## IS INFLATION BACK?

**With GDP growth of nearly 7% this year, the US economy is in the midst of a spectacular but uneven recovery, erasing the losses generated by the pandemic, but also leaving numerous workers behind. Fuelled by rising commodity prices and surging consumption, inflation has reached a peak of 5%, the highest since 2008. Esteeming that this flare up will be short lived, the Federal Reserve (Fed) is being tolerant and will forego a preventative tightening of monetary policy. Its top priority is to see the recovery spread to all sectors of the economy and to restore full employment in the labour market.**

Inflation at 5% is something the United States has not seen in a long time. You have to look back to the summer of 2008 to find comparable pricing dynamics, when soaring oil prices sent Americans' energy bills skyrocketing (Brent crude oil peaked at over USD 140 a barrel). The arrival of the financial crisis quickly cut short this upsurge in prices. Thirteen years later, the emergence of inflation is again the centre of debate, especially whether or not it is likely to become entrenched.

### A TEMPORARY FLARE UP

Yet the current bout of pricing pressures is not only about oil. At 3.8% in May, core inflation, excluding energy and food prices, is also accelerating under pressure from strong demand. In 2020, households saved nearly USD 3,000 billion, double the amount in a normal year, and these partially forced savings are fuelling the appetite for consumption in 2021, especially for travel. Although transport equipment and services (automobiles, plane tickets, etc.) account for barely 15% of the core price index, they explain half of the increase in core inflation, which seems to be highly concentrated. Excluding these two items, inflation would have held within the Fed's 2% target.

At this stage, it is hard to conclude anything but that it was a circumstantial flare up, especially since there are no obvious second round effects in which all wages would respond to the shock and maintain prices rising. In certain sectors under pressure, like online retailing, hiring needs are of course accompanied by pay increases, which are also justified by surging productivity gains (see chart 2). Inversely, however, a good number of more traditional businesses that were disrupted by the digital revolution are feeling pressure to reduce staff size and costs (see below and chart 3). In the end, the aggregated indexes are not showing signs of overshooting. Although average hourly wage increases seemed to be accelerating for a moment, they were primarily due to a composition effect, since the Covid-19 pandemic mainly eliminated the lowest paid jobs. According to the employment cost index, which is available on a quarterly basis and does not show the same bias, wage growth remained stable and even slowed slightly (wages and salaries rose 2.7% year-on-year in Q1 2021, vs. 3.1% in Q1 2020).

### THE LABOUR MARKET HAS NOT FULLY RECOVERED YET

Considering that the upsurge in prices will be temporary, the Fed will forego a preventative tightening of monetary policy, a strategy that Fed chairman Jerome Powell reaffirmed during recent testimony before Congress[1]. Full employment is still the Fed's main objective, especially now that the Federal Open Market Committee (FOMC) is giving secondary importance to its inflation target (FOMC, 2020).

Although the labour market is regaining strength (2.4 million jobs have been created since the beginning of 2021), it is still convalescing.

GROWTH AND INFLATION (%)

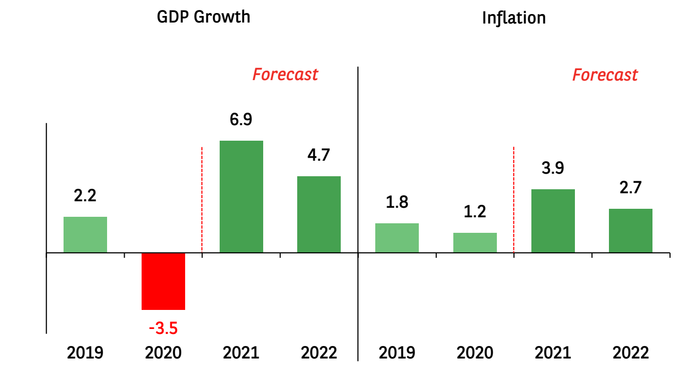


CHART 1 SOURCE: BNP PARIBAS GLOBAL MARKETS

PRODUCTIVITY IN ONLINE RETAILING*
(2019 = 100)

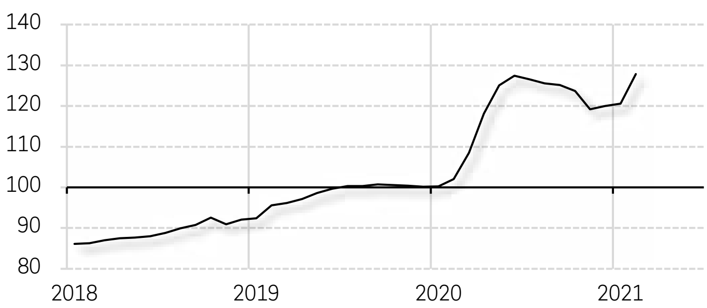


CHART 2 SOURCE: SAINT LOUIS FED, BLS

At 5.8% in May, the unemployment rate is high by American standards, and nearly 8 million jobs are still missing compared to the pre-pandemic situation. Moreover, job losses were also very unequally distributed (see chart 3). During the crisis, employment increased in certain sectors pertaining to the internet (online retailing, home delivery, storage, computer hardware production, technical expertise, etc.) and to residential construction, while other sectors continue to pay a heavy toll. Hotel and restaurant services, the leisure and entertainment industry, in-home care and services, and transport services and travel agencies continue to be very hard hit.

