



## MORNING BRIEFING

November 22, 2021

### The Genie Is Out of the Bottle

Check out the accompanying [chart collection](#).

(1) Inflation is turning out to be both pesky and persistent. (2) Powell's latest pivot. (3) Blaming supply-chain disruptions for inflation rather than excessively stimulative fiscal and monetary policies. (4) FOMC consensus expects inflation to drop close to 2% next year. (5) We expect FOMC will raise inflation target from 2% to 3% next year. (6) Inflation blast from the past: COLAs are back already. (7) Regional price indexes remain inflated. (8) Are inflationary expectations really "well anchored" at 2%? (9) Average inflation targeting is a bad idea. (10) Movie review: "Dopesick" (+ + +).

**YRI Monday Webinar.** This week, join Dr. Ed's pre-recorded webinar [here](#). (Sign in with your Zoom credentials.) Replays are available [here](#).

**Inflation I: Persistent & Pesky.** This year's surge in inflation is no longer considered transitory but persistent. During the spring and summer of this year, Fed officials, led by Fed Chair Jerome Powell, promoted the narrative that the higher inflation we'd begun to see was transitory because of the base effect. That's the phenomenon whereby some prices that had been depressed by last year's lockdowns and social-distancing restrictions rebounded sharply earlier this year as the economy reopened. Now they are settling down and no longer spiking overall inflation rates. But those rates are still elevated because prices have been heating up recently in other parts of the economy. In addition, wages are rising at a faster pace.

In my book [Fed Watching](#) (2020), I titled the chapter on the current Fed chair "Jerome Powell: The Pragmatic Pivoter." He proved true to form at his November 3 post-FOMC-meeting [press conference](#), pivoting again by acknowledging that inflation was turning out to be more persistent than he had expected.

Powell used the word "transitory" six times during the presser in reference to this year's surge in the inflation rate, but he undermined its import by saying that the word might not actually help to convey the Fed's message: "[I]t's become a word that's attracted a lot of attention that maybe is distracting from our message, which we want to be as clear as possible." He used forms of a word that's the antithesis of "transitory"—i.e., "persistent"—nearly twice as much, 11 times, when discussing the risk that inflation might not be so

transitory after all.

Powell attributed this risk to supply-chain disruptions: “We see shortages and bottlenecks persisting into next year, well into next year. We see higher inflation persisting, and we have to be in [a] position to address that risk ... should it create a threat of more persistent, longer-term inflation, and that’s what we think our policy is doing now. It’s putting us in a position to be able to address the range of plausible outcomes.” In effect, the Fed chair is telling us that higher inflation will remain persistent as long as supply-chain disruptions persist.

Looking at the causes of supply-chain disruptions provides no assurance that they’ll dissipate anytime soon. With US imports at a record high, a case can be made that the supply side of our economy has been overwhelmed by the demand shock fueled by excessively easy fiscal and monetary policies, particularly in the US ([Fig. 1](#)). This puts a large part of the blame for the acceleration of inflation on Washington’s policymakers—back where it belongs. Here’s an update of our thinking on inflation and some of the most recent inflation indicators:

(1) *Our inflation outlook.* We expect the headline PCED inflation rate to increase 4.5% this year and 3.5% next year. It was 4.4% y/y during September. We expect it will range between 4.0% and 5.0% through mid-2022. Then it should moderate to 3.0%-4.0% during the second half of next year ([Fig. 2](#)). As we’ve previously stated, we won’t be surprised if the FOMC decides to raise the Fed’s inflation target from 2.0% to 3.0% next year.

(2) *The FOMC’s forecast.* The FOMC’s latest [Summary of Economic Projections](#) (SAP), dated September 22, shows that the consensus inflation forecast of the committee’s participants for 2021 was 4.2% for the headline PCED. That’s up from 3.4% in June and 2.4% in March. Their significant miss for this year didn’t change their happy inflation outlook for 2022 (2.2%), 2023 (2.2), and 2024 (2.1).

Melissa and I can hardly wait for the December 15 release of the SAP. The latest headline PCED inflation reading for September was 4.4%. October’s headline CPI was up 6.2%. We expect that the next SAP will show a more persistent inflation problem going into next year.

(3) *Oh, Deere, COLAs are back!* On November 17, the United Auto Workers, said 10,000 members ratified a new six-year contract with Deere & Co., the giant manufacturer of farm and construction equipment, by a vote of 61% to 39%. They had rejected two previous offers.

