



Florida TaxWatch
ECONOMIC COMMENTARY
**THE GREAT IMBALANCE: INFLATION'S
INFLUENCE IN THE COVID-19 ECONOMY**
JANUARY 2022

INFLATION IS HARDLY A NEW PHENOMENON EXCLUSIVE TO THE COVID-19 PANDEMIC; however, for decades preceding the pandemic, price increases were a subtle and often unnoticed component of the economy. The last time inflation posed a serious and prolonged threat to economic growth—in the early 1980s—Ronald Reagan was the president, the Iranian Hostage Crisis had ended, and *Indiana Jones: Raiders of the Lost Ark* made its theater debut. The early 1980s signified the end of what economists called “The Great Inflation” period in U.S. history.

For consumers and businesses entering 2022 with expectations that the new year would deliver unhindered growth, inflation is one drag on the economic outlook. From facing tough decisions to raise menu prices to encountering higher prices at the local grocery store, Florida business owners and consumers alike are confronted with the harsh realities of pandemic-induced inflation—the result of a great imbalance between supply and demand.

HIGHER CONSUMER AND PRODUCER PRICES

Although various measures exist to gauge national and regional inflation, the Consumer Price Index (CPI) is often cited and measures the average change in the prices paid by consumers for commonly purchased goods and services. As of the latest data available, the CPI soared 7.0 percent higher in December 2021 compared to a year earlier—the highest one-year increase

since 1982.¹ Excluding the more volatile food and energy components, core CPI rose by 5.5 percent, the sharpest increase since February 1991.²

Table 1. Consumer Price Increases for Certain Goods and Services (As of Dec. 2021)

Good/Service	Price Increase (Year-Over-Year)
Gas	49.6%
Used Cars and Trucks	37.3%
Rental Cars	36.0%
Hotels	27.6%
Furniture	13.8%
Meats, Poultry, Fish	12.6%
New Cars and Trucks	11.8%
Restaurant Prices	6.6%
Electricity	6.3%
Apparel	5.8%
TVs	4.4%

Source: U.S. Bureau of Labor Statistics (BLS)

When broken down by various product categories, certain item prices have grown significantly over the past year. Bacon prices, for example, are up 19 percent year-over-year, rental cars are up by 36 percent, and fuel prices are up a staggering 50 percent (See Table 1 for additional categories).

¹ U.S. Bureau of Labor Statistics (BLS), “Consumer Price Index – December 2021,” Jan. 12, 2021.
² Ibid. Note: Excluding more volatile components of CPI, such as food and energy prices, is a common practice among economists as it often provides a more stable trend for long-term analysis.

Inflation is also exhibiting regional variation throughout the state of Florida. By major cities, Tampa leads the list with the highest year-over-year price increase at 8.0 percent. Not only does this lead other major cities such as Orlando, Jacksonville, and Miami, but it also surpasses both the southern U.S. and national averages (See Table 2).³

Table 2. CPI Increases in Major Florida Cities Compared to U.S./Southern Average⁴

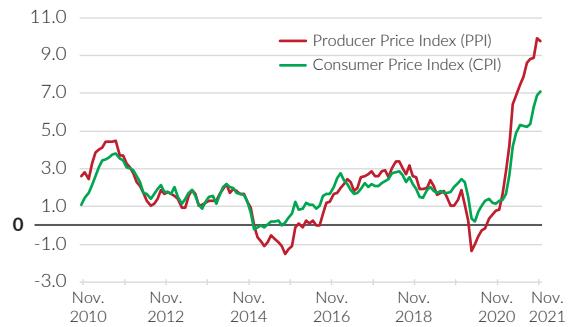
Region/Metropolitan Area	Price Increase (Year-Over-Year)
Tampa	8.0%
Orlando	6.8%
Jacksonville	6.8%
Miami	5.7%
Southern U.S. Average	7.2%
National Average	6.8%

Source: U.S. Bureau of Labor Statistics (BLS)

Headlines about consumer prices often garner most of the attention for their resonance with everyday customers; however, just as consequential are price increases for producers ranging from local manufacturers to multi-state businesses. The Producer Price Index (PPI) looks at price changes from the seller's perspective, reflecting the production costs for various goods and services. The PPI serves as a leading economic indicator since businesses may end up passing on higher prices to consumers.⁵

According to the most recent PPI release, producer prices increased by 9.7 percent over the year in December 2021—the largest advance since 2010 and higher than the CPI.⁶ When evaluating the course of CPI and PPI over the last decade, the two measures have often followed the same path (see Fig. 1).

