What Does “Transitory” Inflation Mean?

Description

Last Wednesday, Bank of Canada Governor Tim Macklem addressed Canadians on the growing rate of inflation. It’s “transitory,” he said. Though a complicated mix of factors would prolong our current inflationary period (most notably short supply chains), we would eventually see prices fall again.

The word “transitory” may bring some relief (at least to those using it). But it also adds some mystery: how long is transitory? Will it ever become permanent with today’s prices? Let’s take a look at the bank’s new buzzword and see.

What is transitory inflation?

Recall that inflation happens when prices gradually increase over a period of time. Though we may experience bigger price hikes in certain years over others, the Bank of Canada and the federal government typically work together to keep inflation rates averaging around 2%, with a target range of 1% to 3%.

Last month, however, the inflation rate soared far above the target range, hitting an 18-year high of 4.1%. Though, normally, banks and the federal government would be scrambling to figure out how to bring inflation down (especially with the monetary policy framework coming up at the end of the year), they’ve been rallying around their new buzz word, “transitory” inflation.

“Transitory” inflation is basically pandemic-produced price hikes. It’s transitory in the sense that once supplies go back up, prices will deflate to normal levels. Because the pandemic shut down production last year, they argue, we’re experiencing a supply shortage of everyday necessities. At the same time, as lockdowns ease up, consumer demand has risen to higher levels, bringing prices to the levels we’re seeing today.

How long will transitory inflation last?

That may sound good on paper. But for those who are feeling cash-strapped from price hikes, the real question is: how long is “*transitory*? exactly?

The Bank of Canada and the government don’t have a good answer. After a few months of bullish confidence that the rate will decrease by the end of the year, Tim Macklem finally admitted this month that high inflation may be more persistent than they originally thought. Though, of course, he didn’t back down from his confident stance that prices would eventually go down, he didn’t give an estimate of when that might happen.

Will transitory inflation become permanent?

First off, Canada isn’t the only country experiencing high levels of inflation. The U.S. as well as many countries in Europe are also facing short supplies, high consumer demand, and rising prices. The global price hike of certain commodities, such as crude oil and timber, is certainly linked to the pandemic, with the price of other goods — food, retail gas, furniture — following suit.

It’s quite possible that the prices of these goods will return to normal levels once we get supply under control. But that’s easier said than done. Right now, both the Fed and the Bank of England expect inflation to be above their 2% target all the way out to 2024 and 2023, respectively. A transitory inflation period of three to four years certainly doesn’t feel very temporary, especially when you’re among those who earn a low income.

At the end of the day, it’s impossible to predict when prices will fall back to normal, if at all. It’s possible we could be paying higher costs for daily goods for most of 2022, perhaps 2023. While that may not be great news, until we get some straight answers, it might be best to prepare for the worst.

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