

Inflationary Outlook: Economic conditions, questions, and possible outcomes

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CBEA Mission (Started 2019)

Our Mission.

The CBEA supports the economic growth and diversification of Wyoming's economy through applied economic and business analytics for communities, industries and entrepreneurs who desire a thriving and prosperous Wyoming.

Our mission is to:

- Provide **professional economic insight** about Wyoming by tracking and interpreting regional conditions and supplying local and state economic forecasts
- Undertake **economic impact assessments**
- **Conduct specialized analyses**, studies and projects, including guidance for investors, policymakers, and entrepreneurs
- Study and disseminate population demographic and workforce conditions to **support regional development**

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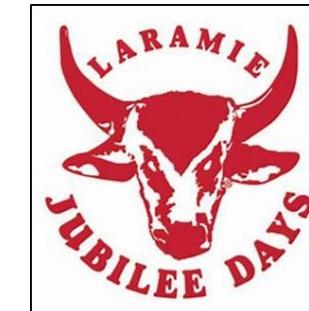


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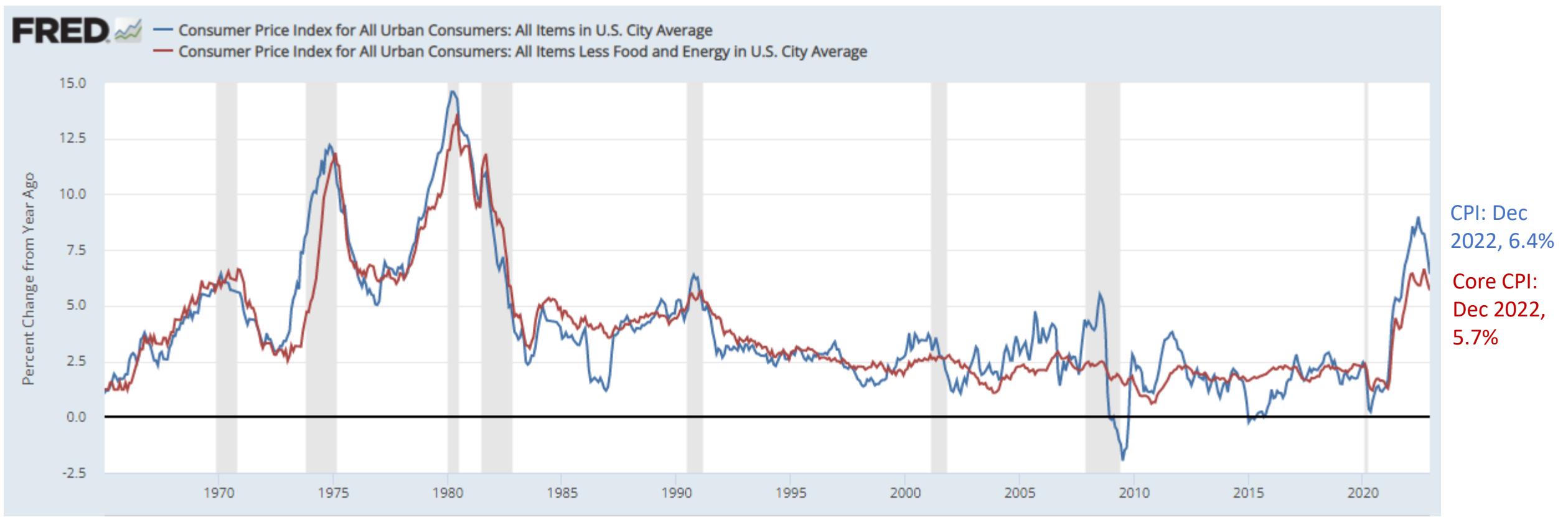
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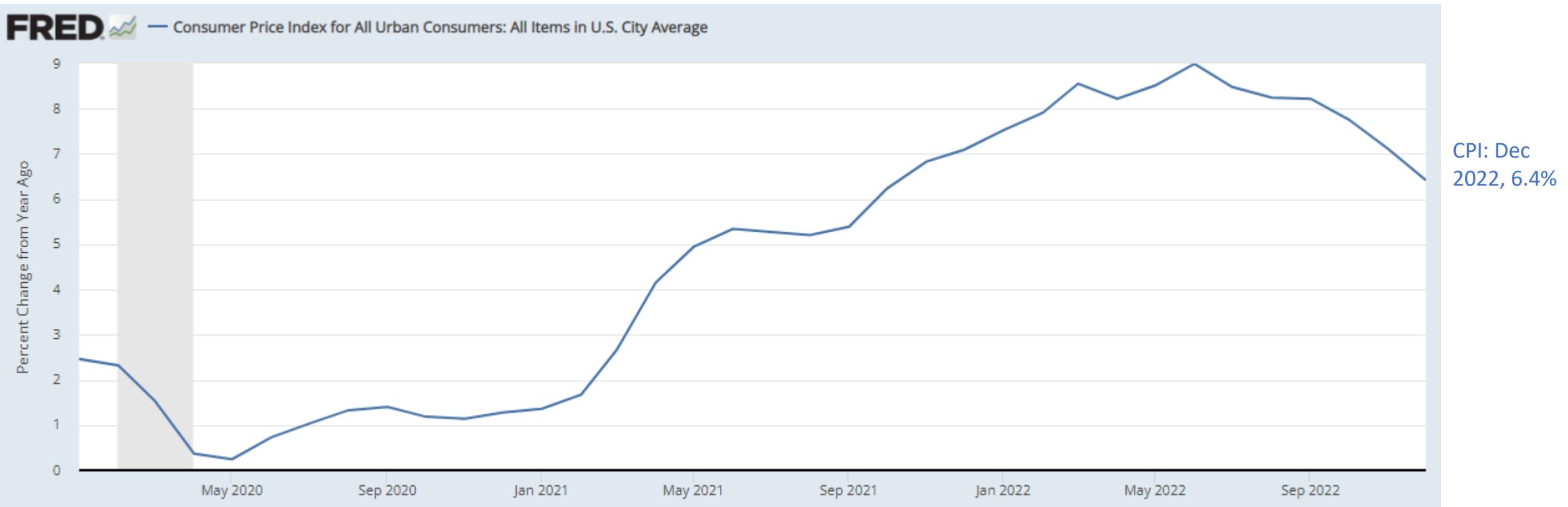
Inflation Measurement

