Rodney's Take

June 13, 2022

That's Going to Leave a Mark

As I told subscribers in the last Rodney's Weekly Wrap, I thought that annual inflation would ease a bit in May because of the base effect. As the measure included more of the rising prices from this time last year, it would reflect a smaller annual increase. That didn't happen. While the base effect is a real thing, prices jumped enough last month to overwhelm the rising base in 2021.

Used car prices, which had been trending lower for three months, turned up by 1.8% and are now 16.1% higher than last year. New car prices also climbed 1% last month and are up 12.6% over last year. Energy is an obvious issue, with gasoline prices up 4.1% for the month and 48.7% over last year. Fuel oil logged the largest price increase, up 16.9% for the month and 106.7% for the year, the largest increase on record. With the computer chip supply shortage still raging on and the energy markets in flux because of Russia, it's hard to see how these prices will ease this year. The best we can hope for is that prices will stop marching higher or at least that the rate of ascent will slow.

But don't overlook shelter. Rent and owner's equivalent rent (an imputed shelter cost for homeowners) don't move very fast in either direction, but they're sticky and important. With home prices shooting higher over the past two years, it was just a matter of time before renters suffered sticker shock when renewing their leases or moving to new cities. Rent and owner's equivalent rent both increased 0.6% last month and were up 5.2% and 5.1%

over last year. The steady march higher in housing costs should last at least another year as the recent jump in real estate works through the system.

Higher prices hurt everyone, but especially young adults, who spend more of their budget on energy and shelter than those in other age groups. And unfortunately, incomes aren't rising fast enough to compensate. Last month, real average earnings dropped 3% for the year, as inflation ate up all of our income gains and then some. The same thing likely will happen to the economy as a whole.

While Janet Yellen claims she doesn't see signs of a recession, a flashing neon sign that reads "Recession!" is there for the rest of us to see. As inflation marches higher, it deflates nominal growth, resulting in declining real growth, which points to recession. The Atlanta Fed's GDPNow model showed real second-quarter growth at a mere 0.9%, and that was before the inflation numbers.

All of this brings us to Wednesday, when the Federal Reserve will announce its latest monetary policy decision. Before last Friday, the world expected the Fed to raise rates by 0.50% at both the June and July meetings. If the bankers stay the course, investors might worry that they aren't moving fast enough to fight inflation and send the markets lower. If the bankers raise rates by 0.75% or even 1.00%, investors might cheer the move with a face-ripping rally, but rising rates could send the economy into a deeper recession than what looks like is already baked in. The entire mess comes down to one word, stagflation.

While that word might conjure images of the 1970s, it won't be the same. Disco and leisure suits are out. So is unemployment, and that's the key. As long as unemployment remains low, inflation will be painful but not catastrophic. This leaves the Fed walking a very thin line, trying to address inflation that it didn't create while not destroying demand to such a level that unemployment comes roaring back.

Rodney

Got a question or comment? You can contact us at info@hsdent.com.