The contract includes an \$8,500 restart bonus, an immediate 10% raise, two 5% raises, and two large bonuses through 2026. Total retirement benefits for an average worker will rise by \$270,000. Most important as an economic signal, wages will be adjusted each quarter based on inflation.

A November 18 *WSJ* [editorial](#) rightly warned that such cost-of-living adjustments (COLAs) “were a feature of the 1970s economy but faded as inflation was brought under control. The longer inflation stays high today, the more workers will demand COLAs, putting employers on the hook for long-term costs they can’t control. Once COLAs are embedded into labor contracts, they become hard to wring out. This is how you get a wage-price spiral and durable inflation.”

(4) *Regional price indexes remain inflated.* The latest pesky news on the inflation front are the prices-paid and prices-received indexes in three of the five regional business surveys available so far for November, conducted by the Federal Reserve Banks ([Fig. 3](#) and [Fig 4](#)). The indexes for the New York, Philadelphia, and Kansas City districts all remained near their recent record highs this month. Confirming that supply disruptions are an important source of inflationary pressures, the regional series on unfilled orders and delivery times remained elevated this month ([Fig. 5](#)).

(5) *Inflationary expectations rising.* In a November 8 [speech](#) titled “Flexible Average Inflation Targeting and Prospects for U.S. Monetary Policy,” Fed Vice Chair Richard Clarida stated: “Given this economic outlook and so long as inflation expectations remain well anchored at the 2 percent longer-run goal—which, based on the Fed staff’s common inflation expectations (CIE) index, I judge at present to be the case—a policy normalization path similar to the median SEP dot plot on page 4 of our September 2021 projections would, under these conditions, be entirely consistent, to me, with our new flexible average inflation targeting framework and the policy rate reaction function.” Translated from the Fed speak, that long sentence means he anticipates one or two rate hikes of 25bps each during the second half of next year.

But we have a problem with Clarida’s reasoning: A CIE showing inflation “well anchored” at 2.0% makes no sense. The CIE is an [experimental indicator](#) reflecting seven different surveys and inflationary expectations in the TIPS market. It does not include the monthly survey of inflation expectations conducted by the Federal Reserve Bank of New York, which shows the one-year-ahead expectation at 5.7% during October and the three-years-ahead expectation at 4.2% during the month ([Fig. 6](#)). Those expectations make more sense than

the CIE and certainly aren't well anchored anywhere near 2.0%!

Moreover, the 10-year expected inflation proxy implied by the spread between the nominal yield and the TIPS yield was 2.65% on Friday ([Fig. 7](#)). We aren't convinced that it is a useful indicator of market-based inflationary expectations, especially since the Fed is rigging the market by purchasing lots of TIPS for no good reason. The Fed currently owns over 20% of the inflation indexed notes and bonds issued by the US Treasury ([Fig. 8](#) and [Fig. 9](#)).

(6) *More Bidenflation coming.* And by the way, there's more fiscal stimulus coming from Biden's Build Back Better spending program on infrastructure. In addition, there could be even more spending on social programs if the social spending bill that passed the House on Friday makes it through the Senate.

**Inflation II: Have FAITH?** Melissa and I agree with Willem Buiter's November 14 *FT* [article](#) in which he critiques the Fed's adoption of "average inflation targeting" (AIT). In August 2020, the Fed committed to overshooting its 2.0% inflation target for the PCED to make up for having undershot it ever since the target was set in January 2012 ([Fig. 10](#) and [Fig. 11](#)). The Fed has been doing a great job of overshooting it so far this year!

Buiter concludes: "Why should unintended and mostly unavoidable inflation targeting failures in the past justify future deliberate failures? And the cost of adopting AIT could be serious: future periods of unnecessary, deliberate above-target inflation. It is time to get rid of this potentially costly nonsense."

In our book [The Fed and the Great Virus Crisis](#) (2021), we expanded "AIT" to "FAITH," or "flexible average inflation targeting hope." We concluded that the 2020 FAITH statement clearly gives more weight to maximizing employment than to keeping a 2.0% lid on inflation: "Under Fed Chair Powell, the Fed is likely to try to heat up the economy to overcome the GVC-induced hysteresis."

As noted above, we are forecasting that the Fed will "correct" for overshooting its inflation target this year by raising it from 2.0% to 3.0% next year!

