US INFLATION SIGNALS
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"Come writers and critics
Who prophesize with your pen
And keep your eyes wide
The chance won't come again
And don't speak too soon
For the wheel's still in spin". Bob Dylan, "The Times They Are A-changin'"

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OVERVIEW AND CONCLUSION

In their noble war to generate sufficient inflation, insure economic recovery, and slash unemployment, central bankers in America, Europe, and Japan have fought with extraordinary weapons such as monumental money printing and longstanding interest rate yield repression. On the inflation front, they battle furiously to achieve and sustain an inflation target of about two percent. This allegedly good (desirable, reasonable, prudent) goal contrasts not only with bad "excessive" inflation, but also with bad "too low" inflation and evil (or at least really bad) of deflation.

For several months, widely-watched inflationary yardsticks such as the consumer price index indicated too low inflation or inflamed worries regarding deflation. The consequences of the 2007-2009 international economic disaster probably have not disappeared, and the dramatic slump in petroleum prices after mid-2014 has troubled many inflation seekers. In any event, most economic forecasters, including central banking captains, have postponed the achievement of sufficient inflation as measured by such signposts rather far out into the future. Consequently, marketplace warriors, political leaders, and the financial media have focused relatively little on other gauges warning of notable potential for increased inflation in benchmarks such as the consumer price index.

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The worldwide global economy of course is interconnected and complex. Numerous variables intertwine to produce any given inflation level and trend. Inflation acceleration need not appear first or strongest in beloved indicators such as consumer prices or personal consumption expenditures. Although the United States is not a financial island, focus on the American landscape.

"Inflation" is not confined to measures such as the CPI or personal consumption expenditures; "the economy" includes other inflation benchmarks. Various indicators signal there is more inflation "around" in the US than most believe. Underline American wage increases. Note central bank and marketplace murmurings regarding high valuations or so-called asset bubbles; keep in mind the climbs in US equities and home prices from their financial crisis depths. Money supply growth remains robust. The steely determination of the Fed and its central banking allies to achieve their inflation objectives heralds that monetary policy probably will remain quite lax for some time even if the US eventually raises rates. These factors collectively warn that at least in America, deflationary forces "in general" have found strong adversaries. The recent spike in key interest rates such as the 10 year US government note (and the German Bund) in part reflects this inflation.

Despite the recent rate of change in US consumer prices and personal consumption expenditures, probably neither deflation nor dangerously low inflation are on the American horizon. In addition, sustained "too low" inflation in America probably should not be a worry for the near term. Nevertheless, although a sustained jump in PCE and CPI inflation rates much beyond the Fed's desired two percent target currently appears unlikely, "sufficient" inflation in America may be achieved faster than many predict.

AMERICA: PCE AND CPI INFLATION

The US price index for personal consumption expenditures rose 1.3 percent year-on-year in calendar 2014 (1.2pc in 2013), below the Fed's two percent goal. Recent statistics and the Fed's forecasts for calendar 2015 also display inflation well under the objective. US PCE was flat in April 2015 versus the preceding month. March 2015 rose merely .2pc month-on-month (February 2015 inched up only .2pc, and January 2015 actually fell .5pc month-on month). From the year-on-year vantage point, April 2015 crawled merely .1pc higher year-on-year. January 2015 edged up only .2pc year-on-year, with February and March each increasing .3pc year-on-year. The recent slump in PCE growth represented a worrisome shift from October 2014's 1.4pc year-on-year growth. (Bureau of Economic Analysis, 6/1/15, Table 9, Table 11; Interactive Table 2.3.4).

The Federal Reserve's "Summary of Economic Projections" (3/18/15. Table 1) midpoint of the central tendency for overall PCE price inflation is only .7pc for calendar 2015 (compare its December 2014 projection of 1.3pc). The sentinel thereafter sees inflation heading toward its target, with calendar 2016 PCE inflation at 1.8pc and 2017 just short of 2.0pc. The "Longer run" central tendency is 2.0pc.

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Of course slower US (and worldwide) GDP growth may help to decelerate inflation. The International Monetary Fund's 2015 Article IV Consultation with the United States (5/28/15; released 6/4/15) forecast US real GDP (annual average) at 2.5 percent for 2015 and 3.0pc for 2016. Flag the higher growth predictions it heralded only a few weeks before the Article IV meeting ("World Economic Outlook", April 2015, Chapter 1, Table 1.1) of 3.1pc for both 2015 and 2016. The IMF's Article IV predicts US PCE inflation (Q4/Q4) of only .7 percent for 2015 and 1.5pc for 2016, proclaiming the Fed will reach its 2.0pc objective only by mid-2017.

