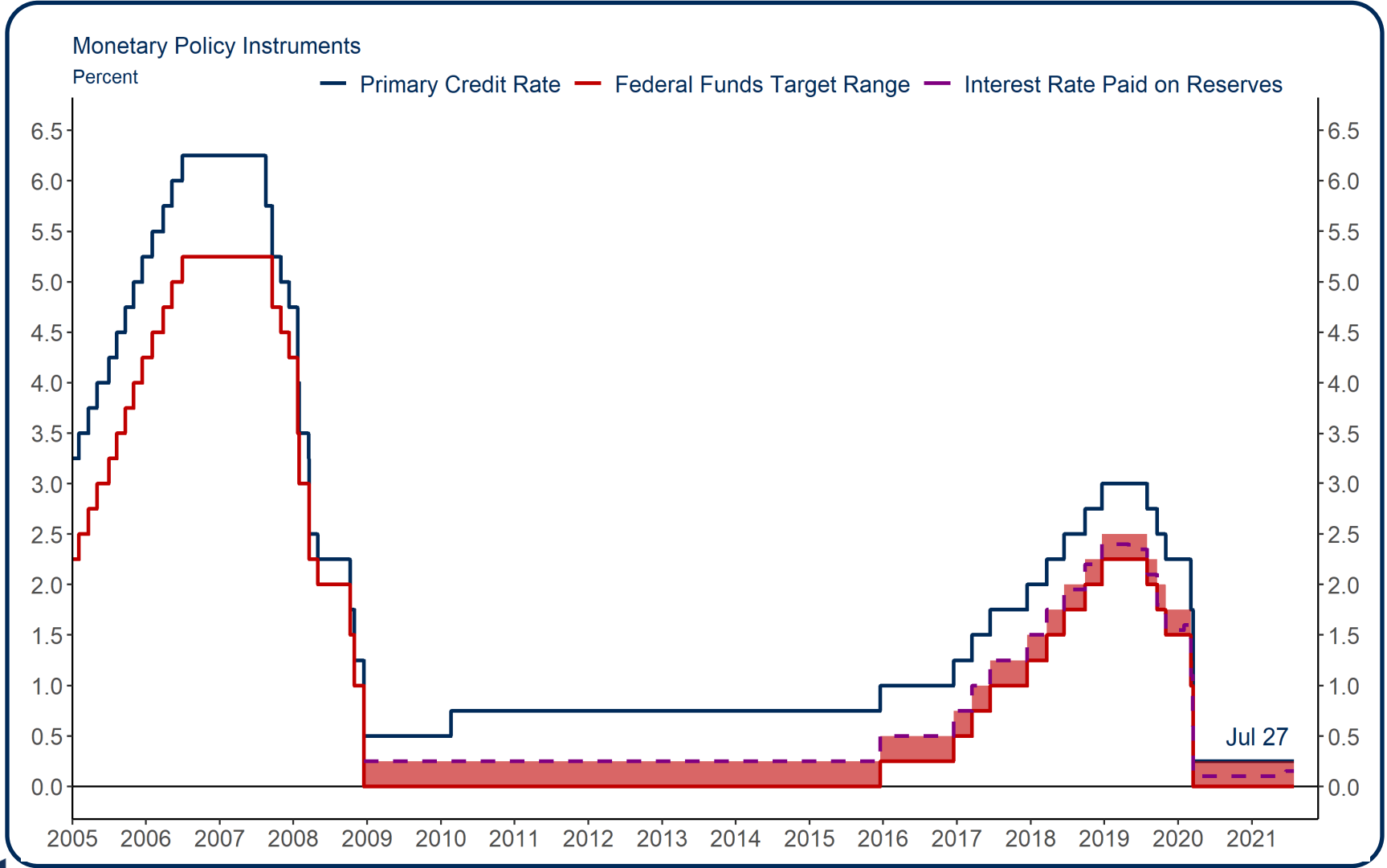
Poll #2

Are you concerned about inflation?