- “Headline Inflation” Rate: Consumer Price Index (CPI)
- “Core” Inflation: CPI excluding food and energy
- Other measures that are important:
 - PPI: Producer Price Index and its sub-indices => seen as a leading indicator of CPI and consumer inflation.
- Most important measures for the Federal Reserve:
 - Personal Consumption Expenditures Price Index (PCE)
 - “Core” PCE – PCE excluding food and energy.
 - Most important measure to Federal Reserve – this is the “2% target” measure.
 - (Generally – the Fed will look at both PCE and core PCE depending on circumstances.)

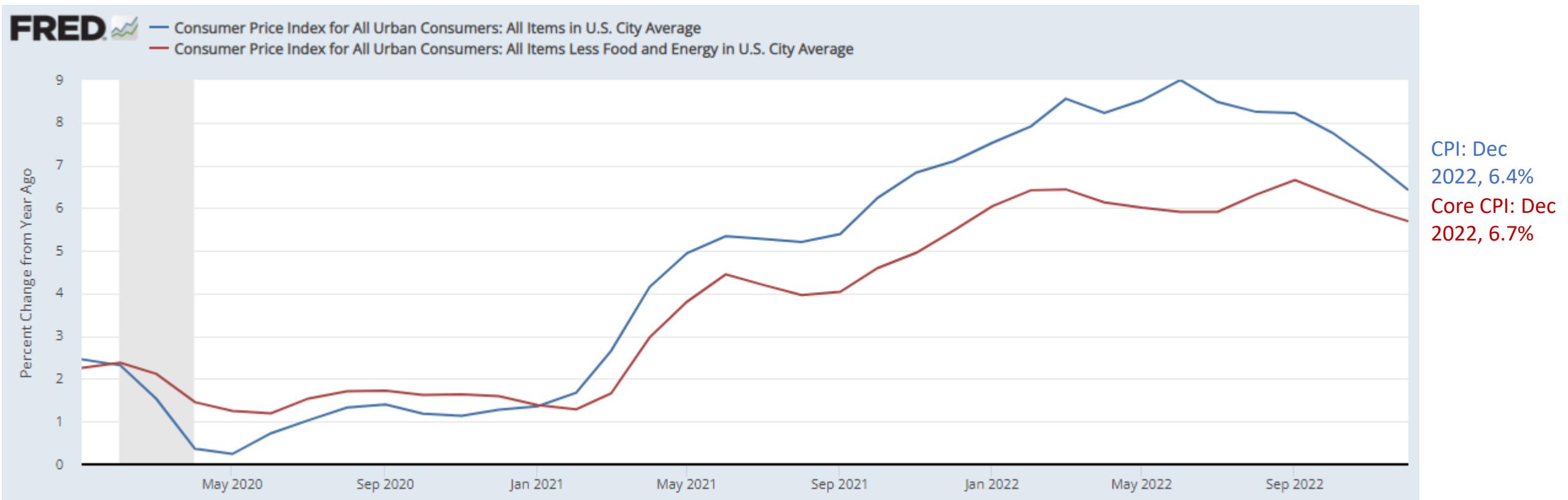
This is not the 1970s, but...



