Economic Monthly [US]

Despite strong growth of prices and wages, the Fed's "dovish" stance remains unchanged

SAI YABUKI
ECONOMIC RESEARCH OFFICE

MUFG Bank, Ltd.
A member of MUFG, a global financial group

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Opinions were divided at the Federal Open Market Committee over the risks associated with inflation. In the Minutes for the June meeting, which were published on 7th July, several participants said that "downside risks to inflation remained" and pointed to the possibility that "temporary price pressures might unwind faster than currently anticipated". Meanwhile, several participants expressed concern that "longer-term inflation expectations might rise to inappropriate levels if elevated inflation readings persisted."

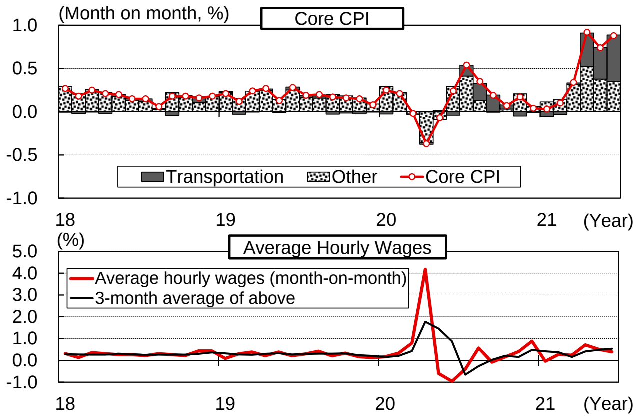
Both the growth of prices and wages remain at high levels. The Consumer Price Index (CPI) for June, which was announced on 13th July, accelerated to 0.9% month-on-month on a core basis (Chart 1, upper), and growth is still being driven by used cars ("transportation"). In addition, labour statistics for June show average hourly wages for private employees rose 0.4% from the previous month and exceed the average pace in 2018 and 2019 (Chart 1, lower).

That being said, there appear to be signs that the used-car market is starting to cool. Wholesale prices, which tend to precede CPI for used cars, has fallen for the last two months (Chart 2, upper), and the upward pressure from demand due to government cash payments during March and April has subsided. In the future, it appears that the tightening of the balance between supply and demand will also start to ease. Furthermore, in industries where wages are relatively low and working from home is difficult, such as "retail" and "leisure and hospitality", there has been a marked rise in wages (Chart 2, lower). This suggests the labour market is tightening due to labour supply constraints on the back of increased unemployment benefits, concerns about the spread of COVID-19 and the need to care for children due to school closures. However, increased unemployment benefits will have ended by autumn and a further uptake of vaccinations thanks to a government incentive* and the reopening of schools are likely to lead to a recovery of the labour supply in these industries and slower growth of wages.

The strong growth of prices and wages are due to the effects of temporary factors and although there are some who have expressed concern about the upside risks to inflation, "dovish" participants at the FOMC meeting, including Chair Powell, instead emphasised the downside risks to inflation. It is likely that the next step to monetary policy normalisation will be a cautious one.

*On 29th July, President Biden called on state and local governments to offer a financial incentive of USD 100 to people who are newly vaccinated against COVID-19.

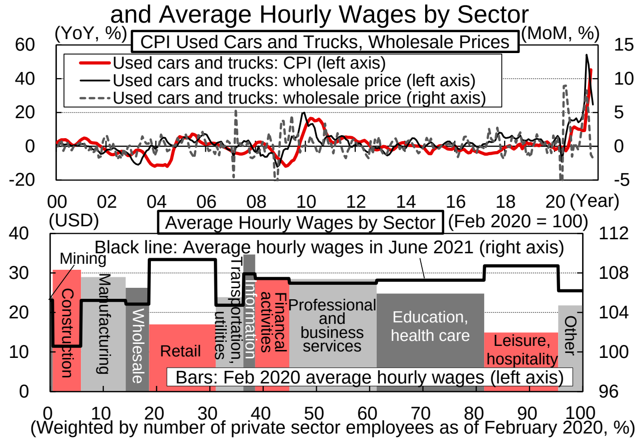
Chart 1: Core CPI, Average Hourly Wages



Note: Average Hourly Wages refers to wages of production and non-supervisory employees

Source: US Department of Labor, MUFG Bank Economic Research Office

Chart 2: Used Cars and Trucks: CPI & Wholesale Prices, and Average Hourly Wages by Sector



Source: US Department of Labor, Cox Automotive, MUFG Bank Economic Research Office

Translation by Elizabeth Foster

For further details, please contact the Economic Research Office, MUFG Bank

Managing Director, Rei Tsuruta Tel: +81-(0)3-3240-3204

Written by Sai Yabuki <sai_yabuki@mufg.jp>