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Weekly Commentary

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Inflation in the slow lane

The Federal Reserve's new monetary policy framework indicates it will allow inflation to rise above its long-held 2% target. The economy indicates that is going to be a long haul.

Inflation rose in August more than some had forecast, but forecasts don't mean much these days. The consumer price index (CPI) increased 0.4%, but that is actually lower than the reading in July (0.6%) and much was due to a surge in used vehicle sales. In fact, it was the greatest increase since 1969—any cars or trucks built then that are still running now have the "Classic Motor Vehicle" designation on their license plates! In any case, this huge bump was due to pent-up demand and won't have legs, or wheels.

It is important to note that the Fed prefers to judge inflation by the personal consumption expenditure metric, or the PCE index. It says this measure better captures the true changes in prices people face. Also, the weight that the CPI gives to the basket of goods from which it calculates inflation is updated only every two years. It doesn't capture new products coming to market or even if consumers buy something with a lower price. Unfortunately, however, the core PCE also has been running far short of 2%. But, just as few predicted inflation would have such trouble moving materially beyond this level for so many years, few foresaw a pandemic like Covid-19, so it may be that inflation picks up quicker than thought and the financial markets begin to operate more normally.

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Views are as of September 11, 2020, and are subject to change based on market conditions and other factors.