



The US inflation prospect in the rest of 2021 and in 2022

July 2021 presentation

by Professor Tim Congdon CBE,

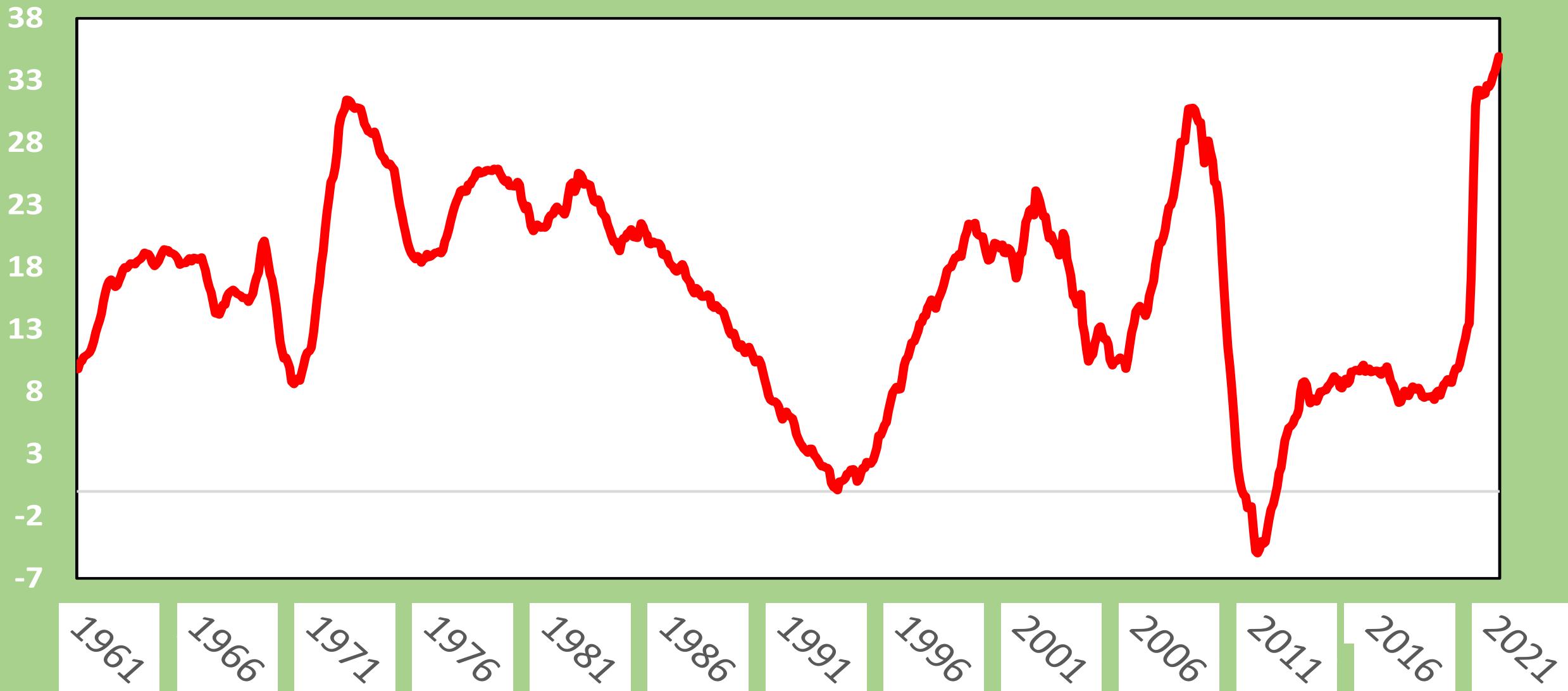
*Chairman of the Institute of International Monetary Research
at the University of Buckingham*

What does our analysis tell us about the US economy in the next two years?

