Higher Prices: Transitory or Not?

Global Implications of Rising Producer, Consumer, and Asset Price Inflation

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Global Implications of Rising Producer, Consumer, and Asset Price Inflation
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Faster inflation pressures are cropping up everywhere and among a host of goods, services, and assets. Markets are worried and central banks are starting to take notice. Businesses are in a quandary and consumers are feeling the heat.

While higher prices are anticipated as the world rebounds from the pandemic-induced recession, the intensity of select price increases has caught some off guard. Moreover, everyone is wondering if upward inflation pressures are just transitory outcroppings of a pandemic supply-and-demand tug-of-war, or if elevated prices are here to stay.

The answer is that many of the pressures businesses and households are experiencing are largely temporary and will fade as the pandemic recovery works itself out. However, high costs for select consumables are here to stay, warranting close monitoring and potential action by central banks. Moreover, the largely transitory nature of most price hikes notwithstanding, central banks may not be able to wait until prices calm before scaling back large-scale asset purchases and/or raising interest rates.

Insights for What’s Ahead

- Businesses and consumers should expect elevated inflation rates for goods, services, and assets over the next 12 to 18 months. For consumer prices, this means above 2 percent inflation, which is a target for central banks of many economies. The timelines for the prices of individual goods, services, and assets to peak and subside will vary.

- Some of these higher costs are a function of pandemic disruptions to supply chains and shifts in consumer demand amid mobility restrictions. These costs should retreat once households return to a more balanced diet of goods and services consumption. Elevated price inflation for other items is likely to be more persistent and reflect structural factors, including sustained demand for housing and high-tech products.

- The People’s Bank of China (PBOC), China’s central bank, is not expected to hike interest rates in response to inflation, but the government is using communications with producers and regulation to rein in inflationary pressures among commodities and housing markets. The European Central Bank (ECB) believes that Consumer Price Index inflation will not exceed its 2 percent target sustainably, signaling no rate hikes to curb inflation.

- 1970s-style inflation in the US is still a remote possibility, in our view. The Federal Reserve’s average inflation targeting regime allows for a sustained period of above-target inflation before action. Nonetheless, if key circuit breakers are breached, including notably higher long-term consumer inflation expectations, then the Fed might hike rates sooner than what markets are currently pricing in. This is a
reiteration of our stance in the Q1 StraightTalk®. Select members of the Federal Open Market Committee (FOMC) are already considering the initiation of discussions to begin tapering large-scale asset purchases (LSAPs) given outsized GDP growth and rising prices, even though labor market slack remains.

- Some upward wage pressures may subside in the US toward the end of this year as children return to school and generous unemployment benefits expire. However, wage pressures are likely to reemerge later in 2022 as labor markets tighten nearer to prepandemic readings. In Germany and the UK, housing price growth may be a more important driver of future price changes.

**Which Prices Are Rising, and Where?**

**Prices are rising in economies among the vanguard of the global pandemic recovery.** Although the US has been the focus in the news, inflationary pressures are picking up around the world—mainly among economies that have or are close to recovering from the COVID-19 pandemic-induced recession. Economies rebounding rapidly include the US, China, several Asian emerging markets, and parts of Western Europe.

**Prices are rising for producers and consumers.** Rising producer prices are reflected in producer price indexes spanning the globe. Regional PMIs are showing that higher input costs are a major factor in the rise in prices for consumers (Figure 1). Many of the costs are for upstream goods like raw materials (Figure 2) that are filtering down into prices for intermediate and finished goods (Figure 3). Meanwhile, consumer prices are ticking upward in the US and Europe as firms appear more willing to display long-absent pricing power by passing on higher input costs to households (Figure 4). So far, CPI inflation in China remains subdued, as firms are still absorbing higher prices in profit margins.

**Figure 1. Firms Are Experiencing Higher Price Pressures, Looking to Raise Prices**

**Figure 2. Commodity Prices Are Spiking for Energy and Nonenergy Materials**


Sources: Energy Information Administration/Wall Street Journal, Hamburgisches Wirtschaftsinstitut, and The Conference Board
Asset prices are also on the rise. Global equity markets have been buffeted recently amid volatility around cryptocurrencies, and as investors are starting to fear tapering of the US’ extraordinarily accommodative monetary policy as growth and inflation prospects rise. However, volatility still remains generally low, and the recent movements do little to undo the massive appreciation in equity market prices since central banks came to the rescue when the pandemic caused a massive sell-off in March 2020 (Figure 5 and Figure 6).