A. Yes,

B. No

The Fed's response so far



Source: Board of Governors via Haver Analytics

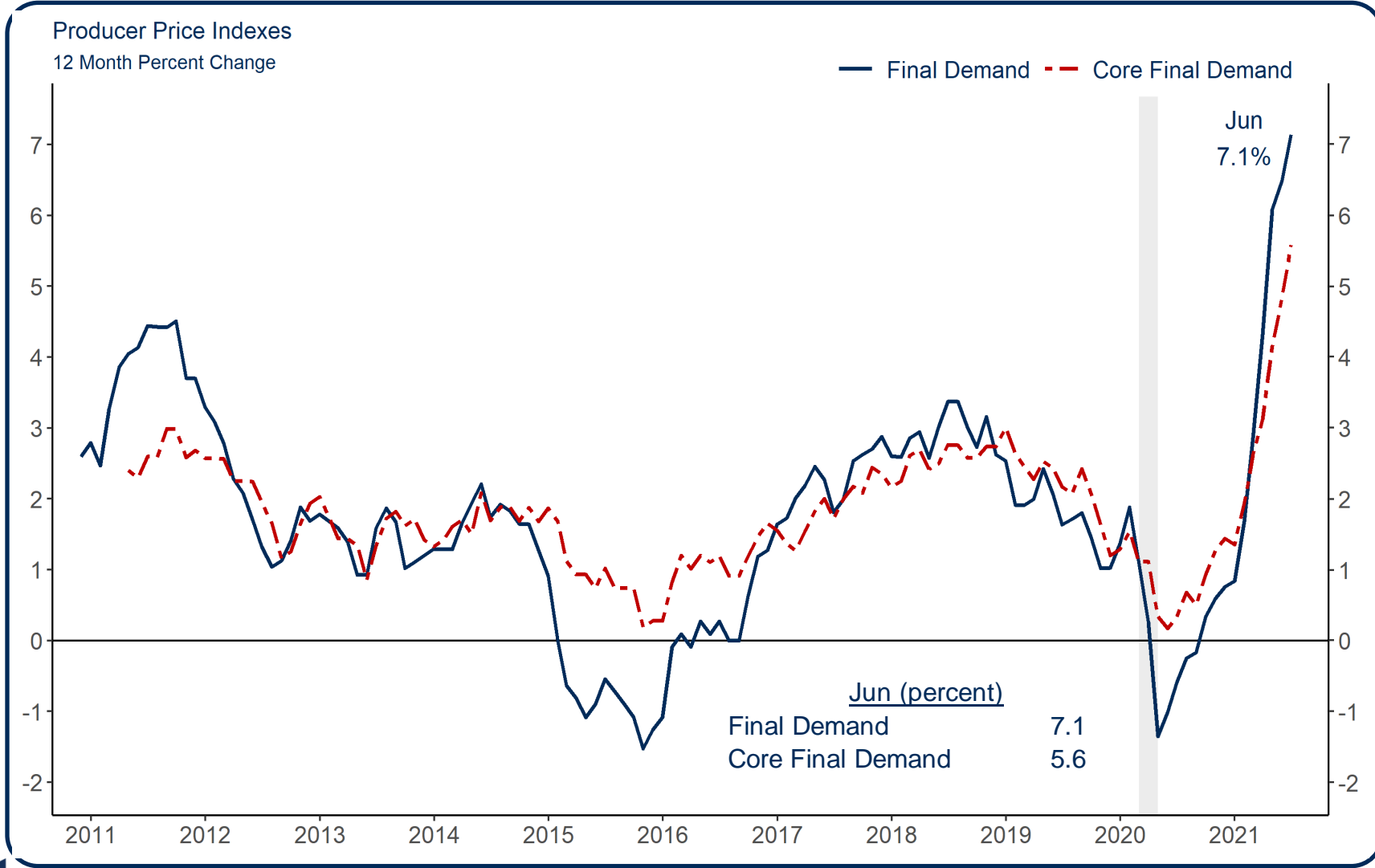
Inflation 101

- **What is it?**
 - **Inflation** is a measure of the growth in overall prices in the economy. It reduces the purchasing power of money.
 - **Price stability** occurs when volatility in inflation is minimized.
- **How are interest rates and inflation related?**
 - **Interest rates** compensate lenders for the reduction in the purchasing power of money that **inflation** creates.
- **How is it measured?**
 - Inflation is typically measured using the **Consumer Price Index (CPI)**. Uses data from the Consumer Expenditure Survey for prices in a basket of goods, containing food & beverage, rent, apparel, transportation, medical care, education, etc.
 - **Core CPI** strips out food and fuel prices, since these can be highly volatile, but usually price spikes are corrected quickly in the market.