- Assume that 'life returns to normal' in a medical sense by the end of next year, i.e., the fourth quarter (Q4) of 2022.
- Assume that the velocity of circulation of money, broadly-defined (i.e., M3), is **5% lower** than on average in 2018 and 2019.
- Assume that the growth of money, broadly-defined, runs at 0.4% a month (i.e., a roughly 5% annual rate) from Q1 2021 to Q4 2022.
- **THEN THE IMPLIED EQUILIBRIUM LEVEL OF U.S. NATIONAL INCOME IS ABOUT 30% HIGHER IN Q4 2022 THAN IN Q1 2021. ON THIS BASIS, THE INSTITUTE OF INTERNATIONAL MONETARY RESEARCH EXPECTS THE ANNUAL RATE OF U.S. CONSUMER INFLATION TO BE TYPICALLY IN THE 5% - 10% BAND IN THE NEXT TWO YEARS.**



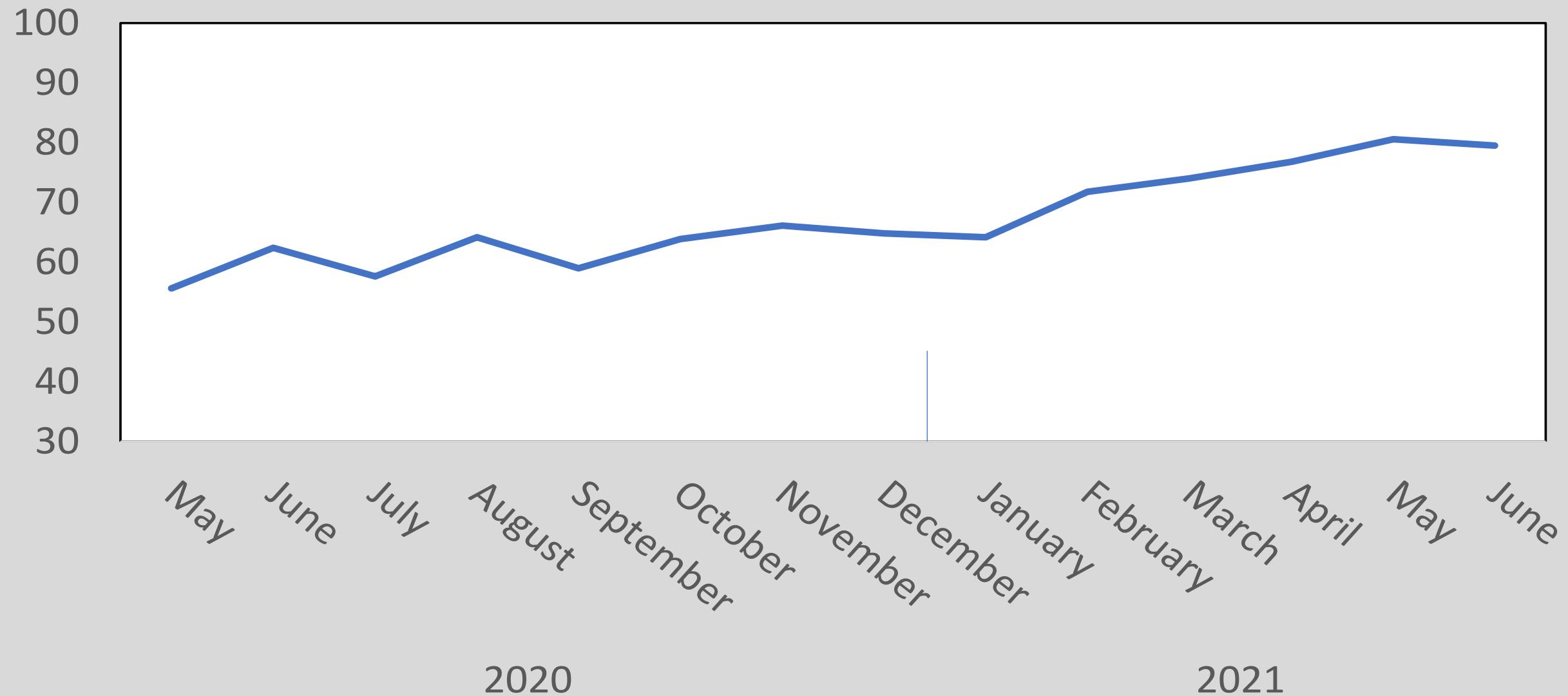
Increase in broad money (M3) on *two* years earlier, %



