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What it Took to Tame Inflation in the U.S.

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U.S. Inflationary Pressures to Persist in 2022

- In May, the 12-month inflation rate reached 8.6% and StratInfo thinks the rate will peak at around 10%+ during the second half of this year given continued growth in spending and pass-through of accumulated cost increases. There are several key factors behind the accelerating inflation which have been aggravated by the war in Ukraine:
  i. higher oil prices, WTI crude averaged $109.55/barrel during May; and prices of agricultural products and metals impacted by blockade on Russian trade;
  ii. demand-pull pressures on prices have abated somewhat as fiscal stimulus spending runs out; however consumer spending on services is still strong as well as pent-up demand for goods that are is still on order;
  iii. continued supply chain disruption which can be triggered by a shortage of just one key input as demonstrated by automobiles; and
  iv. rising unit labor costs (ULC) shown by the ULC index which was up 8.2% in 1stQ with respect to 2021.

- Another indicator of downstream inflation, the Producer Price Index (the sub-index of all goods, mostly raw materials such as energy, chemicals, plastic construction products, iron and steel, primary metals, and fabricated components used in the first stages of production) surged last year and appeared to slow down in January 2022, but that was before the shock in oil and other commodity prices due to the Russian invasion of Ukraine in February.

- Last year the strongest cost pressures were in the stage 2 level of production; in May of this year, the 12-month increase in stage 2 costs was 46.7%. As they travel through the supply chain, these cost pressures will accelerate consumer price inflation during the second half of this year, and possibly at a faster pace if consumer spending keeps rising.

BLS has divided the production process into 4 stages: Stage 1 is comprised as raw materials and services at the beginning phase of production; stage 2 industries use the semi-processed raw materials from stage 1; stage 3 represents manufactured inputs; and stage 4 measures the prices of inputs that are used in production of the goods purchased by the final end users such as consumers. Source: Bureau of Labor.

What it took to tame inflation in the U.S.

What it took to battle double-digit inflation in the U.S.:

- The highest 12-month inflation rate in the past 71 years was **14.7% in April 1980**.
- **Paul Volker** was named Chairman of Fed starting in **August 1979**, he took inflation seriously;
- **round 1 of Fed tightening**: in his first month Chairman Volker started raising the Fed Funds rate from 10.47% to 17.61% by April 1980,
- **recession 1**: February 1980 – July 1980;
- that was not enough, **high inflation persisted**; so the Fed was more forceful in round 2,
- **round 2 of Fed tightening**: starting in August 1980, the **Fed Funds rate** was increased from 9.61% to **19.04% by July of 1981**,
- **recession 2**: August 1981- November 1982, **by the latter date inflation had fallen to 4.6%.**