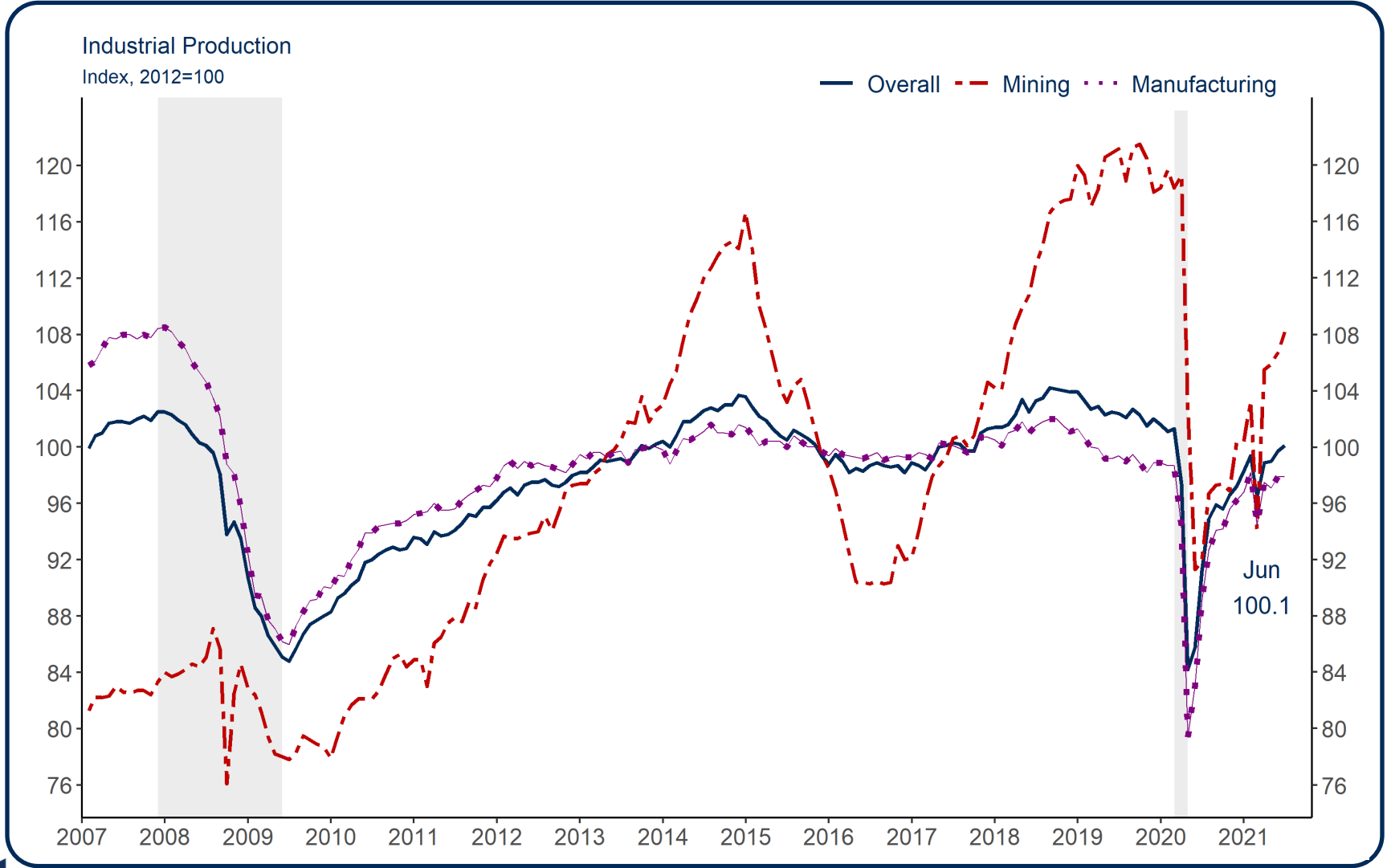
Inflation 101, cont'd

- **What is the Fed's inflation target?**
 - In 2012, the Fed announced a symmetric, medium-term inflation target of **2%**.
 - Guidance in August 2020 highlighted flexibility in responding to recessions with respect to achieving the target.
- **Why does the Fed have an inflation target?**
 - A target helps create **predictability** → **price stability**.