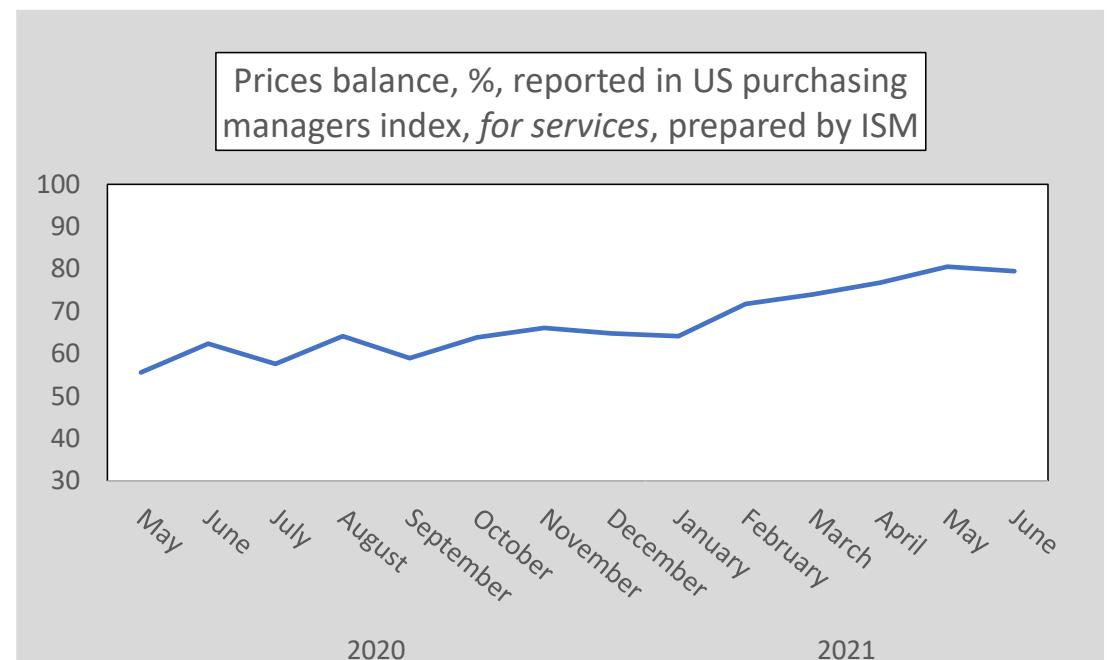
Prices balance, %, reported in US purchasing
managers index, *for manufacturing*, prepared by ISM



Prices balance, %, reported in US purchasing
managers index, *for services*, prepared by ISM



On the basis of these two charts, a reasonable view is that the average monthly increase in the 2nd half of 2021 will be higher than the average monthly increase in the 1st half.



The average monthly increase in the CPI in the first six months of 2021 was 0.7%.

The consumer price index

Assumed monthly increase from June 2021

	0.3%	0.5%	0.7%
Jul-21	5.2	5.4	5.6
Aug-21	5.2	5.6	6.0
Sep-21	5.3	6.0	6.6
Oct-21	5.6	6.4	7.3
Nov-21	6.0	7.0	8.1
Dec-21	6.2	7.5	8.8
Jan-22	6.1	7.6	9.1
Feb-22	5.8	7.5	9.2
Mar-22	5.4	7.3	9.2
Apr-22	4.8	6.9	9.1
May-22	4.3	6.6	9.0
Jun-22	3.7	6.2	8.7

The average monthly increase in the PCE deflator in the first five months of 2021 was 0.45%.