1 Powell J. H. (2021), *The Federal Reserve's Response to the Coronavirus Pandemic*, Testimony before the Congress select subcommittee on the Coronavirus crisis, June 22.

Another sign that the job market has not fully recovered yet is the labour force participation rate (workers and those actively seeking work as a share of the total population), which is still much lower than pre-crisis levels, even within the working age population (20 to 64 age group). About 3 million individuals have left the labour market, which can be attributed to several factors. Certain categories of workers (extras earning tips, the self-employed, seasonal workers, etc.) who were unable to work during the crisis have had more trouble than others justifying revenues that make them eligible for unemployment benefits (eligibility requirements differ from one state to the next). With the closing of schools and day care centres, many single mothers with children had no choice but to halt or postpone their job searches. Exclusion from the labour market may also have been accentuated by the digital divide and trouble accessing the internet.

It is not really surprising that low-skilled, low paid social categories were hit hardest. According to the Bureau of Labor Statistics (BLS), people with few or no diplomas (high school education or less) only account for 30% of the active population, but explain 80% of the post-Covid collapse. Even as the health crisis is widening inequalities, the Biden administration is having a hard time passing its reform measures. Without an agreement on its financing, the American Jobs Plan is proving to be much less ambitious than the initial version (see box). The American Families Plan calls for investing USD 1.8 trillion in improving education and health conditions for low-income families, but its only chance of passing depends on using the so-called fiscal reconciliation procedure for the second time this fiscal year (ending 30 September), in which case the government would only need to obtain a simple majority of 50 votes in the Senate.

Completed on 28 June 2021

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## A LESS AMBITIOUS INFRASTRUCTURE PLAN

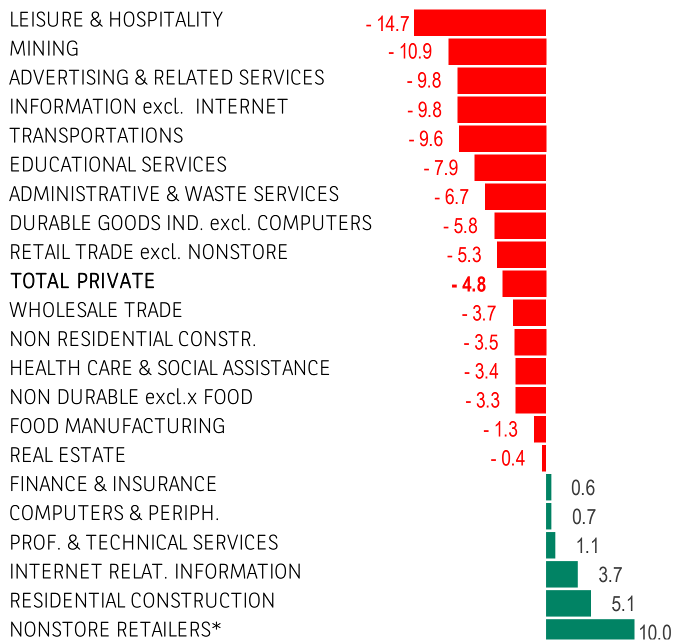
The initial version of the American Jobs Plan (AJP) dated March 2021 called for investing USD 2.3 trillion in infrastructure over an 8-year period, but this figure has been constantly revised downwards ever since. President Biden managed to reach a bipartisan agreement in the Senate that would slash the AJP to a more moderate sum of USD 1.2 trillion (again over 8 years).

The biggest source of contention was the financing segment, which initially called for raising the corporate tax rate from 21% to 28%, and is now set to be covered by unused resources from the American Rescue Plan approved last March. The Committee for a Responsible Federal Budget (CRFB) currently estimates these funds at USD 876 billion (out of a total budget of USD 1.9 trillion), although there will obviously be less in the future when the AJP is rolled out.

Specifically, the bipartisan agreement calls for devoting USD 579 billion to new spending, and the remaining USD 325 bn to existing programmes. As in the initial version, a substantial share of the budget (USD 312 billion) goes to transport equipment, especially land-based equipment. The other major programme consists of renovating the telecommunications, water and power networks. In a major concession by the Biden administration to reach a bipartisan agreement, the new plan no longer covers efforts to improve housing, renovate public facilities, schools, housing, energy tax credits, etc. or to improve access to healthcare, which amounted to nearly USD 1 trillion in the initial version of the AJP.

SOURCE: CRFB, PRESS

EMPLOYMENT TRENDS BY SECTOR
%, FROM JANUARY 2020 TO MAY 2021




(*) inc. storage & shipment

CHART 3

SOURCE: BLS