The IMF fears little regarding inflation in advanced countries in general. Its April 2015 WEO (Statistical Appendix, Table A5) has consumer prices of advanced economies up .4pc in 2015 (less than 2014's 1.4pc), 1.4pc in 2016, and 2.0pc in 2020.

The Fed's falling short on its key inflation measures, especially for calendar 2015, is mirrored in viewpoints regarding other realms such as the Eurozone. According to the European Central Bank's Press Conference (6/3/15), HICP annual inflation for the Euro Area (June 2015 projections) is only .3pc in 2015, though it marches up 1.5pc in 2016 and 1.8pc in 2017.

The OECD (6/2/15) measure of annual OECD inflation (all items) slowed to an advance of .4pc in the year to April 2015 (an 11.5pc year-on-year retreat in energy prices played a crucial part in generating this modest all items increase). March 2015 rose only .6pc year-on-year. Compare June 2014's 2.1pc year-on-year increase and the overall 2014 OECD average of 1.7pc. The OECD indicates the US achieved its inflation high during 2014 in May (and June) at 2.1pc.

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The US consumer price index for April 2015 (all urban consumers, all items, seasonally adjusted; Bureau of Labor Statistics, Table A, 5/22/15) rose merely .1pc month-on-month, declining .2pc year-on-year (before seasonal adjustment). For the months January 2015 through April 2015, the year-on-year changes were flat to slightly negative (April 2015's was the most negative), which probably increased worries about too low inflation; compare June 2014's year-on-year 2.1pc climb. Yet based on April 2015's .1pc month-on-month increase, current CPI inflation is fairly low, about 1.2pc annualized, but it is not declining.

However, the CPI all items less food and energy weathervane rose .3pc in April 2015 versus the prior month. It also was up .2pc in each of the three preceding calendar months. The unadjusted year-on-year advance for April 2015 was 1.8pc. So if one focuses outside of the food and energy patch, arguably some modest inflation in the US consumer price sector exists nowadays.

WAGES

"Men were weighed by their dollars, measures gauged by their dollars; life was auctioneered, appraised, put up, and knocked down for its dollars." Charles Dickens, "Martin Chuzzlewit"

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Recent US wage data indicates inflation exceeding the Fed's revered two percent signpost. Significantly, real average weekly earnings have steadily ascended from their flat year-on-year level in June 2014. They rose 3.0pc year-on-year in January 2015, 2.6pc year-on-year in February 2015, 2.1pc in March 2015, and 2.3pc in April 2015 (Bureau of Labor Statistics, Table A-1). In the more distant past, this measure sometimes has been negative (for example, -.2pc back in December 2013).

Not also the climb in the employment cost index (12 month percent change, Bureau of Labor Statistics, not seasonally adjusted). After dropping to a low of 1.4pc in 4Q09, 3Q14 and 4Q14 rose to 2.2pc, with 1Q15 up 2.6pc.

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Economic inequality, partly manifested by the majestic paydays of top corporate executives relative to the paychecks of average (and especially impoverished) workers, eventually can encourage agitation for profitable corporations (and other employers) to provide wage boosts to their employees.

Heated campaigns for increases in the minimum wage capture national economic and political attention nowadays. To some extent, successful fights for a minimum wage boost probably helps elevate overall wage inflation, if only slightly.

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Stanley Fisher (Vice Chairman of the Federal Reserve) recently noted ("What have we learned from the crises of the last 20 years?"; 6/1/15): "there is now growing evidence that recessions lead not only to a lower level of future output, but also to a persistently lower growth rate." How much labor "slack" is there in the US marketplace? Are marketplace guardians overestimating the size of the output gap or when it will be closed?

The International Monetary Fund (World Economic Outlook database, April 2015) indicates the US output gap as a percent of potential GDP was about -5.1pc in 2009, falling to around -2.0pc in

2014. Its estimate of the 2015 output gap is about -1.0pc, with 2016's merely -.1pc; 2017's is a slightly positive .1pc (no output gap in 2017).

US headline unemployment in May 2015 was 5.5 percent, a sharp fall from its 10.0 percent plateau in October 2009 (Bureau of Labor Statistics, 6/5/15). The Fed's "Economic Projections" indicate calendar 2015 unemployment at 5.1pc, with 2016's 5.0pc (midpoint of central tendency). Since December 2014's 5.6pc, headline unemployment has stuck around 5.5pc (low was April 2015's 5.4pc). Suppose there is little or no slack in the labor force (and a small or no output gap), perhaps in part due to the worldwide economic disaster following the Goldilocks Era. Little labor slack and a tiny output gap, all else equal, probably will help to propel average wages uphill. Fed determination to push the unemployment rate lower than current levels via further continuation of highly accommodative monetary policies could assist inflation "in general".

