Future Inflation Likely to be Much Warmer, but January Prices are Still Cool

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Consumer prices were well behaved in January as headline CPI climbed by +0.3% and core CPI was unchanged for the second straight month. Energy prices (+3.5%) were the primary driver of the headline. Core CPI was weighed down by falling prices on both new and used vehicles and a small +0.1% increase in owner's equivalent rent. On a year-over-year basis, headline CPI held steady at a subdued +1.4% pace, while core CPI slipped from +1.6% to +1.4%, well below the Fed's target.

Inflation is a story for late spring and early summer. It's almost certain to spike in April and May as prices will likely be significantly higher than a year ago when much of the country was shuttered and purchases were limited. This year-over-year "base effect" will be short-lived, but economists are still preparing investors for this appearance of sharply escalating prices. The impending base effect isn't the only inflationary concern for 2021. Skyrocketing stocks and increased home prices have boosted household wealth to record highs in each of the last three quarters, and an unprecedented +25% year-over-year increase in the M2 money supply has elevated the savings rate. *This represents huge capacity to spend when the virus threat eases.* If something even close to Biden's $1.9 trillion aid deal passes on top of the $900 billion package six weeks ago, there'll be even more dollars rattling around waiting to be spent. This is good news for future economic growth, but raises the possibility of overheating.

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The Fed has historically targeted a +2.0% inflation rate. They've indicated they'll allow inflation to move above that mark "for a time" to make up for the fact that inflation has fallen below the target for much of the last two decades. Fed officials won't be spooked by the spring/summer base surge, and are expected to allow prices to rise later this year, especially in the hobbled service sector, without intervening. The question is how future markets will react to negative real rates of interest as the inflation rate rises far above market yields.

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Market Indications as of 11:20 A.M. Central Time

DOW	Down 39 to 31,336 (HIGH: 31,385)
NASDAQ	Down 73 ro 13,935 (HIGH: 14,008)
S&P 500	Down 11 to 3,899 (HIGH: 3,915)
1-Yr T-bill	current yield 0.07%; opening yield 0.07%
2-Yr T-note	current yield 0.11%; opening yield 0.12%
5-Yr T-note	current yield 0.46%; opening yield 0.48%
10-Yr T-note	current yield 1.13%; opening yield 1.16%
30-Yr T-bond	current yield 1.93%; opening yield 1.95%