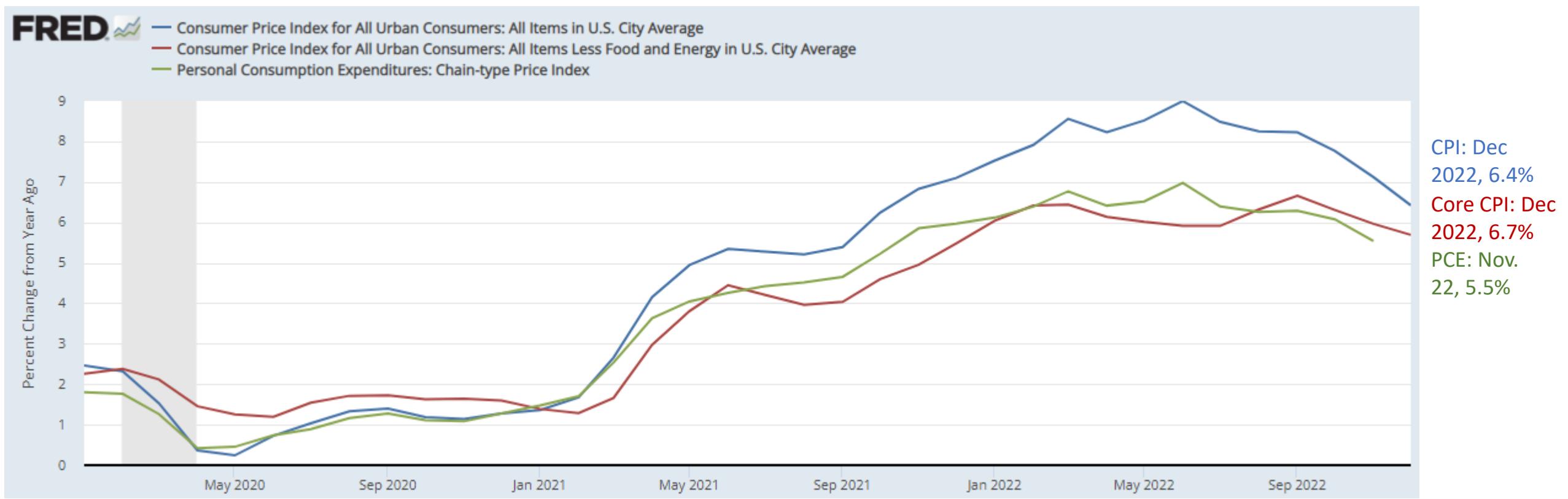
Inflation rates: Have we peaked?



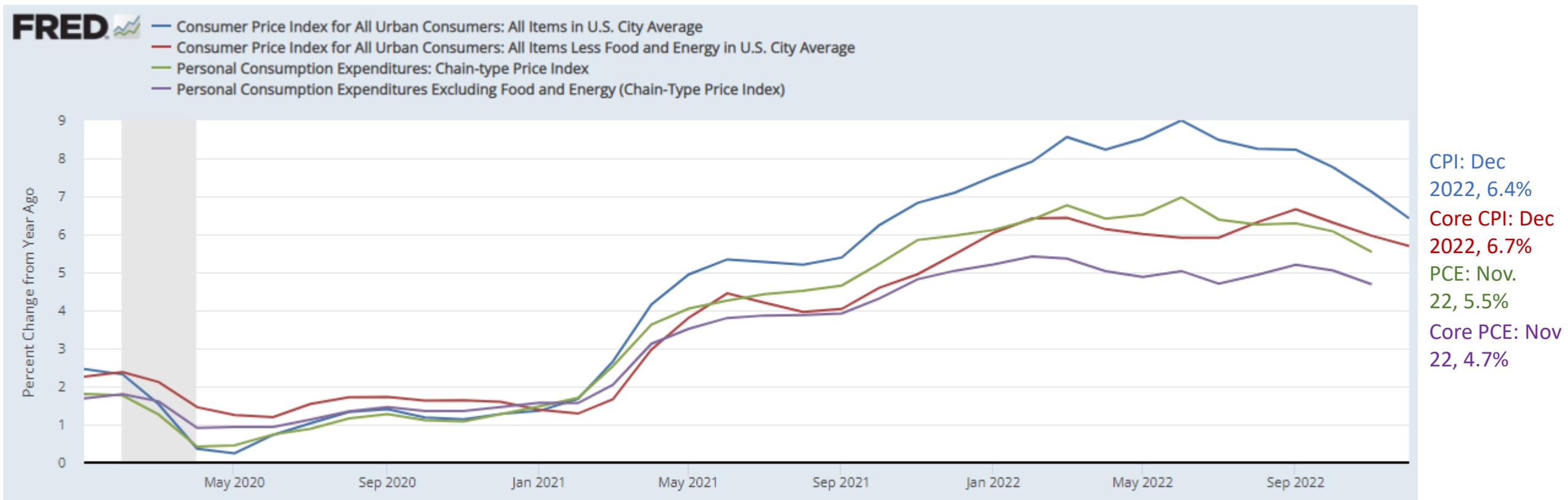
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So, has Inflation Peaked?

- Headline Numbers
 - Appear to have peaked.
 - CPI and PCE all-items indices have declined since June when CPI = 9.0%, PCE = 7.0%.
 - Input price inflation has declined significantly
- Worrisome changes though...
 - Core numbers flat or rising – CPI “core” hit highest point in 40 years last month.
 - PCE core declining only slowly (cannot rule out that it has not declined when consider noise in the data)
 - Inflation has moved from goods to services
 - Gasoline prices rising again, rents reflect increases from last year – very slow to adjust.
- **Have we peaked? Maybe, but inflation shows no sign of falling significantly yet**
=> Inflation has inertia – if this is a peak, picture a plateau (Casper Mountain versus the Grand Teton).

Sources of Inflation

Contributions to inflation

10 pct. pts.