(Willem Buiter is currently a visiting professor at Columbia. He was an external member of the Bank of England's Monetary Policy Committee from June 1997 to May 2000. In 2010, he joined Citigroup as chief economist. Our paths crossed at Yale University's graduate school. He completed his PhD in economics in 1975; I earned mine in 1976.)

**Movie.** “Dopesick” (+ + +) ([link](#)) is a sickening docudrama series on Hulu about how Purdue Pharma reformulated OxyContin and, starting in the late 1990s, marketed the opioid as a miracle drug to relieve pain without the risk of addiction. That turned out to be grossly false advertising, as millions of Americans became addicted to it and many died from overdoses. The company attributed the problem to illegal “drug diversion,” which was also grossly false and criminally negligent. However, while prosecutors eventually shut down this homegrown drug lord and imposed a huge fine on the company, no one from Purdue went to jail. The series strongly suggests that a key Federal Drug Administration official turned a blind eye and was rewarded with a cushy job at Purdue. “Regulatory capture” can be a deadly consequence of crony capitalism. The cast of the series, including Michael Keaton and Kaitlyn Dever, is outstanding.

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## Calendars

**US: Mon:** Existing Home Sales 6.20mu, Chicago Fed National Activity Index. **Tues:** M-PMI & NM-PMI Flash Estimates 59.0/59.1, Richmond Fed Manufacturing Index, API Weekly Crude Oil Inventories. (Bloomberg estimates)

**Global: Mon:** Eurozone Consumer Confidence -5.5, UK CBI Industrial Trends Orders 18, Buba Monthly Report. **Tues:** Germany GDP; Eurozone, Germany, and France C-PMI Flash Estimates 53.1/51.0/53.4; Eurozone, Germany, and France M-PMI Flash Estimates 57.2/56.7/52.8; Eurozone, Germany, and France NM-PMI Flash Estimates 53.6/51.5/55.5; UK C-PMI, M-PMI & NM-PMI Flash Estimates 54.1/56.3/54.6; Bullock. (Bloomberg estimates)

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## Strategy Indicators

**Global Stock Markets Performance** ([link](#)): The US MSCI index has now risen in six of the past seven weeks. It gained 0.2% last week to finish 0.2% below its record high on Tuesday. The US MSCI ranked eighth of the 49 global stock markets that we follow in a week when just eight of the 49 countries rose in US dollar terms. The AC World ex-US index performed worse, falling 1.0% to 3.1% below its June 15 record high, as all regions fell. EM Asia was the best-performing region last week, albeit with a decline of 0.7%, ahead of EAFE (-0.8%). EM Latin America was the biggest underperformer, with a decline of 4.7%,

followed by EM Eastern Europe (-3.9), EMEA (-2.4), BRIC (-2.3), and EMU (-1.3). Pakistan was the best-performing country last week, with a gain of 3.8%, followed by Taiwan (2.4), Sri Lanka (1.9), and Indonesia (1.3). Austria was the worst performer, with a decline of 6.6%, followed by Poland (-6.5), Peru (-6.4), Argentina (-6.2), and Colombia (-5.9). EMEA is now the top-performing region ytd with a gain of 24.8%, not much ahead of the United States (24.3), and easily beating EM Eastern Europe (18.6), EMU (12.3), EAFE (9.2), and the AC World ex-US (6.8). The following regions are lagging the AC World ex-US: EM Latin America (-14.7), BRIC (-7.4), and EM Asia (-3.4). The top-performing countries ytd: the Czech Republic (33.4), the Netherlands (32.1), Argentina (29.2), Austria (28.5), and India (27.7). The biggest laggards of 2021 so far: Brazil (-23.8), Peru (-23.8), Pakistan (-23.1), Turkey (-22.7), and Colombia (-19.6).