Deflator for personal consumption expenditures

Assumed monthly increase from June 2021

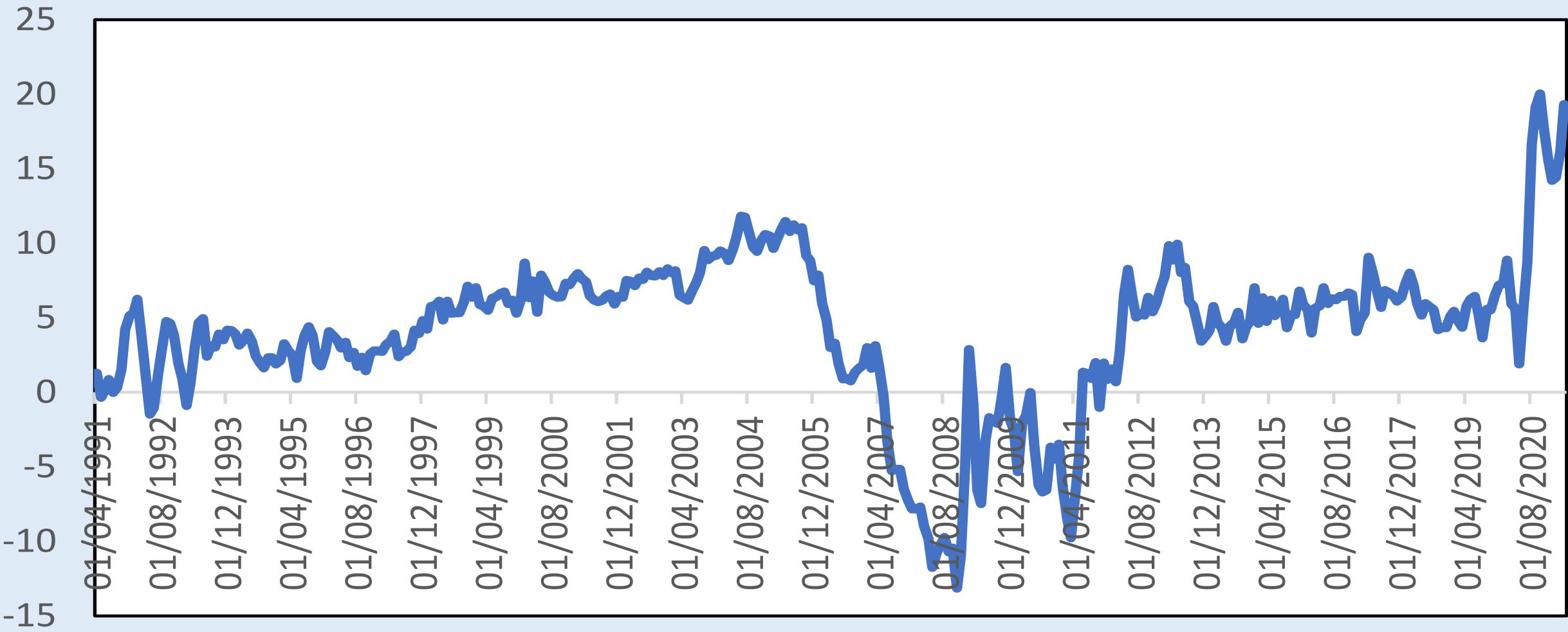
	0.2%	0.4%	0.6%
Jun-21	3.6	3.8	4.0
Jul-21	3.5	4.0	4.4
Aug-21	3.4	4.1	4.7
Sep-21	3.5	4.3	5.1
Oct-21	3.7	4.7	5.7
Nov-21	3.9	5.1	6.4
Dec-21	3.7	5.1	6.6
Jan-22	3.6	5.3	7.0
Feb-22	3.5	5.4	7.3
Mar-22	3.1	5.2	7.3
Apr-22	2.7	5.0	7.3
May-22	2.4	4.9	7.4
Jun-22	2.4	4.9	7.4

Fundamental identities

- **Growth of aggregate demand (GDP on the expenditure measure) = growth of output (GDP on the output measure)**
 - This matters to the future path of 'the output gap' (i.e., actual output relative to its trend level).
- **Growth of aggregate demand = Growth in final sales + Change in inventory accumulation**
 - The inventory component can be very important to the booms and busts in the trade cycle.

