



Summary

- **March CPI confirmed strong Q1 inflation, delaying expectations for the Fed's first rate cut. Transportation services and shelter inflation are key for future policy adjustments**
- **Import prices rose more than expected in April. While Chinese import prices remain deflationary, the pace of decline has been slowing, posing slight upside risk to core goods inflation**
- **Despite the strong Q1 inflation readings, cooling in the labour market, evidenced by declining job openings and a steady quits rate, suggests wage pressures may continue to ease**
- **Commodity prices rose in March and April, with copper reaching a two-year high thanks to better manufacturing data from China and Europe. Gold prices continued higher**
- **The Fed announced a slowdown in QT starting this month, and despite higher tax collections, Treasury issuance for Q2 was revised higher due to overestimated receipts**
- **Entering 2024, the market expected over 160bps of rate cuts, driven by disinflationary momentum in Q4. With momentum stalling in Q1, only a single cut is now fully priced for 2024**

About this document

US Inflation Watch presents over 20 charts comprising key inflation indicators grouped into different categories including consumer/producer price inflation, commodity prices, wage inflation, inflation expectations and monetary indicators.

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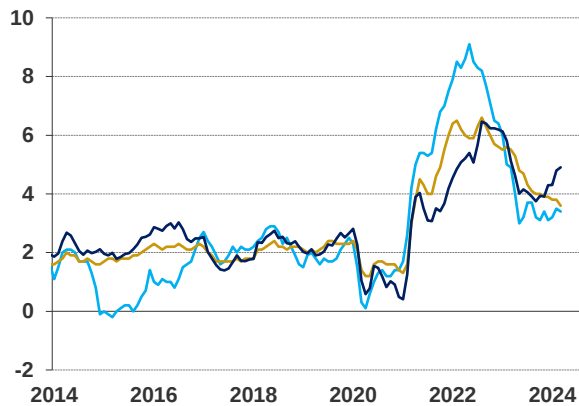
The Importance of Inflation

Inflation is the single most important indicator when measuring real wealth as it determines what wealth can buy i.e. purchasing power. If 'nominal' wealth doubles over 25 years but the level of prices also doubles, there is no net gain in 'real' wealth. It only takes annual inflation of 2.8% to cause a doubling in prices over 25 years.

About Altana Wealth

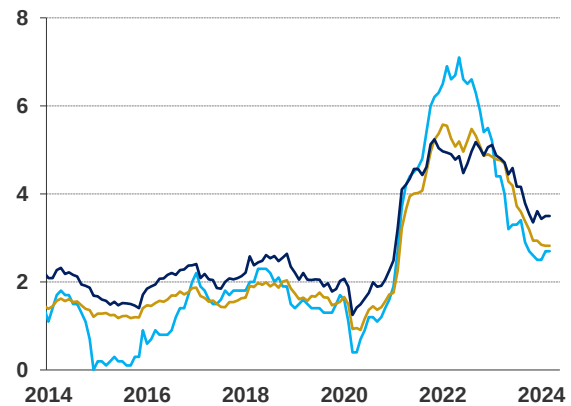
Altana Wealth is a specialist fund manager focused on delivering alpha where we have a competitive edge from niche strategies. As co-investors in all our funds, our interests are aligned with those of our investors. Altana was set-up by Lee Robinson, co-founder of highly successful Trafalgar Asset Managers in 2010. Our funds have won multiple performance awards over the last few years.

Consumer prices as measured by CPI (% y/y)



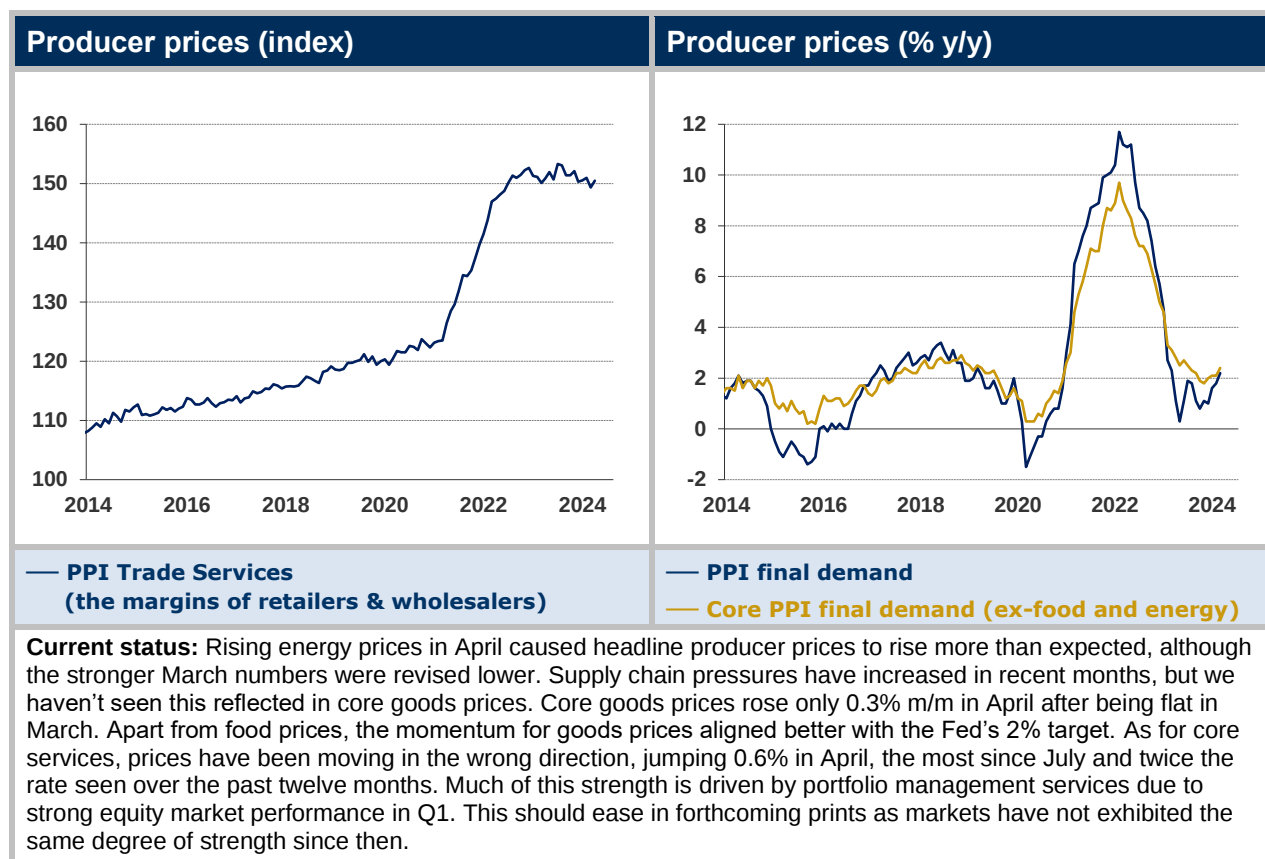
— Total CPI
— Core CPI
— Core CPI Services (ex-housing), supercore