Meanwhile, home prices are soaring. Extremely low interest rates are helping to fuel housing price inflation across the world. The OECD housing price index was up 6.6 percent
year-on-year in Q4 2020 compared to 2.5 percent prepandemic (Figure 7). Prices are particularly elevated, and in some cases frothy, in economies that are recovering more quickly.

**Wages are rising in the US.** Demand for labor in the US outstrips supply, despite more than 8 million workers unemployed. This demand is notably high in industries that require manual and/or in-person services, as well as among businesses where remote work is not possible. Hence, firms are raising wages and offering incentives to attract workers. Notably, in Q1 2021, wages for services workers surged over the three-month period (Figure 8). Wages are also rising as firms are either voluntarily raising their minimum wages or are being prompted to by state and local minimum-wage increases.

**Figure 7. Home Prices Levitating Across Major Economies Around the Globe**

**Figure 8. Wages and Salaries Spiked for US Services Workers in Q1 2021**

Sources: OECD, S&P CoreLogic Case-Shiller, Bureau of Labor Statistics, and The Conference Board

Sources: Bureau of Labor Statistics and The Conference Board

**Which Price Increases Are Transitory?**

**Most goods price increases are transitory.** Higher costs for commodity prices reflect continued powerful demand for goods among consumers who were in the upper part of the K-shaped economic downturn and recovery.¹ These households did not experience interruptions in employment or income, and those with assets benefited from asset price appreciation, including for financial and housing assets. Many families in the lower portion of the K also contributed to demand for goods, which were paid for by direct transfers from governments via unemployment benefits and cash checks. As governments lift mobility

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¹ K-shaped recovery refers to the fact that there were disparate impacts on economies, industries, and individuals during the pandemic, depending upon whether they were vulnerable to restrictions on in-person services. Economies, industries, and workers that were highly vulnerable to such restrictions were and continue to be in the bottom portion of the K. Economies, industries, and workers that were more inured to disruptions in in-person services are said to be in the upper portion of the K.
restrictions and travel bans, and businesses reopen, households will crave in-person services, potentially lessening some of the pressure on goods prices.

**Goods prices are also high because of temporary supply-chain disruptions and bottlenecks, mostly due to the pandemic.** As economies shut down last year and remain restricted in activities, supply chains have borne the brunt of goods demand pressure, in some cases forcing firms to raise prices (Figure 9). A prepandemic shortage of shipping containers; labor supply shortages for the shipping, ports, transportation, and warehousing industries; and a variety of incidences (e.g., the Suez Canal debacle) and natural disasters (e.g., Texas US deep freeze) have forced firms to raise prices for goods. Again, as households shift demand from majority goods to a more balanced mix of goods and in-person services, associated supply-chain issues should resolve, and prices should ease.

**Increases in in-person services costs are anticipated, but also likely to be temporary.** In-person services firms are now reopening, in some cases still at limited capacity, but with rising operating costs. As demand swells, these firms must find inputs (e.g., food for restaurants), which are experiencing inflation pressures, and workers, whose supply is constrained in areas by factors including fear of infection, lack of dependent-care options, and generous government supports. Moreover, some workers are being more selective about the jobs they are taking, looking to bolster their incomes after years of relatively modest wage growth. Hence, prices for services like food away-from-home and airline tickets are surging, notably in the US (Figure 10). However, once consumers become satiated with in-person services, and/or return to a more balanced basket of goods and services consumption, prices for most services should also stabilize or fall.

**Past checks on faster inflation are still present, and new dampeners are emerging.** Many of the dampening pressures that have kept global inflation largely at bay since the
Great Financial Crisis are likely to reemerge. Such dynamics include the disinflationary effects of automation, which many more firms are actively seeking; businesses converting employees to lower-cost contractors with few benefits; pricing competition among online and big-box stores that continue to deliver the discounts that consumers seek; and continued use of globalized supply chains that in normal times keep prices of goods in line. Emerging disinflationary pressures include potential strength in the currencies of economies that emerge from the pandemic sooner than others, and remote work, which allows households to reduce costs associated with working in the office, but also allows businesses to cut travel costs, reduce office space, and hire less expensive workers from anywhere in the world.

Central banks may not be able to wait for transitory pricing pressures to fade. Unfortunately, the combination of base effects from last year’s tumble in prices and the clash of pandemic-era price hikes is happening all at once. These dynamics are causing inflation expectations among investors and consumers to rise, and it may take 12 to 18 months for these transitory upward inflation pressures to resolve themselves. Indeed, it could even be longer; while some large economies are well on their way to recovery, many are not. Notably, as of late May, only 10 percent of the world population has received at least one vaccine dose. This means that supply-chain disruptions and gyrations in goods and services demand may linger in some economies for longer than expected. In the meantime, central banks—including the Fed, ECB, and PBOC—may be prompted to start removing easing policies sooner than expected if inflation pressures exceed targets by more than policymakers anticipate and over a longer period than desired.

