

181 Ways To Say That US Price Pressures Are Broadening

- While the Beige Book ([here](#)) can often be stale and over-emphasize anecdotal evidence, it can be worth emphasizing when policy developments or abrupt shocks impact business conditions in such fashion as to place the focus upon anecdotal signals over lagging confirmation in “hard” data (subject to revisions). This may be one of those times. It’s no accident that the Beige Book mentions ‘price’ or ‘prices’ 181 times. It has tended to have many references to price pressures in past editions but the balance of the current references is overwhelmingly pointed higher versus past Beige Books such as after the commodity collapse in 2014–15. **This time, it is tariff concerns that are increasingly magnifying other underlying price pressures** as this edition of the Beige Book is the first to capture the steel and aluminum tariffs. At issue is that while the share of the CPI basket that is affected directly and indirectly by tariffs may be modest, the common assumption of limited pass-through into CPI may prove to be too low going forward. On this latter point, Beige Book guidance faces the risk of following other evidence toward greater-than-anticipated price pressures over the rest of the summer.
- Indeed the main thing of mild interest in the Beige Book is the anecdotal inflation guidance. **All districts are saying that price increases are “modest to moderate” and pass-through to consumers is “slight to moderate.”** I’m not exactly sure what the difference is between slight and modest but the signals on import prices, producer prices and consumer prices all point in the same direction of slightly firmer pressures. **Such indications may be low-balling the risk. Consider two arguments that follow.**
- For one, the steel and aluminum tariffs are relatively fresh and so it may be premature for the Beige Book—based upon opinions expressed up to July 9th—to provide clear guidance on the full degree of price pass-through stemming from the tariffs. **The tariffs on washing machines that were applied in February are a potentially better example of pass-through risk.** As the accompanying chart demonstrates, tariff pass-through is a) approaching 100%, and b) spread over about four months and counting up to the June CPI report. If anything close to this degree of tariff pass-through occurs in other categories then watch out going forward. Clearly little of the tariff was absorbed in company profit margins. This may reflect the pricing power of foreign producers.
- Second, note the fairly strong anecdotal warnings on the effects of the Trump administration’s steel tariffs:

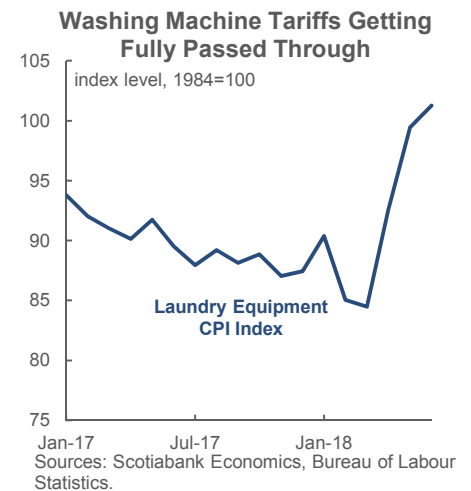
"One machinery manufacturer noted that the effects of the steel tariffs have been chaotic to its supply chain—disrupting planned orders, increasing prices, and prompting some panic buying."

"Additionally, a Maryland can manufacturer said he could not get the quality of steel needed domestically and anticipated losing business to foreign competitors who are not faced with steel tariffs."

Also, from the energy patch: "Expectations regarding future business conditions remained positive, supported by a favorable outlook for oil prices, but contacts expressed concern about steel tariffs, pipeline capacity constraints, and worker shortages."

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- Therefore one inference is to treat the Beige Book's guidance on pass-through as a) early for most items like lumber, steel and aluminum, and b) perhaps low-balled compared to where we may find inflation going over coming months.
- **The second inference relates to the potential (albeit likely remote) for auto tariffs.** One argument has been it would just ding auto company margins or induce changes to the composition of cars and trucks produced, imported and sold among other possible incidence effects that could even induce pressure to enhance auto financing terms even further. But the lesson from the 'laundry machines' case file offers a stronger caution. Generally, one is most likely to get maximum pass-through of inflation to end consumers at the point of full employment and zip spare capacity. USD strength may mitigate some or a fair portion of this albeit that many of the affected commodities are priced in USD terms already. Tariffs to date offer relatively transitory level adjustments to prices that will be difficult to ignore over 2018H2. When Chair Powell says gradual rate increases are appropriate "for now" he may be indicating awareness of the need to take out insurance against inflation upsides through tightened policy but aware of the uncertainty over the second round effects to demand and broader price pressures.
- The rest of the Beige Book is not particularly informative and is just focused upon more trade policy concerns that were previously expressed while signalling that fresh growth momentum is "moderate or modest" which is consistent with peak-growth being behind us in Q2.

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