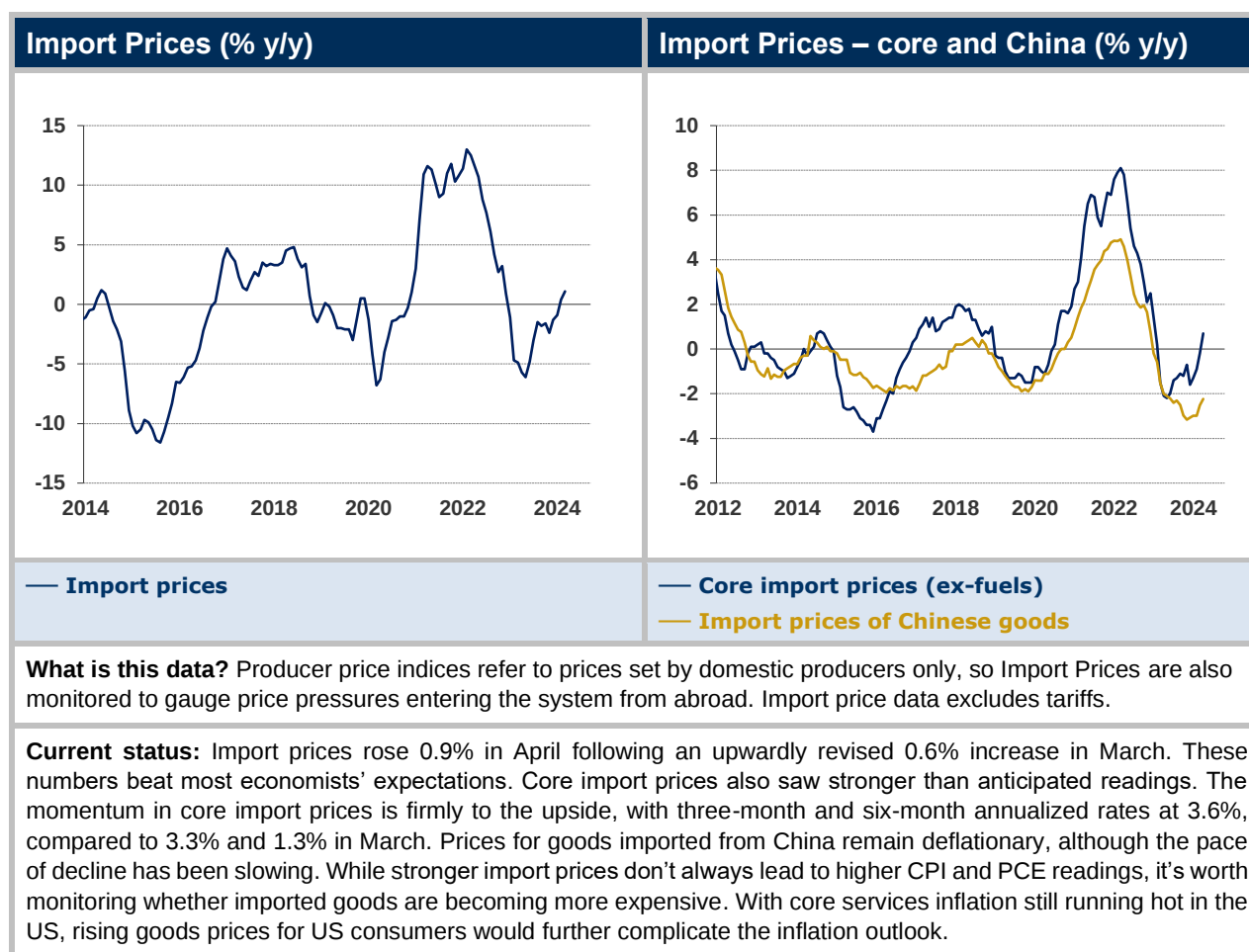
Consumer prices as measured by PCE (% y/y)



— Total PCE
— Core PCE
— Core PCE Services (ex-housing), supercore

Current status: The March CPI confirmed the strength in Q1 inflation numbers, delaying expectations for the first rate cut by the Federal Reserve. Although seasonality and new year price effects posed upside risks, the figures were too strong to attribute solely to these dynamics. Core CPI services ex-housing grew 0.65% in March, more than twice the rate observed throughout Q4 2023. Despite April's softer m/m reading of 0.42%, the y/y rate is nearing 5%, which is far too high for the Federal Reserve. Notably, core PCE inflation has not been running as hot as core CPI, creating a growing wedge between the two in recent months. The Fed targets core PCE, which is calculated differently to core CPI due to varying component weightings. Nevertheless, core PCE numbers in Q1 were strong enough to lead officials to push back against easing policy. High services inflation continues to weigh on inflation progress while core goods remain deflationary. Shelter disinflation remains too slow, although April saw the smallest monthly increase in rent inflation since 2021. Fed officials would welcome more of this. The Fed are adamant that shelter disinflation will continue, even if it's taking longer than expected. Coming back to non-housing core services, inflation here appears heavily concentrated in transportation services. In both March and April, transportation services, things like vehicle insurance and maintenance and repair costs, accounted for over 50% of the monthly increase in the supercore readings. In April, transportation services inflation was running at a y/y rate of +11%, and with a weight of 24%, it accounted for over 53% of the strength in y/y core CPI services ex-housing. These figures reflect the lagged effects of inflation in used cars and replacement parts that peaked in 2022 and should soon decline. The high inflation prints from Q1 may be behind us, implying more benign readings moving forward. The key to the Fed beginning its easing cycle rests on shelter disinflation picking up, and transportation services inflation slowing. Low/falling market rent and used car prices point to both happening, but the path may be bumpy. To understand the direction of travel for inflation and the Fed's rate path, we recommend closely monitoring shelter and transportation price trends.