Which Price Increases Are More Persistent?
Some price hikes are likely not temporary and may be more persistent in nature.

Prices for high-tech goods, automobiles, and rare earths may remain elevated for the foreseeable future. A chip shortage was prompted by supply-chain disruptions coupled with robust demand for technology that can be consumed from home and autos that accommodate domestic travel and suburban living as many people moved out of city centers while they worked remotely. Also, many people sought to replace vehicles of older vintage, some held since the global Great Financial Crisis, with newer models, fueling demand for semiconductors. However, the chip shortage is unlikely to be resolved quickly, as factories that produce the high-end chips required for items like cell phones and cars cannot be reproduced quickly. It can take anywhere from five to 10 years to build a new semiconductor factory. Hence, prices for goods requiring semiconductors may remain elevated for several years (Figure 11). Also, a global push toward “greener” battery-fueled cars make keep prices for rare earths elevated.

Increasing automation and industrial policies may also keep chip prices high. As more firms look to automate tasks to save money and/or promote digital transformation, strong demand for the chips used to drive these technologies will continue. The specter of industrial policies in which governments limit the use of disinflationary global supply chains for select goods, including high tech, could also mean many more years of elevated prices for key tech components.
Prices for goods related to housing may stay high for some time. Prices for inputs to housing, including lumber, steel, and copper, plus wages for workers in the construction industry, may remain high and continue to rise (Figure 12). We do anticipate that demand for housing will remain robust, especially in the US. Moreover, US sawmills are stating that they do not plan to build more mills to accommodate rising demand.

Housing price rises may stay sticky. Indeed, home prices that are currently being fueled by strong demand—given the surge in remote work—and limited supply will face limitations. Once central banks start raising interest rates, markets that allow borrowing for home purchases will be constrained by increases in mortgage rates. Also, select economies (e.g., Canada, China) are using macroprudential policy tools to extinguish pockets of froth in local housing markets. Moreover, if prices rise by too much, many younger and less affluent buyers will be priced out of markets, potentially cooling demand. Still, as interest rates are likely to rise only so much over the next few years, and the desire to work remotely is likely to remain robust going forward, housing market prices may continue to stay elevated, even while prices for many goods and services recede.

Figure 11. Some Price Inflation Likely to Be More Persistent: Autos, High-Tech Gadgets

![Graph showing US PCE Deflators (YoY)](image1)

Sources: Bureau of Labor Statistics and The Conference Board

Figure 12. Some Price Inflation Likely to Be More Persistent: Wood, Semiconductors

![Graph showing US Producer Prices (YoY% Changes)](image2)

Sources: Bureau of Labor Statistics and The Conference Board
What Are Our Regional Inflation Outlooks?

**United States**

1970s-style inflation in the US is still a remote possibility in our view. In the Q1 StraightTalk®, we discussed inflationary pressures in the US and stated that while most price increases are transitory, some are likely more persistent. While the present intensity of inflation pressures is greater than in our March base case at the time, the story is still the same. Many of the pressures on prices and wages are a function of pandemic-era distortions and probably will diminish over the next 12 to 18 months. Notably, select wage pressures associated with labor supply shortages should subside by September as children return to in-person schooling and generous unemployment benefits expire. Moreover, many of the factors that dampened prices over the last two decades are likely to reemerge. However, select price hikes will not be ameliorated by the end of the pandemic due to dynamics that existed pre-pandemic and/or factors that are structural in nature.

Nonetheless, inflation forecasts, including ours, have ticked higher. Since March, we have materially upgraded our US growth forecast from 5.5 percent year-on-year in 2021 to 6.4 percent (Figure 14). With those upgrades to the growth forecast, we also raised our projections for both total and core personal consumption expenditure (PCE) deflator inflation—the Fed’s preferred measures of inflation. Moreover, spikes in commodity prices amid strong demand for goods like food, energy, and lumber for housing, and upticks in wages due to labor shortages as demand for “frontline” workers increases, also prompted us to raise our inflation projections for the US. The inflation forecast for May is now closer to our March upside scenario for GDP growth. We are also generally in line with consensus growth and inflation forecasts, which anticipate elevated inflation this year and most of next year, but cooling in 2023 (Figure 15). Still, the April PCE inflation print may indicate further upward revisions to our forecast.

