

US inflation surge heaps pressure on the Fed

Yet another blowout inflation reading makes it increasingly difficult for the Fed to stick to its position that elevated inflation readings are merely "transitory". Pipeline cost pressures continue to build and corporates are looking to pass them onto customers in an environment of such robust demand. The case for a 2022 rate hike is strong



4.5% YoY Highest rate of core inflation since 1991

Price pressures are building

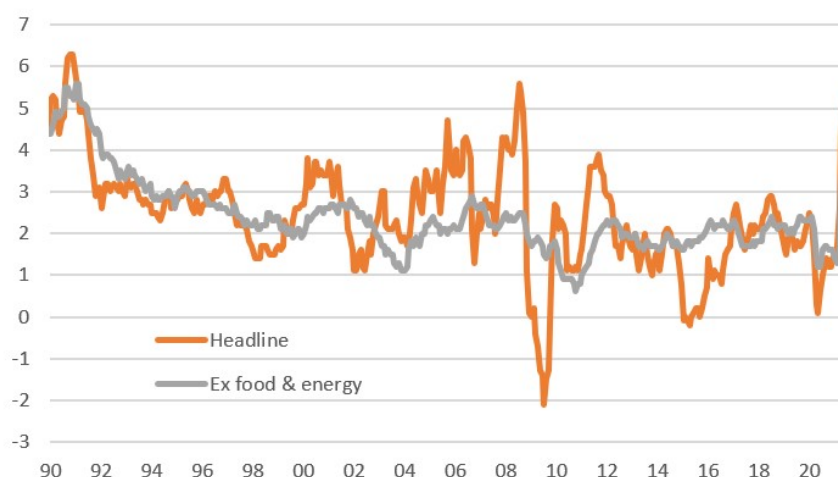
US consumer price inflation jumped 0.9% month-on-month in June after recording a 0.6% gain in May with 0.8% increases in April and 0.6% in March. This was well ahead of the consensus prediction of 0.5% while the core (ex food and energy) also rose 0.9% MoM versus the 0.4%

consensus. Given the strong run of MoM readings over the past few months it makes it very difficult for the Federal Reserve to stick to their position that inflation is merely “transitory”. Today’s surprise outcome also supports calls for a swifter removal of the massive monetary stimulus the Fed have injected into the economy

There were 0.3% or 0.4% MoM component readings throughout, suggesting broad inflation pressures while the bigger gains were once again seen in used car prices (10.5% MoM) and new vehicles up 2% – consumers have cash in their pockets and rental car companies are looking to rebuild fleets at a time when auto output is being constrained by component shortages. Meanwhile, food rose 0.8% MoM, apparel was up 0.7%, housing rose 0.4%, gasoline rose 2.5% MoM with medical care the only component to post a decline (-0.1% MoM).

This means that the annual rate of headline inflation is now running at 5.4% – just below the 2008 oil price spike induced peak of 5.6%. However the annual rate of core inflation is now 4.5%, which it was last at in November 1991!

Annual US inflation 1980-2021 (%)



Source: Macrobond, ING

Past the peak on headline inflation, but the decline will be slow

Over the past few months annual inflation has surged as we compared price levels in a vibrant re-opened economy with those from 12 months before when the US was still largely in lockdown. This deep divergence should soon gradually fade with the annual rates of inflation edging lower as we move through 3Q. Nonetheless, we are not as optimistic as the Federal Reserve in thinking that we will quickly get back down to the 2% region. We continue to doubt the Fed’s narrative that inflation is “transitory” and instead see the risks that it stays elevated for many more months.

Demand will continue to exceed supply

The key reason is that the stimulus fuelled economy is booming. Demand appears to be outpacing the supply capacity of the economy given the scarring that the pandemic has caused. We see no imminent end to the ongoing frictions such as supply chain strains and a lack of suitable workers.

The fact that numerous surveys report inventory levels at record low levels while order backlogs are at record highs and supplier delivery times remain extreme shows that there are stresses

throughout the economy. This is giving a sense that corporates have more pricing power than they have seen in years and therefore have the ability to pass higher costs onto consumers.

This was seen in today's National Federation of Independent Business survey with a net 47% of respondents currently raising their prices – the highest balance since January 1981 – with a net 44% of firms looking to raise prices further over the next three months. This casts even more doubt on the Fed's position that we should soon expect a significant decline in price pressures.

NFIB survey shows companies are looking to raise prices at record rates (1975-2021)

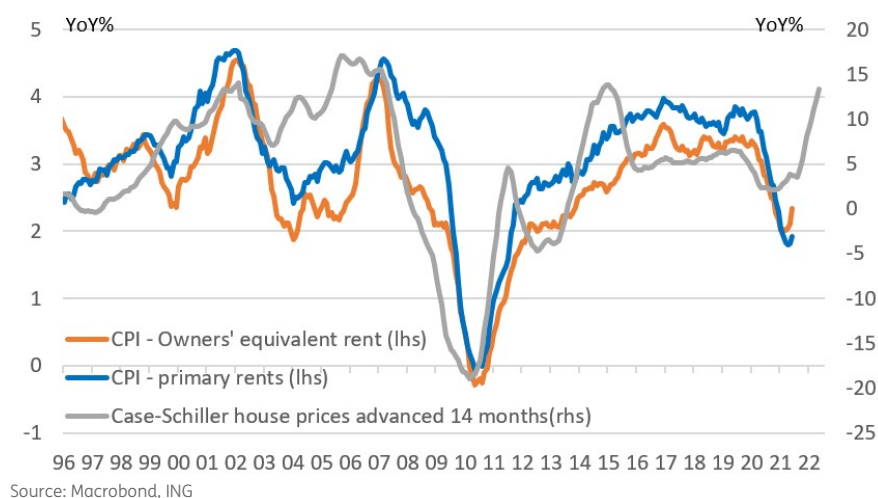


Source: Macrobond, ING

Watch housing costs in coming months

The upside inflation risks will be compounded by housing costs since primary rents and owners' equivalent rent account for a third of the CPI basket. Movements in these components tend to lag 12-18 months below house price changes, as the chart below shows. We suspect that the housing components of inflation will be the story to watch through the second half of this year.

House prices and the relationship with housing CPI costs



2022 Fed rate rises are coming

We forecast that US headline inflation will stay above 4% through until 1Q22 with core inflation unlikely to get below 3% until the summer of next year. We also expect the strong growth to story continue and with workers remaining in short supply, we see further wage pressure.

Consequently, there appears little reason to continue with Federal Reserve QE asset purchases of \$120bn per month and we will look to Jerome Powell's testimony tomorrow and the August Jackson Hole Conference for hints of an upcoming taper. We are currently expecting the taper to start in 4Q and to conclude relatively swiftly before the end of 2Q22.

The Fed have shifted their viewpoint to a 2023 start point for interest rate increases, but we think this is too late and are now predicting two in the second half of 2022. We would not be surprised to see two more Fed officials switch their view in September and that would bring the median Fed position also into 2022.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.