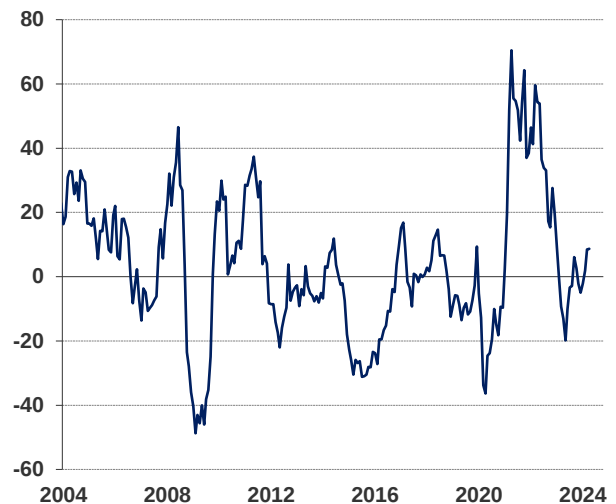




CRB-TR/J Commodity Price Index

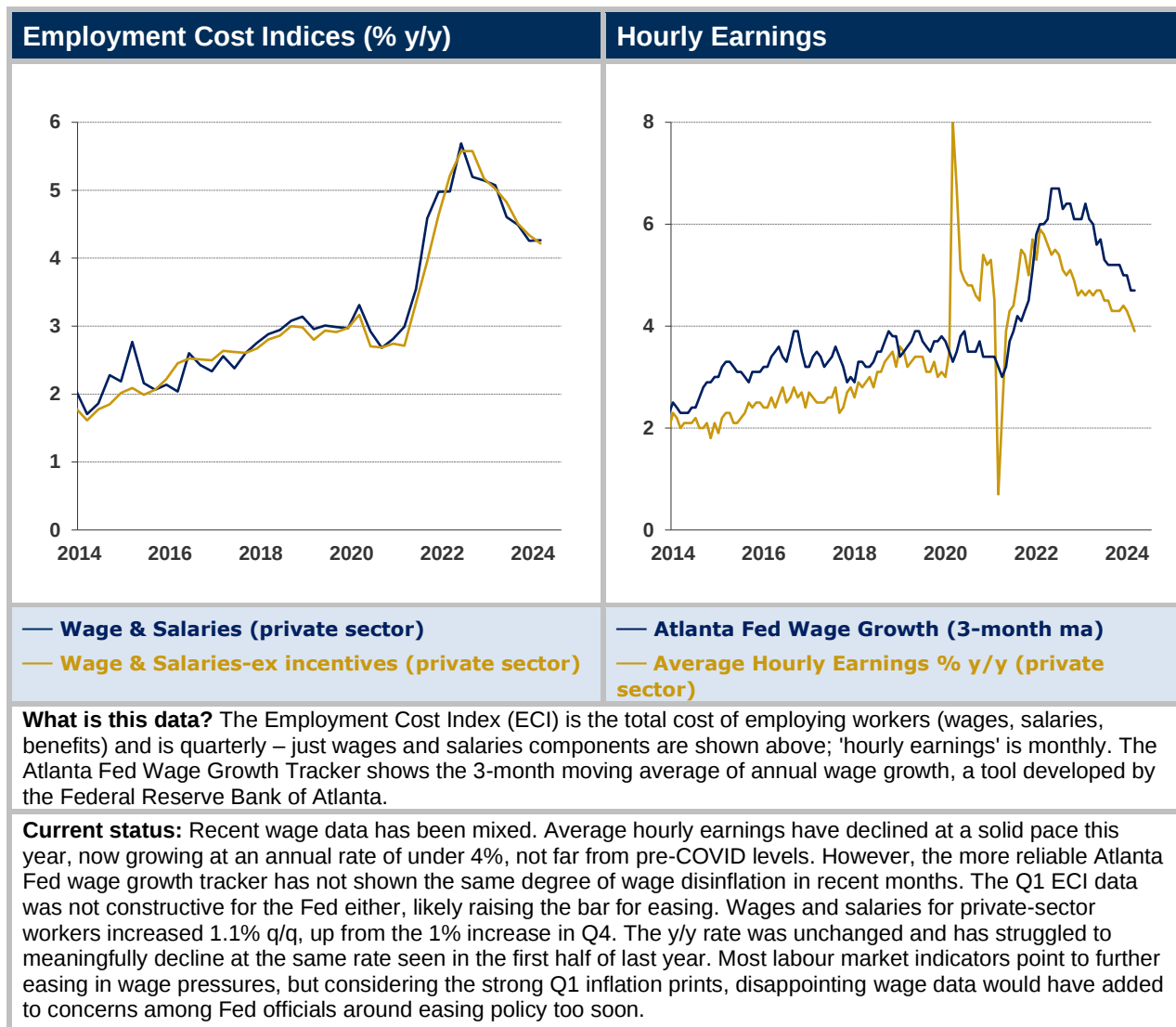


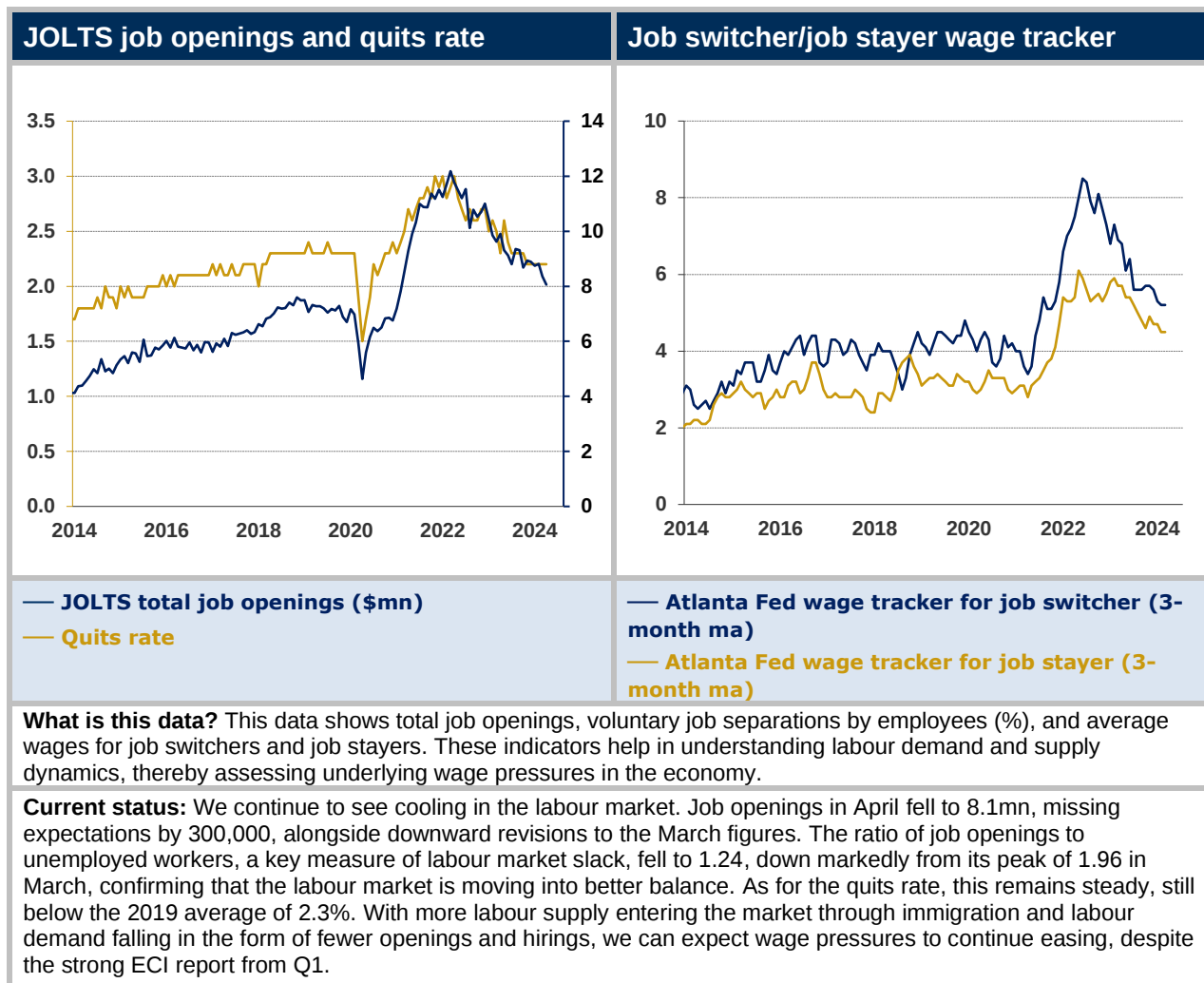
CRB-TR/J Commodity Prices (% y/y)