 - Inflation **low** → linked with low consumer and business confidence, as people hold back from spending.
 - Inflation **high** → reduces price predictability making consumption and investment decisions harder; can escalate into hyperinflation as people hoard goods and offload currency.

Producer price index shows supply constraints



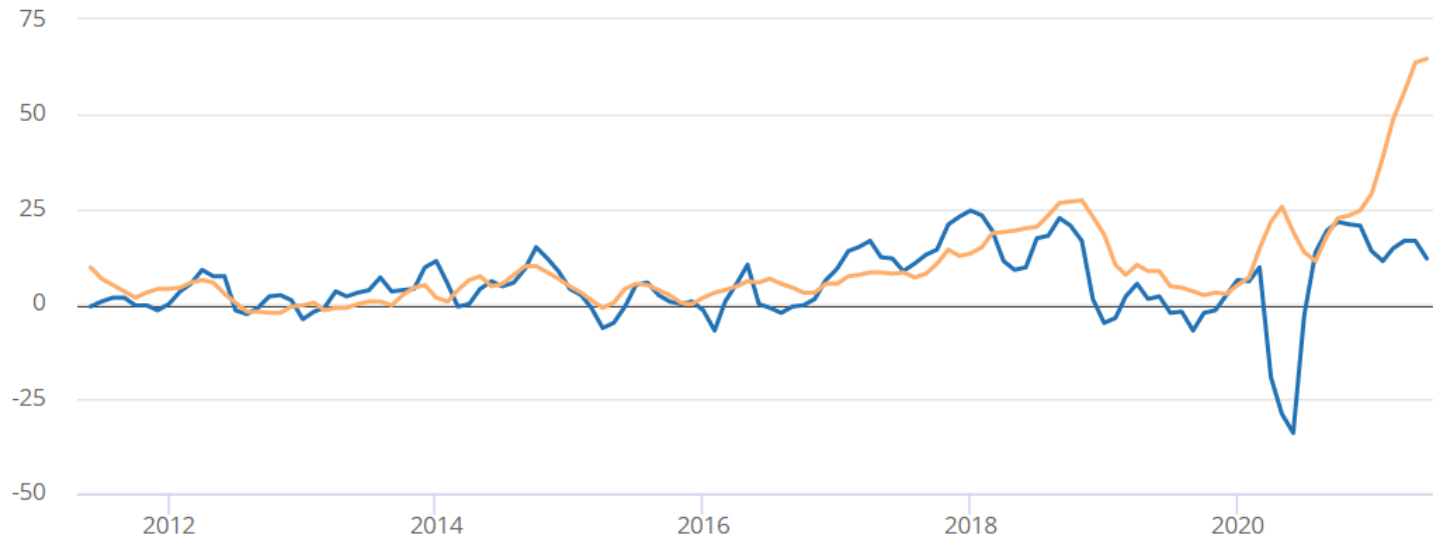
Supply response: industrial production ramping up



