

HOW SERIOUS IS THE INFLATION THREAT?

PRESENTATION TO A WEBINAR HOSTED BY JAMIESON COOTE BONDS

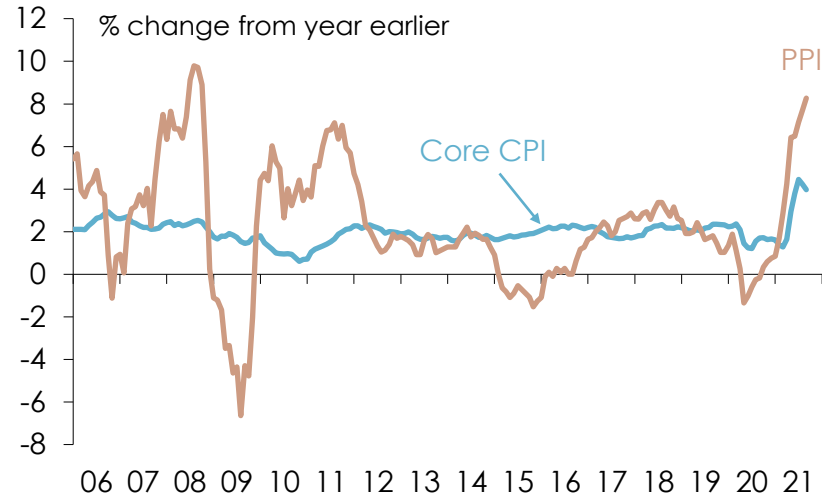
7TH OCTOBER 2021

SAUL ESLAKE

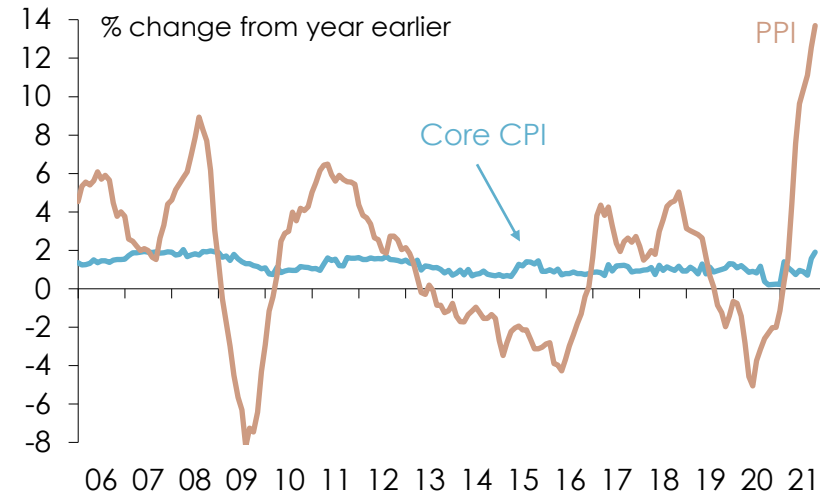
CORINNA ECONOMIC ADVISORY
INDEPENDENT ECONOMICS

'Upstream' prices are surging in all major economies: but only in the US and (to a lesser extent) the UK is this feeding into core CPI inflation

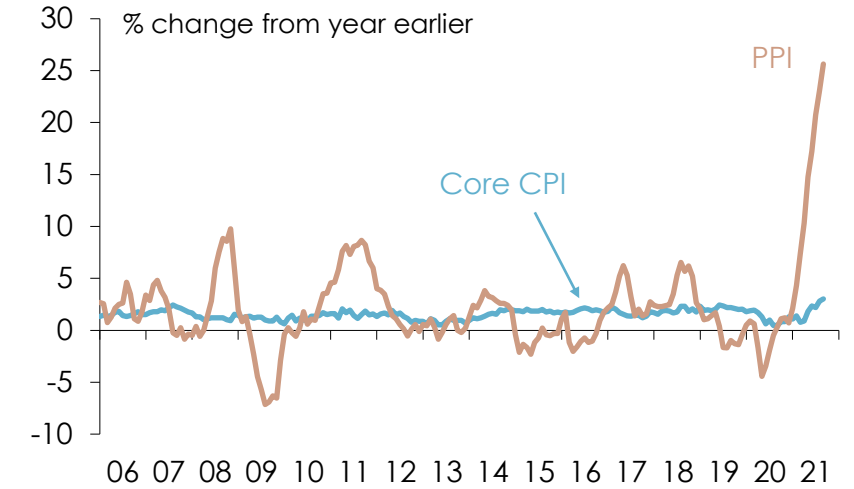
United States



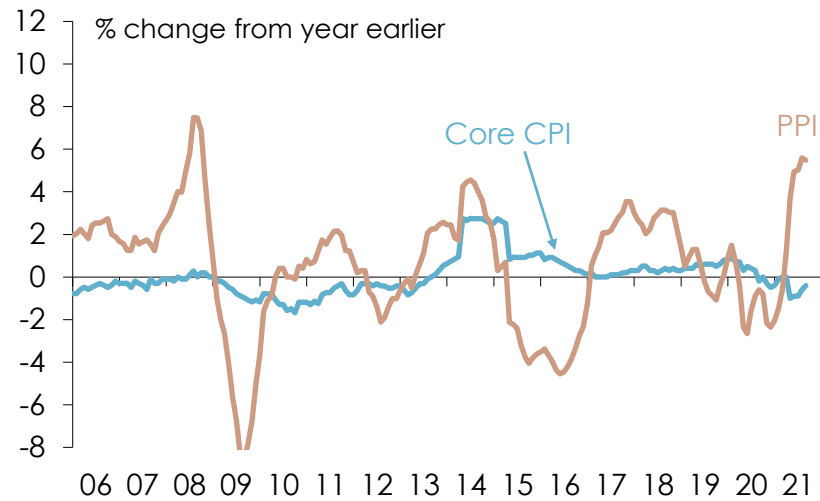
Euro area



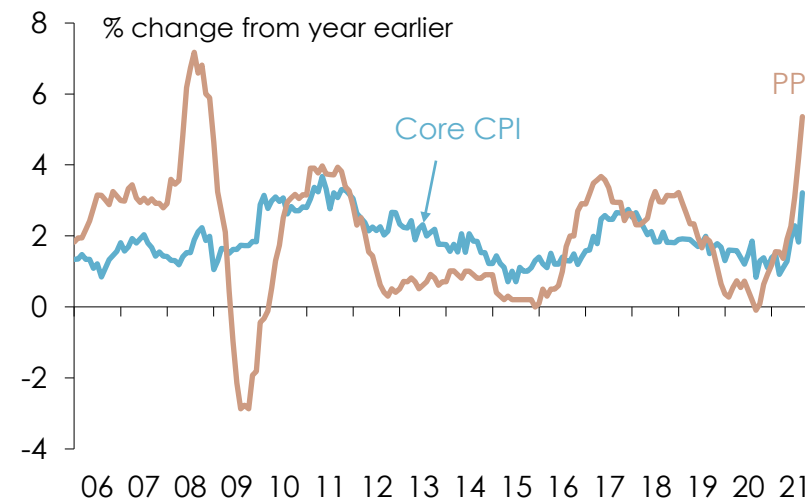
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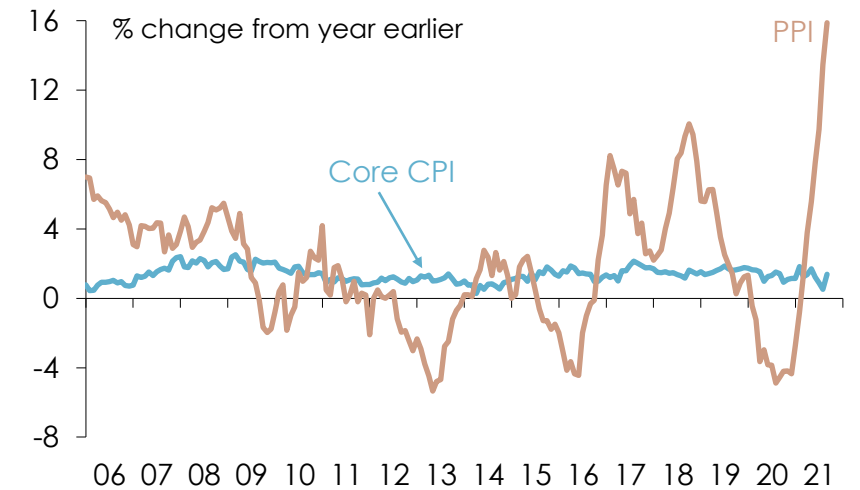
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United Kingdom



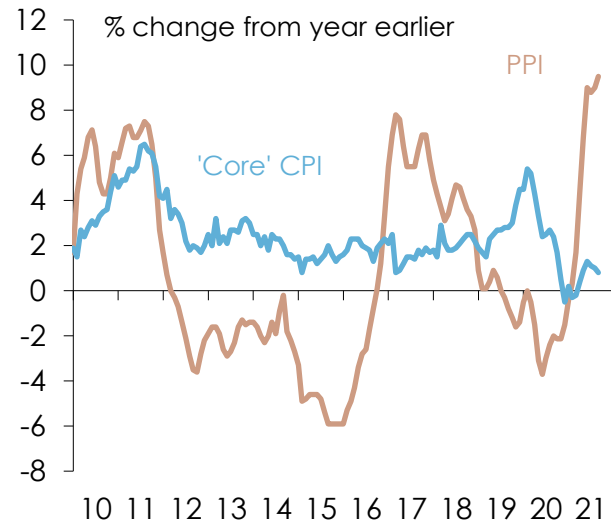
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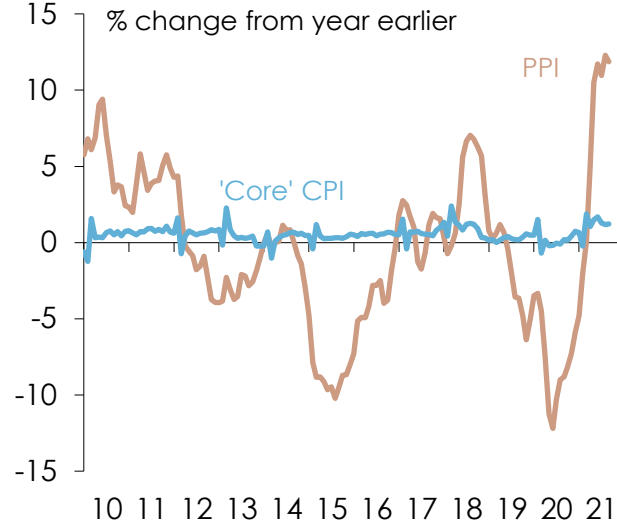
Sources: [US Bureau of Labor Statistics](#); [Statistics Bureau of Japan](#); [Eurostat](#); [UK Office for National Statistics](#); [Statistics Canada](#); [Statistics Sweden](#).

There's been very little pass-through of higher producer prices into 'core' consumer price inflation in Asia

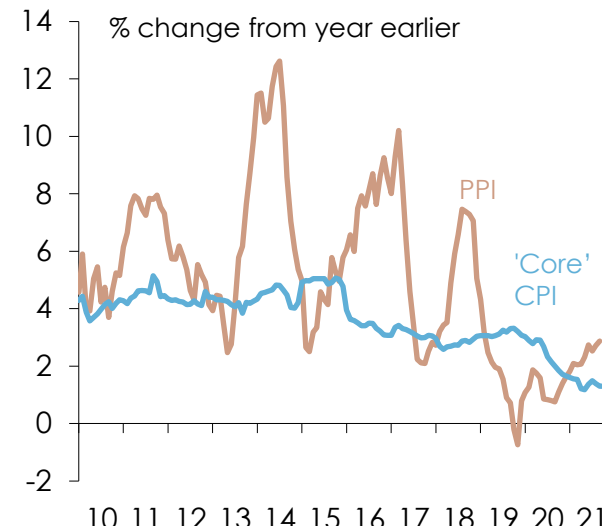
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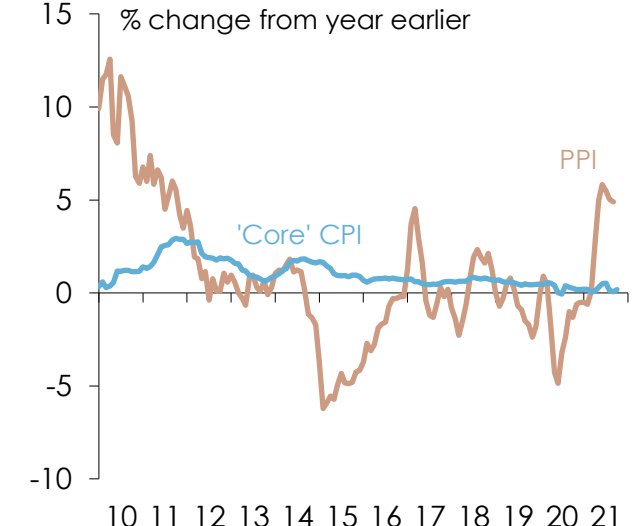
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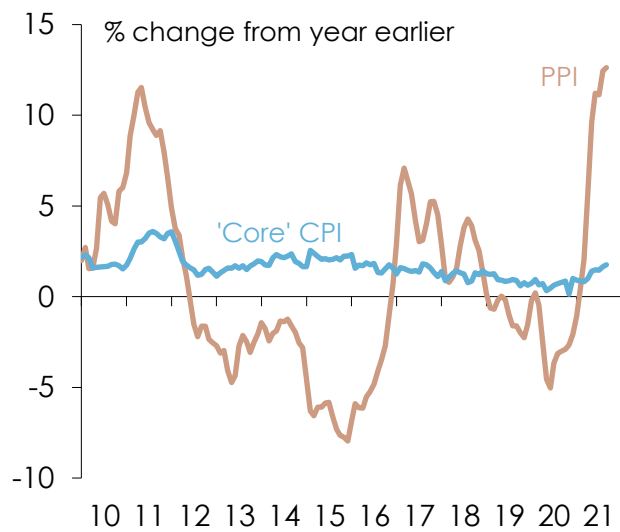
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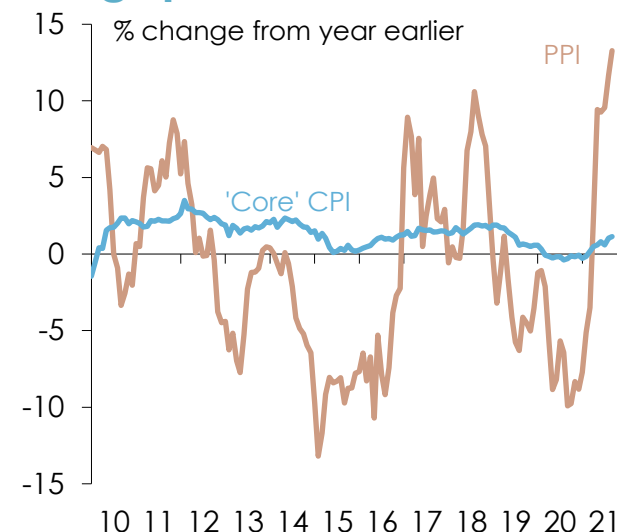
Thailand



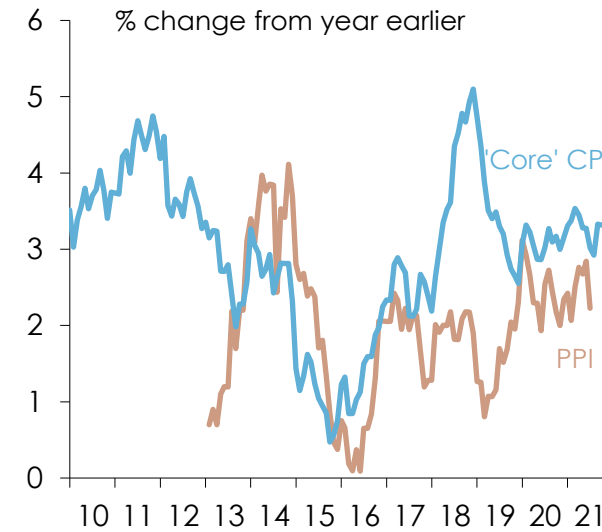
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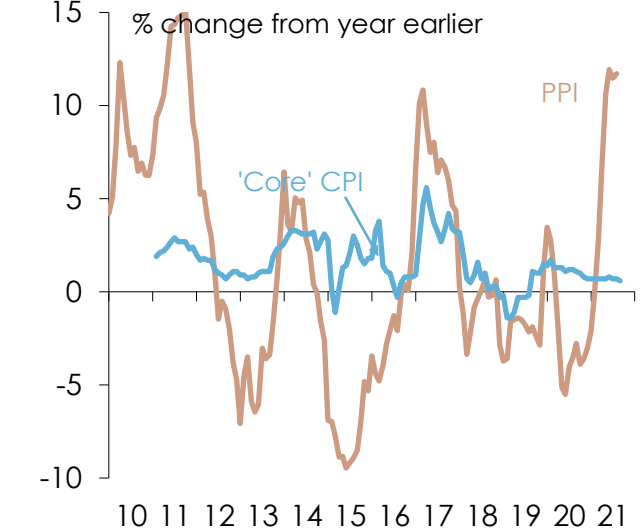
Singapore



