

Source: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items in U.S. City Average [CPIAUCSL], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CPIAUCSL>, July 27, 2021.

Source: U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: Used Cars and Trucks in U.S. City Average [CUSR0000SETA02], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CUSR0000SETA02>, July 26, 2021.

U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items Less Food and Energy in U.S. City Average [CPILFESL], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/CPILFESL>, July 27, 2021.

Inflation: Transitory or Persistent?

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If you bought a used car recently, you might be able to sell it for a quick profit. The price of used cars and trucks was up 10.5% in June, and 45.2% from last year, bucking conventional wisdom that cars are depreciating assets. While broader inflation has surpassed expectations, used cars and trucks alone made up over one-third of the total price increase in the Consumer Price Index (CPI) in June, which accelerated 5.4% compared to year-ago levels. This has many investors and consumers worried

about persistently higher long-term inflation. In a recent testimony to Congress, Federal Reserve Chairman Jerome Powell cited two primary reasons why inflation has exceeded expectations:

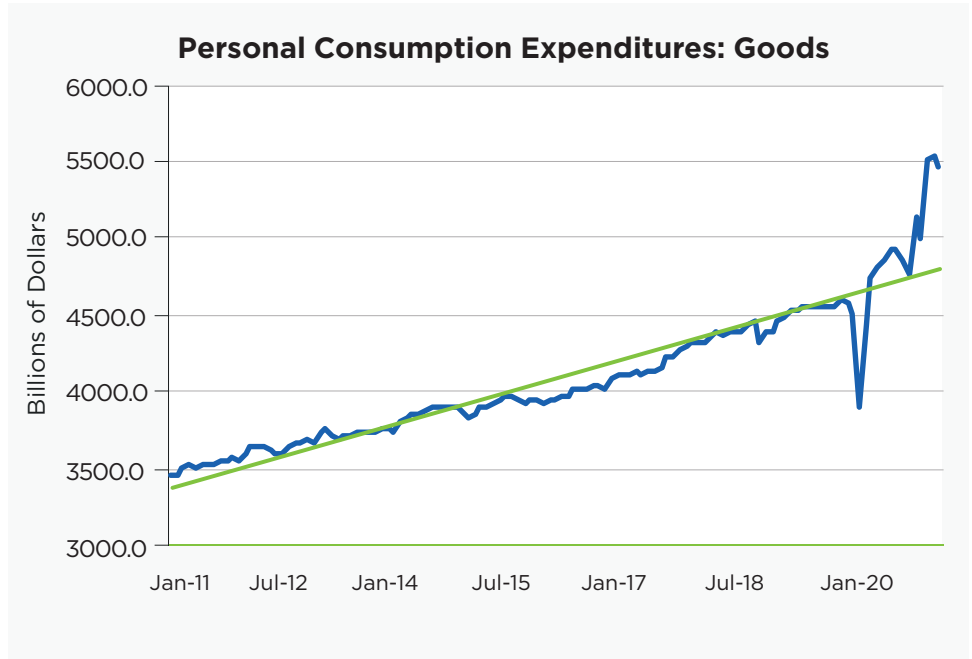
1. Strong demand & low supply
2. Supply chain bottlenecks

It's the Fed's view that these price pressures are being driven by pandemic related factors and will moderate towards the end of the year.

Low Inventories + Surging Demand

At the onset of COVID, many businesses paired down production in anticipation of a recession and reduced consumer spending. However, demand rebounded much quicker than expected as consumers, aided by historic fiscal stimulus, shifted demand from services to goods. Spending on goods is well above the pre-pandemic trend.

The combination of low inventories and surging demand has pushed the inventories to sales ratio to the lowest level in over 10 years. Businesses are now scrambling to ramp up production to meet this demand, causing supply chain constraints and bottlenecks.



Source: U.S. Bureau of Economic Analysis, Personal Consumption Expenditures: Goods [DGDSRC1], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/DGDSRC1>, July 26, 2021.