US house prices (purchase-only, monthly)

3-month annualised rate of change, %



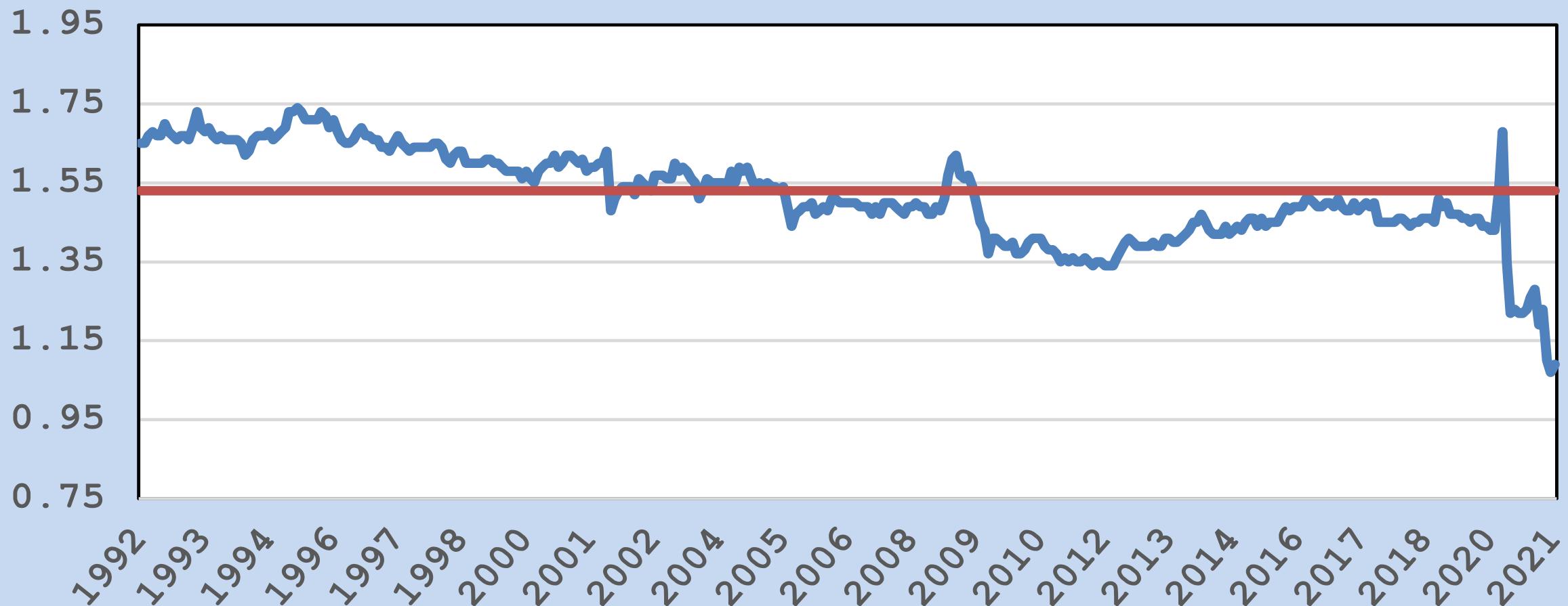
Total Business: Inventories-to-Sales Ratio
Data are monthly and seasonally adjusted



