U.S. Price Pressures Percolate With Surging Sales, Input Costs

February 19, 2021

by Reade Pickert, Olivia Rockeman

The U.S. economy is starting to display pockets of price pressures, further stoking the debate among economists and market participants over the future path of inflation.

Among reports Wednesday, retail sales powered ahead with the strongest advance in seven months, topping all estimates and indicating hearty consumer demand at the start of the year.

Meanwhile, a measure of producer prices surged last month by the most in records dating back to 2009, while a private survey of homebuilders showed growing concern about soaring costs of building materials after a robust year for home sales.

While inflation gauges are expected to pick up steam this year, most notably in the second quarter, many economists -- including those at the Federal Reserve -- anticipate that annual price gains exceeding the central bank's 2% target will prove temporary amid still-high unemployment.

Yet recent economic data and expectations of a potential $1.9 trillion in additional fiscal stimulus present upside risks to inflation expectations.

For instance, the health-care services component of the producer-price index, which feeds directly into the core personal consumption expenditures price index tracked by the Fed, surged in January. That introduces "upside risks to the Fed's current forecast for core inflation," said Brett Ryan, senior U.S. economist at Deutsche Bank AG.

If sustained, the Fed may reach its inflation goal sooner than anticipated, "potentially bringing forward the timing of tightening," he said.

The Labor Department's PPI report also showed the cost of lumber and other construction materials were up 10.4% from January of last year, the most in records. Softwood lumber alone has surged 73%. Price pressures have also developed within manufacturing, where materials costs rose in January by the most since 2018.

On Capitol Hill, Democrats are pressing forward on President Joe Biden's $1.9 trillion relief plan. Many Republicans say the package is too big, and even Lawrence Summers, who served as Treasury secretary under President Bill Clinton and as a senior economic adviser to Barack Obama, has cautioned a package of that size could spur an inflationary outbreak.

The impact of the relief package passed in December was evident in the 5.3% jump in retail sales, as $600 stimulus payments lined the pockets of consumers. Many Americans, however, are saving rather than spending the latest relief checks, potential tinder for a resurgence in demand later this year for services that have been particularly hard hit by the pandemic.

But Fed Chair Jerome Powell has pushed back against the idea that the economy may overheat with additional stimulus, noting in a recent speech that it could take "many years" to overcome scars from long-term unemployment. Even when the jobless rate was at 3.5% a year ago, signs of inflation were scarce.

Should inflation remain broadly tame, widespread vaccinations should allow for a pickup in activities such as travel and help stabilize prices for hotel stays and airfares. The degree to which pent-up demand may drive inflation metrics higher is unclear.

For their part, Fed officials at the January policy meeting "stressed the importance of distinguishing between such one-time changes in relative prices and changes in the underlying trend for inflation," according to minutes released Wednesday. Such moves "could temporarily raise measured inflation but would be unlikely to have a lasting effect."

So-called base effects will influence annual changes in inflation. For several months beginning in March, the price indexes

will be compared with the same periods a year ago when inflation slowed considerably as the nation shut down to try to contain the coronavirus.

Boston Fed President Eric Rosengren said Wednesday he wouldn't be surprised to see higher inflation prints in the near term -- with some prices moving up and statistical comparisons to the low inflation figures last year -- but he also doesn't expect to see sustained 2% inflation for the next two years as long as unemployment remains high.

But Kansas City Fed President Esther George said earlier this week that price pressures could build as people return to work. Whether there is "broad-based, persistent pressure on prices that requires the Federal Reserve" to change its policy stance will be "among the core of our deliberations over the coming years," she said.