Philippines



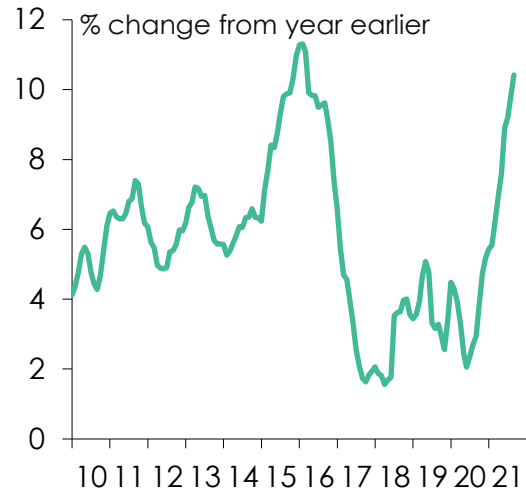
Malaysia



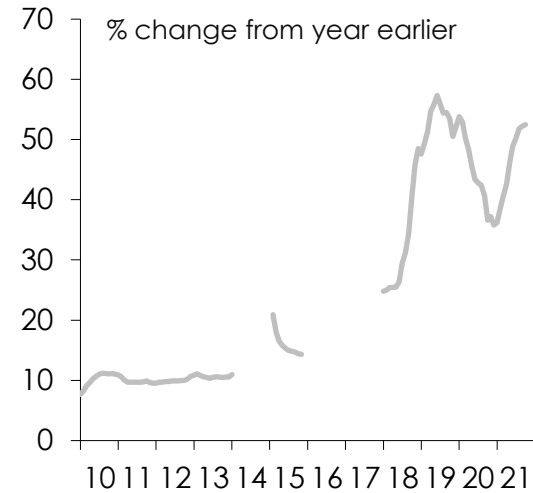
Note: 'Core' CPIs measure different things in different Asian economies – see footnotes to [slide 58](#). Sources: [China National Bureau of Statistics](#); [Statistics Korea](#); [Bank of Korea](#); [Taiwan Statistical Bureau](#); [Singstat](#); [Monetary Authority of Singapore](#); [Statistics Indonesia](#); [Philippine Statistics Authority](#); [Thailand Bureau of Trade and Economic Indices](#); [Department of Statistics Malaysia](#).

Consumer price inflation is rising in many other 'emerging' markets

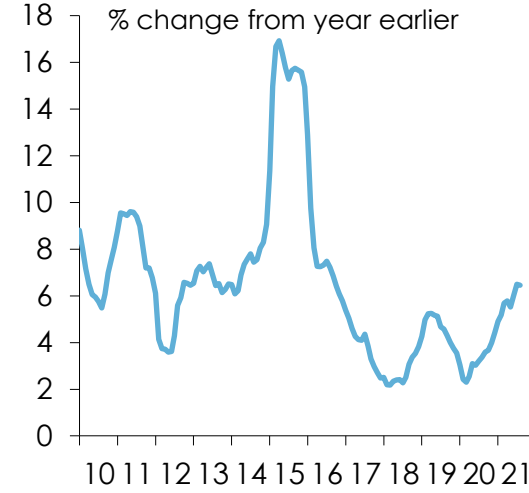
Brazil



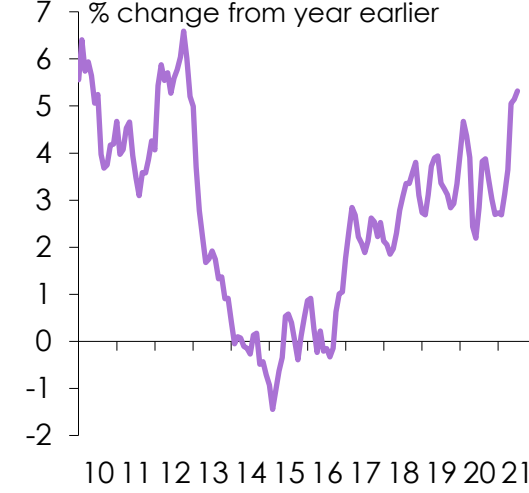
Argentina



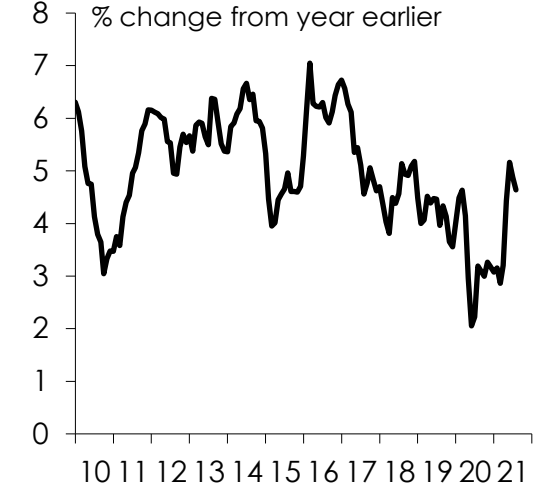
Russia



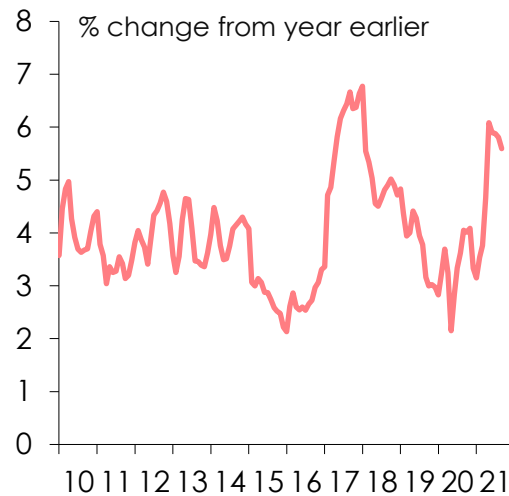
Hungary



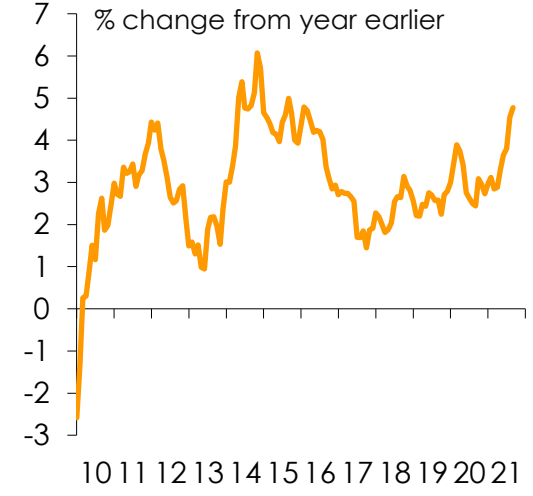
South Africa



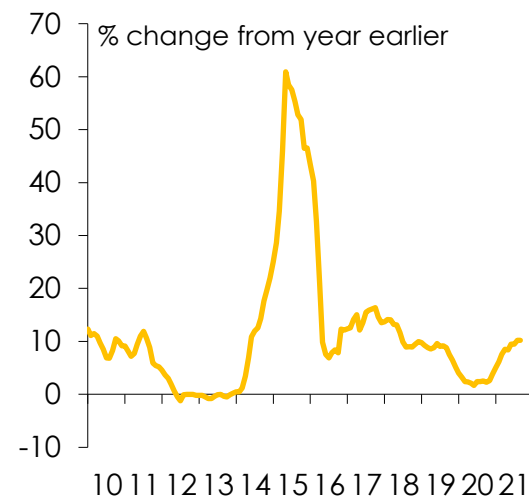
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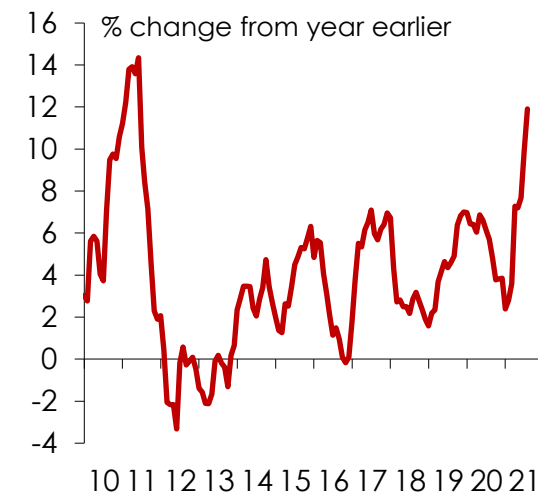
Chile



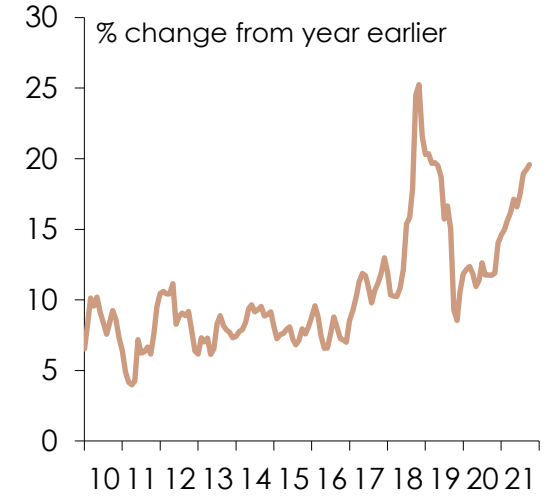
Ukraine



Georgia



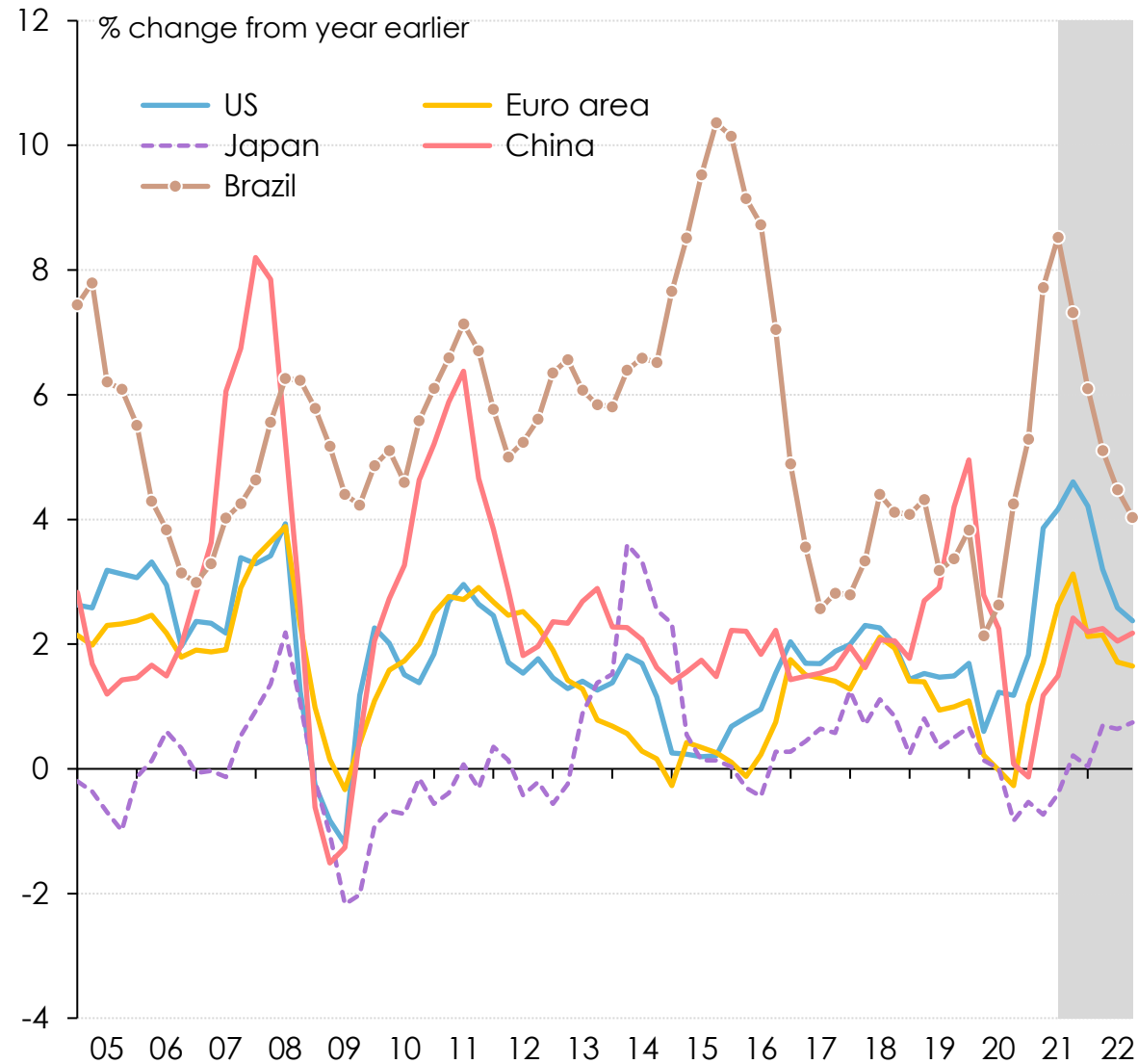
Turkey



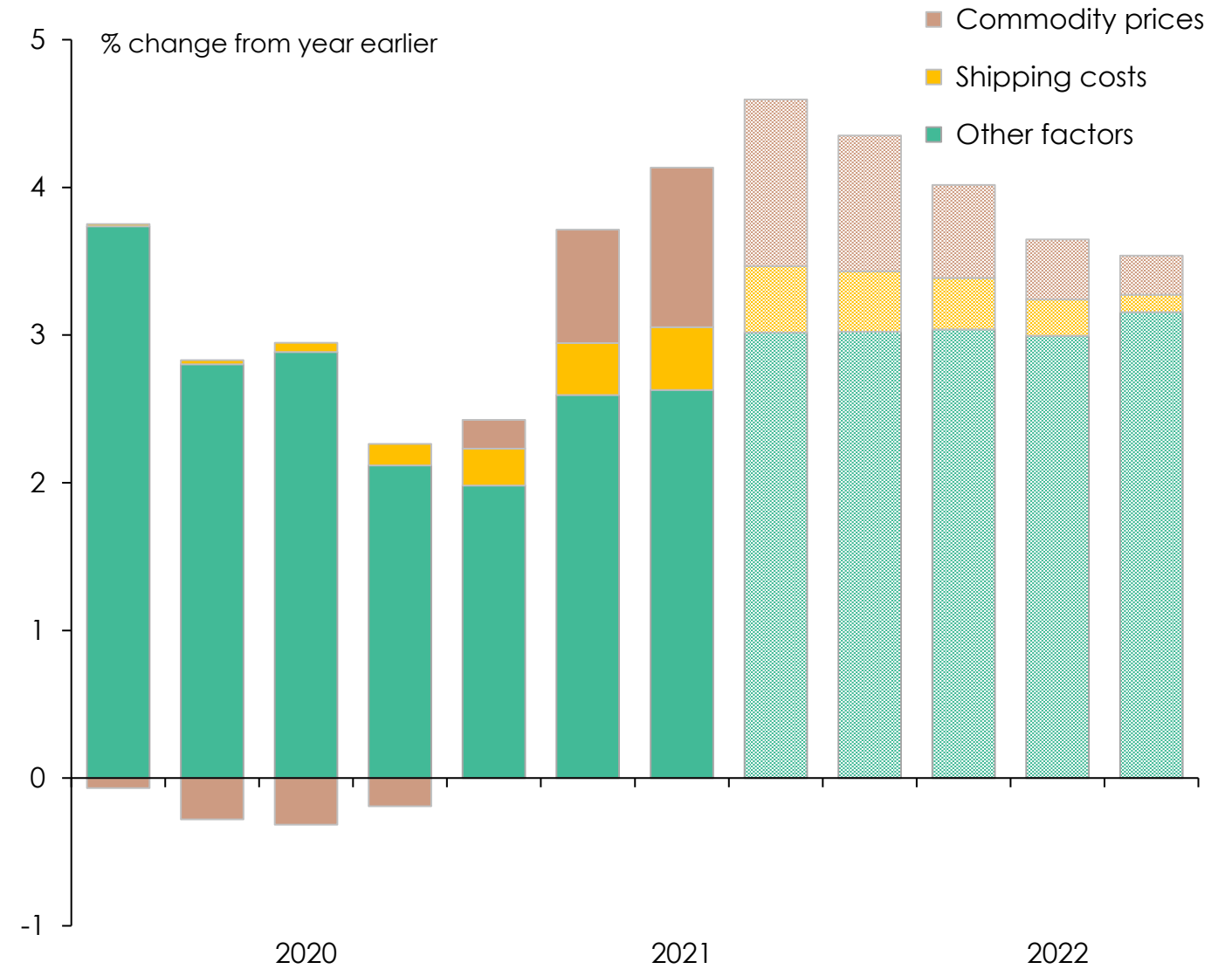
Sources: [Instituto Brasileiro de Geografia e Estatística](#); [Instituto Nacional de Estadística y Geografía](#) (Mexico); [Instituto Nacional de Estadística y Censos](#) (Argentina); [Instituto Nacional de Estadísticas](#) (Chile); [Rosstat](#); [Ukrstat](#); [Központi Statisztikai Hivatal](#) (Hungary); [Sak'art'velos Statistiki Erovnuli Samsakhuri](#) (Georgia); [Statistics South Africa](#); [Turkstat](#).