ASSET PRICE INFLATION: STOCKS AND HOMES

From Oscar Wilde's play, "Lady Windermere's Fan":
Cecil Graham: "What is a cynic?"
Lord Darlington: "A man who knows the price of everything and the value of nothing."
Cecil Graham: "And a sentimentalist, my dear Darlington, is a man who sees an absurd value in everything, and doesn't know the market price of any single thing."

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The PCE and CPI are not the only important measures of "inflation" and "deflation" around.

Federal Reserve strategists have struggled valiantly to rebuild and further increase US household balance sheet net worth following the dreadful troughs of the global economic disaster. Their success has been glorious. Money printing and sustained interest rate yield repression have been key armaments in the Fed's arsenal. The Federal Funds rate has been under .25pc since December 2008 (monthly average; Fed H.15). Stocks and homes are important household balance sheet components. Underscore the remarkable price inflation in stocks and homes assisted by the Fed (and helped by other central banks) and applauded by politicians, armies of marketplace investors, and the financial media.

Yield repression has encouraged quests for yield (return), including via US equities (and lower grade debt securities). The triumphant American stock bull charge obviously has been massive. The S+P 500, standing decisively over 2000, skyrockets well over three times its 3/6/09 bottom at 667. Its recent high is 5/20/15's 2135.

Significant leverage (easy credit) regarding stocks parallels the Fed's long-running highly accommodative monetary policy. NYSE margin debt reached a new record in April 2015 at $507.2 billion.

Does the S+P 500 currently reflect "irrational exuberance"? Whether the S+P 500 is "reasonably priced", "fairly valued", "overvalued", "too high", "frothy", or a "bubble" is a matter of opinion depending on the observer's definitions and perspective. Corporate earnings levels and trends as well as numerous other variables obviously influence many viewpoints. Nevertheless, recent widespread marketplace talk about high valuations and bubbles in US stocks underlines the noteworthy inflation (real increases) in their prices.

Financial regulators probably do not want to scare US stock bulls (including investors) by labeling the US stock marketplace (and related territories) with words such as “too high”, “bubbles”, “(significant) broad-based excesses”, or “irrational levels”.

Yet Federal Reserve Board Chairman Janet Yellin recently confessed that “equity market valuations at this point generally are quite high (5/6/15 comment at the “Finance and Society” conference; see the IMF’s video; Financial Times, 5/7/15, p3). In her 3/18/15 FOMC Press Conference, she declared “overall measures of equity valuations are on the high side but not outside of historical ranges.”

And the International Monetary Fund’s Article IV Consultation (Paragraph 11; 5/28/15) cryptically noted: “there are signs of stretched valuations across a range of U.S. asset markets.” Currently the system has “pockets of vulnerabilities”, not “broad-based excesses”.

The BloombergBusiness website headlines “Goldman Sachs Asked Two of the World’s Best-Known Economists [Robert Shiller and Jeremy Siegel] If U.S. Stocks Are in a Bubble” (6/1/15).

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Take a look at the Case-Shiller home price index (5/26/15). March 2015’s US national index rose 4.1 percent year-on-year to 168.0. This is notably above the Fed’s two percent inflation target for the PCE. Admittedly the home price index still rests beneath its 184.6 July 2006 peak. However, March 2015 soars 25.4pc (roughly over eight percent for each of the past three years) from its February 2012 low at 134.0. The 20 city index in March 2015 stood at 175.2, jumping 30.6pc from its March 2012 bottom (July 2006 peak 206.5).

Although the S&P’s Press Release spokesperson describes the “long stretch of strong reports” for 35 consecutive months “as a rebound in home prices, not bubble and not a reason to be fearful”. However, he admits “it is no surprise that people are asking if we’re in a new home price bubble.”

MONEY SUPPLY GROWTH

Despite substantial money printing by the US and others, money supply growth has not attracted substantial marketplace attention. Yet arguably it should, particularly when one views it alongside inflationary signs such as rising wages and substantial rallies in stock and real estate prices. Sustained money supply growth, after first confronting and turning aside deflationary assaults, eventually may help to produce higher inflation, including in the PCE and CPI yardsticks.