**S&P 1500/500/400/600 Performance** ([link](#)): Two of these three indexes were at record highs last week. LargeCap posted the only gain for the week, rising 0.3% compared to declines for MidCap (-1.1%) and SmallCap (-2.2). LargeCap is just 0.1% below its record high on Thursday and MidCap ended the week 1.4% below its Tuesday record. SmallCap is the biggest laggard, trading 2.9% below its record on November 9. Just five of the 33 sectors were higher for the week, compared to 11 sectors rising a week earlier. LargeCap Consumer Discretionary was the best performer of the week with a gain of 3.8%, ahead of LargeCap Tech (2.4), SmallCap Utilities (1.7), LargeCap Utilities (0.9), and MidCap Utilities (0.2). SmallCap Energy was the worst performer, with a decline of 11.0%, followed by MidCap Energy (-5.4), LargeCap Energy (-5.2), SmallCap Materials (-4.2), and SmallCap Communication Services (-3.2). SmallCap remains the leader in the 2021 derby with a gain of 27.2% ytd, ahead of LargeCap (25.1) and MidCap (24.5). Thirty-two of the 33 sectors are higher ytd, paced by these best sector performers: SmallCap Energy (66.5), MidCap Energy (61.4), SmallCap Consumer Discretionary (45.5), LargeCap Energy (44.0), and MidCap Consumer Discretionary (34.5). The biggest laggards so far in 2021: MidCap Communication Services (-1.6), MidCap Consumer Staples (6.4), LargeCap Utilities (6.8), LargeCap Consumer Staples (7.7), and MidCap Utilities (9.0).

**S&P 500 Sectors and Industries Performance** ([link](#)): Three of the 11 S&P 500 sectors rose last week, and the same three outperformed the composite index's 0.3% gain. That compares to a 0.3% decline for the S&P 500 a week earlier, when five sectors rose and seven outperformed the index. Consumer Discretionary was the best performer, with a gain of 3.8%, ahead of Tech (2.4%) and Utilities (0.9). The worst performers this week: Energy (-5.2), Financials (-2.8), Materials (-2.0), Industrials (-1.2), Communication Services (-1.0), Consumer Staples (-1.0), Health Care (-0.7), and Real Estate (-0.1). With respect to 2021's performance, the S&P 500 has risen 25.1% so far, with all 11 sectors higher ytd and five



beating the broader index. Energy remains in the top spot as the leading sector with a gain of 44.0% ytd, followed by Financials (32.1), Real Estate (32.1), Tech (31.2), and Consumer Discretionary (28.5). This year's laggards to date, albeit with gains: Utilities (6.8), Consumer Staples (7.7), Health Care (16.9), Industrials (19.0), Materials (21.6), and Communication Services (23.9).

**S&P 500 Technical Indicators** ([link](#)): The S&P 500 rose 0.3% last week, but weakened relative to its 50-day moving average (50-dma) and 200-day moving average (200-dma). The index closed above its 50-dma for a sixth week after two weeks below, and was above its 200-dma for a 73rd straight week. The S&P 500's 50-dma moved higher for a sixth week after falling for two weeks for the first time since last October. The index fell to 4.1% above its rising 50-dma from 4.2% a week earlier and a 27-week high of 4.9% the week before that. That's still up from an 11-month low of 2.0% below in early October. The index had been mostly trading above its 50-dma since late April 2020; in June 2020, it was 11.7% above, which was the highest since its record high of 14.0% in May 2009. That compares to 27.7% below on March 23, 2020—its lowest reading since it was 29.7% below on Black Monday, October 19, 1987. The price index was above its 200-dma for a 73rd week last week, but dropped to 9.7% above its rising 200-dma from 9.9% a week earlier and a nine-week high of 10.8% the week before that. That's still up from an 11-month low of 5.0% at the beginning of October. That compares to 17.0% above in early December, which was the highest since November 2009 and up from the 26.6% below registered on March 23—the lowest reading since March 2009. At its worst levels of the Great Financial Crisis, the S&P 500 index was 25.5% below its 50-dma on October 10, 2008 and 39.6% below its 200-dma on November 11, 2008.

**S&P 500 Sectors Technical Indicators** ([link](#)): Nine of the 11 S&P 500 sectors traded above their 50-dmas, down from all 11 above in the prior two weeks as Energy and Financials fell below. That compares to just two sectors above in early October and all 11 sectors above at the beginning of May. Eight sectors now have a rising 50-dma, up from seven a week earlier, as Real Estate reversed higher w/w. Communication Services, Health Care, and Utilities are the only three sectors with a falling 50-dma. Looking at the more stable longer-term 200-dmas, all sectors were above for a fifth week, up from nine at the beginning of October when Materials and Utilities dropped out of the club for one week. All 11 sectors have had rising 200-dmas for 36 straight weeks. For perspective, back in April 2020, just one sector (Health Care) was trading above its 200-dma. Notably, Energy's 200-dma finally turned higher in mid-December after mostly falling since October 2018.