The OECD estimates that higher commodity prices and shipping costs account for three-quarters of the increase in G20 inflation so far this year

Inflation in major advanced economies



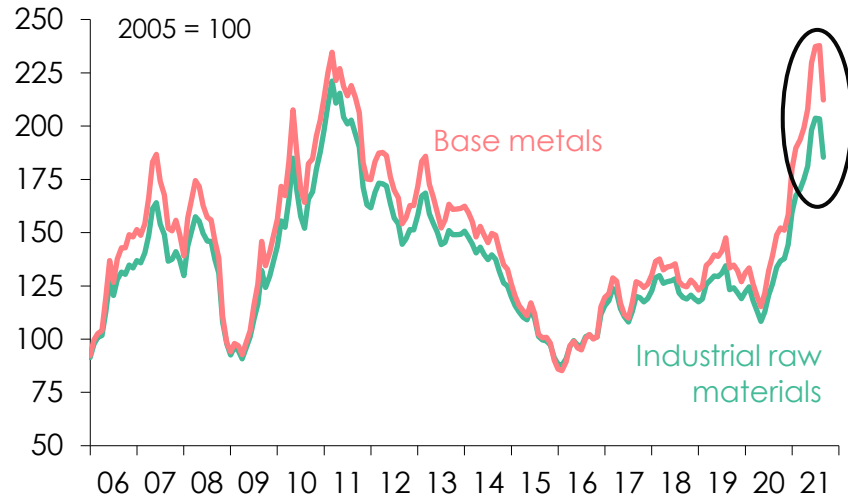
Contribution to annual G20 inflation



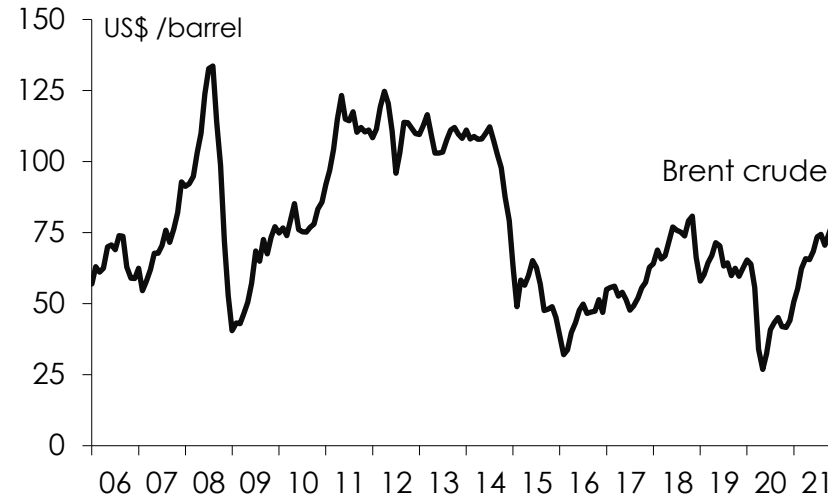
Source: OECD, [Economic Outlook, Interim Report](#), 21st September 2021.

It's possible that 'upstream' pressures – with the important exception of natural gas – may have peaked

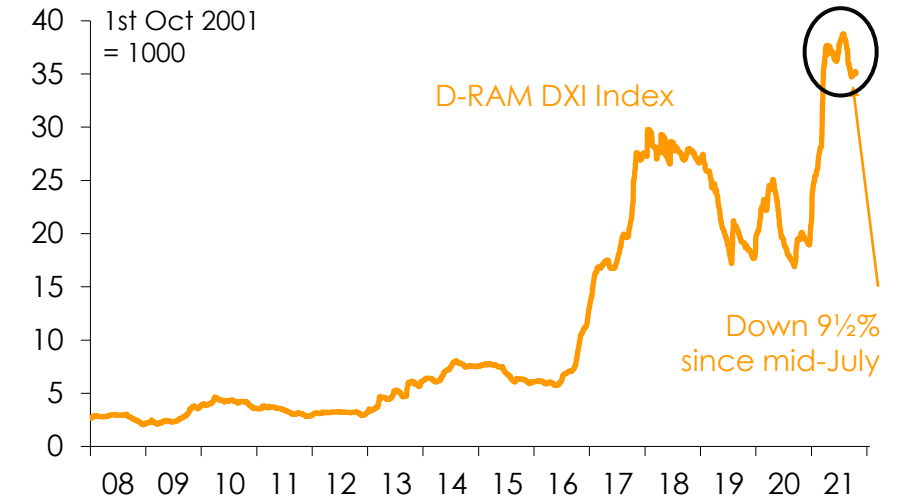
'Hard' commodity prices



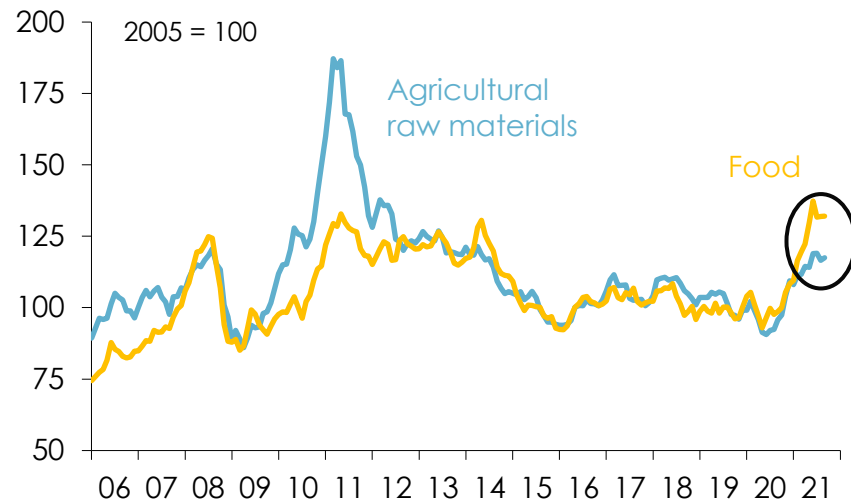
Crude oil price



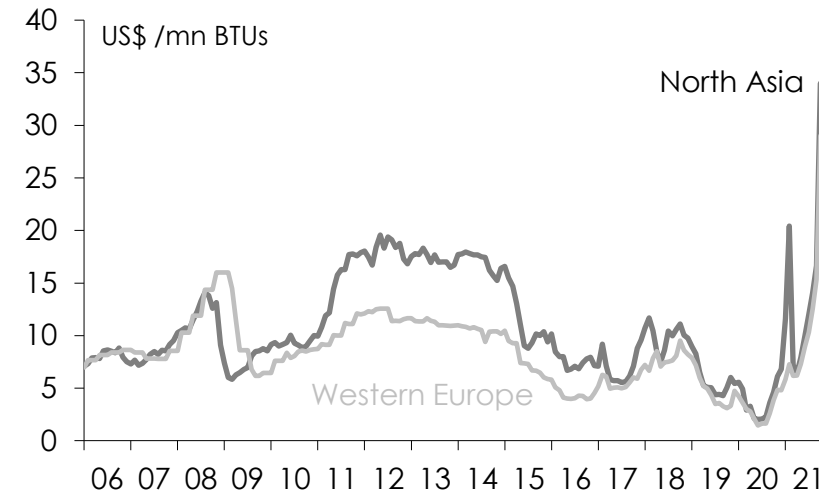
Semiconductor prices



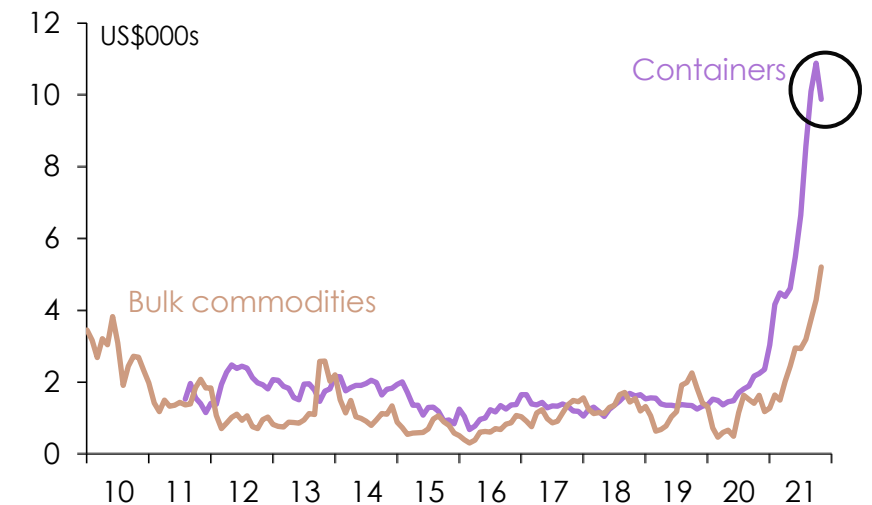
'Soft' commodity prices



Liquefied natural gas prices



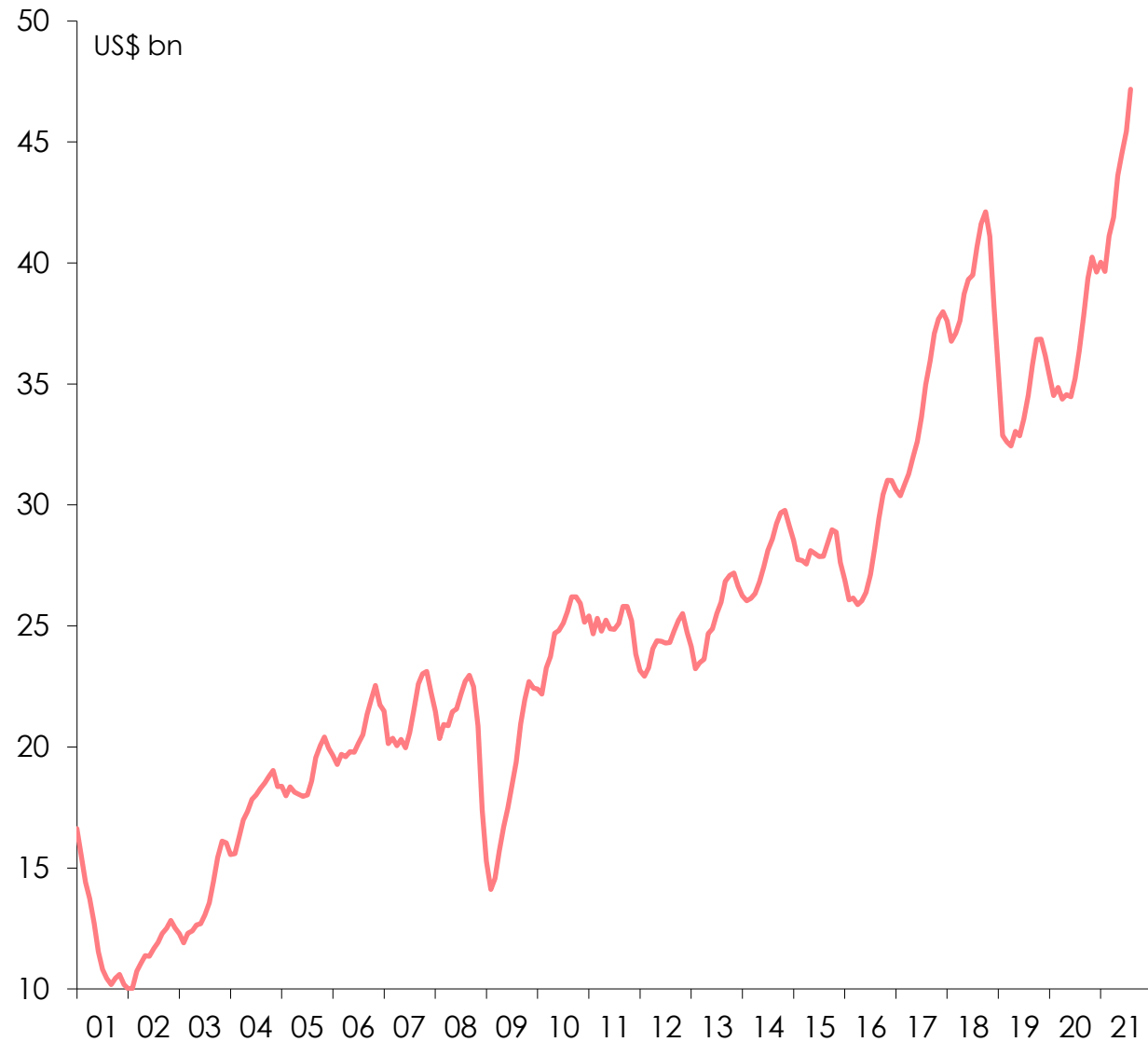
Shipping freight costs



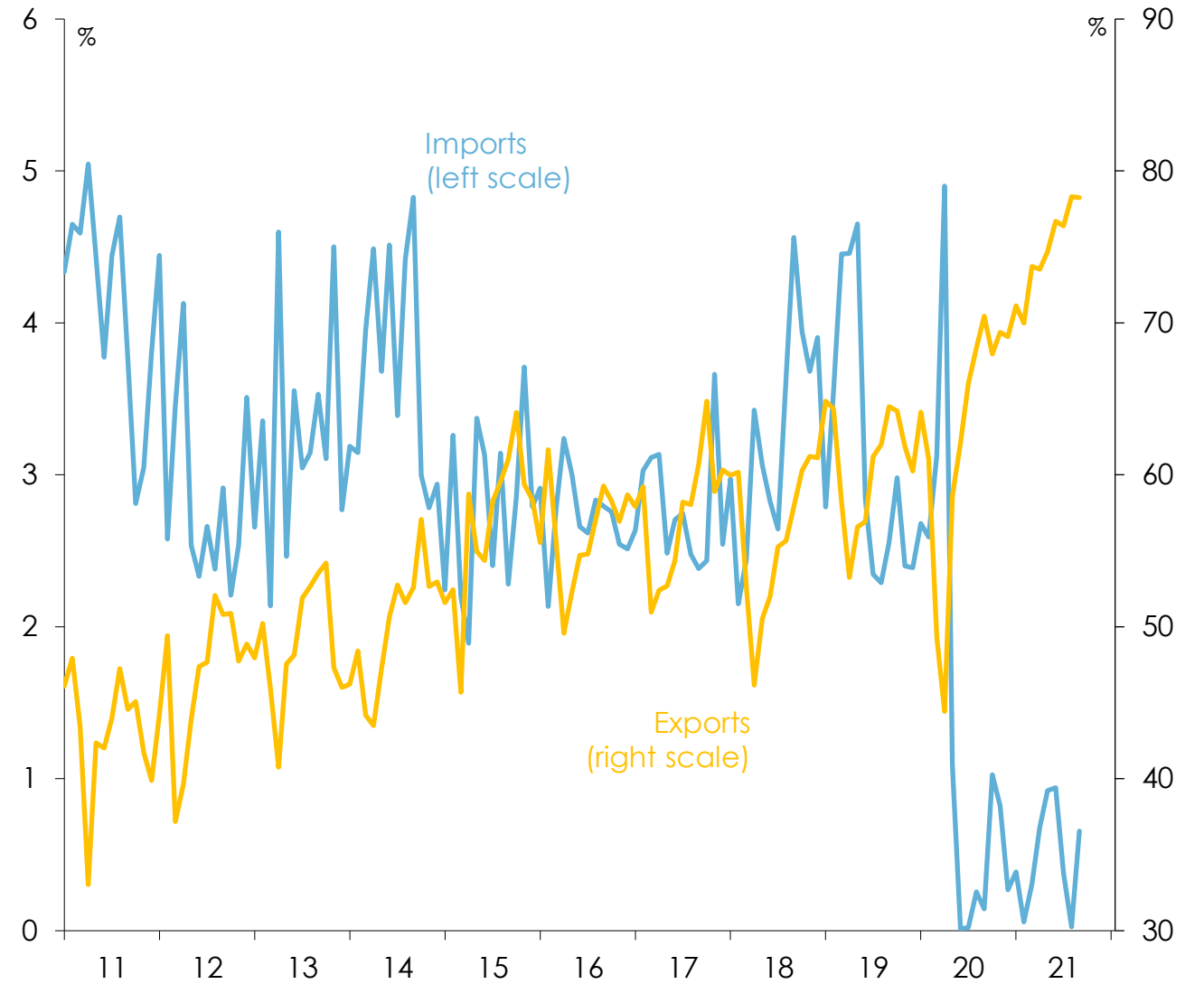
Sources: [International Monetary Fund](#); [Freightos](#); [Drewry](#); [The Baltic Exchange](#); Refinitiv Datastream;

