PORTFOLIO MONTHLY REPORT – June 2021

Situation

Last month I mentioned that the big discussion at the moment is if the current spike in inflation is transitory or accelerating. There is no dispute that inflation has arrived. In the USA the number for May was +5% year on year, the highest reading since Aug 2008. In the UK it was at 2.1% and even in Germany it was quoted at 2.5%. These are all higher than central bank targets and they expect it to rise through the summer but then fall away at the end of the year.

The reason the central banks expect it to fall and that the current numbers are transitory is the base effect. Last year in the Spring the policy response to Covid19 was to restrict business and therefore activity was reduced. This will pass so they argue and with it the inflation numbers will decline. But there are several problems with this argument.

Firstly as the chart above shows the commodities index (CRB) is pointing towards rising prices. After a long period of falling commodity prices, with lower highs and lower lows, the cycle has turned and technical investors would argue that the trend is now for higher highs and higher lows as we go into a new cycle which will last several years.

Secondly last year has seen turmoil in the global supply chain. Production and distribution channels have resulted in shortages. Lumber shot up in price. Oil is up from $20 last year to now $70. Shipping containers which cost $3,000 to rent last year are now $10,000. All these cost increase will be passed on to end consumers where possible.

Thirdly as pointed out last month, the central banks, in response to Covid19, have printed huge amounts of money and created debts never before seen in peace time. The cutting of interest rates to zero and endless bond buying (QE) has also resulted in some rising asset prices. That in itself is inflationary when people, for example, extract cash from higher home values then consumer prices will be under pressure.

The main argument in favour of only transitory inflation, is the claim that wage growth is the real cause of consumer price inflation and this will be low because large numbers of people are without jobs. However the policy response to the crisis was to send people money. The western economies are sending cash to people which will get spent putting pressure on prices. And there are examples of actual wage growth. Recently McDonalds said they are giving 36,000 employees a 10% wage increase. Other companies will follow and once wages rise they are unlikely to be cut.

Transitory or accelerating is the question ?

Best wishes

Tim 7 July 2021