US M2 money supply expanded at a 6.0pc annual rate in the 12 months from April 2014 to April 2015 (seasonally adjusted; Federal Reserve H.6). In the three months from January 2015 to April 2015, it increased 6.4pc. Currency in circulation for the week ended 6/3/15 grew about 6.9 percent year-on-year (Fed H.4.1). Note also the huge expansion of the US monetary base from about $875 billion in mid-September 2008 to nearly $4.0 trillion in late May 2015 (see Fed H.3 and St. Louis Fed data).

Compare such money supply growth with recent nominal US GDP growth rates. The higher growth rate in money supply figures contrasts with those in nominal GDP, hinting of inflation risks. US nominal GDP rose 3.9 percent in calendar 2014 versus calendar 2013. In 1Q15, nominal GDP tumbled at an annual rate of .9pc (real GDP fell .7pc; Bureau of Economic Analysis, 5/29/15).

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The US is not the only region with notable money supply growth. The European Central Bank pointed out (6/3/15) that annual growth rate of M3 in the Euro Area increased to 5.3pc in April 2015.

EXIT STRATEGIES

Despite Fed rhetoric regarding its exit strategy, it still lacks a coherent, well-developed one. Comments about data dependence, normalization, and being vigilant and hints about rate increases is not a substantial policy. Tinkering talk about "adjusting the interest rate it pays on excess reserve balances" and using "an overnight reverse repurchase agreement facility and other supplementary tools as needed" ("Policy Normalization Principles and Plans"; 9/17/04) does not substitute for a strong, clear, and viable (even if changeable) framework.

The Fed and its central bank comrades around the globe have created huge rivers of liquidity via QE. Some may wonder why the Fed thus far shows no genuine (or courageous) willingness to sell out much (if any) of its enormous inventory of government and mortgage-backed securities. As of 6/3/15, it held over $2.3 trillion in US Treasury notes and bonds and over $1.7 trillion in mortgage-backed securities (H.4.1). After all, this marketplace general engaged in long-lasting and supposedly well-reasoned quantitative easing (money printing) campaigns to acquire massive amounts of debt securities.

Does Japan have an exit strategy for reversing its gargantuan QQE scheme? Incidentally, the ECB admits it has no exit strategy from its unconventional policies yet (see its Press Conference, 6/3/15).

Suppose many marketplace observers eventually perceive the Fed has little if any credible exit strategy. This viewpoint, when coupled with ongoing significant money supply growth and other inflationary signs, may reduce faith that inflationary expectations are well-anchored. Rising inflationary expectations thereby may tend to increase assorted actual inflation measures, including the PCE and CPI.

Watch signals such as the US five year forward inflation expectation rate (St. Louis Fed); this has hovered around two percent in recent weeks. Since the start of 2010, it approximately has ranged between slightly under two pc to around three pc.

INTEREST RATES

"Flights to quality", hunts for suitable yield (return), and other supply/demand considerations, not just low inflation statistics, can rally prices of debt securities. Yet did sustained central bank yield repression create or at least encourage "too low" yields for (a price "bubble" in) key government debt securities such as those of the United States and Germany? In the Eurozone, the terrifying enemy called deflation neared. The European Central Bank fired back with a huge quantitative easing (money printing) plan involving government debt securities. Some European government security interest rate yields went negative.

However, was a US (and German) debt security price bubble recently popped?

The 10 year US government note established an important yield low at 1.64 percent on 1/30/15, above 7/25/12's major bottom at 1.38pc. Since January 2015's valley, the US 10 year rate shot up about 50 percent to 6/5/15's 2.44pc. The 1/2/14 summit at 3.05pc represents important resistance. In any case, what should the yield on US 10 year government notes be if inflation (such as in the PCE) is 1.5 percent or higher?

The 10 year German government note made a key bottom on 4/17/15 close to zero, at .05 percent (not long after the UST 10 year note made a minor low at 1.80pc on 4/3/15). Bund yields thereafter blasted higher, reaching almost one percent on 6/4/15. The Japanese 10 year JGB made a significant trough in 2015 shortly before the UST's, on 1/20/15 at .20 percent.

US stocks advanced victoriously from their March 2009 major low for many reasons, including strong corporate earnings and share buybacks. Yet money printing and yield repression also assisted the S+P 500's mighty ascent. So if US stocks recently reached "too high" levels, perhaps rising interest rates (or growing fears of them) will inspire those equities to retreat (burst their bubble).

Regardless of whether or not American government note yields recently were (or are still) "too low", the recent sharp increase in UST 10 year note rates may reflect not just a "technical correction" or a growing belief that the Federal Funds rate (and thus yields in US government securities) will rise in the relatively near future. That noteworthy UST yield leap probably also warns that US inflation "in general" has grown or will do so soon.

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