The factors contributing to the spikes in semi-conductor chip prices and container shipping freight rates seem to be abating

World semi-conductor chip sales



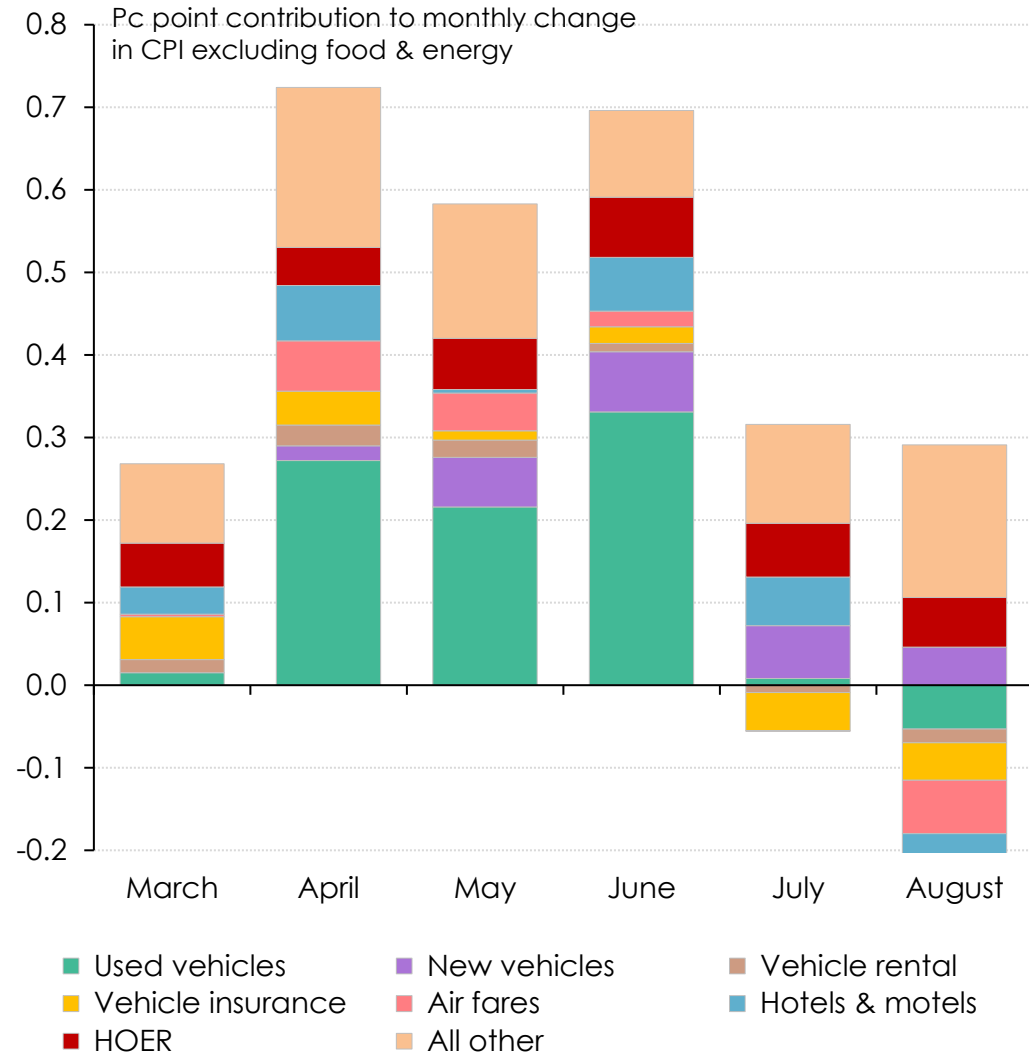
Empty containers passing through the Port of Los Angeles



Sources: [Semiconductor Industry Association](#); [Port of Los Angeles](#).

US consumer prices recorded their smallest increase since January in August with many of the contributors to the recent spike now abating

Contributions to recent monthly changes in CPI excluding food and energy



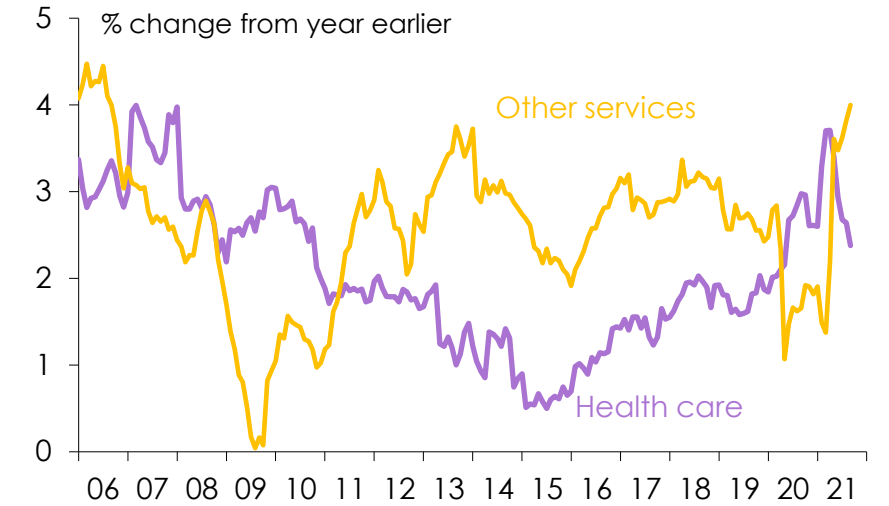
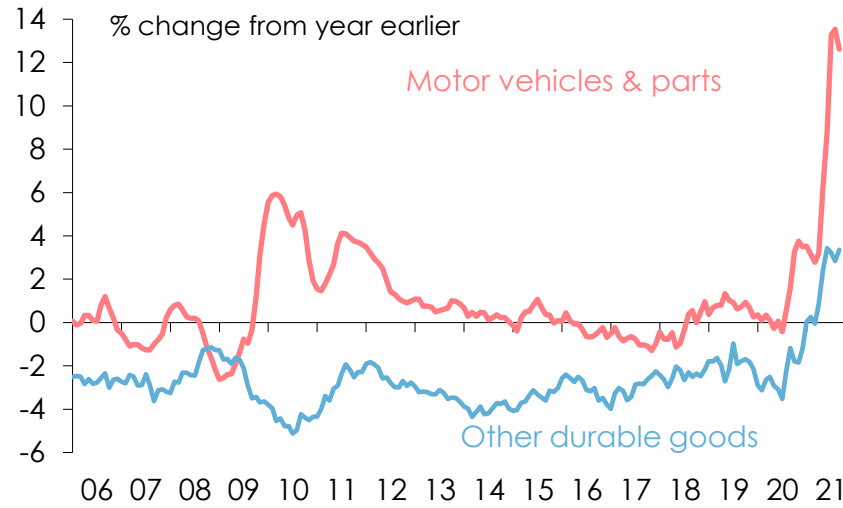
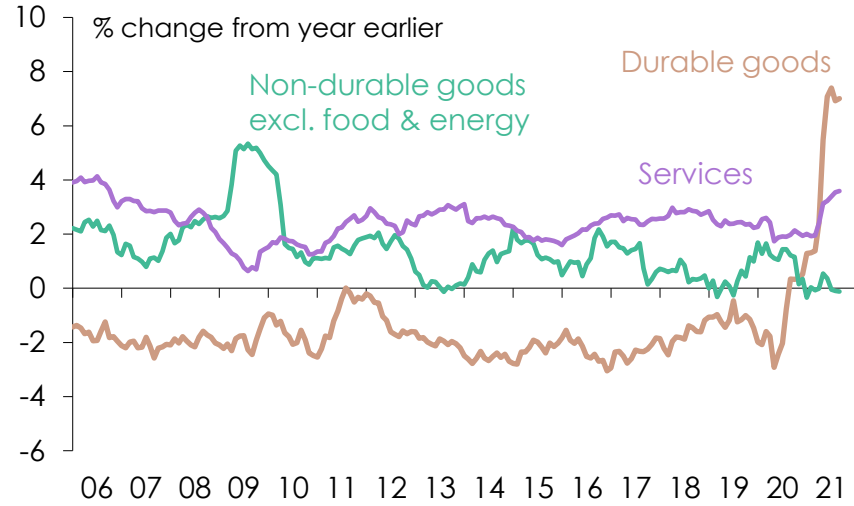
Price indices for items which have contributed most to recent monthly changes in the 'core' US CPI (rebased to December 2019 = 100)



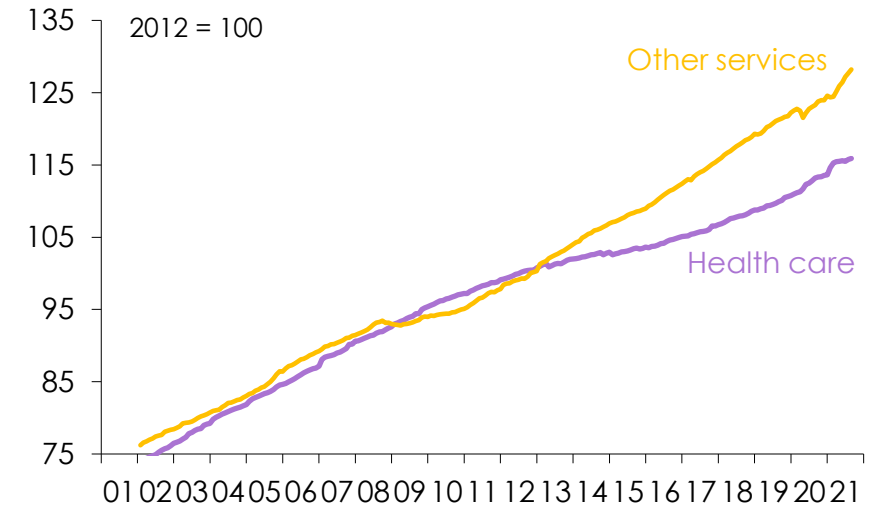
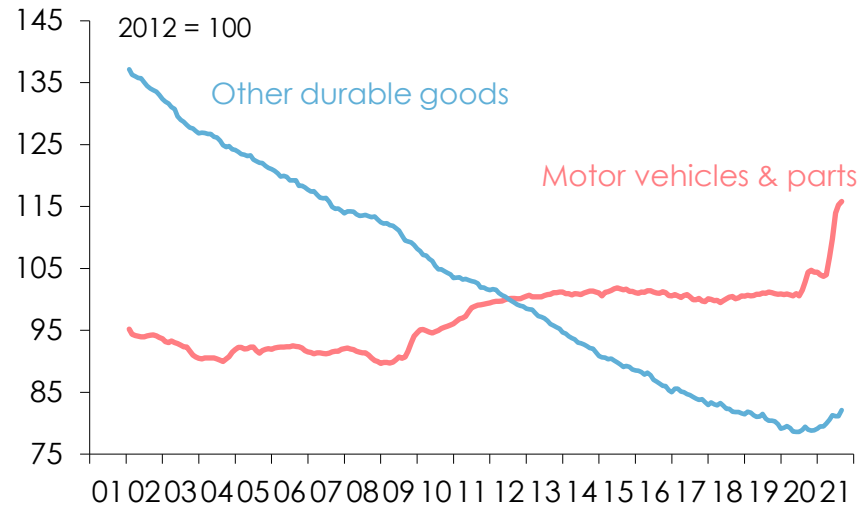
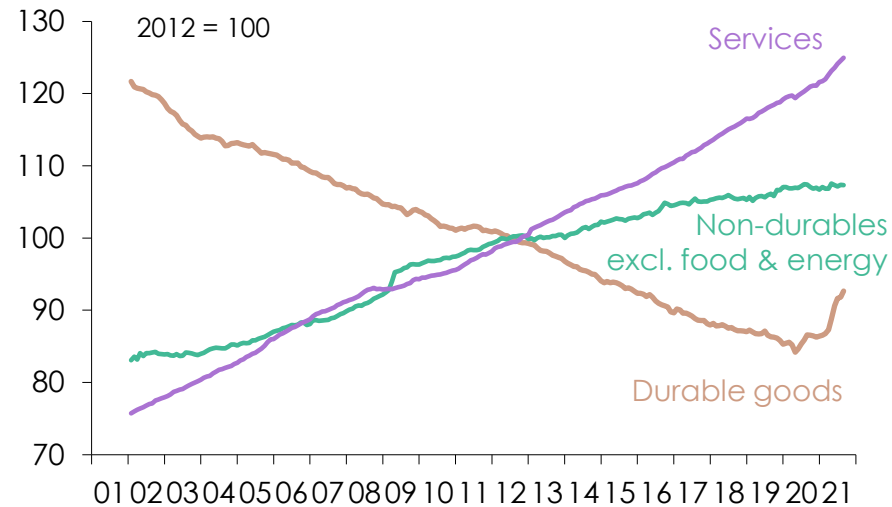
Note: 'HOER' = home-owners' equivalent rent (a measure of the 'imputed rent' notionally paid by owner-occupiers to themselves), and which accounts for 28½% of the CPI excluding food and energy. Source: US Bureau of Labor Statistics, Consumer Price Index Table 6; Corinna.

PCE price deflators highlight the significant role of durable goods in the 'disinflation' of the past 20 years and the more recent 'spike' in inflation

Implicit price deflators of personal consumption expenditures – per cent changes over 12-month intervals



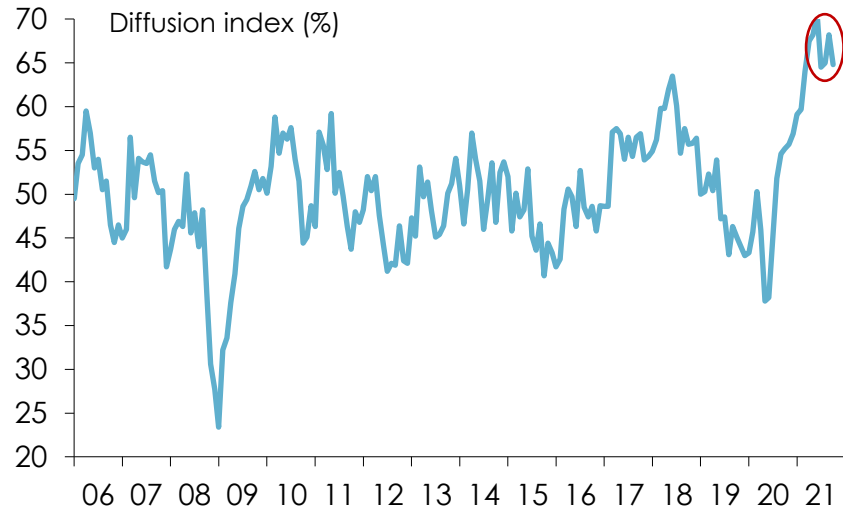
Implicit price deflators of personal consumption expenditures – levels



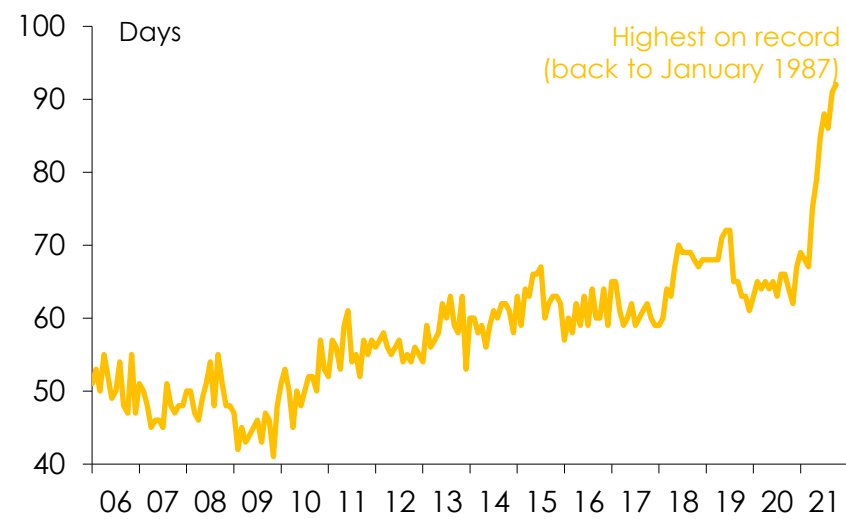
Source: [US Bureau of Economic Analysis](#).

