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U.S. Economic Outlook Report: **How Inflation Impacts Both Consumers and Businesses; Plus a Sneak Peek at Holiday 2021**

Prevedere Chief Economist, Andrew Duguay, provides a personal view on topical economic issues

Inflation has been a hot topic in the media the last few weeks, and generally, the focus has been on the consumer because the consumer drives the economy. The big question today is, how is rising inflation going to impact the consumer? Despite increasing inflation heading into the second half of 2021 and the holiday shopping season, there are still signals that consumers will have enough strength to keep spending.

Inflation Impact on Consumers

In the last few months, inflation has increased to a 6% annual rate which is uncomfortably high. People have real earning power when hourly wages rise above inflation because they make more than inflation is taking away. However, hourly wages have recently decreased as a result of new entrants into the labor force. As a result, inflation has now surpassed hourly wages, which may seem alarming on the surface.

However, looking at weekly wages provides a more holistic picture of the current situation. With the recent labor constraints, current employees often work overtime, which means weekly wages rising fast. This is good for the economy because it provides a buffer where weekly wages are rising faster than inflation, even though hourly wages have recently not kept pace.

Another important detail about current inflation is that some of it is transitory and will likely go back down. Some core commodity prices are already starting to reverse, which will help alleviate some of the temporary inflationary pressure across the economy. Meanwhile, wage gains have historically been "sticky." Therefore, the recent wage gains are not likely to reverse course.

Inflation Impact on Businesses

While all of the attention has been on the consumer lately, not enough people are paying attention to the impact of inflation on businesses. In fact, companies are absorbing most of the inflationary pressure. For example, the media has been talking a lot about the increase in the consumer price index, but the producer price index is currently at its highest level since the 1970s and is up over 19% on a year-over-year basis. This is especially alarming compared to the consumer price index, which is only up about 5% on a year-over-year basis.

The impact of inflation is happening all along the supply chain. Manufacturers are trying to pass increased costs off to the secondary manufacturers who are trying to pass the costs to the distributors, and then the distributors to the retailers, and finally through to the consumer. So somewhere along that line, the 19% inflation is reduced to about 5% by the time it reaches the consumer.

2nd Half of 2021 Business Expectations

For the remainder of 2021, the central theme is "watch your margin." Consumers are ready to buy, but as a business, if you are not careful, you could be losing margins because of this unprecedented difference between producer price inflation and consumer price inflation.

Heading into the second half of the year, businesses need to be aware of all the pressures they are facing. Some people might look at the stock market and think that business conditions are fine right now. However, the next few quarters will likely be challenging as global supply chain issues remain. Ultimately, the supply chain is a global problem, making it more challenging to solve because the U.S. can only stimulate its own economy with domestic policy measures rather than correct the entire global supply chain.

Holiday Season 2021 Sneak Peek

Ultimately, businesses are in a tricky spot for the remainder of 2021. Costs will be rising, and the ability to pass those costs through the supply chain might be limited and challenging. As a result, businesses need to be careful that they are not caught holding the higher-cost goods without being able to pass them down the supply chain.

While businesses face a challenging few months ahead, consumers are well-positioned to have a good holiday season and increase their spending. Even though consumer sentiment dipped a little bit last month, consumers have a lot of savings, and wages are still rising, so they have a lot of buying power right now. On the business side, the unprecedented level of demand comes with a few caveats, so now is the time to take advantage of the healthy consumer and rising wages and hopefully be able to adapt pricing strategies along the way.

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