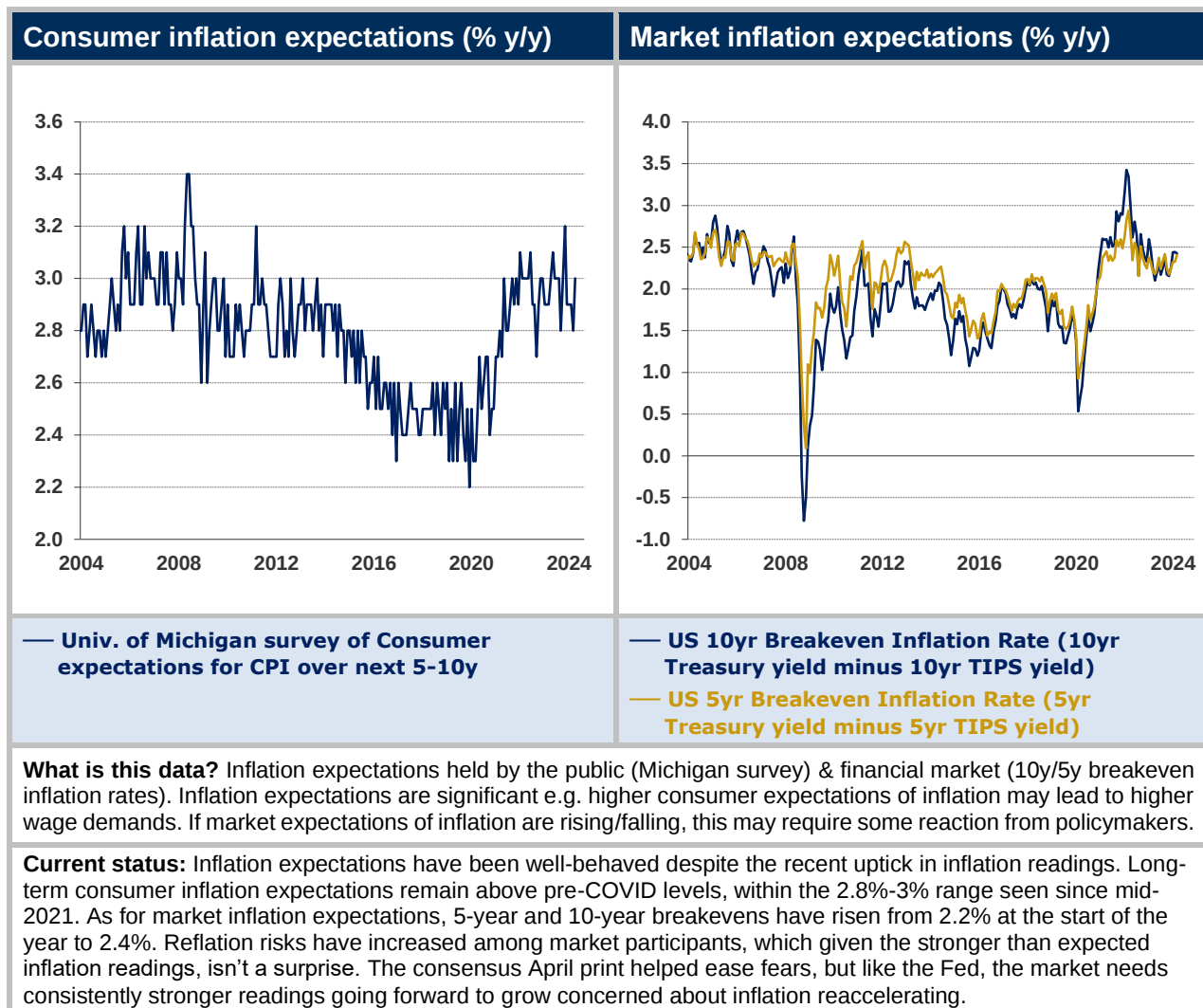


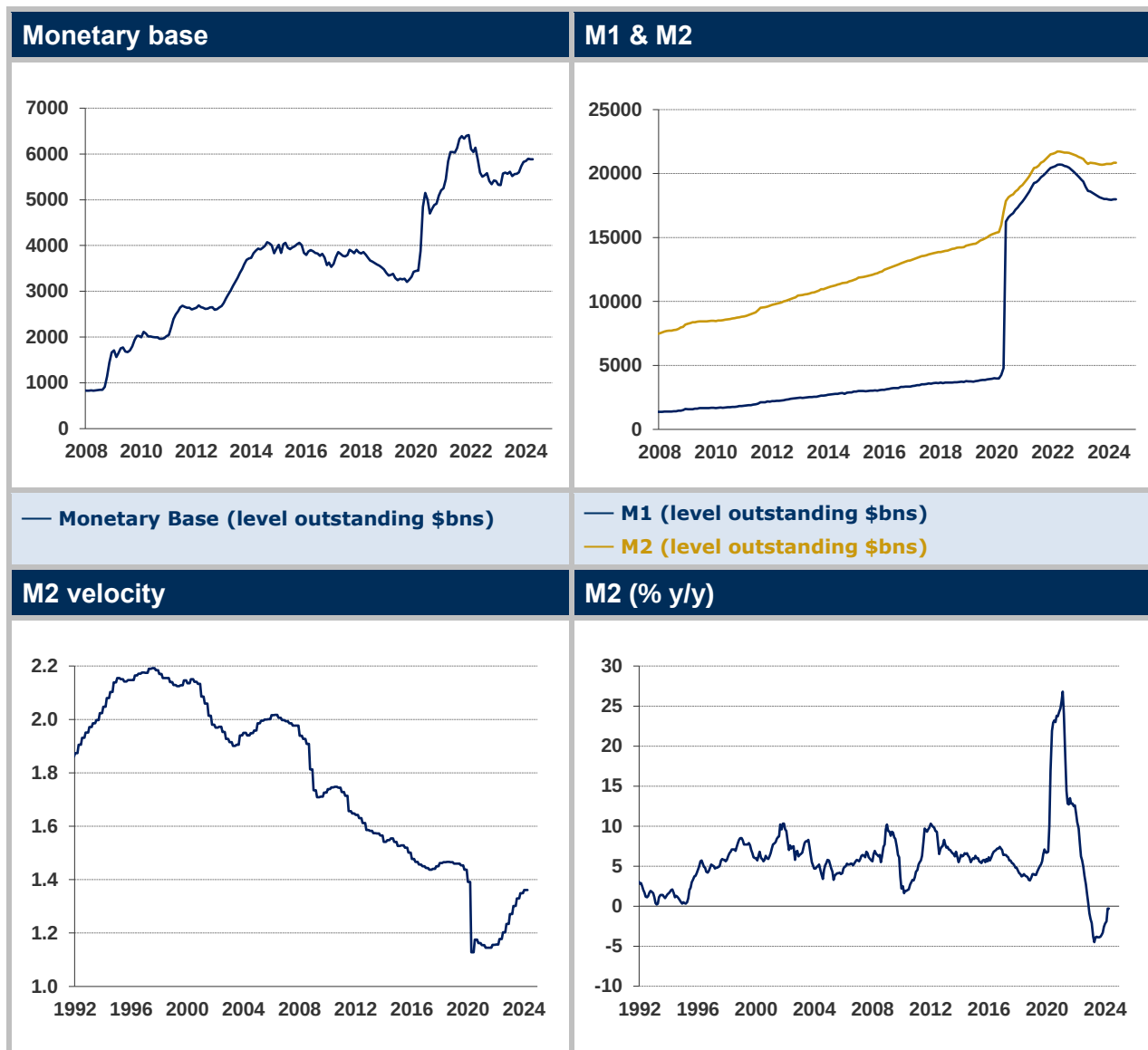
What is this data? CRB Index is a basket of commodity prices - a timelier indication of Crude PPI.

Current status: Commodity prices in March and April moved higher, with copper surging to a two-year high in April as the growth reacceleration narrative began to develop. This stemmed mainly from improving manufacturing data out of China and Europe. Chinese manufacturing showed two consecutive months of expansion after five months of PMI readings indicating contraction. Although Europe remains in a manufacturing recession, the bottom in manufacturing activity looks to be in as recent data has shown significant improvement. Escalating geopolitical tensions in the