There have been some serious supply-chain difficulties in the US – particularly in the auto sector – but they may have now peaked

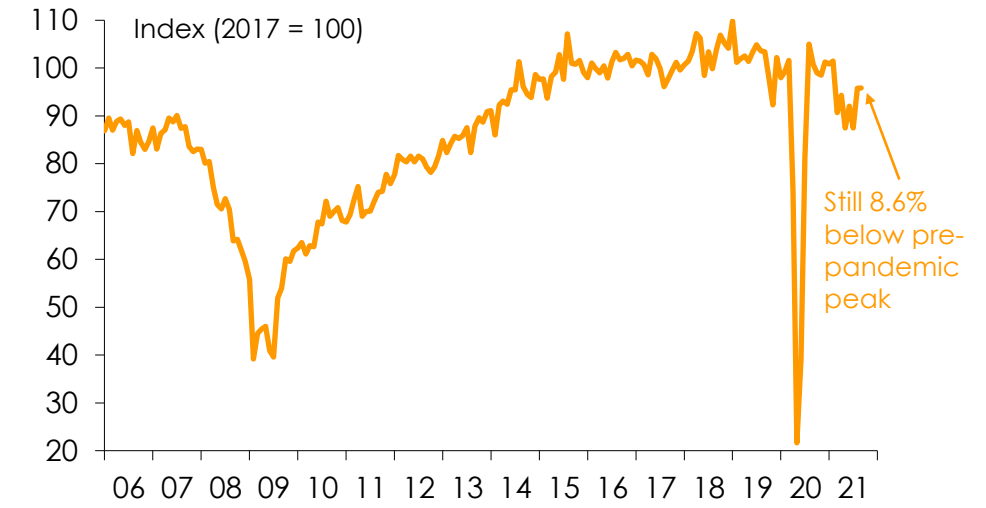
Manufacturers' order backlogs



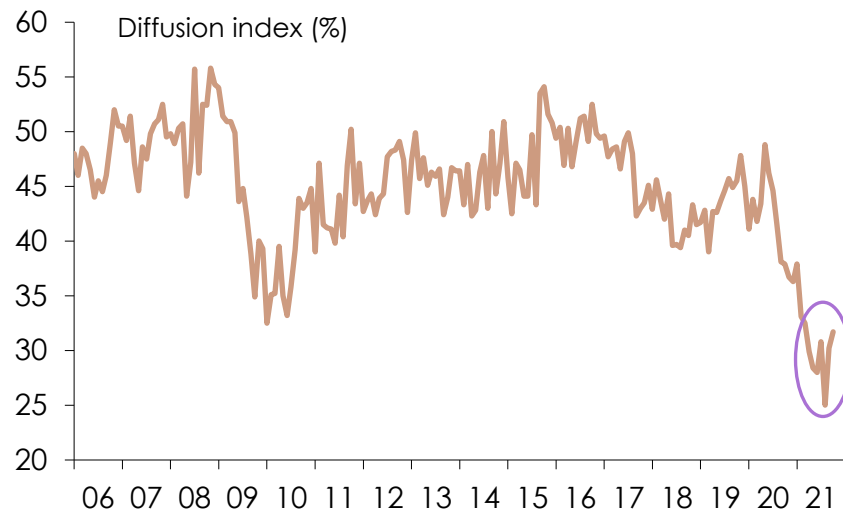
Lead-time for production materials



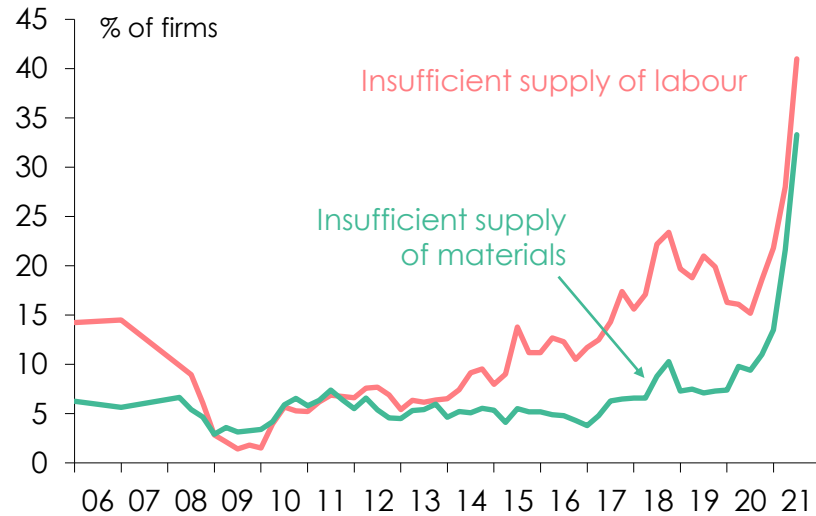
Motor vehicles & parts production



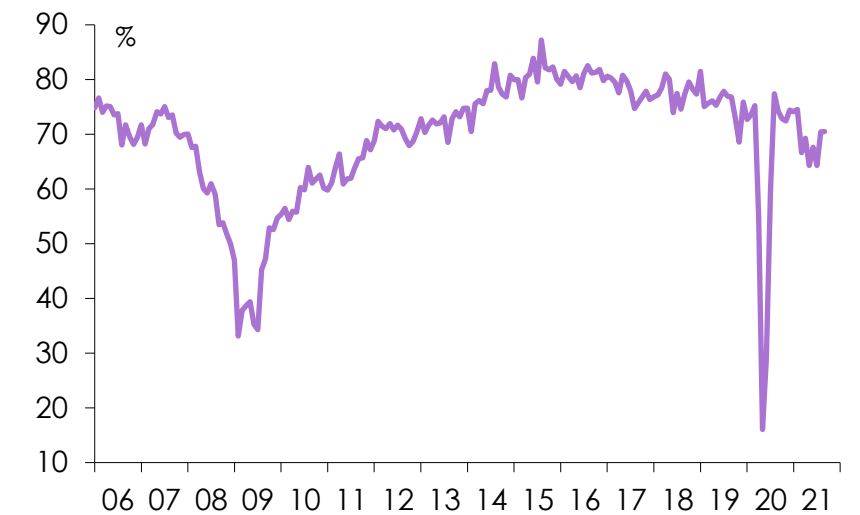
Manufacturers' customer inventories



Reasons for < full capacity



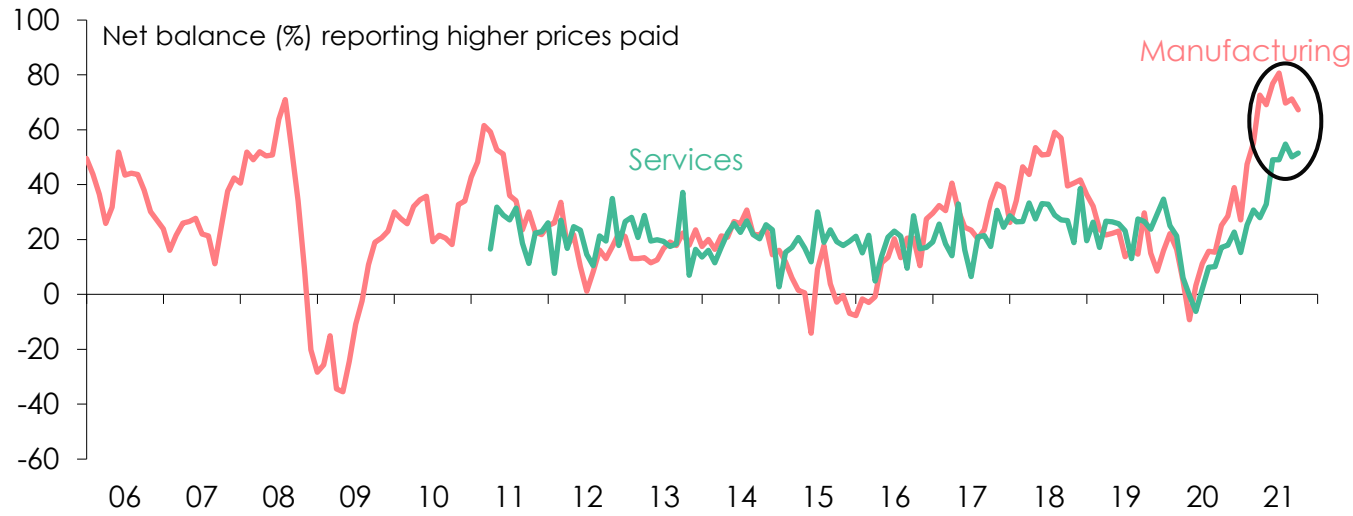
Auto industry capacity utilization



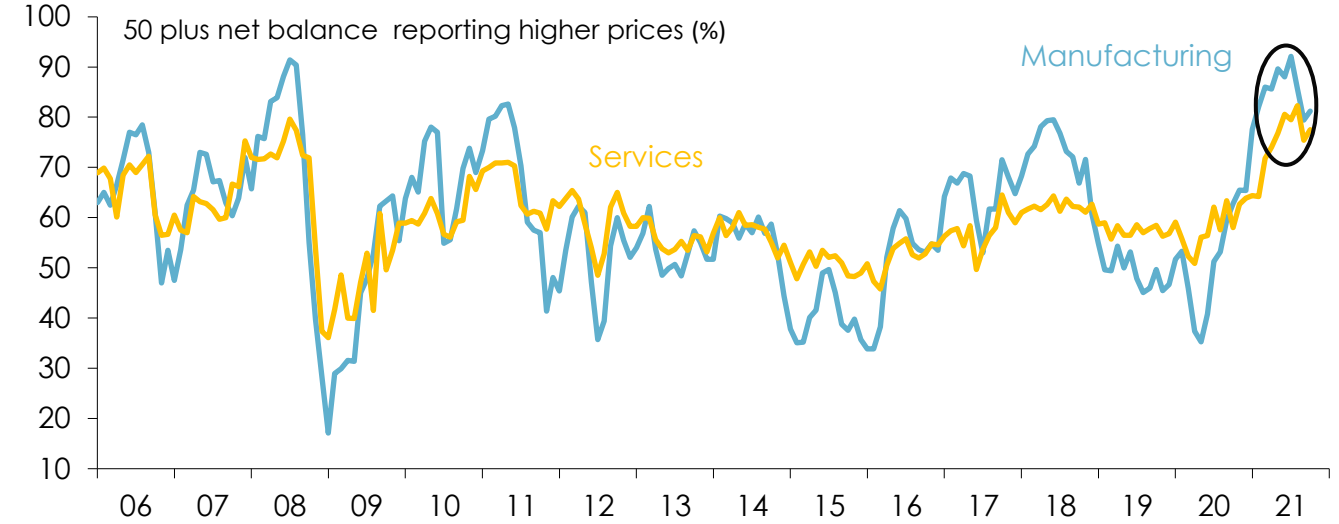
Note: The diffusion index of order backlogs is 50 plus the percentage of respondents reporting longer backlogs minus the percentage reporting shorter backlogs (and similarly for customer inventories). 'Reasons for < full capacity' means reasons for operating at less than full capacity. Sources: Institute for Supply Management, [Report on Business](#); US Census Bureau, [Quarterly Survey of Plant Capacity Utilization](#); Board of Governors of the Federal Reserve System, [Industrial Production and Capacity Utilization - G17](#).

Survey measures also suggest that ‘upstream’ price pressures in the US may be peaking – and import price inflation could also be easing