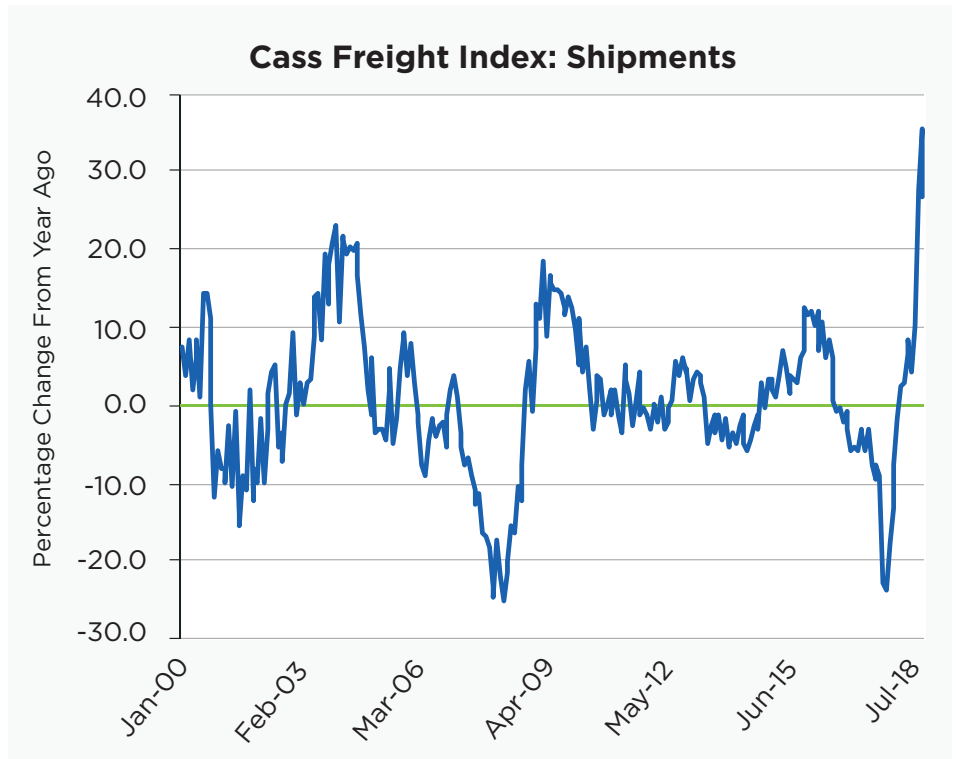


Source: U.S. Census Bureau, Total Business: Inventories to Sales Ratio [ISRATIO], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/ISRATIO>, July 26, 2021.

Supply Chain Constraints

On March 23rd, one of the largest container ships in the world ran aground in the Suez Canal, one of the busiest waterways and a key route in international shipping lanes. This held up global supply chains for weeks and pushed the cost of shipping dry goods as measured by the Baltic Dry Index to 11-year highs.

In addition, Cass Information Systems, which provides data on all modes of U.S. domestic freight, reported a record year-over-year increase in shipments and all-time highs in expenditures. Despite much of the recent inflationary pressure coming from pandemic related factors and supply chain issues, it could take a while for this to normalize.



Source: Cass Information Systems, Inc., Cass Freight Index: Shipments [FRGSHPUSM649NCIS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/FRGSHPUSM649NCIS>, July 27, 2021.

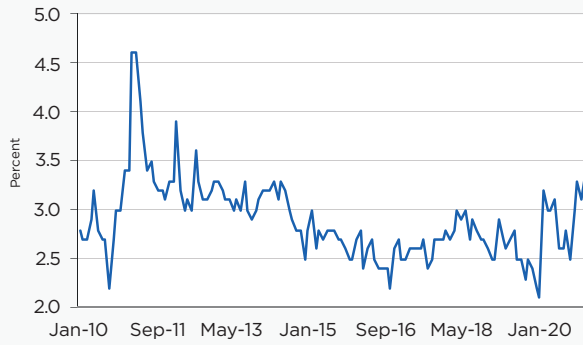


Cass Freight Index: Expenditures

Source: Cass Information Systems, Inc., Cass Freight Index: Expenditures [FRGEXPUSM649NCIS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/FRGEXPUSM649NCIS>, July 27, 2021.

University of Michigan: Inflation Expectation

Source: University of Michigan, University of Michigan: Inflation Expectation [MICH], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/MICH>, July 26, 2021.



Main Street Inflation Expectations Are Rising

The New York Fed does a “Survey of Consumers” which reported that expectations for one-year ahead inflation accelerated to 4.8%. The University of Michigan’s survey shows inflation expectations for the next 12 months at 4.6%.

In addition, the NFIB small business survey showed that 47% of small businesses are currently raising prices, while another 44% plan to raise prices, as owners pass on rising labor and input costs to consumers.

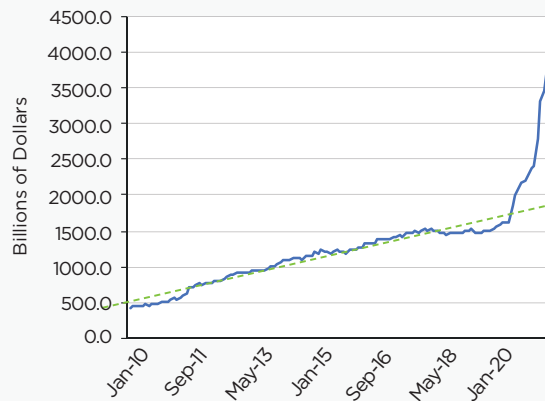


Producer Price Index: All Commodities

Source: U.S. Bureau of Labor Statistics, Producer Price Index by Commodity: All Commodities [PPIACO], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/PPIACO>, July 26, 2021.