Middle East, alongside tight supply conditions, drove the Brent oil benchmark above \$90 per barrel in early April. However, as the likelihood of further escalation diminished, much of the geopolitical risk was priced out, causing oil prices to decline throughout April-good news in terms of marginal inflationary pressures. Gold continued to charge higher in March and April, rising to as much as \$2,400 an ounce, spurred by further central bank stockpiling.









About the data

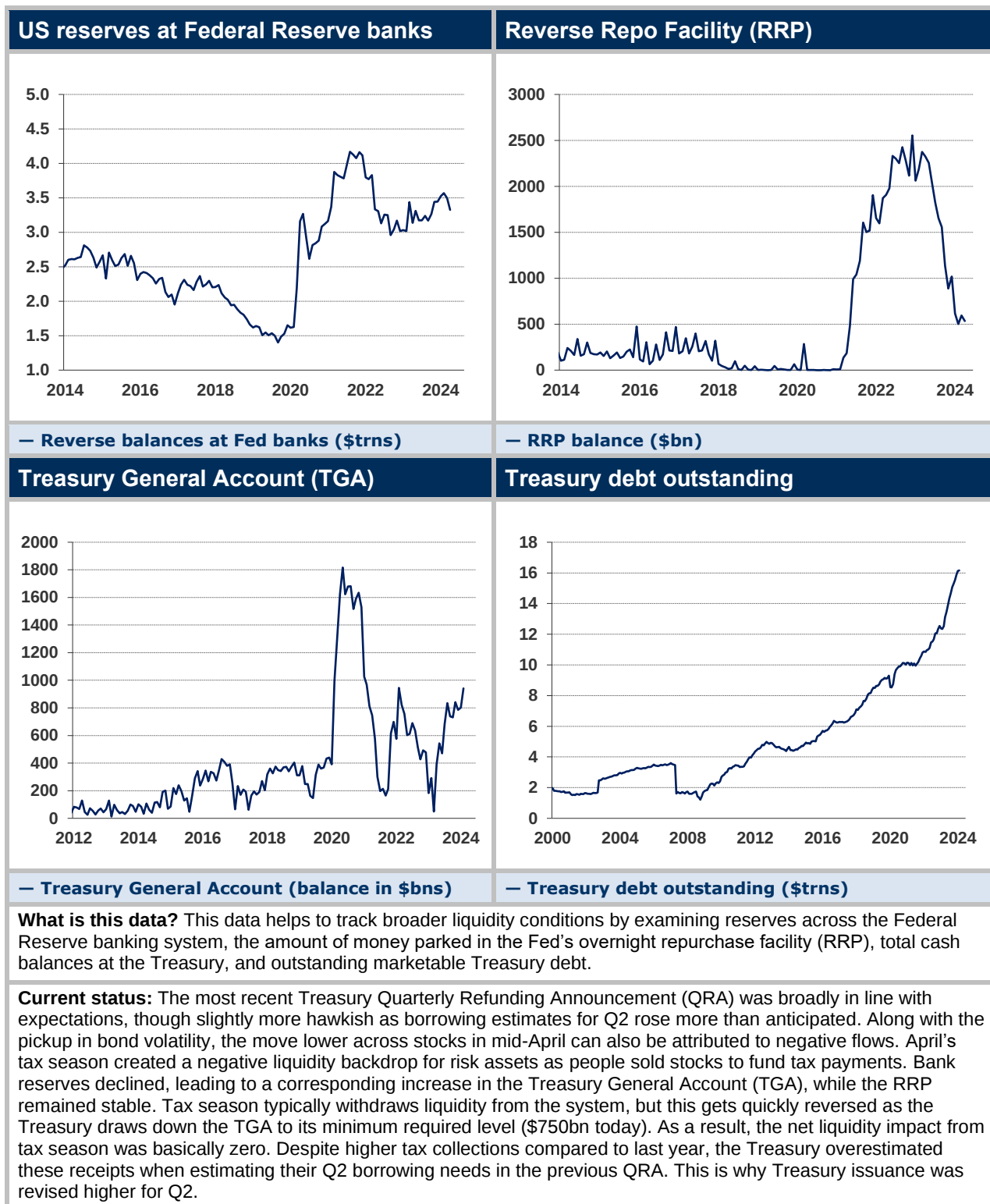
Monetary base = M0 (or notes & coins in circulation) + notes & coins held by banks and the central bank + bank reserves held by the banking system at the central bank. **Note:** the last two items are *not in circulation*

