



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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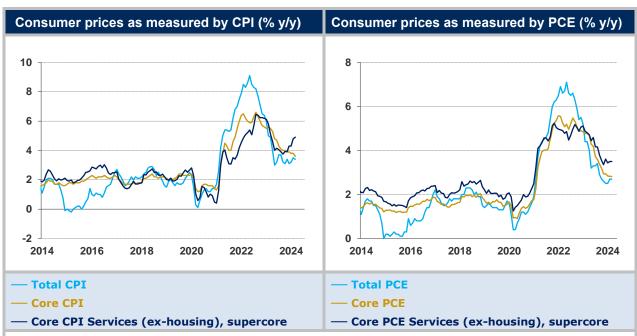
The Importance of Inflation

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

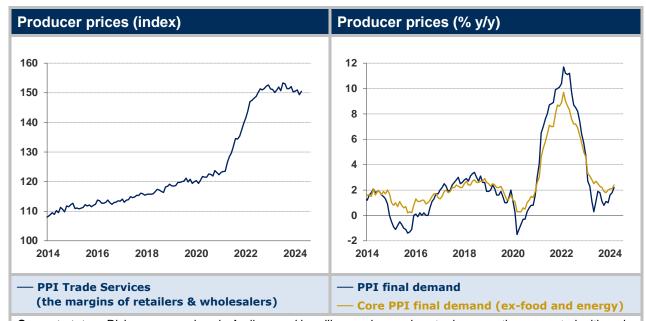
Altana Wealth is a specialist fund manager focused on delivering alpha where we have a competitive edge from niche strategies. As co-investors in all our funds, our interests are aligned with those of our investors. Altana was set-up by Lee Robinson, co-founder of highly successful Trafalgar Asset Managers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





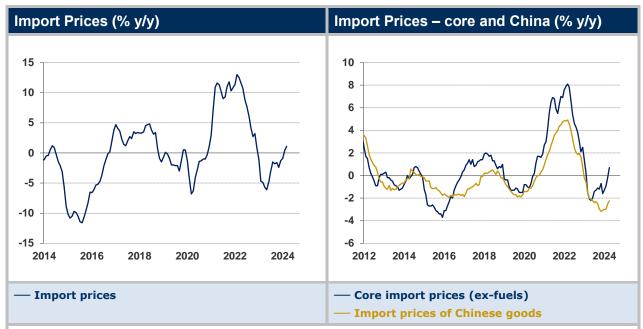
Current status: The March CPI confirmed the strength in Q1 inflation numbers, delaying expectations for the first rate cut by the Federal Reserve. Although seasonality and new year price effects posed upside risks, the figures were too strong to attribute solely to these dynamics. Core CPI services ex-housing 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 v/v 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.





Current status: Rising energy prices in April caused headline producer prices to rise more than expected, although the stronger March numbers were revised lower. Supply chain pressures have increased in recent months, but we haven't seen this reflected in core goods prices. Core goods prices rose only 0.3% m/m in April after being flat in March. Apart from food prices, the momentum for goods prices aligned better with the Fed's 2% target. As for core services, prices have been moving in the wrong direction, jumping 0.6% in April, the most since July and twice the rate seen over the past twelve months. Much of this strength is driven by portfolio management services due to strong equity market performance in Q1. This should ease in forthcoming prints as markets have not exhibited the same degree of strength since then.

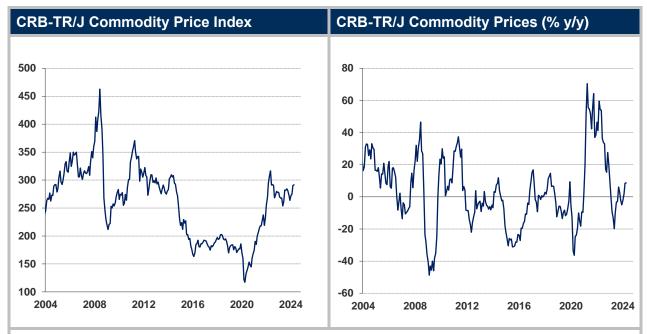




What is this data? Producer price indices refer to prices set by domestic producers only, so Import Prices are also monitored to gauge price pressures entering the system from abroad. Import price data excludes tariffs.

Current status: Import prices rose 0.9% in April following an upwardly revised 0.6% increase in March. These numbers beat most economists' expectations. Core import prices also saw stronger than anticipated readings. The momentum in core import prices is firmly to the upside, with three-month and six-month annualized rates at 3.6%, compared to 3.3% and 1.3% in March. Prices for goods imported from China remain deflationary, although the pace of decline has been slowing. While stronger import prices don't always lead to higher CPI and PCE readings, it's worth monitoring whether imported goods are becoming more expensive. With core services inflation still running hot in the US, rising goods prices for US consumers would further complicate the inflation outlook.

