RAMBLER INVESTMENT FUND

Inflation: Through the Lens of the Delta Variant

Charles Kintner

The economic climate of developed nations has been greatly shaken as of late due to COVID-19. While the stock market has been performing at record levels, we now must consider the long-term effects of the original coronavirus: persistent inflation and the new Delta variant. Both are starting to erode confidence in a national economic recovery that was formed as vaccinations and the Dow Jones hit record-highs. Inflation is becoming readily apparent to consumers across the United States, with concerns of the "silent tax" quickly becoming out-of-control as well as the new, more contagious Delta variant.

If we assume that the original COVID-19 strain was the impetus of current inflation, the Delta variant will be the impetus of future inflation – does it pose a significant threat? At the time of this article's writing, coronavirus cases have risen for forty-three days straight, without sign of plateauing. The Delta variant now makes up roughly 83% of total COVID-19 cases. The variant's more contagious nature (analogous to smallpox) makes it especially dangerous for those who are still unvaccinated, and those communities with low vaccination rates. While it may seem encouraging that vaccination rates are beginning to increase, there is a significant lag time between the first and second doses of the vaccine, and we have still not reached herd immunity.

Is this vaccination effort too little, too late? Even with immediate vaccine administration there is still a significant threat posed by mass-gatherings that would be easily solved with another shutdown that could result in economic stagnation. Despite the words of public health officials assuring that there are no plans to implement restrictions, it seems increasingly likely that shutdowns will occur again until herd immunity status is reached and/or the Delta variant is fully under control. This is a Herculean task many public health officials believe is insurmountable until vaccine hesitancy is stamped out.

Inflation, however, is a problem that has been festering for the past several months; between increasing manufacturing costs and government expenditure the United States is bound to experience it. How much has the coronavirus affected the inflation rate? According to the New York Federal Reserve, inflation for 2021 is expected to be around 2.8%, up from 1.4% in 2020. Let's break down what might be the cause of a doubling inflation rate.

First, manufacturing costs. The relationship between manufacturing costs, prices, and wages are all reflected in the concept of the wage-price spiral (also known as the cost-push spiral). This concept holds that if businesses increase prices to protect their profit margins from rising costs, *ceteris paribus*, a worker's taxable salary must increase at an equal rate to the current CPI to maintain commensurate purchasing power. In layman's terms, an increase in manufacturing costs is "passed on" to consumers and wages increase with prices. Does this model hold true?

Indeed, it does. Companies who manufacture durable goods (such as Whirlpool) have had to increase prices by 12% to make up for more expensive raw materials, and they are hardly alone in that adjustment. Companies that manufacture washers, driers, dishwashers, refrigerators, and freezers are all feeling the pressure. Raw materials such as steel, lumber, and gravel have hit record highs. Semiconductors and silicon wafers bottleneck the automotive industry, which is making new cars less accessible and fueling the used car market. Where a backorder of a Whirlpool washing machine could be fulfilled in under two weeks, it now takes two months. Evidently, manufacturer's costs have increased dramatically over the past year. How much of this extra cost is incurred by consumers?

Assuming the logical nature of the cost-push spiral model, one can look at the Consumer Price Index (CPI). This index measures the price level of a weighted average market basket of consumer goods and services purchased by households. The CPI index posted a record increase in March of 2021 of 0.6%, up from 0.4% the month prior – the largest monthly increase in over eight years.

Now that it is established that the cost-push inflation spiral might be occurring, one can say with a great deal of confidence that unchecked inflation may pose a problem to the ongoing economic success of the United States. This fear is exacerbated by 5.2 trillion dollars of government spending over the course of the pandemic, which began with then-president Donald Trump's 2.2 trillion dollar coronavirus relief package, followed by the Biden administration's 3 trillion relief package, with another one trillion in the tubes for the bipartisan infrastructure bill. This is of particular concern over the backdrop of rock-bottom interest rates, which the Fed has no plans to raise.

Federal Reserve Chair Jerome Powell stated that rate raising should occur after the labor market recovers – but this was before the Delta variant. While throwing cold water on the economy through heightened interest rates would be a good idea to manage rampant inflation post-recovery, the Delta variant throws a dangerous wrench into the plans of the Federal

Reserve. If the labor market does not recover sufficiently, or the economy slows again, we could be in the dangerous crossroads of increased government spending, inflation, and heightened interest rates.

What some economists and investors fear is the return of 1970s stagflation: high interest rates coupled with high inflation due to a multitude of factors, but mainly a hike in oil price and a stagnate economy. While this fear might be unrealistic, many causes of the 1970s economic slowdown are present in 2021 – higher oil prices, rising prices, a cost-push inflation spiral, and a rise in unemployment if the Delta variant spreads as quickly as argued. While the Biden administration hopes that we've moved onto the era of "easy money" without consequence, one must consider the wise (albeit paraphrased) words of the late great Milton Friedman: "there is no such thing as a free lunch".