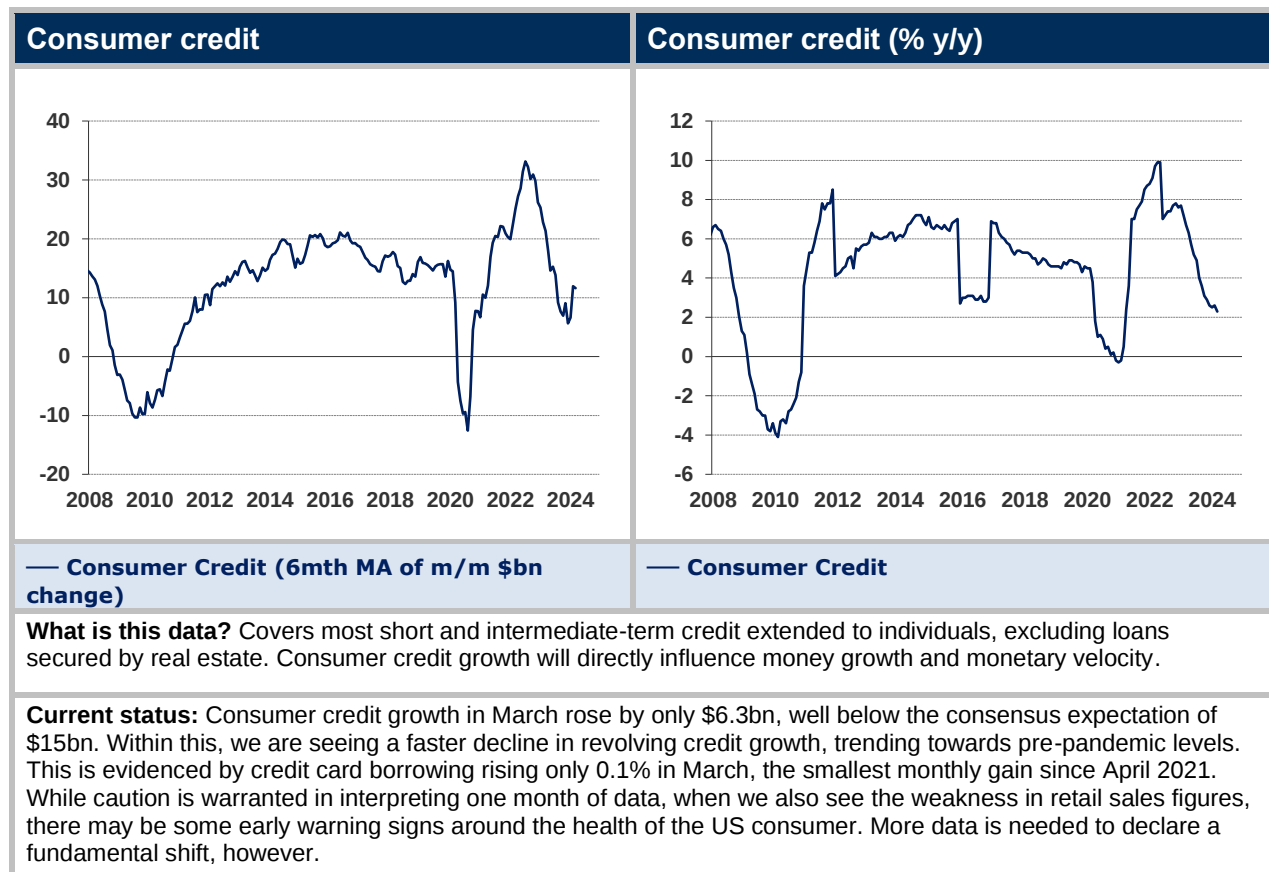
M1 = M0 + demand deposits + other checkable deposits (inc savings deposits previously in M2 – recently revised)

M2 = M1 + time deposits < \$100k + retail money funds.

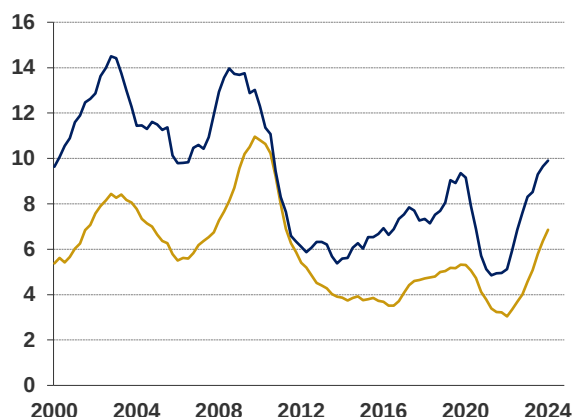
M2 Velocity = Nominal GDP/M2 shows how often the money stock is used for spending on goods & services and is inversely related to the 'demand for money' i.e. holding that money rather than exchanging it for goods and services.

Current status: Bank reserves fell in April by over \$113 billion, leading to a slight decline in the monetary base. As we discuss next, tax season was largely responsible for this fall in bank reserves. April tax selling also led to the largest monthly decline in money market fund assets in two years, as people withdrew cash to fund their large capital gains bills. M1 was depressed in April as a result. The Fed announced in their May FOMC meeting that the pace of QT will slow from June. Currently, the Fed allows up to \$60 billion a month in Treasuries and up to \$35 billion in mortgage-backed securities to roll off. The rate of Treasury roll-off will now slow from \$60 billion to \$25 billion, which should help support the monetary base going forward as more cash gets added to bank balance sheets. As for credit growth, bank lending was solid throughout March and April, although there was some notable softening in residential real estate as mortgage rates rose back above 7%.