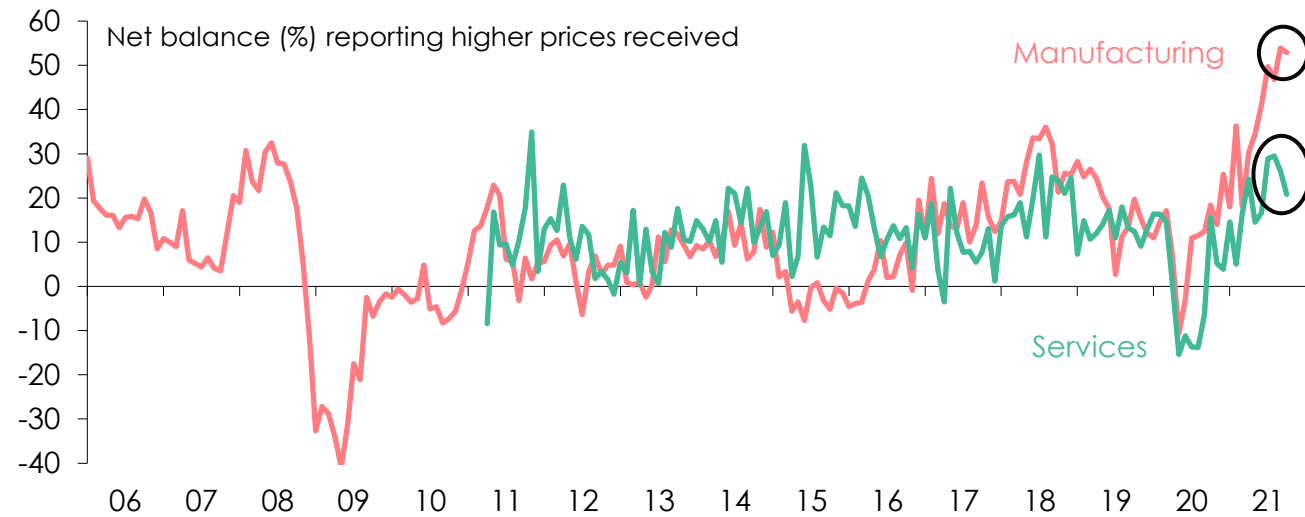
Philadelphia Fed survey – prices



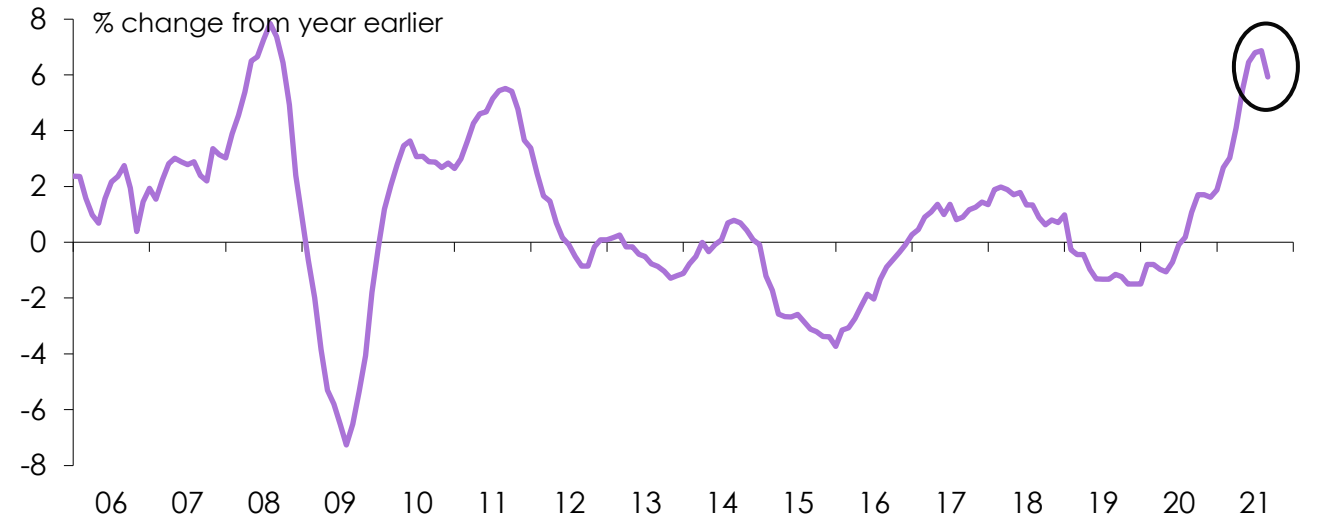
ISM survey – prices paid



‘Philadelphia Fed survey – prices received



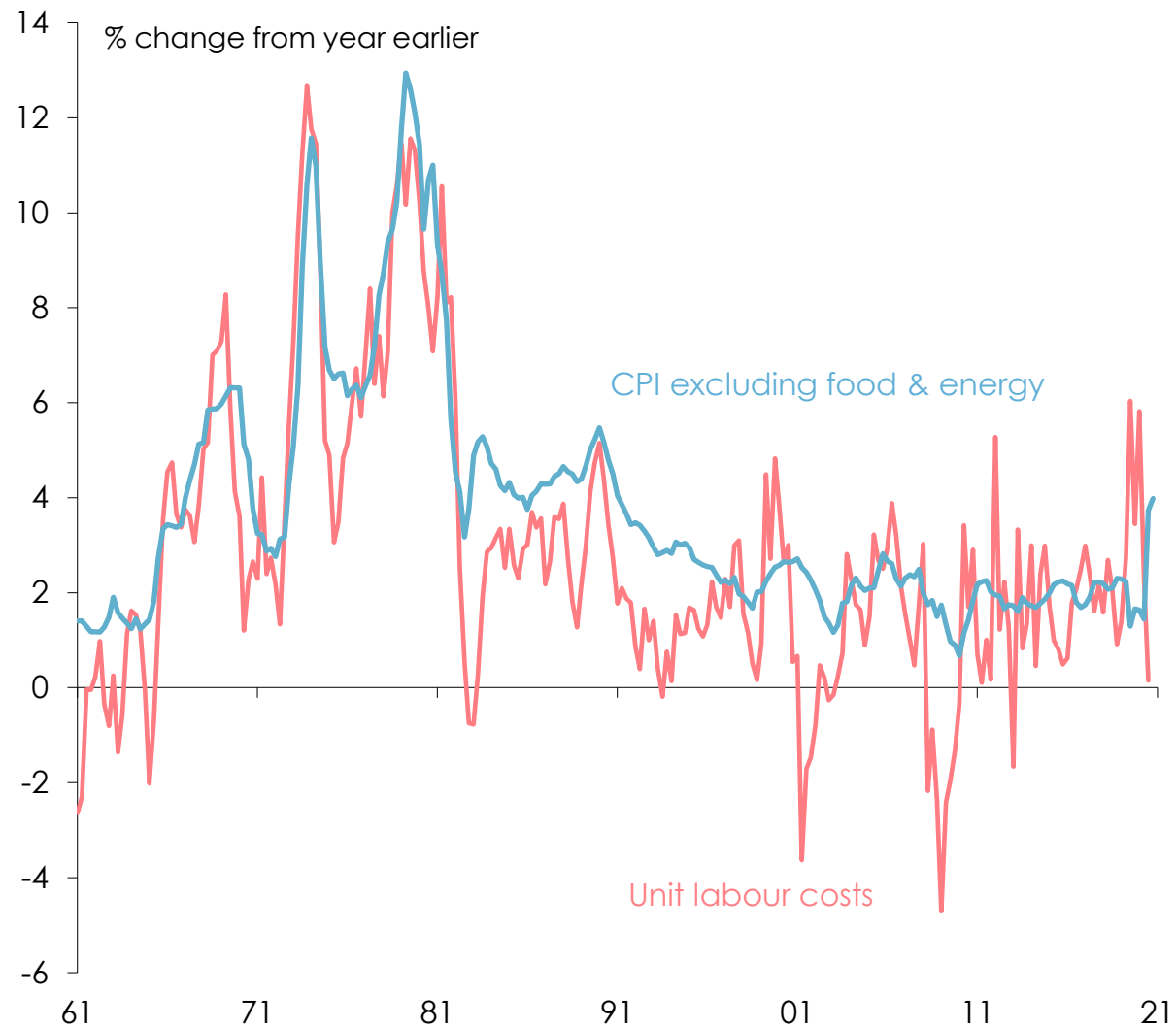
Import prices (excluding petroleum)



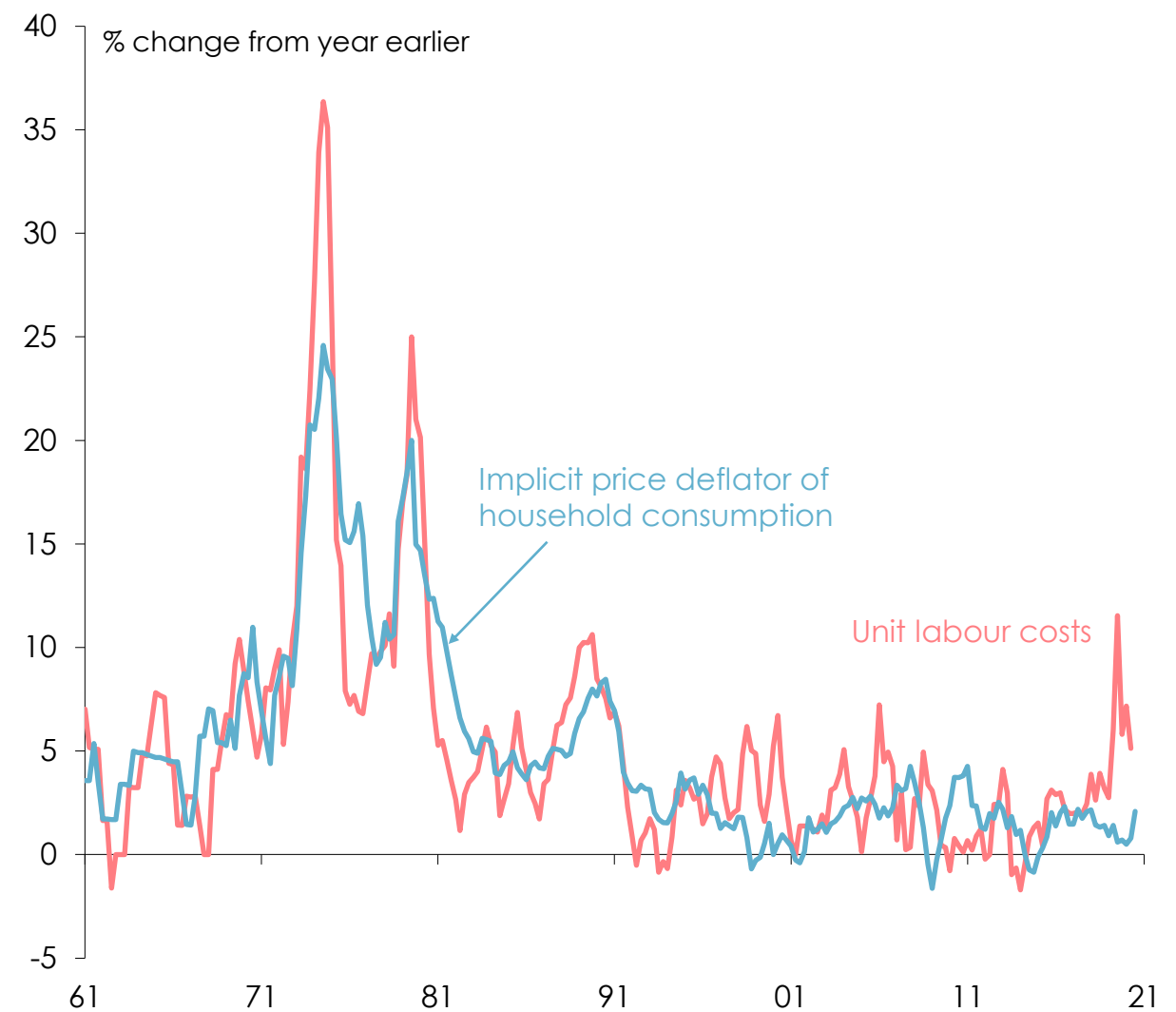
Note: The usefulness of the Business Outlook surveys conducted by the Federal Reserve Bank of Philadelphia is that the area which it covers (eastern and central Pennsylvania, southern New Jersey and Delaware) is a reasonable proxy for the broader US economy. Sources: [Federal Reserve Bank of Philadelphia](#); [Institute for Supply Management](#); [US Bureau of Labor Statistics](#).

History suggests that a broadly-based acceleration in labour costs is a key element of any sustained rise in inflation

Consumer price inflation and unit labour costs – United States



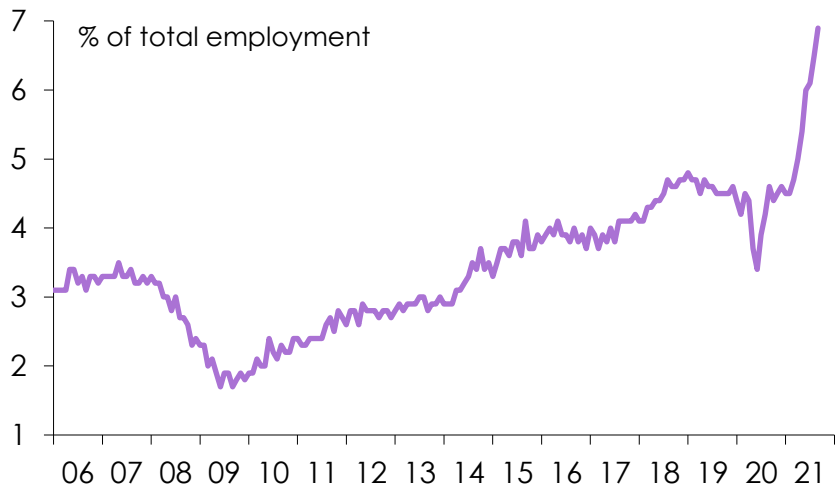
Consumer price inflation and unit labour costs – United Kingdom



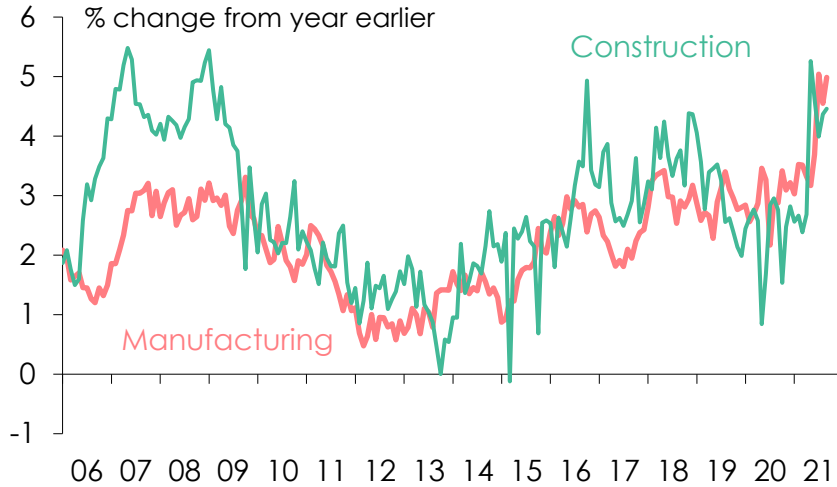
Note: 'unit labour costs' is labour costs (wages or salaries plus 'on costs') per unit of output – ie, it measures the extent to which growth in real wages exceeds growth in labour productivity. Sources: [US Bureau of Economic Analysis](#); [US Bureau of Labor Statistics](#); UK [Office for National Statistics](#).

...and although the US labour market does seem to be tightening in some respects, there's no evidence of a broad-based pick up in wages growth