## US Economic Indicators

**Regional M-PMIs** ([link](#)): Three Fed districts (New York, Philadelphia, and Kansas City) now have reported on manufacturing activity for November and show the manufacturing sector expanded at a near-record pace. The composite index climbed to 31.3 this month after falling from 29.0 to 24.9 last month, closing in on April's record high of 35.8. Both the Philadelphia (to 39.0 from 23.8) and New York (30.9 from 19.8) regions showed a sharp acceleration in growth, while the Kansas City (24.0 from 31.0) region showed slower, though still robust, growth. New orders (to 24.1 from 27.4) continued to grow at a healthy pace as billings in the Philadelphia (to 47.4 from 30.8) region expanded at the fastest pace since the early 1970s—and not too far from its record-high 56.2—while New York's (28.8 from 24.3) continued to grow at a strong rate. Orders growth in the Kansas City (to -4.0 from 27) region, however, moved from expansion to contraction. Job gains remained strong, with the employment (to 26.7 from 27.3) measure holding just below October's record pace. Employment was strong in all three regions, with New York's (to 26.0 from 17.1) accelerating, while Philadelphia's (27.2 from 30.7) and Kansas City's (27.0 from 34.0) slowed a bit—though were still slightly above New York's pace.

**Regional Prices Paid & Received Measures** ([link](#)): Inflationary pressures remain elevated, with New York's prices-received (to 50.8 from 43.5) measure accelerating to a new record high this month and its prices-paid measure (83.0 from 78.7) moving back toward May's record-high 83.5. Philadelphia's prices-received (to 62.9 from 51.1) measure climbed to within striking distance of February 1974's record high of 63.8, while its prices-paid (80.0 from 70.3) gauge is just shy of June's 80.7—which was the highest since mid-1979. Meanwhile, Kansas City's measures have eased. Its prices-received (to 50.0 from 47.0) measure accelerated a bit this month, though was below its record high of 61.0 recorded this August, while its prices-paid (77.0 from 87.0) measure slowed from last month's record high.

**Leading Indicators** ([link](#)): “The U.S. LEI rose sharply in October suggesting the current economic expansion will continue into 2022 and may even gain some momentum in the final months of this year,” said Ataman Ozyildirim, senior director of economic research at the Conference Board. Leading indicators continued its sharp ascent last month, not posting a decline since April 2020. Leading indicators jumped 0.9% m/m and 22.2% during the 18 months through October—surpassing its previous record high by 5.6%. Of the 10 components of the LEI, eight rose, while two declined—consumer expectations (-0.10) and average workweek (-0.07ppt). Leading October's gain was jobless claims (+0.62ppt), followed by the interest rate spread (+0.17), building permits (+0.11), and the new orders



diffusion index (+0.08); the remaining components contributed modestly. Despite October's solid increase, the Conference Board warns that rising prices and supply-chain bottlenecks pose challenges to growth and are not expected to dissipate until well into 2022. Though despite these headwinds, it is forecasting that growth will be around 5.0% (saar) this quarter and slow to a still-solid 2.6% increase during Q1-2022.

**Coincident Indicators** ([link](#)): The Coincident Economic Index (CEI) climbed for the eighth time this year, advancing 0.5% in October and 3.2% year to date—to within 1.0% of February 2020's record high. All four components of the CEI contributed positively in October, with industrial production—which was the only component in the red in September—leading the pack. Here's a look at how the four components performed in October: 1) Industrial production (+0.23ppt) rebounded in October by a larger-than-expected 1.6%, following a 1.3% decline in September and flat output in August. The Fed reports that half of October's gain was a bounce back from the effects of Hurricane Ida, though the sharp rebound in motor vehicle production last month implies that manufacturers probably are better addressing supply shortages as well. 2) Payroll employment (+0.19) was above expectations in October after falling short the prior two months—and there were big upward revisions to payrolls in both September and August. Payroll employment rose 531,000, while both September and August payrolls were revised higher for a net gain of 235,000. Total payroll employment has recovered 18.2 million jobs since bottoming last April, though is still 4.2 million below its pre-pandemic level. 3) Real personal income less transfer payments (+0.05) increased in September for the seventh time in eight months, by 0.2% m/m and 1.6% over the period—to a new record high. 4) Real manufacturing & trade sales (+0.03) advanced for the second month, by a total of 0.5%, after falling four of the prior five months by 2.4%. It's within 1.9% of March's record high.

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