**Figure 13. Core Consumer and Producer Prices Are Rising in the US**

**Figure 14. The Conference Board Has Raised Its Inflation Projections**

Sources: Bureau of Labor Statistics, Bureau of Economic Analysis, and The Conference Board

Sources: Bureau of Economic Analysis, Oxford Economics model, and The Conference Board
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**The Fed may not be able to wait,** even though the consumer price inflation in tow and anticipated for the balance of this year and early next is likely to be transitory. Although “substantial further progress” has yet to be achieved in terms of labor market healing, real GDP growth—albeit unbalanced and highly concentrated in fiscal support–fueled consumer spending—is strong, absorbing slack in the economy. Moreover, consumer prices now appear on course to rise by more than the Fed estimated in its March Summary of Economic Projections (i.e., 2.2 percent by Q4 2021). Already, select members of the FOMC are contemplating starting discussions about tapering LSAPs (quantitative easing or QE) given the strong dynamics of US growth and inflation.

**What might cause the Fed to “go?”** A key circuit breaker for the Fed is consumers’ long-term inflation expectations (three to five years). Indeed, our own measure of one-year inflation expectations, along with other gauges, has spiked—first on food prices, then on gasoline and other prices. However, long-term inflation expectations are also beginning to creep higher, albeit from historically low levels (Figure 16). If the Fed deems these increases in inflation expectations untenable, particularly when coupled with strong economic activity, then LSAPs may be tapered soon. Moreover, the Fed may start to raise interest rates ahead of the early 2023 timing currently priced by a battery of 67 economists surveyed by Bloomberg (Figure 17).
China

Current inflation situation

In China, there is mounting inflationary pressure concentrating in the upstream industrial segments. China’s PPI rose by 6.8 percent in April from a year ago, a record since October 2017. In contrast, consumer price inflation has been modest, as the nonfood CPI increased by only 1.3 percent year-on-year in April (Figure 18). Intensified PPI now puts CPI inflation under upward pressure, but given the relatively weak domestic demand, downstream vendors probably will find it difficult to pass on all the cost increase to end users. The result is that first, CPI inflation will be on the rise, but unlikely as significant as PPI, and second, squeezed profit margins in downstream manufacturing segments will weigh on investment growth in the sector.

Policy response

Current producer price inflation in China emanates primarily from the price hike of raw materials (e.g., iron ore, copper, crude oil) in global markets. Because the inflation is not driven by domestic demand, the PBOC is unlikely to attempt any tightening measures in response to the inflation risk. However, that does not mean the government will do nothing. The government met with the largest domestic producers of raw materials in late May and warned about excessive speculation. Commodity prices, including iron ore, steel, and aluminum, tumbled following the news. Because a large share of the upstream segments in China is state owned, the intervention by the government is expected to effectively ease PPI inflation growth in the coming months.
Duration expectation

The surge in upstream prices is expected to be transitory. On the demand side, because the upbeat IP growth in China is mainly driven by strong growth in exports and real estate development, normalizing the trade environment and tightening regulatory restrictions for developer financing should see gradual moderation in China’s IP growth in late 2021 or early 2022. On the supply side, market concerns over the commodity supply disruption in emerging markets should be relieved as the pandemic situation starts to improve. In addition, massive stimulus and fast-growing household income in the US are considered major drivers of current inflation, so a tapering of QE, which is anticipated to start in H2 2021, should also calm the sentiment on the commodity inflation outlook. Unlike in the US, household income growth in China remains relatively weak compared to IP growth, which is another fundamental factor that does not support prolonged intensive inflation.

Figure 18. Producers Are Absorbing Higher Upstream Commodity Price Pressures, Keeping Consumer Price Inflation Under Control

Europe

Prices are rising in Europe, but consumer inflation is not anticipated to exceed the ECB’s 2 percent target sustainably. Quarterly consensus forecasts look for inflation to exceed 2 percent over the Q3 to Q4 2021 period, but trend back to 1.3 percent in early 2022. Moreover, the Euro Area average currently hides some heterogeneity. Annual inflation was negative in Greece in May (-1.1 percent), while annual inflation rose to 4 percent in Luxembourg. Germany is in the spotlight with 2.4 percent in May. Inflation above target in the economic engine of Europe will inflate discussions across the whole continent.