8

Consumer-price index
12-month percentage change

6

4

2

0

-2

2019

'20

'21

'22

Core

Food

Energy

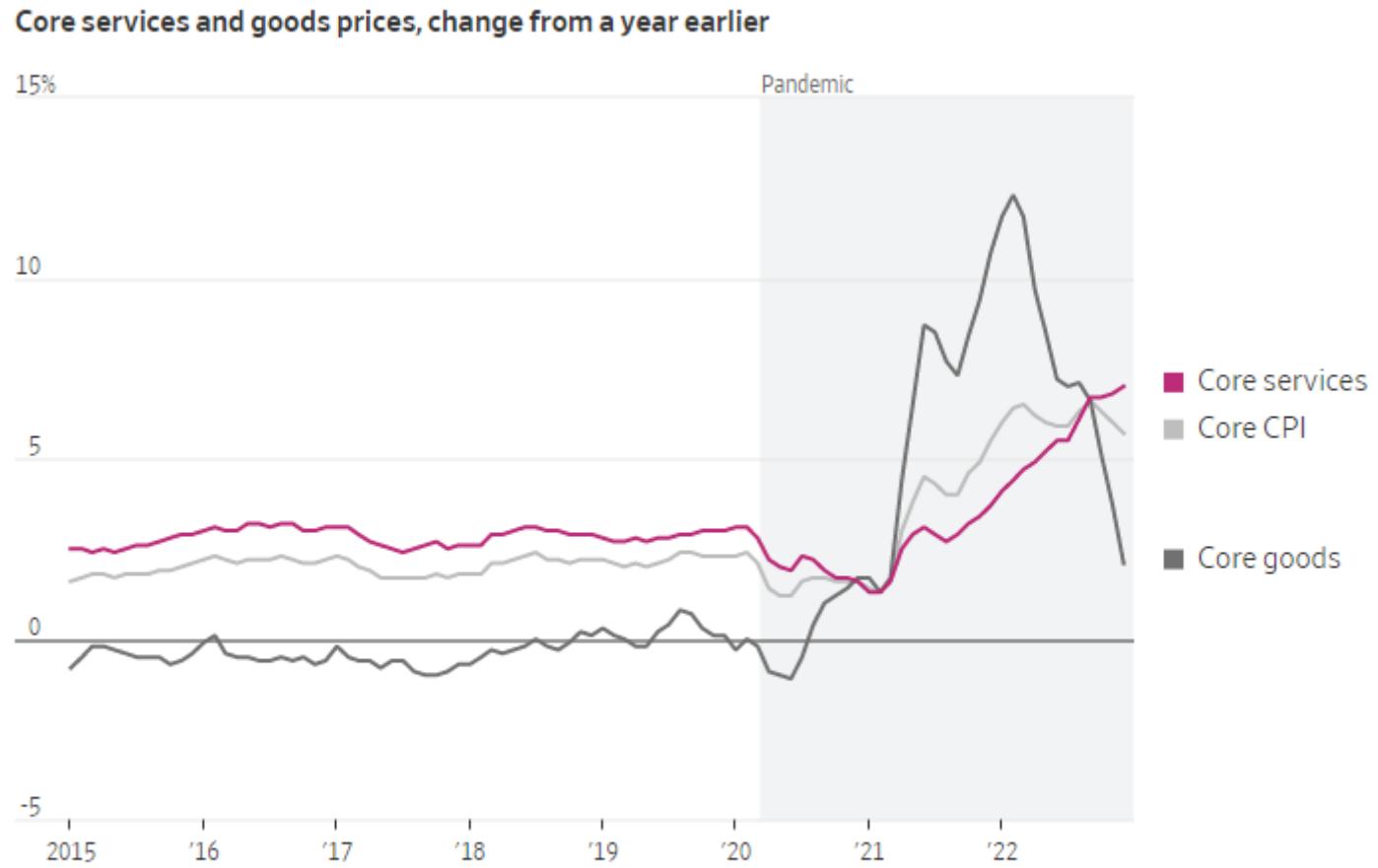
Note: Percentage-point contributions to 12-month percentage changes in the consumer-price index, monthly.