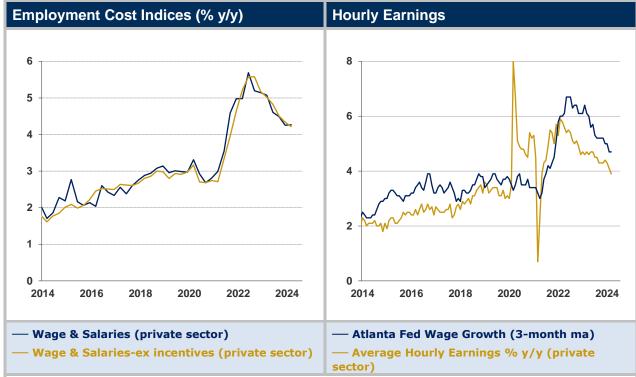




What is this data? CRB Index is a basket of commodity prices - a timelier indication of Crude PPI.

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.

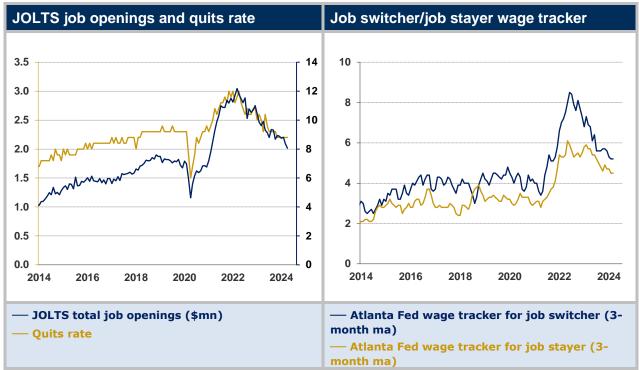




What is this data? The Employment Cost Index (ECI) is the total cost of employing workers (wages, salaries, benefits) and is quarterly – just wages and salaries components are shown above; 'hourly earnings' is monthly. The Atlanta Fed Wage Growth Tracker shows the 3-month moving average of annual wage growth, a tool developed by the Federal Reserve Bank of Atlanta.

Current status: Recent wage data has been mixed. Average hourly earnings have declined at a solid pace this year, now growing at an annual rate of under 4%, not far from pre-COVID levels. However, the more reliable Atlanta Fed wage growth tracker has not shown the same degree of wage disinflation in recent months. The Q1 ECI data was not constructive for the Fed either, likely raising the bar for easing. Wages and salaries for private-sector workers increased 1.1% q/q, up from the 1% increase in Q4. The y/y rate was unchanged and has struggled to meaningfully decline at the same rate seen in the first half of last year. Most labour market indicators point to further easing in wage pressures, but considering the strong Q1 inflation prints, disappointing wage data would have added to concerns among Fed officials around easing policy too soon.





What is this data? This data shows total job openings, voluntary job separations by employees (%), and average wages for job switchers and job stayers. These indicators help in understanding labour demand and supply dynamics, thereby assessing underlying wage pressures in the economy.

Current status: We continue to see cooling in the labour market. Job openings in April fell to 8.1mn, missing expectations by 300,000, alongside downward revisions to the March figures. The ratio of job openings to unemployed workers, a key measure of labour market slack, fell to 1.24, down markedly from its peak of 1.96 in March, confirming that the labour market is moving into better balance. As for the quits rate, this remains steady, still below the 2019 average of 2.3%. With more labour supply entering the market through immigration and labour demand falling in the form of fewer openings and hirings, we can expect wage pressures to continue easing, despite the strong ECI report from Q1.

