Markets in a Minute: October 29, 2021
What's Up With the Global Supply Chain?

Many of us usually give little thought to how things like sneakers and refrigerators end up in stores. Not so lately. Problems with the global supply chain are blamed for having depleted inventories and contributing to inflationary pressures — yet dramatic changes in demand are just as responsible. And just as prices can spike, they can also fall once disruptions abate.

What makes our supply chain so vulnerable?

- As our supply chain has become increasingly global and complex – from railroads in the early 19th century, to the advent of standardized shipping containers in the 1960s – fewer and fewer goods have been produced within the borders of the United States.
- This globalization trend has helped drive down prices while also making us more reliant on these complex systems. Not surprisingly, food products are among the most likely to be made within the U.S., while apparel, computers and electrical equipment are among the least, making the latter more vulnerable to disruptions.
- More than 70% of all domestic goods are moved by truck. Even before the pandemic, the U.S. had a shortage of more than 60,000 truck drivers, which has since climbed to a record-high 80,000 truckers.
- Idiosyncratic issues have added to the pain. Acute weather events (from flooding in China to Hurricane Ida in the U.S.) have disrupted production. And the six-day blockage in March of the Suez Canal by a container ship certainly hasn't helped matters. An estimated 12 percent of global trade flows through the one waterway.

Changes in demand have been particularly acute in the United States:

- Generous fiscal and monetary stimulus put more money into consumers' pockets, driving personal savings rates to record highs.
- Strong gains in equity prices and home values have pushed household net worth above pre-pandemic levels, further stoking demand.
- The types of services and goods U.S. consumers bought changed dramatically in a short period of time. In the early days of the pandemic, work-from-home orders prompted individuals to increase spending on durable goods, such as appliances and exercise equipment. More recently, Americans' desire to eat out and travel brought customers back before many establishments could staff up.

Where do we go from here?

- Production of in-demand goods is slowly catching up. The team at IHS Markit forecasts that semiconductor supply will begin to meet auto industry demand during the second half of next year.
- Energy prices, which have also surged because of supply constraints, are expected to stabilize early next year, when heating demand fades and supplies adjust.
- Goods are gradually reaching end consumers. While as many as half a million containers are waiting off the coast of L.A. and Long Beach to be unloaded, certain key ports are now operating around the clock.

What impact could supply chain disruptions have on the markets?

- With supply not meeting demand, prices will remain elevated for a time. Inflation expectations further out are climbing too – 5-year, 5-year forward inflation expectations (a complicated way the market demonstrates its estimate of inflation 10 years from now) recently reached 2.4%.
- The most dramatic of the price appreciation should abate over the next 12 months or so, a view that both Federal Reserve Chairman Jerome Powell and the Federal Open Market Committee recently reiterated.

In fact, as the many containers get unloaded at ports, we could even face an oversupply of certain goods. Yet, for all the handwringing about shortages, corporate earnings remain remarkably strong.