Fig. 1. Producer Inflation has Exceeded Consumer Inflation Throughout 2021, Even as Both Climb Higher



In recent months, however, the PPI has begun to outpace the CPI by a wider margin, indicating that even greater inflationary pressures remain on the supply side and may foreshadow subsequent price increases for consumers in the months ahead. For Florida restaurants and manufacturers, for example, these higher prices for necessary inputs present a tough decision between absorbing costs (thereby lowering potential profits) or raising prices.

WHY IS INFLATION HIGH?

Higher demand, lower supply. The economic forces at work over the past two years have created a persistent imbalance and triggered the notable rise in inflation witnessed today. Starting in March 2020, businesses responded to virus risks and dwindling demand by severely limiting operations, drawing down inventory, and cutting investment. After a rousing recovery—a product of pent-up demand, vaccine rollouts, and monetary/fiscal stimulus—demand came soaring back.⁷ Many businesses had rushed to respond to heightened demand, but a mix of lower production capacities and constrained supply chains (a legacy of lower output during early 2020) made product shortages ubiquitous and price increases common.⁸

Much debate exists over the role of fiscal policies (e.g., American Rescue Plan) and monetary measures (e.g., lower interest rates) in fueling inflation pressures. Both certainly have had an effect as possessing more disposable income from stimulus payments or having lower interest rates encourages individuals to spend money, pumping currency into the economy.

The key difference, however, lies in the time horizon. In the long run, economists generally agree that monetary policy drives inflation as the Federal Reserve controls the supply of

3 U.S. Bureau of Labor Statistics (BLS), "Southeast Information Office: Florida," Accessed on Jan. 13, 2022.

4 Note: The U.S. Bureau of Labor Statistics (BLS) only reports inflation data for Tampa, Orlando, Jacksonville, and Miami. Data are not currently reported for smaller cities or rural areas.

5 CME Group, "Understanding Consumer Price Index and Producer Price Index," Accessed on Jan. 13, 2022.

6 U.S. Bureau of Labor Statistics (BLS), "Producer Price Indexes – December 2021," Jan. 13, 2021.

7 U.S. News and World Report, "Explainer: Why US Inflation is So High and When It May Ease," Dec. 10, 2021.

8 Congressional Research Service (CRS), "Inflation in the Wake of COVID-19," Sept. 1, 2021.

money and corresponding interest rates.⁹ Expansionary fiscal policy, on the other hand, is often viewed as more short-term in nature since it typically involves temporary increases in spending. At this point in the recovery, too much remains unknown about which specific factors are contributing most to inflation and how long they will last. Nevertheless, at a minimum, inflation is the natural cost of coming out of a severe downturn.

“A sizeable chunk of the inflation we’re seeing is the inevitable result of coming out of the pandemic.”

— DR. JASON FURMAN
PROFESSOR OF ECONOMIC POLICY, HARVARD UNIVERSITY¹⁰

IMPACT ON FLORIDA'S ECONOMY AND GOVERNMENT

With national data suggesting inflation is running hot in the U.S., the trends also have important implications for Florida's economy, government, and taxpayers. Higher prices for everyday goods and services result in lower purchasing power for many Floridians. According to the U.S. Bureau of Labor Statistics (BLS), the purchasing power of the U.S. dollar has decreased 6.5 percent in December 2021 compared to the year prior—the largest one-year decrease since 1982.¹¹ For Florida families residing in low-income and rural areas, these impacts further constrain budgets. Income growth is typically less pronounced in these areas, making it more difficult to adapt to rising prices for essentials like groceries, energy, and gas.¹²

Rising costs can also affect consumer expectations for future inflation. When consumers expect high future inflation, they may be more inclined to purchase items sooner before purchasing power erodes further. The result, however, is more immediate spending and money pumping into the economy, thereby pushing inflation even higher and creating a self-fulfilling prophecy.

For Floridians and others in the southern region, inflation expectations for the year ahead are running at around 6.0 percent, signaling expectations for even higher prices.¹³ Whether this is expediting purchasing decisions is still unclear. One potentially limiting factor is the impact of inflation on consumer confidence. For four consecutive

⁹ Ibid.

¹⁰ U.S. News and World Report, “Explainer: Why US Inflation is So High and When It May Ease,” Dec. 10, 2021.

¹¹ U.S. Bureau of Labor Statistics (BLS), “Consumer Price Index for All Urban Consumers: Purchasing Power of the Consumer Dollar in the U.S.,” Accessed Jan. 13, 2022.

¹² Federal Reserve Bank of St. Louis (FRED), Per Capita Personal Income by County, Annual: Florida, Accessed Jan. 13, 2022.

