Get Ready for the Great U.S. Inflation Mirage of 2021
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The story of U.S. inflation in 2021 could very well amount to this: It’s all a mirage.

Americans are likely to see prices jump across a variety of sectors next year, thanks in part to Covid-19 vaccines that will potentially turbocharge demand for such pandemic casualties as travel and tickets to sporting events.

With prices also climbing for some inputs such as copper and lumber, inflation could very well reach or surpass the Federal Reserve’s 2% target in some months. Financial markets are increasingly pricing in higher inflation in coming years, and debates over whether the central bank should start easing back its record monetary stimulus may intensify.

But one critical ingredient will be missing to sustain higher inflation: a tight labor market.

Many economists discount the odds of a longer-lasting acceleration and note that even if inflation metrics look like they’re rising in coming months, it’s partly a reflection of math. Unemployment is expected to remain elevated throughout the year, and a resurgence in demand for services could be offset by softness in rents and some goods such as used autos.

“We think inflation is going to be muted because unemployment will still be high,” said Michael Feroli, chief U.S. economist at JPMorgan Chase & Co. “There will still be slack in the labor market, which would keep some pressure on wages.”

On Thursday, the Labor Department will issue its consumer price index for November. The median forecast of economists surveyed by Bloomberg calls for a subdued 1.1% year-over-year increase.

Forecasters surveyed by Bloomberg generally expect inflation to temporarily rise above 2% in the second quarter of 2021 before settling back at or slightly below that level.

What Bloomberg’s Economists Say...

“2021 will be a year plagued by numerous unwarranted inflation scares. Consumer inflation will remain weak over the medium term -- until the economy fully absorbs the slack resulting from the pandemic.”

-- Carl Riccadonna and Yelena Shulyatyeva, economists

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Investors are betting more and more, though, that inflation won’t stay so muted.

The 10-year breakeven rate -- a market-based measure of average inflation rates over the next decade -- on Friday reached 1.91%, its highest since May 2019. That key gauge, garnered from inflation-protected securities and standard Treasuries, has surged since touching an 11-year low of 0.47% in March.

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This year’s sluggish spending on services will probably give way to a resurgence throughout 2021 as the nation gets vaccinated. That means Americans will be more at ease partaking in activities such as trips to Disney World, attending Major League Baseball games and enjoying indoor dining at their favorite restaurant -- developments that may give service providers the wherewithal to raise prices.
Services make up about 60% of the overall consumer price index and 75% of the core measure, which excludes food and energy.

In a Bloomberg Opinion piece last week, former New York Fed President Bill Dudley wrote that a rebound in spending on services suggests “sharp price increases might even be needed to balance demand with the available supply, which the pandemic has undoubtedly diminished.”

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One issue in the pipeline: so-called base effects will lead to higher inflation. Price indexes early next year will be compared with the sharp retreats experienced in March and April, which may push inflation to, or above, the Fed’s 2% goal.

Gauges of input prices and costs paid by businesses are also perking up as of late, though factories still have plenty of slack in capacity.

Fed officials are seen taking next year’s data in stride. The Fed goal is based on the Commerce Department’s personal consumption expenditures price index, which tends to rise slightly more slowly than CPI on average. Central bankers adopted a new policy framework in August and signaled a willingness to allow PCE inflation to exceed their target for some time.

“In 2019 we had a really perfect storm for higher inflation,” with low unemployment, goods tariffs and a weaker dollar from prior years, said Matthew Luzzetti, chief U.S. economist at Deutsche Bank AG. “And that really only got us not even back to the Fed’s core inflation objective, so achieving above-target inflation is a really difficult thing for the Fed.”

At 6.7% in November, the jobless rate is almost twice as high as it was in the closing months of 2019, when it stood at a five-decade low of 3.5%. Yet worker compensation costs decelerated then.

Another sector that may see higher inflation is medical care, as providers try to recoup some of the revenue lost during the pandemic, said Sarah House, senior economist at Wells Fargo & Co.

Still, the number of apartment vacancies, as well as renters' lingering financial difficulties, will restrain rents, House said.

Another factor is that “inflation expectations remain well within their historic range,” House said.

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