Inflation fears grow for White House

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Rising prices are putting increasing pressure on President Biden and the Federal Reserve to prevent inflation from derailing the recovery from the coronavirus recession.

A surge of consumer demand unleashed by government stimulus, improving vaccinations and fewer pandemic restrictions is putting a strain on global supply chains. Manufacturers and other hard-hit industries are struggling to get back up and running after a year of lockdown measures, causing supply shortages and raising costs.

All of those factors combined to push the consumer price index (CPI) up 0.8 percent in April and 4.2 percent over the past 12 months, the fastest annual rate since 2008, the Labor Department reported this past week. When stripping out the more volatile prices for food and energy, the index registered the biggest monthly increase since 1982.

While the ramped-up consumer spending is a sign of increased optimism, the Biden administration faces political risks as Americans find themselves dealing with inflation levels that the country hasn't seen in more than a decade.

Deepening concern among Americans about inflation could derail not only Biden's economic agenda but also the Democrats' hopes of defending narrow congressional majorities in the 2022 midterm elections.

"Now people are spending again, and obviously April's numbers show that they're spending even more aggressively than forecasters, most of them, anticipated," said George Selgin, an economic policy expert at the libertarian Cato Institute.

"There are some adverse supply shocks going on, some of which affected the April numbers, but the big story is the pent-up demand and purchasing power that people have finally started to dispose of," he added.

Inflation had been widely expected to rise as the U.S. rebounded from the coronavirus recession following a plunge in consumer spending. But the unexpectedly sharp increases in prices have spurred more criticism from Republican lawmakers who have for months questioned the White House and Fed's handle on inflation.

"There's never been a time that I know of in history where you have had a significant increase in money supply where you don't have inflation," said Sen. Rick Scott (R-Fla.) in an interview with The Hill.

White House and Fed officials say that with the U.S. still down roughly 9 million jobs from the onset of the pandemic, the economy is in no danger of overheating. Instead, they argue that the country cannot afford to let up support and risk another sluggish recovery like the multiyear climb out of the 2007-09 recession.

Biden and Democratic lawmakers are attempting to pass trillions in infrastructure spending after enacting a $1.9 trillion COVID-19 relief bill in March. Though GOP lawmakers are open to a deal on core aspects of infrastructure such as roads, bridges and waterways, they've dug in against Biden's broader agenda and insist it will spur inflation even higher.

"You have to stop the reckless spending," Scott said. "The federal government's got to start living within its means."

Adding to the concerns of inflation hawks is the Fed's all but explicit refusal to raise interest rates before 2022 at the earliest.

Many economists have dismissed those concerns and share the Fed's view that after a few months of high inflation readings, price increases will settle down as the economy settles into a more normal recovery pace.

"We've only seen really two months of strong price increases," said Laura Rosner-Warburton, senior economist at research consultancy MacroPolicy Perspectives.

"It would be premature and kind of an overreaction to look at the [April CPI report] in particular and to be overly concerned," she added.

Rosner-Warburton said April's price jump was driven by three short-term factors: the statistical quirks of a sharp increase coming a year after a deep decline, temporary pandemic-related supply constraints and the release of pent-up demand.

"Last year, we had outright declines in prices, and this year, we're not seeing those declines repeat. So on a year-over-year basis, comparing it looks like inflation is artificially higher because of the decline last year," she said.

Increases in prices for shelter, airfares, recreation, motor vehicle insurance, and household goods and services — which all fell sharply last year — were also major drivers of April's price increases.

While some prices rebounding toward normal levels pushed inflation higher, supply shortages for other products had an even greater effect. Roughly a third of the CPI surge last month came from a 10 percent increase in the price of used cars and trucks alone.

The normal flow of used cars into circulation has been slowed by semiconductor shortages delaying the manufacturing of new autos, Rosner-Warburton said, curtailing overall supply. Demand has also soared as rental car companies that liquidated their fleets during the onset of COVID-19 rush to catch up to Americans looking to hit the road now that more states are lifting coronavirus restrictions.

“Eventually supply should rise to meet this demand, and demand will probably cool off as well as we have the fading effects of the fiscal stimulus. So this bottleneck should not be something persistent,” she said.

Even so, the uncertainty over how much higher inflation will go and for how long has serious potential implications for both Biden and Federal Reserve Chairman Jerome Powell.

The Fed is also trying to sell financial markets on its recently adopted shift in approach to inflation, which calls for allowing price increases to run above the central bank’s target long enough to compensate for decades of shortfalls.

Inflation has run below the Fed’s 2 percent annual target for more than a decade, hindering wage growth and the central bank’s ability to raise interest rates. To flip this trend, Powell and Fed officials say they will not raise interest rates until inflation is on track to compensate for shortfalls and the U.S. reaches maximum employment, something they don’t expect until 2022.

“All of these reasons make this a difficult time for the Fed to start raising interest rates, and that means we have to worry whether it will do so when it needs to do so aggressively enough to meet its targets,” Selgin said.