Supply response: industrial production ramping up

Fifth District Survey of Manufacturing Activity

Diffusion Index, Seasonally Adjusted 3-MMA



Source: Federal Reserve Bank of Richmond

Poll #3

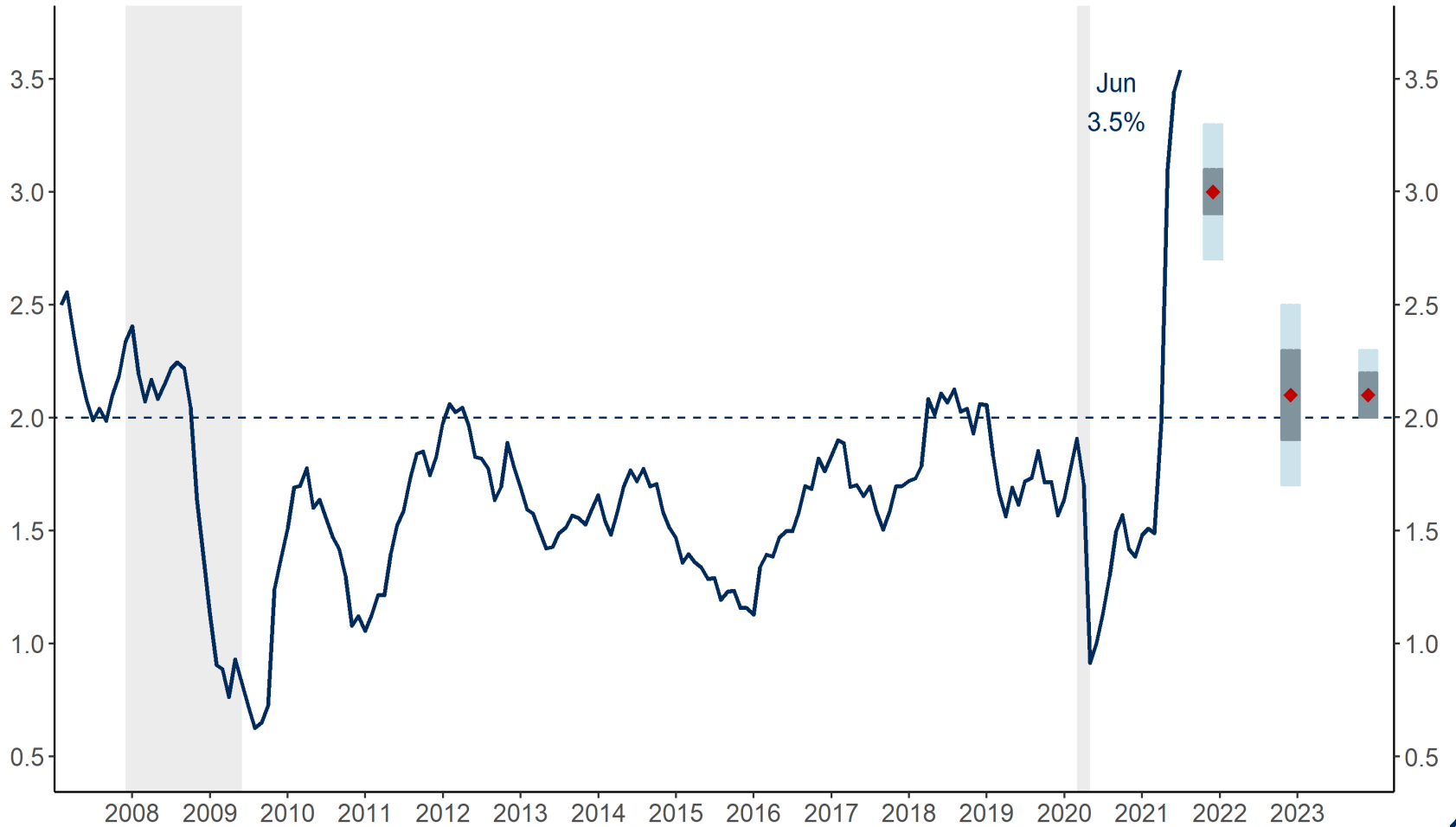
Is your business cutting back on business travel moving forward?

