Chart of the Month

December 2021

Retail sales rose 18.2% year-over-year in November to $566 billion and are now up nearly 50% from the trough last year and more than 20% above the pre-pandemic high in early 2020. Sales are running well over the trend lines dating back to the early 1990s and the recession low in 2009 (see above).

The combination of robust sales and supply shortages has dramatically reduced the inventory-to-sales ratio to a multi-decade low of 1.1x. Historically, as shown below, this ratio has generally ranged between 1.4x to 1.7x. The need to replenish inventories in conjunction with low unemployment, rising wages, and savings from stimulus payments should lead to continued economic growth and high inflation.

The Consumer Price Index increased 6.9% in November to a 39-year high with little or no signs of a letup in the inflation rate over the foreseeable future. The Federal Reserve, which has been behind the curve in fighting inflation throughout the year, officially removed from its statement the reference to inflation being “transitory” at this week’s Federal Open Market Committee meeting.

To help combat inflation, the Fed announced it will taper the purchases of Treasury and mortgage-backed securities to $60 billion per month in January or twice as quickly as previously indicated. At that pace, the Fed should end its quantitative easing by March rather than June. Upon completion, the central bank will be in a position to consider raising the fed funds rate, beginning in the second quarter of next year. The consensus among the policymakers suggests three rate hikes in 2022 (assuming 25 basis points or 0.25% each). If so, the fed funds rate should stand at 0.75%-1.00% a year from now.

If inflation remains stubbornly high, the Fed may have to raise rates faster or perhaps in larger increments (50 basis points or 0.50%). The rate hikes should slow the economy and, by extension, inflation. However, over the past 50 years, there has never been a recession (other than the pandemic-induced plunge in 2020) when the fed funds rate was under 4%. While not a magical number, it would take 15 quarter-point or eight half-point hikes to get to 4% from today’s level of 0.00%-0.25%.

In the meantime, as Chairman Jerome Powell noted at Wednesday’s press conference, the economy should experience “strong growth…high inflation…and rapid progress toward maximum employment.” The overall picture is mixed with potential upside and downside depending on how effectively the Fed pivots from an accommodative to a tighter monetary policy.

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