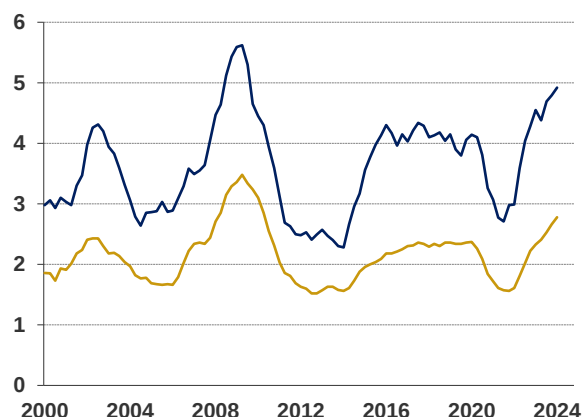
Credit card debt- delinquency rates



— Transition into serious delinquency for ages 18-29

— Transition into serious delinquency for all ages

Auto loan debt-delinquency rates



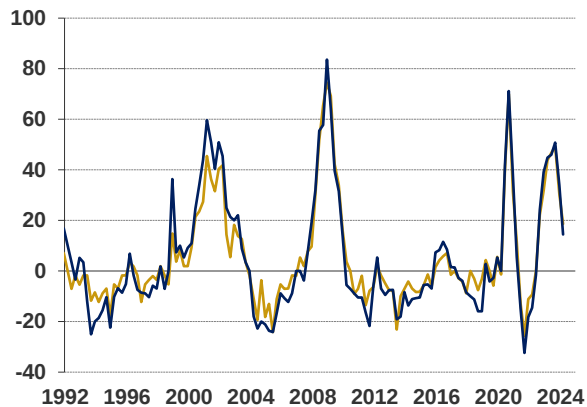
— Transition into serious delinquency for ages 18-29

— Transition into serious delinquency for all ages

What is this data? Quarterly data provided by the NY Fed provides insight into the credit health of consumers, showing the percentage of debt transitioning into serious delinquency, ie over 90 days due.

Current status: Recent data shows an increase in the transition to serious delinquency for all debt types. For credit card debt among those aged between 18-29, delinquency rates have now surpassed pre-COVID levels and are at their highest since 2010. High borrowing rates are clearly straining the most financially stretched consumers. However, across all ages and product categories, transitions into serious delinquency stood at just 1.5% in Q1, well below pre-pandemic levels. While delinquency rates are useful, analysing credit card utilization is equally as important, as the number of people maxing out their credit cards can help in measuring the probability of default. The share of maxed-out borrowers is rising alongside delinquencies, approaching pre-pandemic levels. This increase has been strongest among younger consumers. Any material improvement in delinquency rates would require a decline in maxed-out borrowers, which is unlikely without rate cuts. Therefore, we should expect this trend in delinquencies to continue in the coming quarters, likely putting downward pressure on consumer spending.

