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Weekly Commentary

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Paige Wilhelm
Senior Vice President
Senior Portfolio Manager
Federated Investment Counseling

Slugging it out

The markets are yet again ignoring the oft-proven adage "Don't fight the Fed." This time the ring is inflation and the bout seems destined to go many rounds. With each new fiscal stimulus package, more voices have joined those concerned that runaway inflation is inevitable. Those voices grew much louder last week when the Labor Department reported last week that the consumer price index jumped 4.2% in April from a year ago. That's the highest figure in more than 12 years.

But the Federal Reserve remains unimpressed, willing to take body blows by pundits and hawks. For one, some of the spike is due to base effects—that the improvement is deceiving because it is comparing prices to the heart of the worldwide shutdown of nonessential businesses in April 2020 due to the pandemic. Another is that the economy likely is being juiced by pent-up demand after more than a year of cautious spending. The contention is that the party will end by summer or early fall. Disappointing April retail sales already show that the recovery remains volatile, not tracing a linear (or exponential as some claim) growth trajectory. But the biggest reason is that Fed economists believe the large-scale forces that have held inflation down for years remain: people retiring, automation, manufacturing moving to countries with lower wages and more.

For cash managers, the best scenario is that, while the Fed will probably not give in and raise interest rates in response to the rise in inflation it considers transitory, policymakers might advance their timeline for liftoff and tapering of asset purchases.

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Views are as May 14, 2021 and are subject to change based on market conditions and other factors.