Source: Labor Department

Andrew Barnett/THE WALL STREET JOURNAL

Source: [Wall Street Journal](#), Jan. 12, 2023

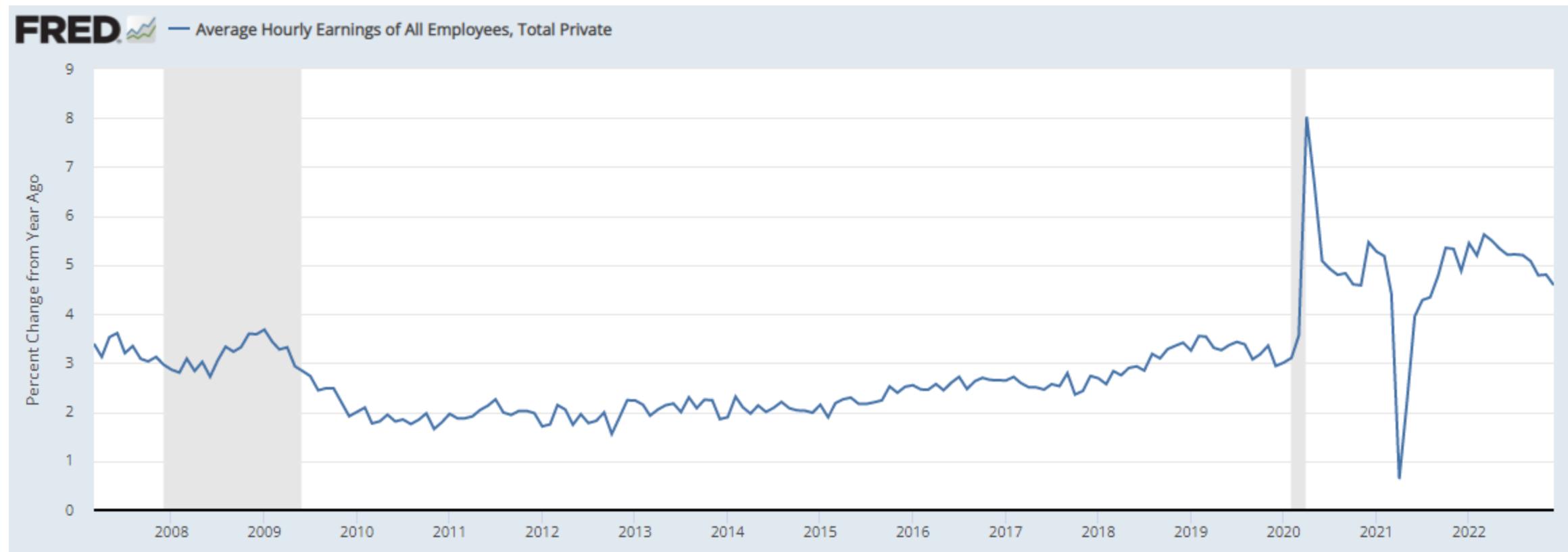
Sources of Inflation



Note: Core CPI refers to consumer-price index less food and energy. Core services refers to services less energy services. Core goods excludes food and energy items.

Source: Labor Department

Wage Growth Rate



Source: Federal Reserve Economic Data (FRED)

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Wage Growth Rate



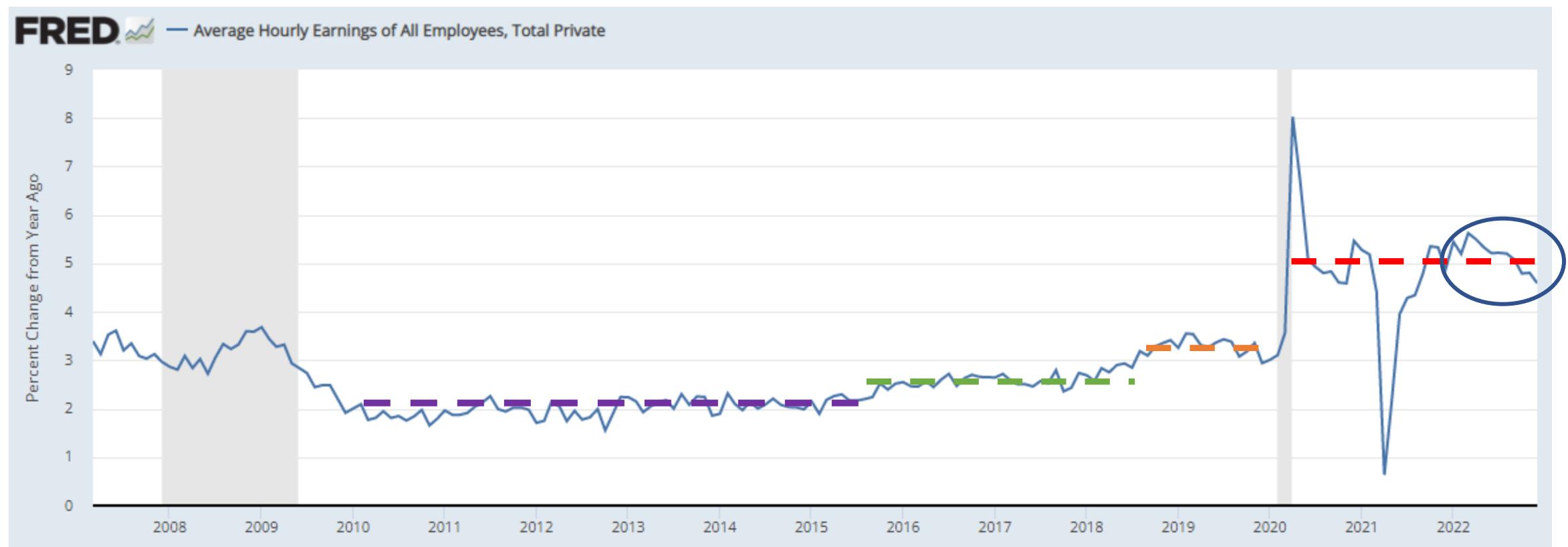
Source: Federal Reserve Economic Data (FRED)