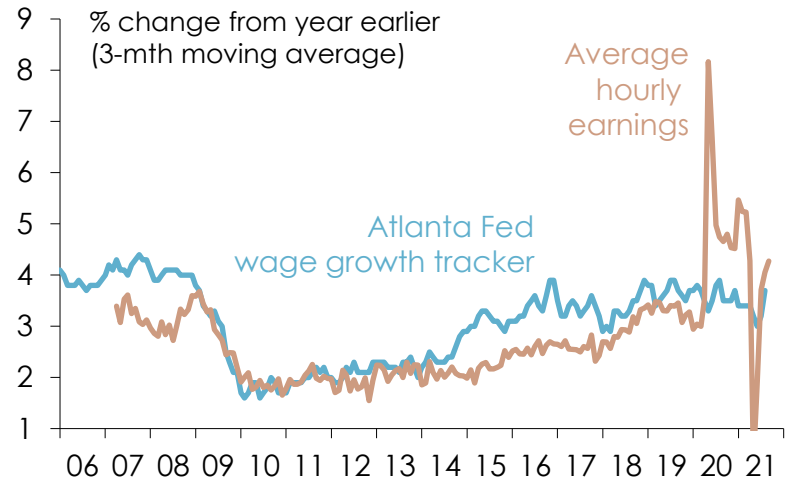
Job openings



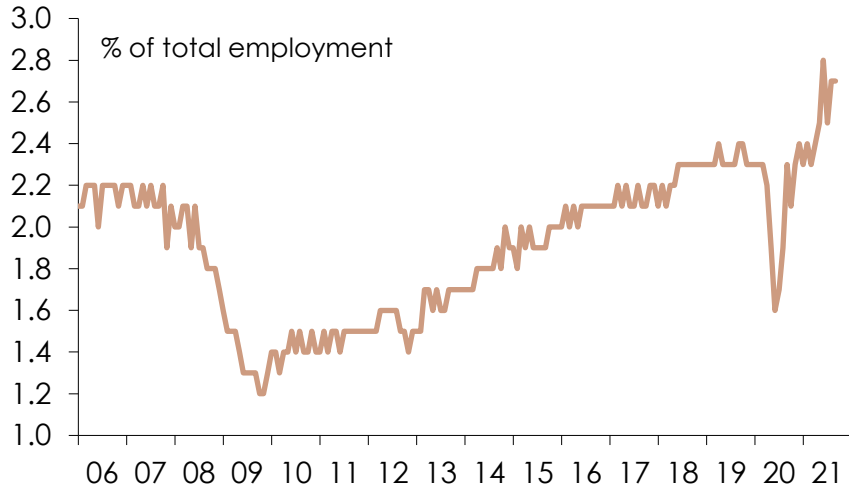
Average hourly earnings



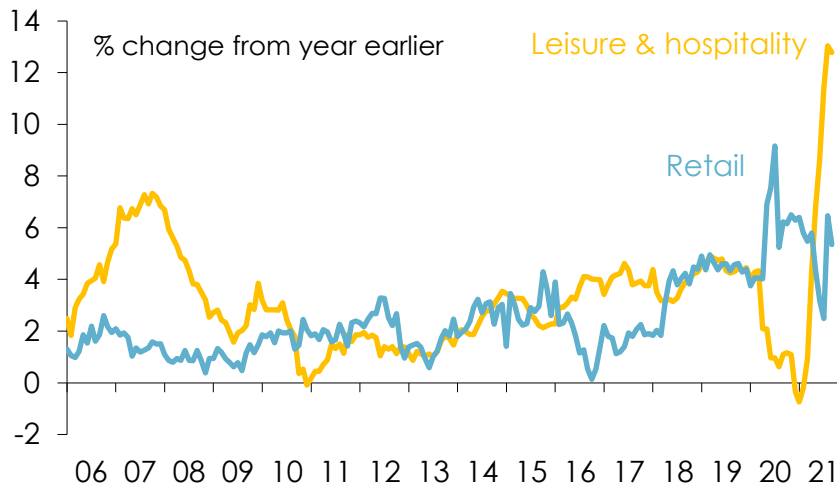
Overall wages growth - monthly



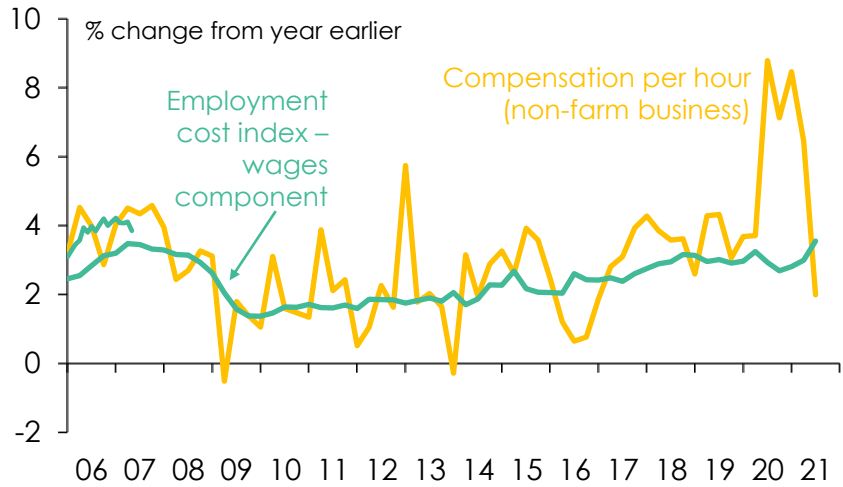
Quit rate



Average hourly earnings



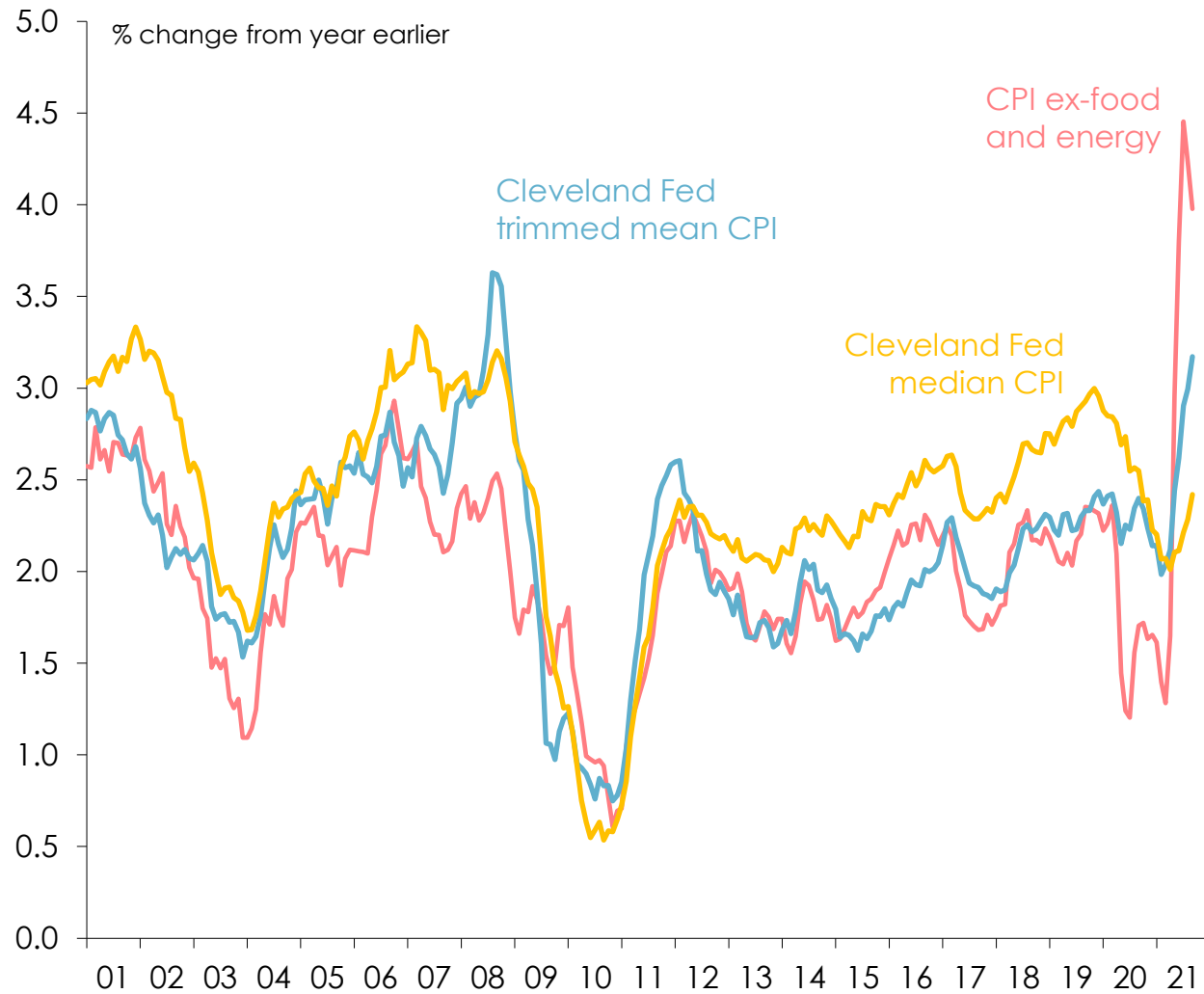
Wages growth - quarterly



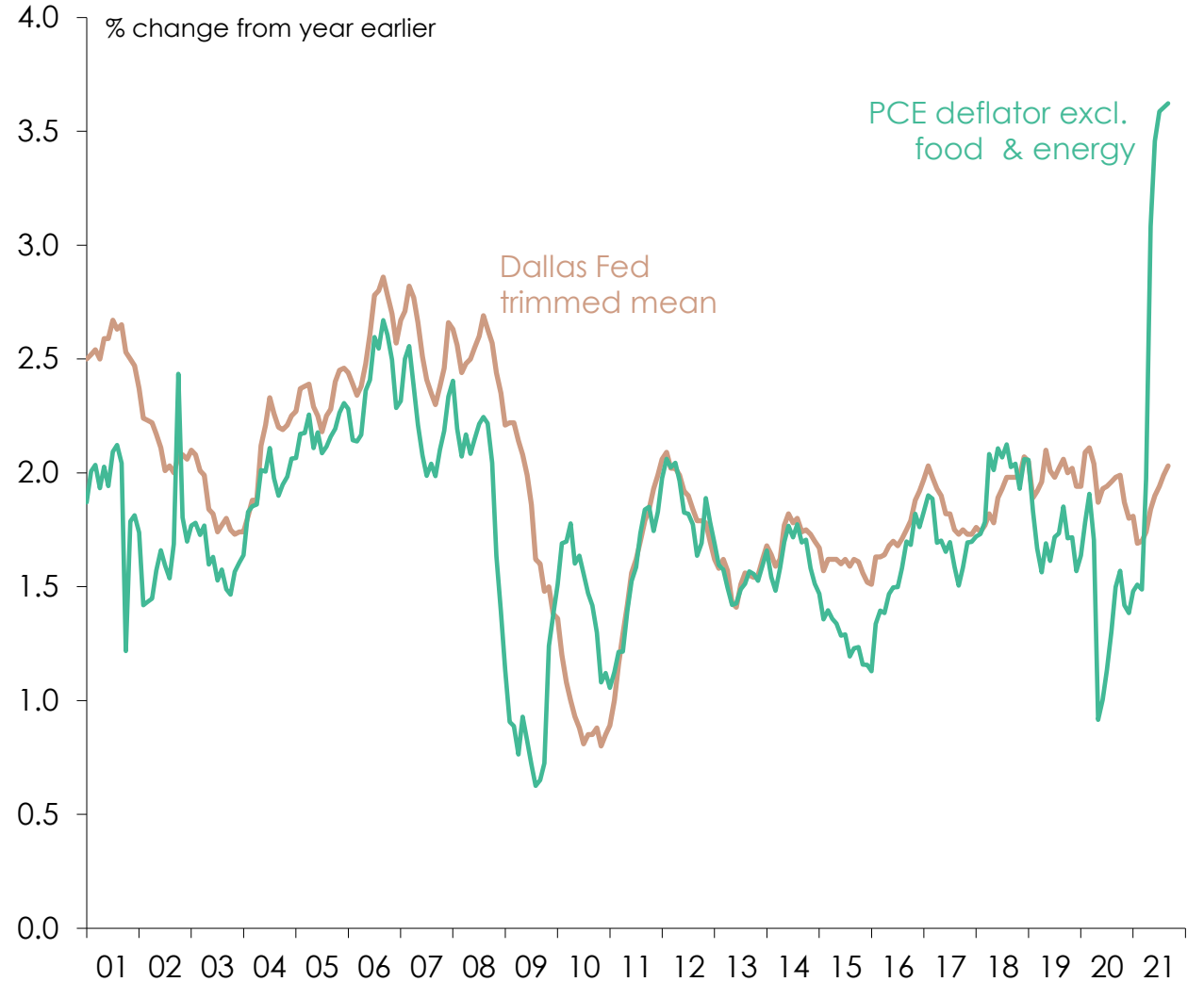
Note: Measures of average hourly earnings (especially the all-industries measures) and of average compensation per hour are affected by changes in the composition of employment (so for example they rose sharply in Q2 2020 when large numbers of low-paid workers were laid off and fell markedly when they returned to work) whereas the Atlanta Fed 'wage growth tracker' (which tracks the wage growth of individuals) and the wages component of the ECI (which is very similar to the ABS' Wage Price Index) are not. Sources: US Bureau of Labor Statistics, [Job Openings and Labor Turnover Survey](#), [Current Employment Statistics](#), [Employment Cost Trends](#) and [Labor Productivity and Costs](#).

Statistical measures of 'underlying' inflation (similar to those used by the RBA) haven't risen nearly as much

Alternative measures of US 'core' CPI inflation



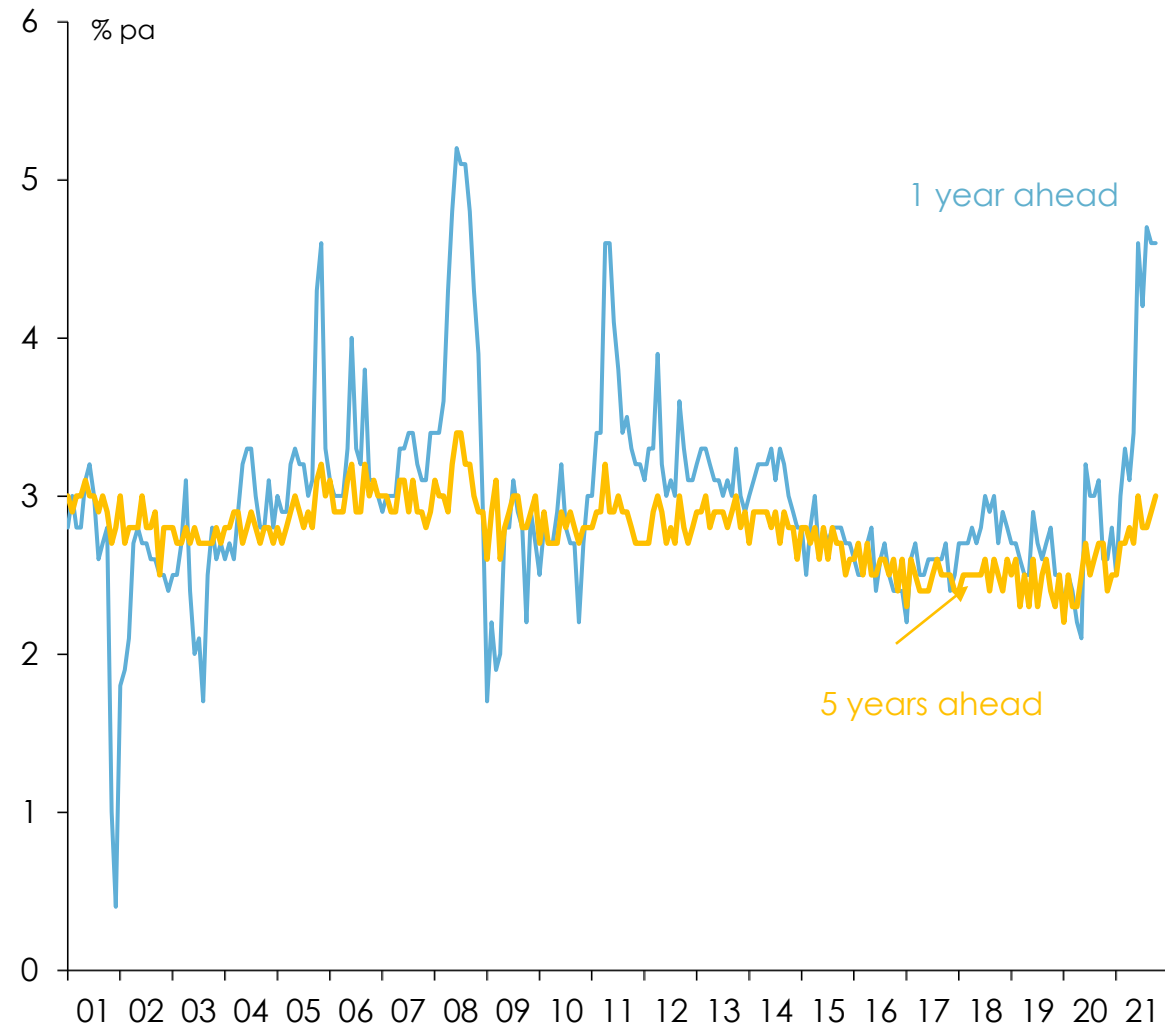
Alternative measures of US 'core' PCE deflator inflation



Note: The 'trimmed mean' CPI inflation rate excludes the components of the CPI whose weights fall in the top and bottom 8% of the distribution of price changes; the median is the component whose price change is in the middle of the distribution of price changes. The 'trimmed mean' of the PCE deflator excludes 24% by weight from the lower tail and 31% by weight from the upper tail of the ranked distribution of price changes. Sources: [US Bureau of Economic Analysis](#); [US Bureau of Labor Statistics](#); [Federal Reserve Bank of Cleveland](#); [Federal Reserve Bank of Dallas](#).

Longer-term household inflation expectations remain 'well-anchored' (as central bankers like to say)

Michigan University survey of household inflation expectations



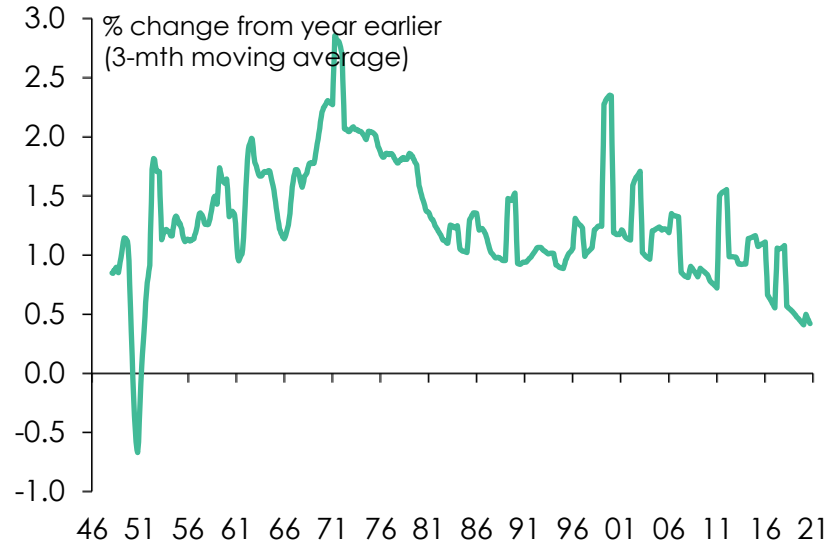
New York Fed survey of consumer inflation expectations



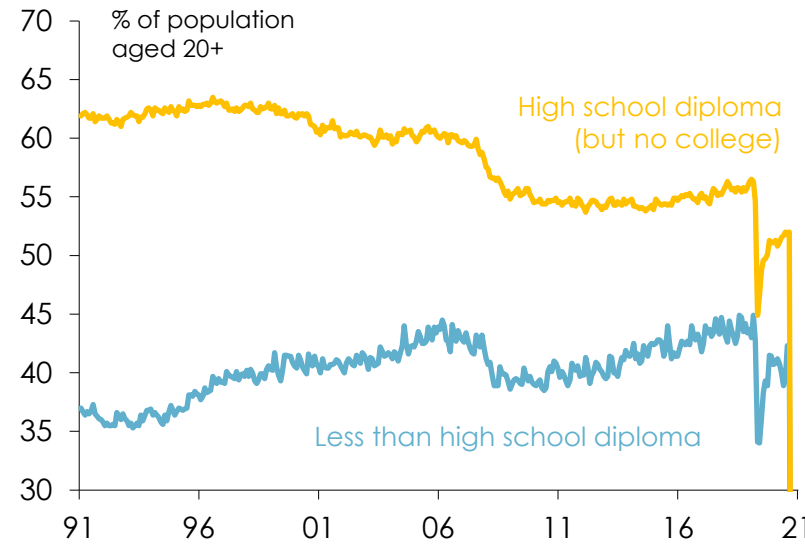
Sources: [Michigan University Survey Research Center](#); [Federal Reserve Bank of New York Center for Microeconomic Data](#).

