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Inflation Nation (First of a Series)

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"Inflation (noun): 2. A continuing rise in the general price level usually attributed to an increase in the volume of money and credit relative to available goods and services."

"Transitory (adjective): 1. Of brief duration: temporary. 2. Tending to pass away: not persistent."

Thanks to Merriam-Webster for these clarifying entries, which together define one perspective on risks of higher prices in the US. But there are also market participants and economists who worry that the unleashing of pent-up consumerism will create inflation akin to the 1970's. If that happens, they fear, the Fed will be hard pressed to put the cost genie back in the bottle.

Nor are the Chicken Littles relegated to a few outliers. In a thought piece published last month entitled "Why Our Managers Disagree on Inflation, Interest Rates and Growth," Franklin Templeton's strategists agreed prices were on the rise but disagreed whether this was "cyclical" (moving with markets) or "secular" (a longer-term feature).

Arguments tend to focus on what happens when short-term effects of government fiscal intervention wear off. The Fed sees a wide variety of data, including very depressed sectors. Unemployment remains almost double of pre-Covid levels, with small businesses challenged.

Yet the flip side of this vaccine-generated recovery is sharp price hikes linked to "Off-Zoom-boom" products and services. Take rental cars. If you can. NBC reported "travelers arriving at Hawaii's Kahului Airport without reservations found rental companies sold out." Used car prices have soared, so the Hertz's sold inventories, and now face shortages.

Similar anecdotes abound about items from lumber and cereal to mayonnaise and dishwashing soap. And as one WSJ article pointed out, "Costs are rising at every step in the production of many goods," including paying "scarce truck drivers to take materials to factories and construction sites."

In a March series [link], we noted the difference between reflation – the natural upward move of prices thanks to an improving economy – and the insidious value erosion from persistent inflation above a certain level. Much of the concern was triggered from April's CPI increase of 4.2%, the highest increase since 2008.

One potential factor in heightened inflation-phobia is generational. It's been over four decades since the US suffered major price shocks. A variety of esoteric elements, including oil supply shortages, conspired to push inflation above 10% three years in a row (1979-'81).

But then, as our *Chart of the Week* shows, core prices sank to low single-digit levels, and have stayed there ever since. Runaway inflation hasn't been witnessed by many market participants, so a modest uptick is alarming.

In this special series we'll examine the underlying causes of this phenomenon and tie it to asset performance – especially private credit.