Wage Growth Rate

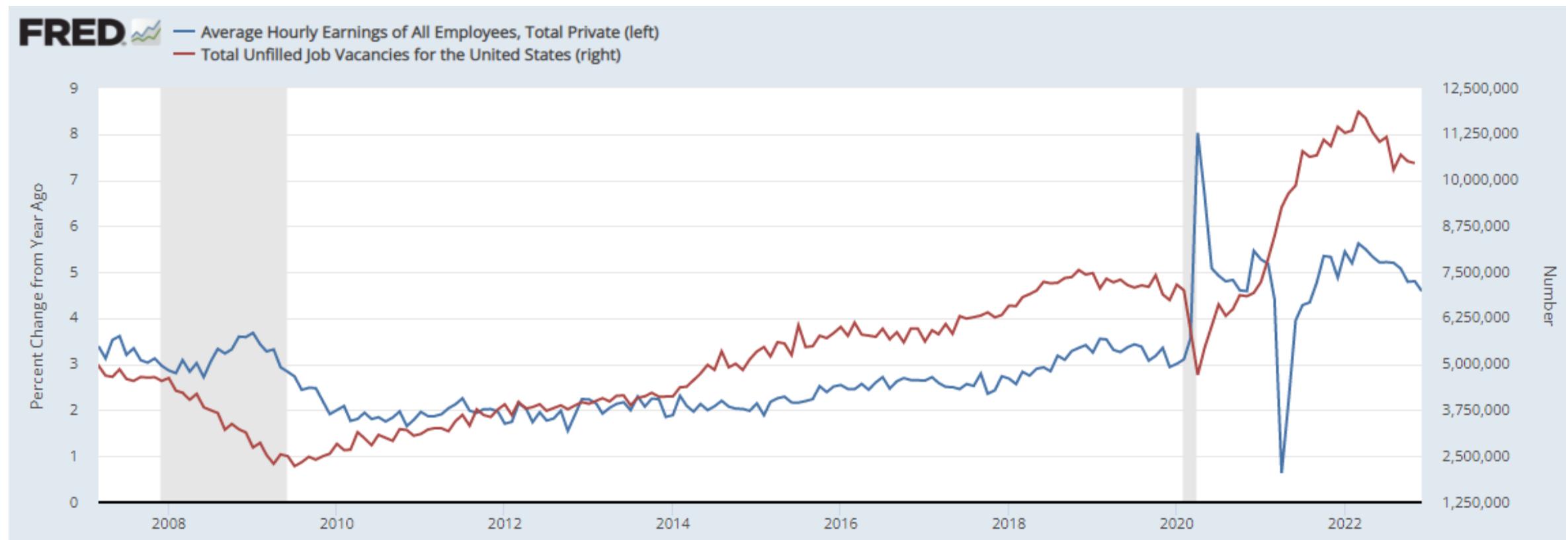


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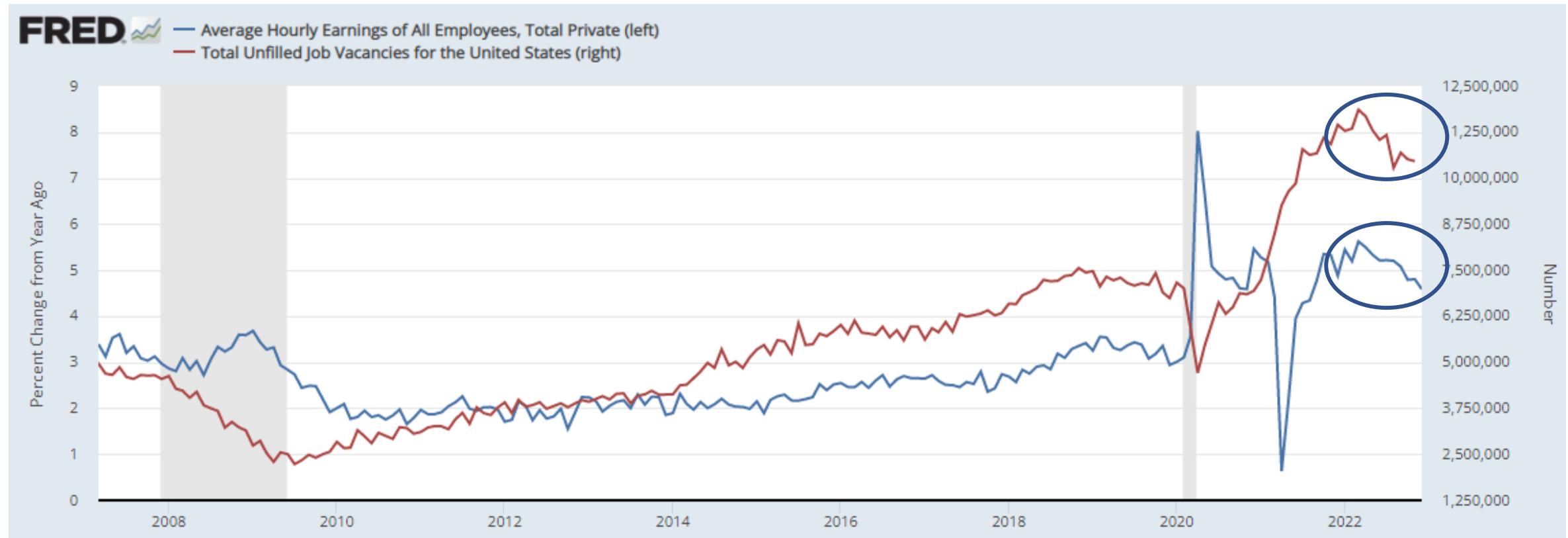
Wage Growth Rate