A. Yes,

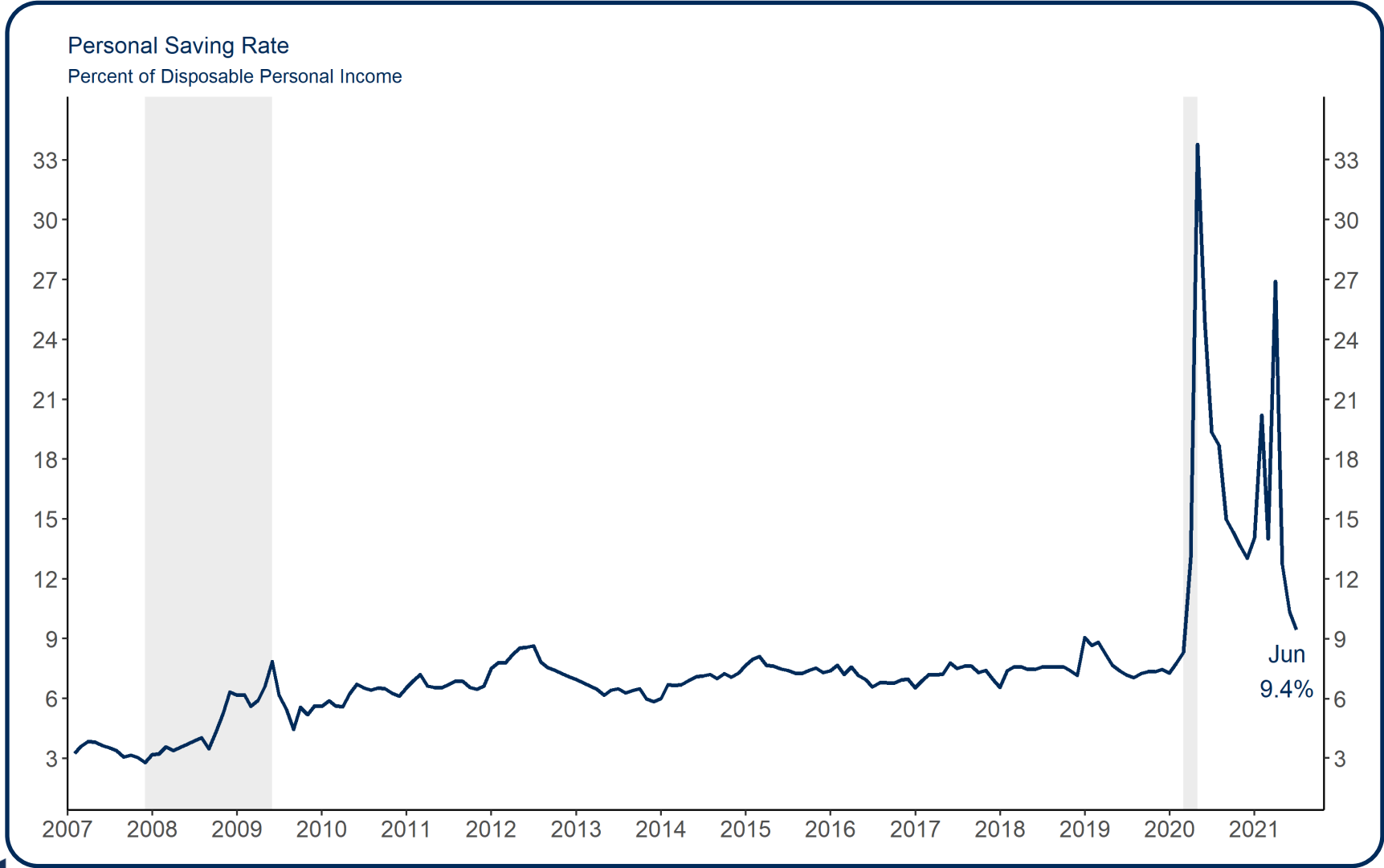
B. No

Inflation above target

Core Personal Consumption Expenditure Price Index
12 Month Percent Change

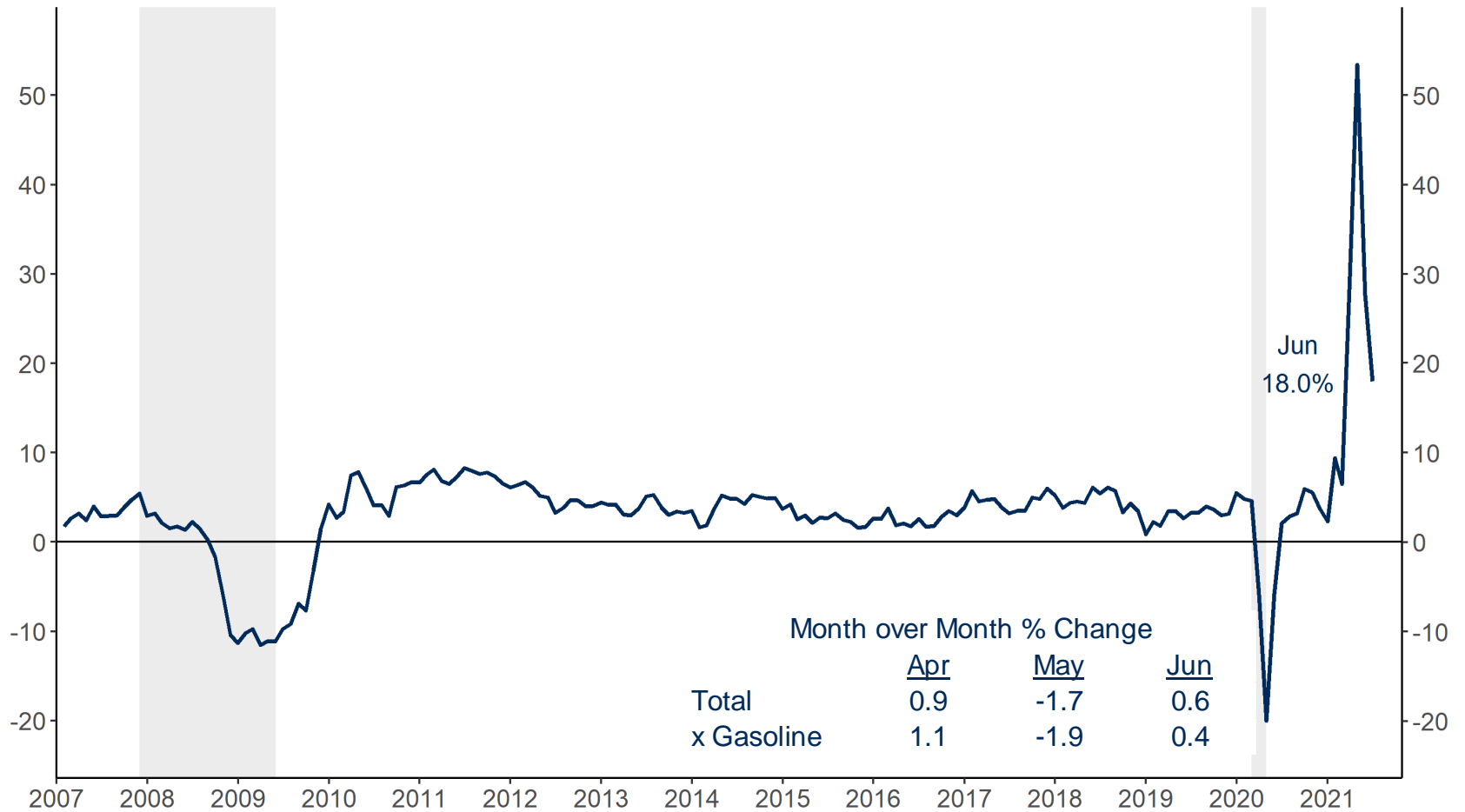


Pent up demand at work



Spending high in retail sales

Retail Sales
12 Month Percent Change



Poll #4

For prices your business is paying, where are they now?

- A. Lower than June 2020,
- B. b) 0-1% higher than June 2020,
- C. c) 2-3% higher than June 2020,
- D. d) 4% or higher than June 2020

How concerned should we be?

- We must consider the **supply response**: Are high prices the cure for high prices?
- **Market forces** can help:
 - **Price transparency** – The internet has allowed price comparison like never before
 - **Market power** – National retailers use purchasing strategies and global sourcing to keep prices low; creates hesitancy to increase prices across retailers
- **The Fed has room to respond**

Conclusion

- Many economic indicators point to gaining strength in the economic recovery.
- The jobs outlook and labor force participation remain a concern, although sunsetting supplemental unemployment insurance benefits and school re-openings should help.
- Growth in producer prices is high, reflecting supply constraints. At the same time, industrial production is rising, too.
- Inflation will continue to attract attention as the factors contributing to it play out over the coming months.
- Expectations are that supply bottlenecks are ‘transitory’ and core inflation will fall to 2.1% in 2022.

Poll #5

Do you think inflation will fall back to below 2% at the end of 2021?

A. Yes

B. No