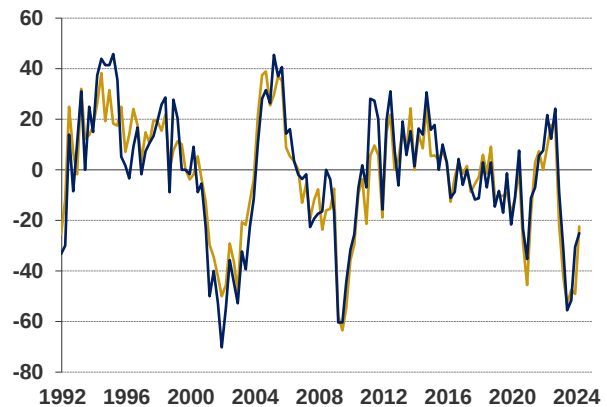
SLOOS- tighter lending standards



— % tightening standards for C&I loans for medium/large firms

— % tightening standards for C&I loans for small firms

SLOOS- stronger demand conditions

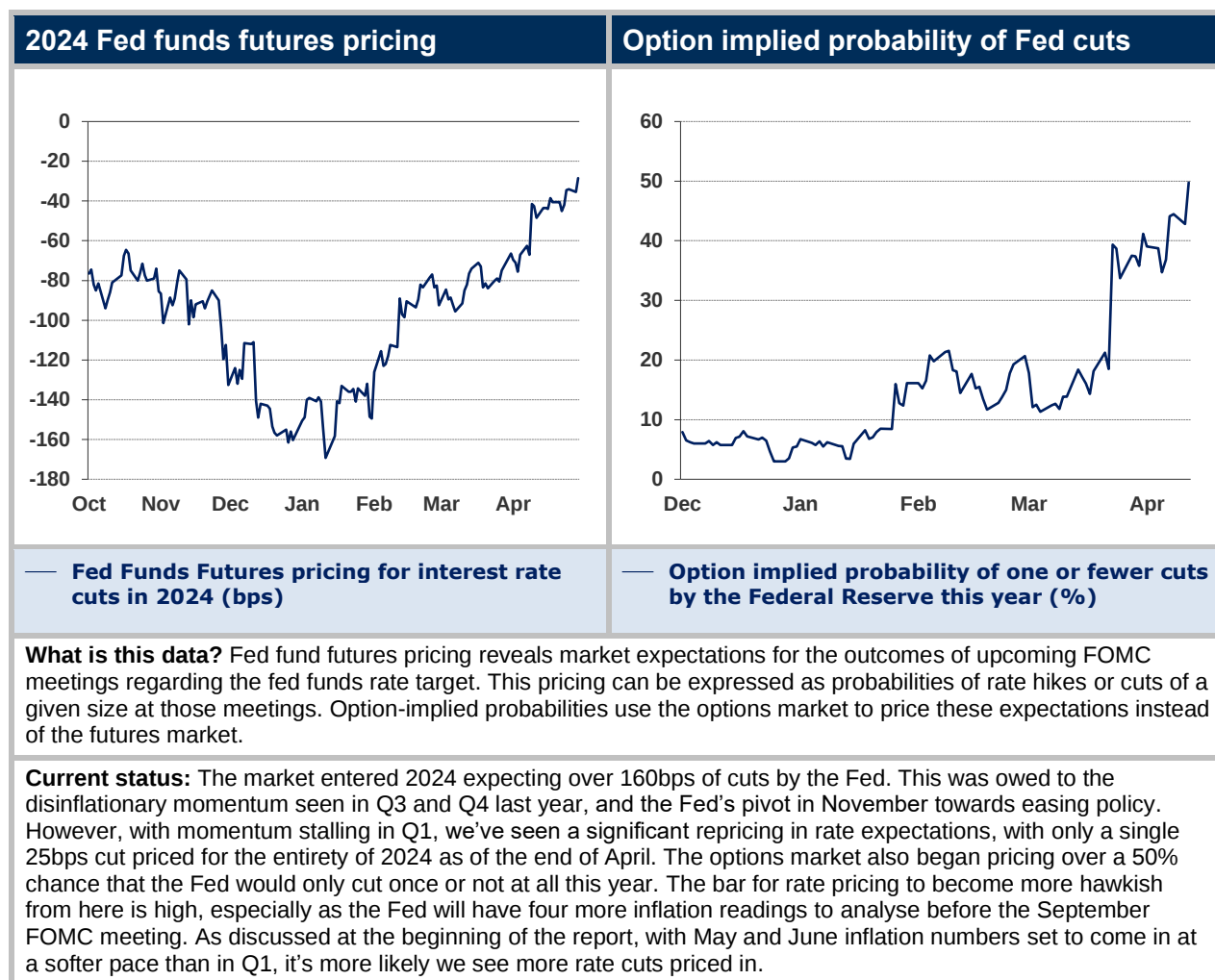


— % reporting stronger demand for C&I loans for medium/large firms

— % reporting stronger demand for C&I loans for small firms

What is this data? Quarterly Fed's Senior Loan Officer Survey provides insights into changes in bank lending standards for commercial and industrial loans. The survey gathers information from senior loan officers at major banks and financial institutions and asks questions about changes in lending standards, demand for loans, and other factors influencing credit availability.

Current status: The Q1 senior loan officer survey showed a smaller percentage of banks tightening lending practices compared to the previous quarter across most loan categories. Although lending standards remain tight, the direction of travel has been constructive since mid-last year. Demand for C&I loans for small businesses saw significant relief in Q1 (from -49% to -22%). This shouldn't come as a surprise given the decline in borrowing rates toward the end of last year. Fed policy tends to lead bank's decisions to tighten or ease lending by a few quarters. When the Fed adopted an easing bias in November, a pickup in economic activity and easing of financial conditions into Q1 and Q2 was to be expected, which is what we saw.



Appendix A – Monetary Indicators

The monetary backdrop is somewhat profound in terms of its potential influence on inflation and is the subject of considerable debate. Below is a simple monetary framework that helps to explain the role of Money in the economy and how it can affect inflation.

A Monetary Framework

The amount of money circulating in the economy will have implications for inflation in the medium-long term. This is best expressed via the **Quantity Theory Identity**

$$M.V \equiv P.Y$$

Where M is the amount of money in the economy, V is the velocity of money (how many times the amount of money is used), P is prices and Y is real output (GDP). Together, P.Y is money or nominal GDP.

As a basic identity this is not controversial. If M (\$500) is used 5 times (V) then \$2,500 will have been spent and will be equal to the value (P.Y) of all goods sold in the economy - e.g. 2,500 items of real output (Y) at \$1 each (P) or 1,000 of (Y) at \$2.50 each (P) etc.

Where the identity becomes more interesting is in the assumptions made about its components. Traditional Monetarists contend that V is fairly stable and predictable, and Y is constrained by the capacity of the economy. So, Monetarists argue that if M is rising faster than Y and V is stable, it follows that P will also rise. In other words, money growth creates inflation.

Others contend that V is not stable and that Y can occasionally deviate substantially away from full capacity, so the relationship between M and P is less obvious. For example, since the Global Financial Crisis the Federal Reserve has made great efforts to increase the supply of money (M), but this has not led to proportionate increases in P.Y. This is due to two things. First, a reduction in velocity - any extra money balances are merely accumulating in the system (higher demand for money) rather than being spent and second, a lower money-multiplier. The money-multiplier represents the rate at which central bank created money (the monetary base) generates additional increases in the total money stock, primarily via the lending of commercial banks – more on money creation below.

In sum, this basic Quantity Theory Identity is a useful framework for analysing the potential interaction between the monetary and real sectors of the economy and the data followed in this document will seek to shed light on what is happening to the various components of this identity.

What is Money?

Another issue is how 'money' or M is defined. Definitions of money include M0, MB (the Monetary Base), M1, M2, M3 and MZM (maturity zero money) and the basic difference between them is primarily related to liquidity. The further we move along the spectrum towards M3 the less liquid 'money' becomes. For example, a large time deposit cannot be spent immediately whereas a checking deposit can. Note that M3 and MZM are no longer used in the US by the Fed.

Definitions

M0 = notes and coins *in circulation* with the non-bank public.

Monetary base = M0 + notes and coins held by banks and the central bank + bank reserves held by the banking system at the central bank (bank reserves) **Note:** the last two items are *not in circulation*.

M1 = M0 + demand deposits and other checkable deposits (including savings deposits after Fed methodological revision – they were previously in M2). **Note:** bank reserves are not included in M1 – important when looking at how Fed QE affects M1 and M2 etc.

M2 = M1 + time deposits less than \$100k + retail money funds. **Note:** institutional money market funds are not included in M2.

M3 = M2 + large time deposits + institutional money market funds + short-term repos and other large liquid assets.

MZM (Money Zero Maturity) = M2 + all money market funds less time deposits **Note:** MZM aimed to identify all forms of 'liquid' money and was a hybrid of M2 and M3.

Who creates Money?

A useful way to think about money – again relevant when considering Fed QE – is who creates it? The short answer is that both the central bank and the commercial banking system create money.

The Monetary Base is created and influenced by the Central Bank and is so-called because it is the base from which all other forms of money (non-M0, M1, M2 etc.) are created by the commercial banking system via bank lending.

For example, using QE as an example, the Fed buys T-Bonds from a bank and credits that bank's account at the Fed with the proceeds. These funds are now reserves. At this point, no money has entered circulation, so no other measure of money apart from the Monetary Base has been affected.

As the Monetary Base has increased, commercial banks are more *able* to create other money by issuing new loans and if they were to do this it would lead to a corresponding rise in deposits. Bank lending is the main driver of 'money creation'. This is because a loan, when advanced to the borrower, will be deposited in the borrowers account i.e. an immediate rise in deposits (higher M1). Or, if the 'loan' is via a credit card, the borrowers account will not be affected, but the recipient of the credit card spending will deposit the revenue in their own bank account, so deposits somewhere in the system will have increased because of the 'loan' (higher M1).

In sum, boosting the Monetary Base (via e.g. Fed QE) increases the ability of banks to create other money such as M1. But the rate at which this happens (the money-multiplier) will come down to a commercial judgement by the banks as to whether or not they would like to advance extra loans.

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