Wage growth rate (blue) vs. Unfilled Jobs (red)

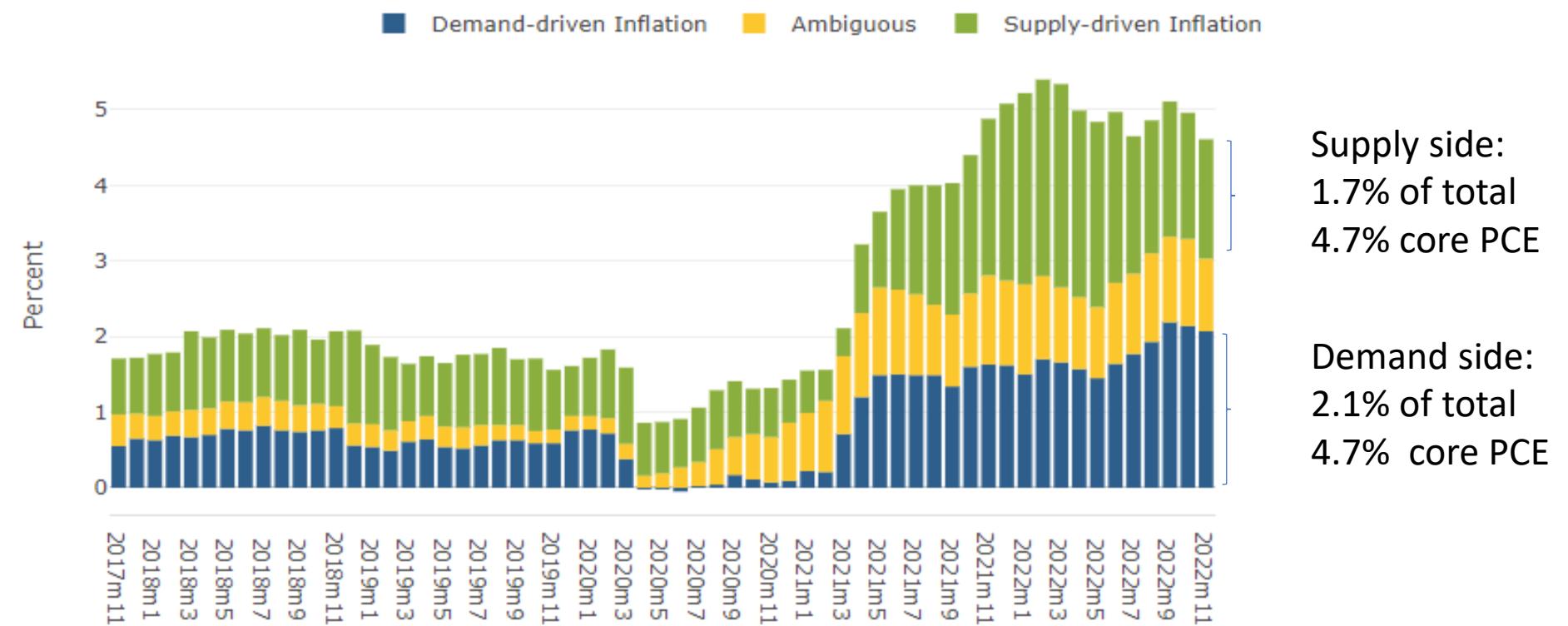


Wage growth rate (blue) vs. Unfilled Jobs (red)



Demand and Supply-side Contributions to Core PCE Inflation

Figure 4: Supply- and Demand-Driven Contributions to Year-over-Year Core PCE Inflation



Drivers of Inflation since Pandemic Recovery began

- Demand side:
 - Relief actions during/Stimulus actions after pandemic
 - Low interest rates
 - Consumers' expenditure shift from services to goods
- Supply side:
 - Labor market tightness (short-staffed industries and skills mismatch) => wage increases
 - Decline in labor participation rate/"Great Resignation"
 - COVID outbreaks
 - On-going shutdowns in China
 - Variant impacts on US economy labor, and service provision
 - Logistics and supply chain issues
 - Includes shortages of critical materials like semiconductors.
 - War in Ukraine/International shocks

Done

Definitely Gone!

Reversing back to normal

Loosening?

May turn into a demand-side effect

Diminishing to gone

???????