¹³ Federal Reserve Bank of New York, Survey of Consumer Expectations: Inflation Expectations for Southern Region, Accessed Jan. 13, 2022.

months toward the end of 2021, consumer sentiment in Florida declined due to growing weariness over supply chain issues, rising costs, and now the Omicron variant.¹⁴

Future expectations can also create an increase in nominal wages as workers demand higher pay to stay on par with a higher cost of living. A dangerous “wage-price” spiral can occur where higher consumer costs and worker demand for higher wages mutually push each other up higher.¹⁵ Based on available data, such an issue has not come to fruition as wage growth in Florida and the South Atlantic region has only been 3.1 percent over the year—below all other regions and the national average.¹⁶ Although this finding does not suggest a wage-price spiral is currently at hand, it is suggestive of another concern: inflation is accelerating the cost of living in many areas.

For Florida's state and local governments, contending with rising prices can lead to diverging outcomes with some benefits and some drawbacks. Similar to how inflation can induce higher wages in the private sector, inflation can potentially place upward pressure on government employee salaries, although these impacts may not be immediate due to budgetary constraints. State procurement for goods and services would conceivably become more expensive, further increasing state costs.

Throughout the pandemic, Florida consumers shifted their spending habits from services to goods to minimize physical exposure and obtain necessary household items.¹⁷ This seismic shift toward durable and non-durable goods led to price inflation for many taxable items, leading to a subsequent boost in Florida sales tax collections.¹⁸ The caveat going forward is that as prices continue to rise, consumers will adjust their purchasing behaviors to either buy cheaper products or reduce purchases, which in turn would eventually limit tax collections.

Based on Florida TaxWatch calculations, a one percent increase in the price of all taxable goods would bring in an estimated \$320 million in additional sales tax revenue for Florida.¹⁹ This estimate should be viewed with caution,

¹⁴ University of Florida (UF), Florida Consumer Sentiment Index, Nov. 30, 2021.

¹⁵ NC State University, “You Decide: Can A Wage-Price Spiral Be Avoided?” Nov. 19, 2021. Note: The “wage-price spiral was prevalent in the 1970s during “The Great Inflation” when inflation hit double digits.

¹⁶ Federal Reserve Bank of Atlanta, Wage Growth Tracker, Accessed on Jan. 13, 2022.

¹⁷ Deloitte, “A spring in consumers’ steps: Americans prepare to get back to their spending ways,” Jun. 28, 2021.

¹⁸ Florida Office of Economic and Demographic Research (EDR), “Florida: An Economic Preview,” Jan. 3, 2022.

¹⁹ Authors Calculations; General Revenue Estimating Conference - Sales Tax Liability (Table 16A). For FY 2021-2022, the total sales tax liability is estimated at \$32 billion. 1% of \$32 billion is \$320 million.

however, since it does not control for the adjustment behavior of consumers in response to higher prices over time and assumes a one percent increase in prices for taxable goods directly translates into a comparable one percent increase in tax revenue. More needs to be known about constantly shifting consumption patterns.

WHAT LIES AHEAD FOR INFLATION IN 2022 AND BEYOND?

Inflation is proving to be anything but “transitory,” as evidenced by comments from the Federal Reserve acknowledging price increases have been lasting longer than expected.²⁰ Yet even with inflation reports signaling higher prices on the immediate horizon, there is hope that 2022 will see inflation begin to taper down. According to some estimates, year-over-year percentage increases in the CPI are anticipated to fall to 4.8 percent by mid-year and then to an even lower 2.8 percent by the end of 2022.²¹ In other words, inflation improvement should begin to materialize by mid-2022 and slowly fall closer to a more characteristic 2.0 percent by 2023.

The Federal Reserve has also signaled it will gradually raise interest rates from their near-zero levels throughout the

pandemic to make borrowing more expensive and temper spending (at risk of weakening the recovery).²² Although there are clearer expectations for impending money supply changes, and to a lesser extent supply chain challenges, the key variable deals with consumers.

Will consumers begin to expect future inflation to become more permanent and shift consumption behaviors/wage demands as a result? The Omicron variant and future variants will also play a large, albeit unknown, role in affecting consumer decisions. For all these reasons—both known and unknown—inflation must be watched closely as policy discussions and debates continue to unfold.


20 AP News, “Powell says spike in inflation lasting longer than expected,” Sept. 27, 2021.


21 Bloomberg Economics (Analysis of BLS Data), “The Clashing Forces That Will Drive Inflation in 2022,” Jan. 11, 2022. <https://www.bloomberg.com/news/articles/2022-01-11/past-the-worst-why-u-s-inflation-could-fade-or-linger-in-2022>


22 New York Times, “Jerome Powell says the Fed is prepared to raise rates to tame inflation,” Jan. 11, 2022.



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