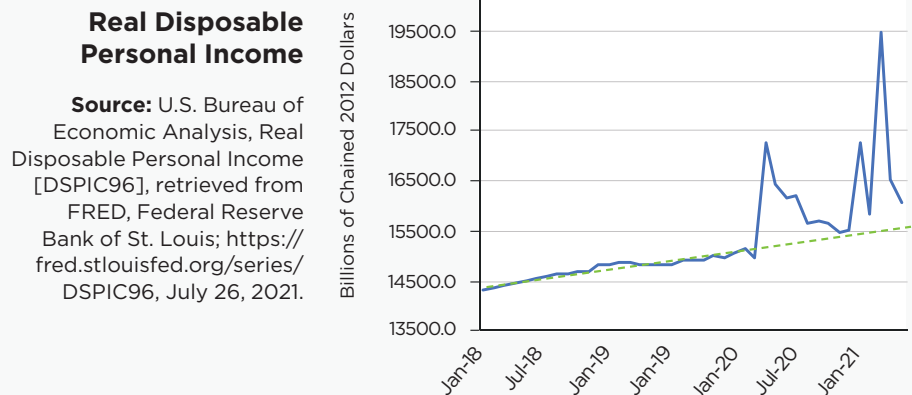
Where does inflation go from here?

It’s hard to tell where long-term inflation will settle. Even after some of the transitory aspects of inflation subside, the demand outlook looks strong. Households have accumulated approximately \$2.4 trillion in excess savings, and disposable income remains above the pre-pandemic trend. This will continue to provide a tailwind to consumer spending.



Demand Deposits: Total

Source: Board of Governors of the Federal Reserve System (US), Demand Deposits: Total [WDDNS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/WDDNS>, July 26, 2021.