Federal Reserve Actions to date



Note: Fed Funds Rate target is a 0.25% band – the upper limit of the band is shown, and lower limit is 0.25% less

Federal Reserve Impact: Mortgage Rates



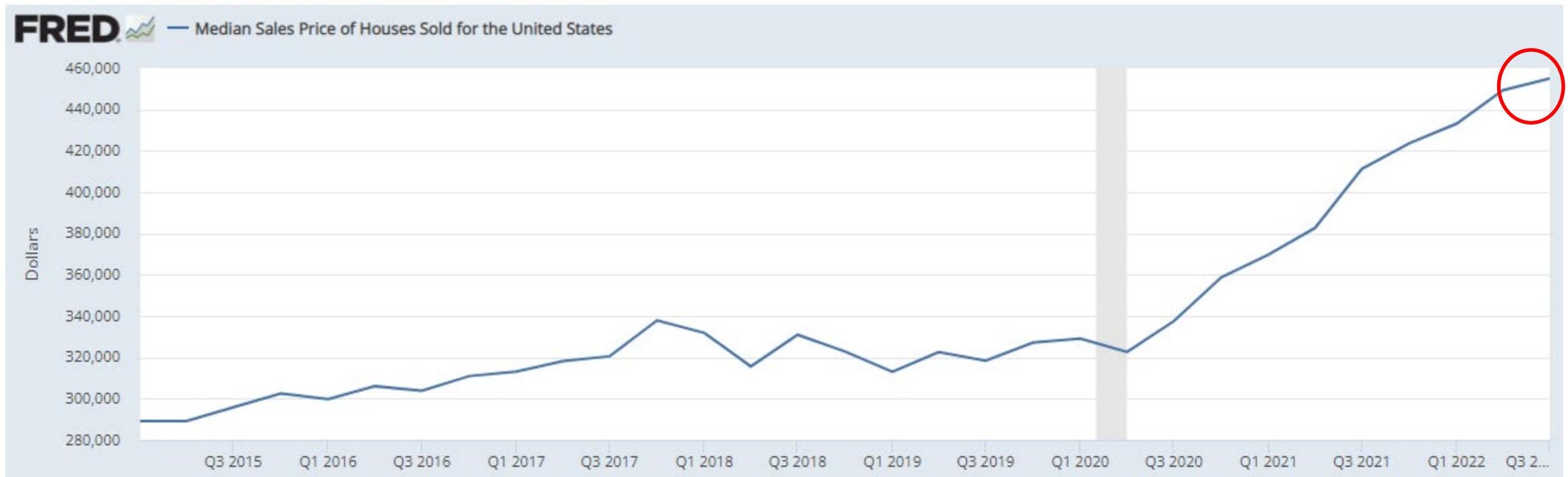
Mortgage rates now at highest point since early 2000s.

Federal Reserve Impact: Home Sales



Home sales have declined about 40% since post-pandemic high as mortgage rates increase.

Federal Reserve Impact: Home Prices



Home price increases appear to be flattening (on much lower volume of sales).

Can the Fed stick a soft landing? How hard will the landing be?

- GDP growth negative two consecutive quarters – then rose to a healthy 3.2%
 - Housing slowdown significant.
 - Other measures indicate slowing in the economy
- Labor market still very strong – possible “jobful recession”?
 - Might unemployment rise because people come back to the job market?
- Consumers have savings and seem to be continuing to spend.
 - Consumer confidence appears to be improving (from a record low)

Fed Policy - Has Inflation Peaked?

- Federal Reserve interest rate policy will depend on this question, and rates will continue until
 - Rates of inflation are clearly declining.
 - Consecutive months of decline
 - Inflation rates are significantly below peak.
 - Willing to induce a recession to slow wage growth to levels consistent with 2% target.
 - “Monetary policy occurs with a long and variable lag”
 - Has the Fed tightened too much too soon?
- Tradeoffs to easing:
 - Concern is expectations of inflation driving inflation (wage-price spiral)
 - Contraction/recession can quash such expectations (lesson of the early 1980s)
 - Fear easing may allow expectations of inflation to persist
 - Market optimism is actually undermining Fed efforts to slow the economy.

Markets betting Fed will soften approach

- Markets
 - Assume inflation has peaked.
 - Current market “expectation” of inflation by end of 2023: 2.7%
 - Fed projects 3 – 4% inflation by end of 2024 and rates must stay high for entire year
 - Assume Fed will not induce a recession that causes significant employment reduction
=> will back off rate increases earlier than expected.

=> Markets will be very volatile through early next year.

- Fed resolve to maintain/increase rates likely to persist despite market hopes.
- Cycles of optimism/pessimism

If market hopes occur (Fed eases) expect significant stock market recovery.*

*assuming no other major change in world – e.g., significant escalation in Ukraine, energy prices, etc.

Fed Actions and Impacts

- Economy appears to be slowing significantly.
 - Though with continuing strength in unemployment levels and low layoffs
- **THIS IS EXACTLY WHAT THE FED WANTS!!**
- Rates will increase and remain high until Fed certain inflation threat is gone.
 - Fed will watch the labor market very carefully.
 - Services inflation rates will be key
 - Current wage increases not compatible with Fed's long-term 2% inflation target.
 - But may be declining
- Predictions...
 - Next Fed Rate meeting (next week) – rates increased an additional 0.25-0.5%
 - Markets betting on 0.25%

⇒ Fed expected rates to rise above 5% in 2023, but has this softened?

⇒ What happens after depends on inflation, wage and growth data*

* What breaks in the meantime may also matter.

Thank You!

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