US labour market tightness owes a lot to restrictions on immigration, and to barriers to the return to the labour market of specific groups

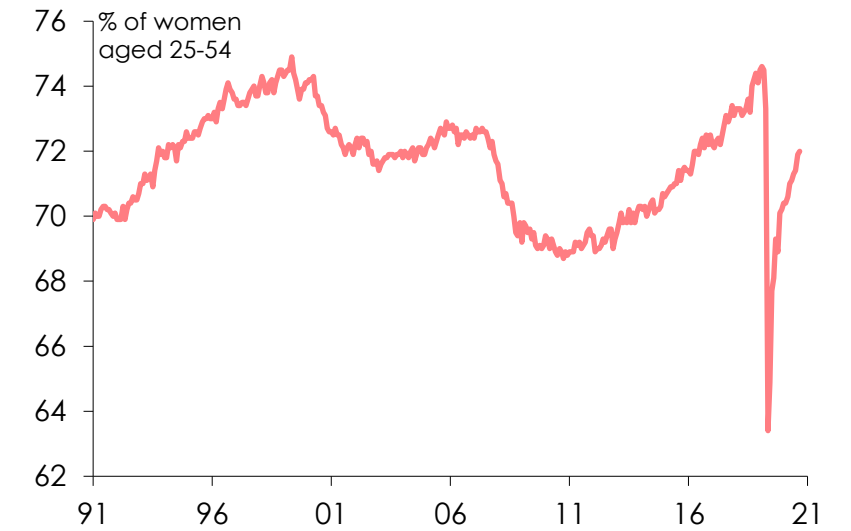
Civilian working age population



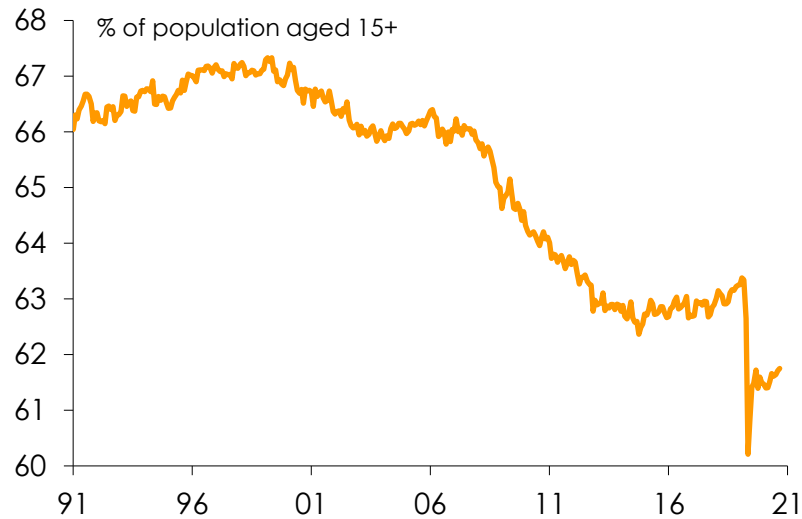
'E-pop' ratio – by education



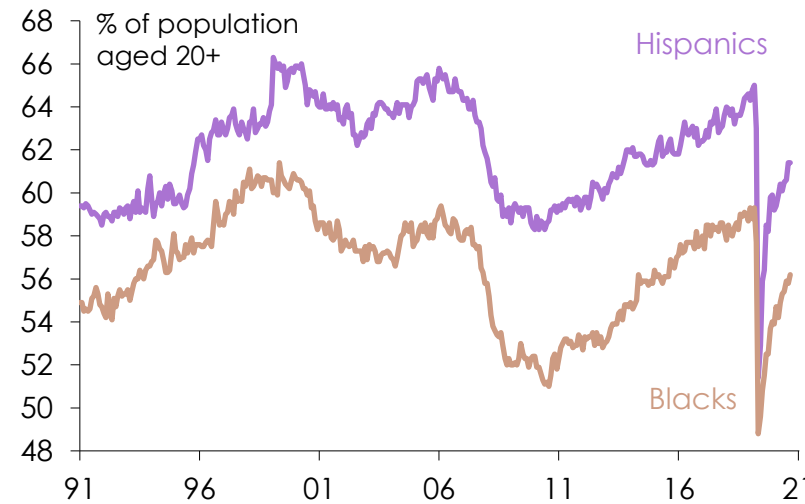
'E-pop' ratio – women 25-54



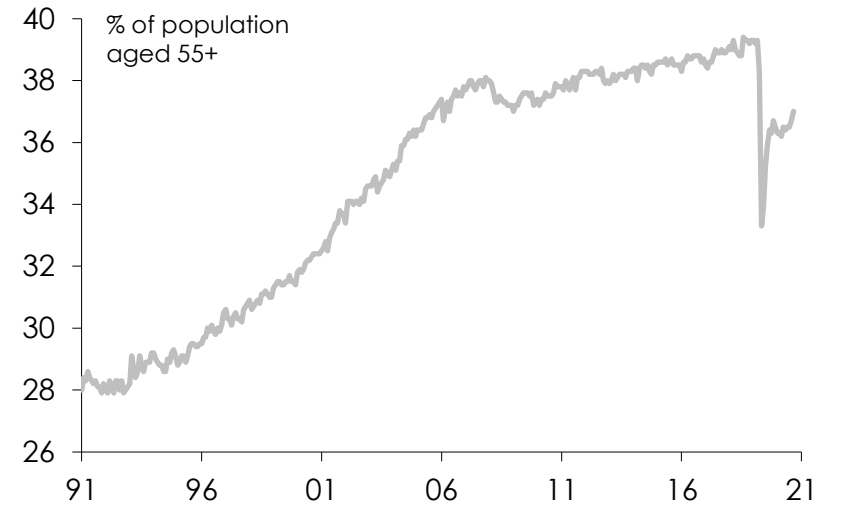
Employment-to-population ratio



'E-Pop' ratio – Blacks & Hispanics



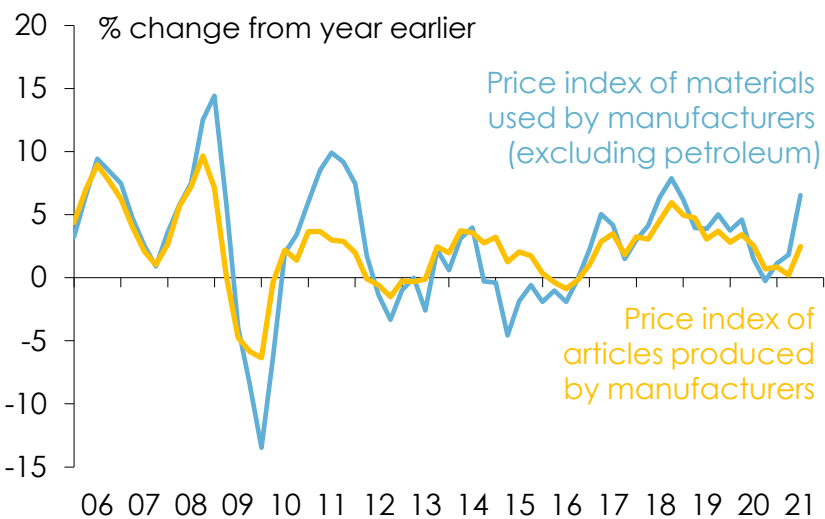
'E-pop' ratio – people 55 & over



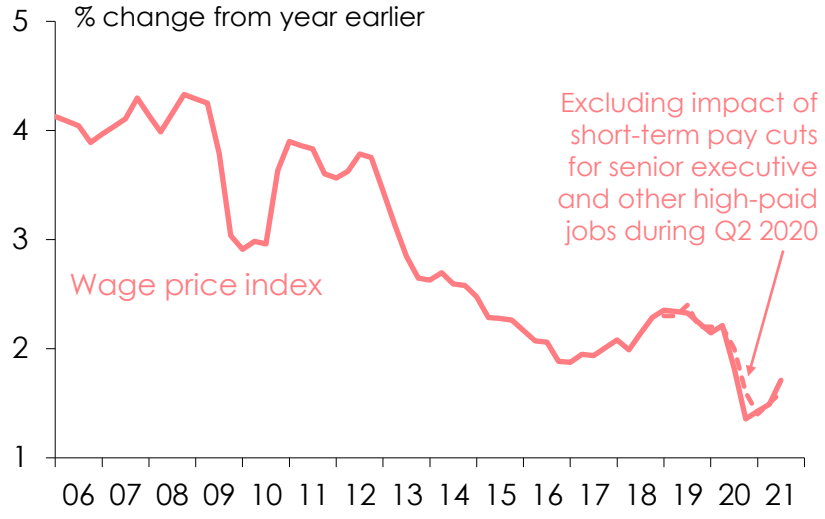
Source: US Bureau of Labor Statistics, [Current Employment Statistics](#).

In Australia, there's no sign of any 'underlying' inflationary pressure at all, except perhaps in the housing sector

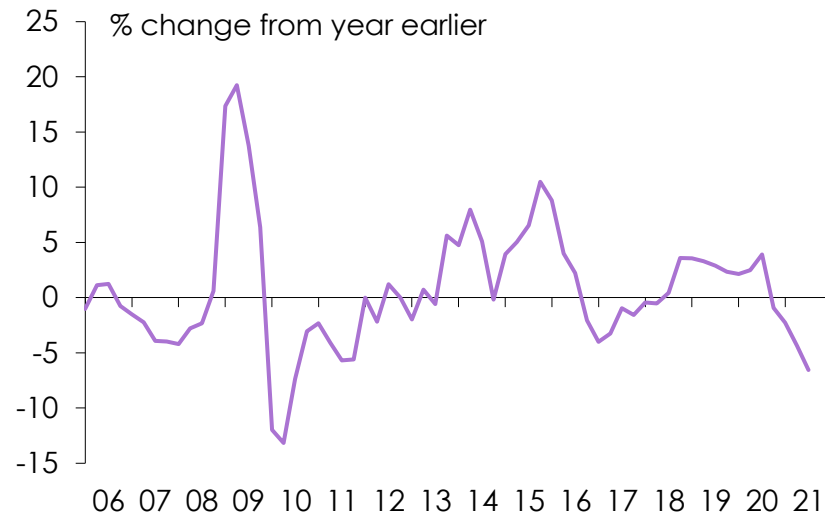
Manufacturers' costs and prices



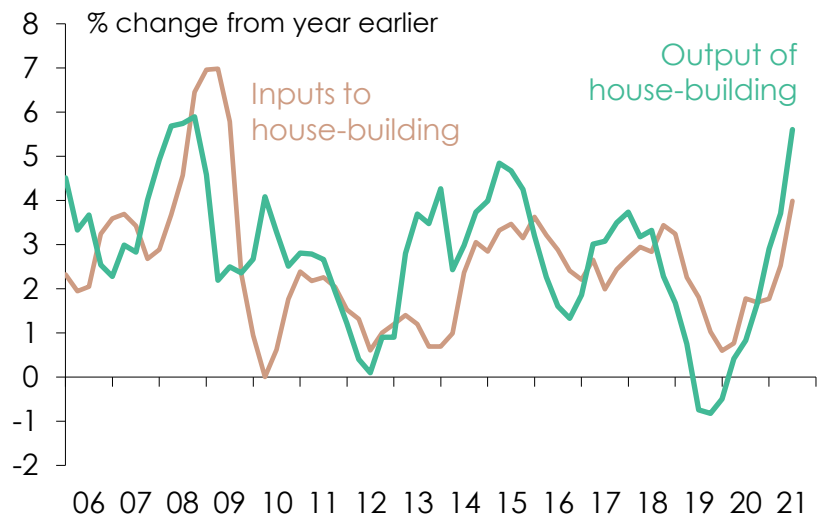
Wages



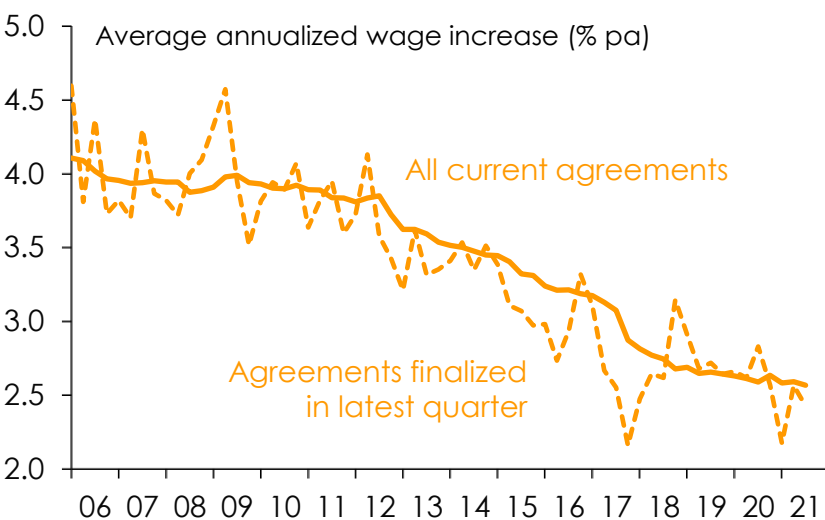
Imported consumer goods prices



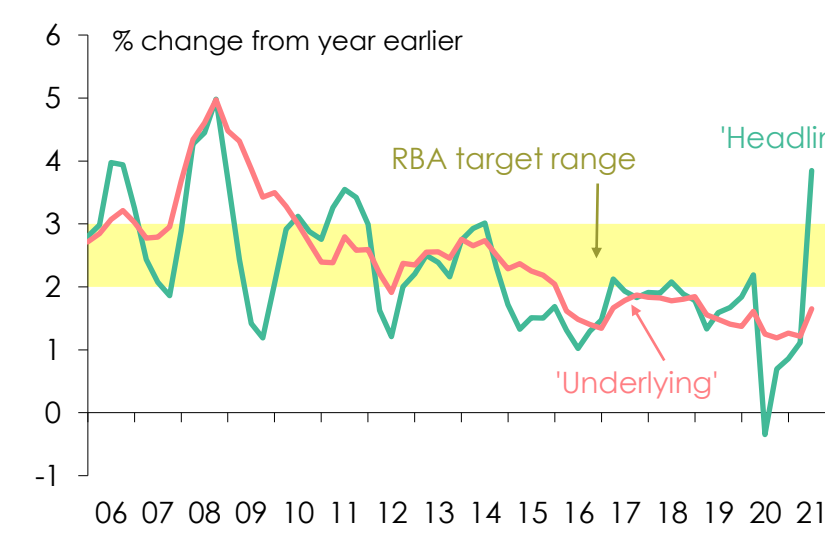
Construction costs and prices



Enterprise bargaining agreements



Consumer prices



Sources: ABS, [Producer Price Indexes](#); [International Trade Price Indexes](#); and [Consumer Price Index](#), June quarter 2021; Attorney-General's Department, [Trends in Federal Enterprise Bargaining](#);

Summary – what are the inflation risks

- ❑ The Fed and other ‘advanced economy’ central banks are probably right to regard the increase in ‘headline’ and (in the US) ‘ex-food-and-energy’ inflation as ‘transitory’
 - although it may take some time for them to be completely vindicated
 - it’s important to remember that ‘advanced’ economy central banks want (and are targeting) higher inflation than that experienced in the past five-ten years
- ❑ The main risks to this view would appear to be
 - the possibility that energy prices remain at elevated levels for much longer than expected, and that this ‘feeds through’ into household and business inflation expectations
 - the possibility that policies designed to accelerate the transition to ‘net zero’ emissions (such as increased and more wide-spread carbon prices) have a wider or longer-lasting impact on inflation
 - the possibility that an excessive focus on ‘security’ of supply chains (in the name of ‘sovereignty’) leads to sustained increases in costs and prices
 - the possibility that long-term restrictions on immigration result in labour markets tightening more rapidly than central banks recognize or anticipate
 - the possibility that it is the capital stock, rather than the supply of labour, which becomes the ‘limiting factor’ on potential output growth, and that central banks fail to recognize that in determining when to start ‘normalizing’ monetary policy
- ❑ The UK may be an ‘outlier’ among ‘advanced’ economies – that is, have a greater inflation risk
 - because of ‘bottle-necks’ caused by Brexit
- ❑ It’s a different situation in most ‘emerging’ economies (outside of Asia)
 - because inflation expectations are far less ‘well anchored’ in non-Asian ‘emerging’ economies
 - and because EM currencies provide an additional channel for transmitting higher inflation

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