Inventories-to-sales ratio in US retail sector

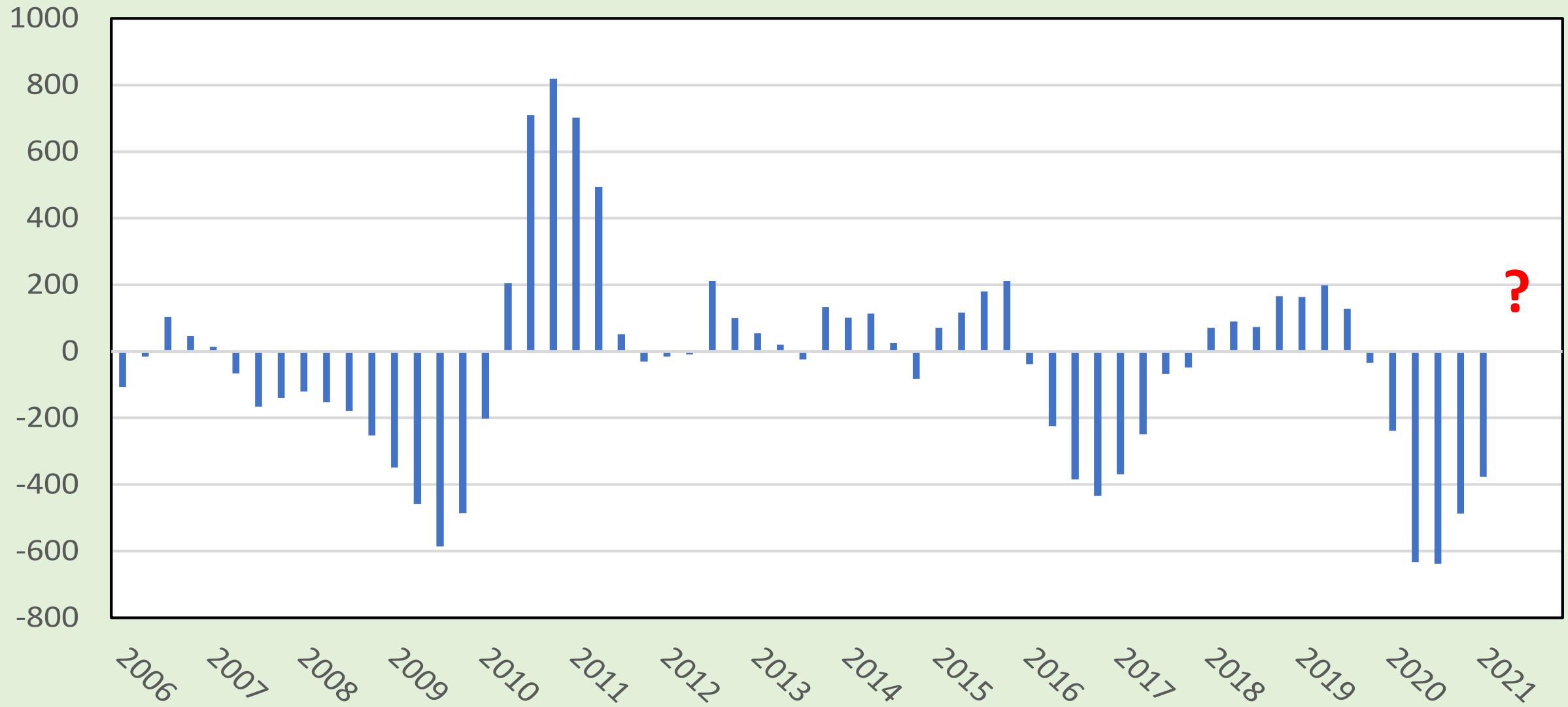
Source: US Census Bureau

— Actual value — Average value (1992 to 2020)



Change in inventory building, current \$b.

Qrtly data, last year, change cf. previous full year



The boom will continue to mid-2022 1.

- **The change in inventory building could add \$750b. - \$1,000b. (i.e., 3% - 4%) to aggregate demand growth in the next year.**
- Meanwhile – in contrast to the aftermath of the Great Recession – balance sheets are very strong, not least because of the jumps in house prices and the stock market.
- So very buoyant inventory building will coincide with strong final sales. **The growth of aggregate demand/output could run at 7% - 10% in real terms in the year to mid-2022 – if the capacity were there.**

The boom will continue to mid-2022 2.

- **Whatever the employment/unemployment totals, the behaviour of inflation shows that at present US output is above its trend level, i.e., the output gap is positive.**
- Inflation tends to rise when the output gap is positive. (This is just New Keynesianism/New Consensus Macro.)
- The boom – above-trend growth in demand and output – will continue to mid-2022. **The level of output will therefore go further above trend, i.e., the output gap will be even more positive in middle of next year than it is at present. So....**

The boom will continue to mid-2022 3.

- **Inflation will be rising until at least mid-2022.**
- In other words, the average monthly increases in the main price indices seen so far in 2021 (0.7% on the CPI and 0.45% on the PCE deflator) will be *exceeded* in the coming year.
- **Inflation will be *accelerating*, not decelerating, into 2022.**