Record Inflation is No Surprise

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Friday's record high inflation number came as a surprise to many. At 8.6 percent, the increase in prices since a year ago represents the highest inflation rate in over 40 years. The figure was 30 basis points higher than the Wall Street Journal consensus of forecasters and, perhaps more importantly, flew in the face of conventional wisdom which held that inflation peaked two months ago and was declining.

As discussed in detail at our annual forecast event in Thousand Oaks on March 8, CERF's views on monetary policy have long been unconventional. We have been outspoken critics of Fed policy since 2012 and were among those that President Biden labeled un-serious last summer when the *serious* economists were claiming that inflation would be transitory.

CERF's forecast of May's inflation figure was characteristically unconventional. Our forecast for all-items CPI in May was *8.6 percent*.

That is, we did not believe that the headline CPI number had peaked in March. And we believe that it still has a way to go now. Although the monthly rate of price increases likely peaked in March, we forecast that the all-items CPI will increase to a level well above 9 percent and will likely not peak until the end of the year.

What follows are thoughts about inflation that we shared last month in the Pacific Coast Business Times' Spring Economic Forecast Issue. Last Friday's inflation figure is welcome validation and means that our forecast is unchanged from a month ago:

> *We take a strong position on the cause of the current bought of inflation. As Milton Friedman famously said, "Inflation is always and everywhere a monetary phenomenon." Between January 2020 and January 2022, the Federal Reserve increased the size of the money supply by more than 40 percent. Minneapolis Fed President Neel Kashkari expressed the Fed's orientation perfectly in March 2020 when he said, "There is an infinite amount of cash in the Federal Reserve." Fed Chair Jerome Powell did his part throughout the Summer of 2020, urging Congress to put more of the Fed's expanded money supply directly into the hands of households. The sum of the resulting relief programs was far greater than all of the*

foregone income that resulted from government-mandated shutdowns. Not surprisingly, the savings rate surged from around 8 percent pre-COVID to more than 30 percent. The resulting surge of consumption of consumer goods drove both congestion at U.S. ports and a surge of consumer prices not seen since the 1970s. Because we see clear signs of classic monetary inflation, we are forced to conclude that the current bought of inflation will be persistent.

As a technical matter, we expect that the headline CPI inflation figure (which is a measured as a percent change from one year ago) will continue rising through the end of 2022, even as the monthly rate of price increases likely peaked in March. We expect the CPI measure of inflation to top 10 percent and to remain high through 2023. Readers don't need to take our word for it. The New York Fed's inflation expectations survey indicates that the median one year ahead expected inflation rate is 6.6 percent. The median three year ahead inflation expectation is 3.7 percent. Economic actors expect that even three years from now, inflation will still be 85 percent above the Fed's target. Because we also believe that the Federal Reserve does not have the fortitude to endure a jarring correction in asset markets, we believe that the Fed will fail to follow through on the policy normalization that is required in order to tame inflation. As such, we believe that inflation is likely to run even higher than today's inflation expectations indicate.

Admittedly, we have been pretty outspoken critics of Fed Policy for some time. We feel even more animated in our criticism now that the Fed finds itself so far behind the curve. The Fed only began the current tightening cycle after the nation had experienced nine months of inflation above five percent and three months above seven percent. The experience in late 2018, the last time the Fed announced an intention to normalize monetary policy, is our best prediction of what will happen in 2022. In the waning days of 2018, the Fed abruptly reversed course following a steep decline in asset prices. We don't believe the Fed will continue tightening during the current cycle as the current market correction deepens.

Inflation is the economic issue of the moment. Real wages declined by 3 percent over the past 12 months. And even higher inflation figures later this year should not surprise anyone.