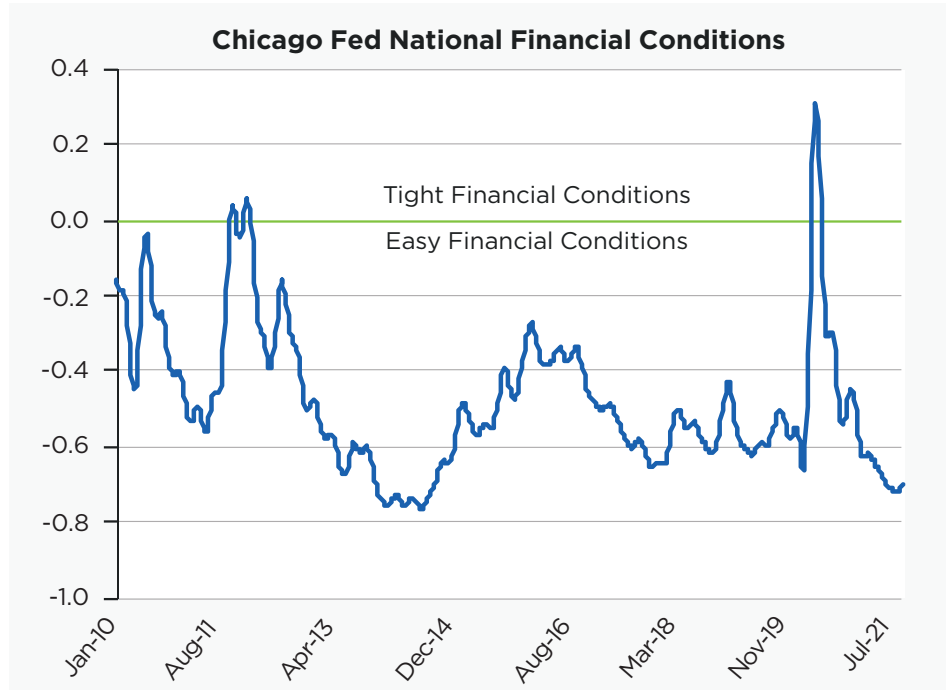


Real Disposable Personal Income

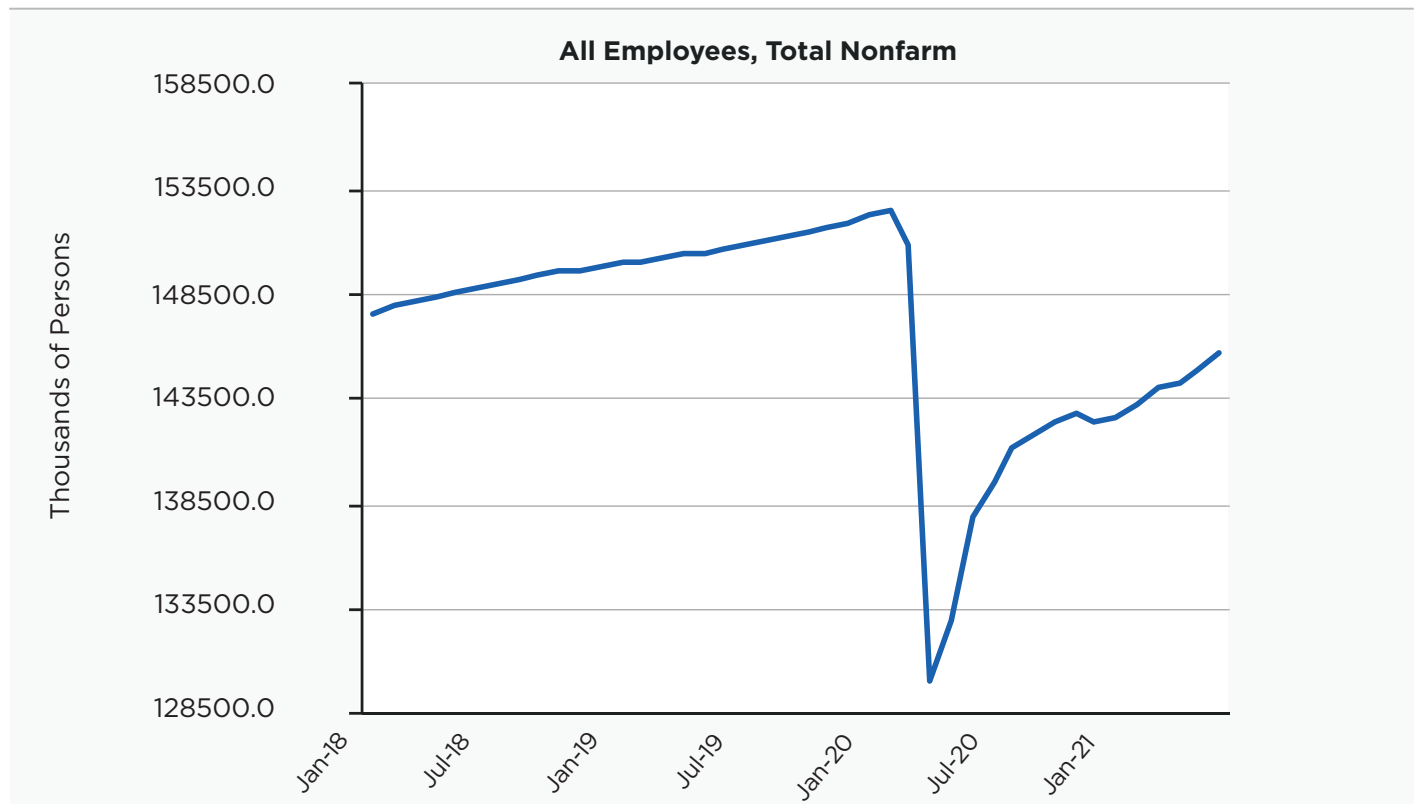
Source: U.S. Bureau of Economic Analysis, Real Disposable Personal Income [DSPIC96], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/DSPIC96>, July 26, 2021.

Monetary Policy will Remain Supportive

Current financial conditions remain extremely accommodative and the Fed will likely remain supportive until at least the end of 2022. Under their new policy framework, the Fed is willing to let inflation overshoot their 2% target to compensate for previous years where inflation remained below the target. I think their comfort level with this framework will be tested in the coming months. They are now looking for the labor market to reach full employment to inform their decision making on when to raise interest rates. Total non-farm payrolls have rebounded from the pandemic lows but still have a lot of ground to make up.



Source: Federal Reserve Bank of Chicago, Chicago Fed National Financial Conditions Index [NFCI], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/NFCI>, July 26, 2021.



Source: U.S. Bureau of Labor Statistics, All Employees, Total Nonfarm [PAYEMS], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/PAYEMS>, July 26, 2021.

The logo for Bank of Ann Arbor, featuring the text "bank of ann arbor" in a white, sans-serif font. The word "bank" is on the top line, "of" is a smaller word between "bank" and "ann", and "ann arbor" is on the bottom line. The entire logo is contained within a blue rounded rectangle with a white border.

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