Producer price pass-through remains uncertain. Producer prices have risen since January. The trend remains, although less marked, even when energy prices are excluded, which signals that companies are facing higher prices, especially for intermediate goods. These prices might reflect an increase in costs due to supply chain–related strains including shortages of raw materials and semiconductors chips, issues with transport capacity, and
increases in transport prices. However, it remains unclear if firms will pass all of these costs on to consumers in the coming months.

**Underlying consumer price activity remains subdued.** Overall consumer price inflation increased in the Euro Area between January and April 2021. However, excluding energy, prices slowed (Figure 19). The recent increase in overall inflation may be explained by base effects due to the collapse in energy prices in spring 2020. The increase in core inflation observed in January and February may be due to a change in the weighting of items in the basket and to the normalization of VAT rates in Germany. The change was implemented to reflect the shift of consumption from services toward goods since the start of the pandemic.

![Figure 19. Core Inflation in Europe Remains Subdued and Well Below 2%](image1)

**Figure 19. Core Inflation in Europe Remains Subdued and Well Below 2%**

**Figure 20. Forecasts Do Not Anticipate Sustained Period of Above 2% Inflation**

Sources: Eurostat, ECB, and The Conference Board

**Strains on supply chains are likely to be transitory:** companies are at work to reorganize supply chains to adapt (see latest Europe CEO Confidence report), while economies (including Japan, US, and the EU) are investing to develop domestic suppliers of strategic goods, including batteries and chips.

**The slow recovery in Euro Area activity in 2021 creates downward pressure that should balance out higher costs associated with supply-chain constraints.** Compared to other major economies (US, China), the Euro Area likely will take longer to heal from the pandemic shock, as it did after the Great Financial Crisis. Indeed, the ECB is still signaling that monetary policy will continue to support the economy and that any short-term fluctuations in prices are expected to be transitory. Moreover, the ECB tends to follow, not lead, the actions of other central banks.

**Forecasters do not expect overall (or underlying) consumer price inflation to average above the 2 percent target over the medium term.** According to the ECB Survey of Professional Forecasters, some pressure on prices is expected in 2021, but no fundamental change in the medium term is in sight (Figure 20). In the first half of April, the ECB posted
the Q2 edition of its “Survey of Professional Forecasters” (SPF). Expectations for inflation in 2021 increased (from 0.9 to 1.6 percent) while they remained unchanged for 2022 and 2023. Core inflation (excluding energy, food, alcohol, and tobacco) is expected to be 1.1 percent in 2021 and 2022 in the SPF.

The ECB believes that pockets of upward inflation pressures are transitory, warranting no action for now. Isabel Schnabel, an executive director at the ECB, sought to soothe concerns about an expected rise in German inflation above 3 percent this year by saying that such a move was unlikely to cause tightening of monetary policy. “Our monetary policy strategy is medium term, and that means that we look through all of these short-term fluctuations,” Schnabel said in a televised interview. “If we actually see that there was suddenly a very rapid development of inflation, which is really not in evidence at the moment, then of course we would have to adjust our measures and of course we would have to do that gradually.”

House prices must be watched closely in the UK. Yearly CPI inflation was 1.5 percent in the UK in April, according to the Office for National Statistics, a rapid increase compared to the previous eight months, when it was below 1 percent. CPIH, the Consumer Price Index including owner-occupiers’ housing costs, increased by 1.6 percent in April due to changes in gas and electricity prices. One issue worth monitoring is the evolution of housing prices: after a Brexit-induced decline, housing prices have started to increase again. Year-on-year growth in real prices was 7.2 percent in Q1 2021, following 5.3 percent in Q4 2020.

Concluding Thoughts – High Inflation: Will It Stay or Go?

Prices for goods, services, and assets are rising among the world’s major economies, but many of the factors contributing to faster inflation appear to be transitory. Indeed, strong consumer demand for goods, coupled with production and distribution supply constraints, are raising prices for goods from the consumer perspective. From the perspective of firms, rising costs all along the value chain, starting with raw materials, plus increasing costs for labor are prompting some firms to consider raising or to actively raise output prices consumers face. Meanwhile, reopening of select large economies is creating a sudden surge in demand for in-person services, and consequently upward pricing pressures. Many of these pressures should lessen or disappear as the pandemic ends and households return to a more balanced diet of goods and services consumption.

However, select pricing pressures are unlikely to fade quickly, particularly those associated with fundamental changes in economic activity. Such changes include the rise of remote work, increased automation, and persistent consumer demand for high-tech gadgets and vehicles. Moreover, some pressures will remain as firms choose not to quickly expand capacity to meet these changing demands.

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3 OECD Analytical House Prices Indicators database - May 2021.
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