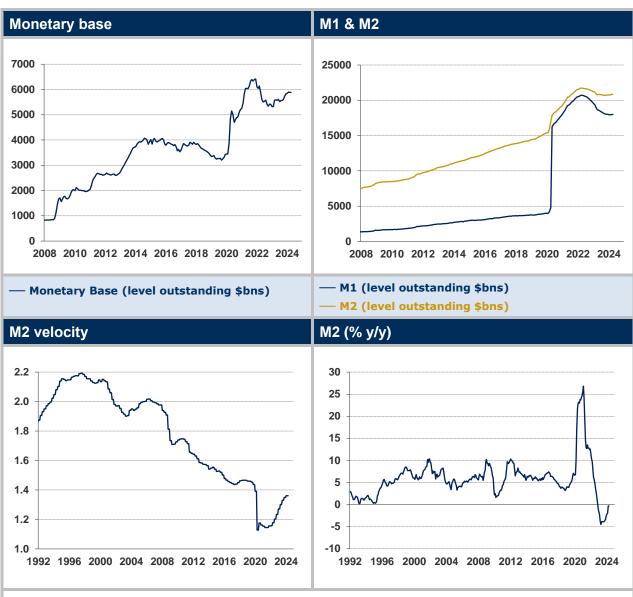




What is this data? Inflation expectations held by the public (Michigan survey) & financial market (10y/5y breakeven inflation rates). Inflation expectations are significant e.g. higher consumer expectations of inflation may lead to higher wage demands. If market expectations of inflation are rising/falling, this may require some reaction from policymakers.

Current status: Inflation expectations have been well-behaved despite the recent uptick in inflation readings. Long-term consumer inflation expectations remain above pre-COVID levels, within the 2.8%-3% range seen since mid-2021. As for market inflation expectations, 5-year and 10-year breakevens have risen from 2.2% at the start of the year to 2.4%. Reflation risks have increased among market participants, which given the stronger than expected inflation readings, isn't a surprise. The consensus April print helped ease fears, but like the Fed, the market needs consistently stronger readings going forward to grow concerned about inflation reaccelerating.





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

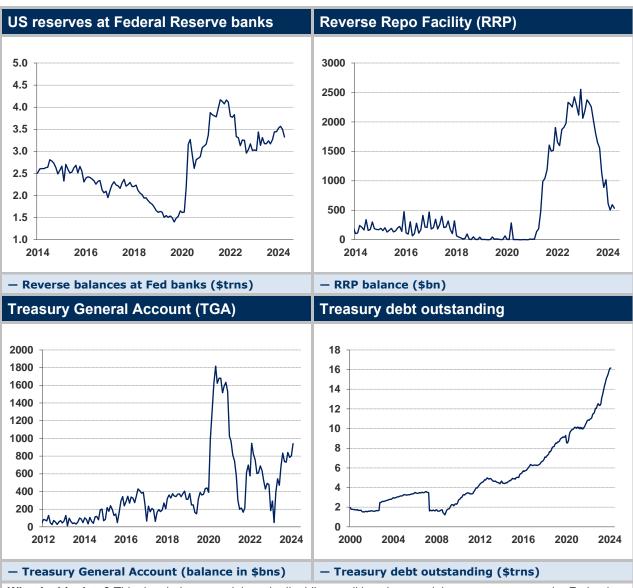
M1 = M0 + demand deposits + other checkable deposits (inc savings deposits previously in M2 - recently revised) M2 = M1 + time deposits<\$100k + retail money funds.

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%.

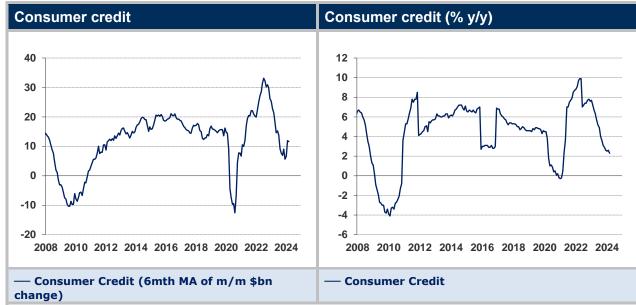




What is this data? This data helps to track broader liquidity conditions by examining reserves across the Federal Reserve banking system, the amount of money parked in the Fed's overnight repurchase facility (RRP), total cash balances at the Treasury, and outstanding marketable Treasury debt.

Current status: The most recent Treasury Quarterly Refunding Announcement (QRA) was broadly in line with expectations, though slightly more hawkish as borrowing estimates for Q2 rose more than anticipated. Along with the pickup in bond volatility, the move lower across stocks in mid-April can also be attributed to negative flows. April's tax season created a negative liquidity backdrop for risk assets as people sold stocks to fund tax payments. Bank reserves declined, leading to a corresponding increase in the Treasury General Account (TGA), while the RRP remained stable. Tax season typically withdraws liquidity from the system, but this gets quickly reversed as the Treasury draws down the TGA to its minimum required level (\$750bn today). As a result, the net liquidity impact from tax season was basically zero. Despite higher tax collections compared to last year, the Treasury overestimated these receipts when estimating their Q2 borrowing needs in the previous QRA. This is why Treasury issuance was revised higher for Q2.

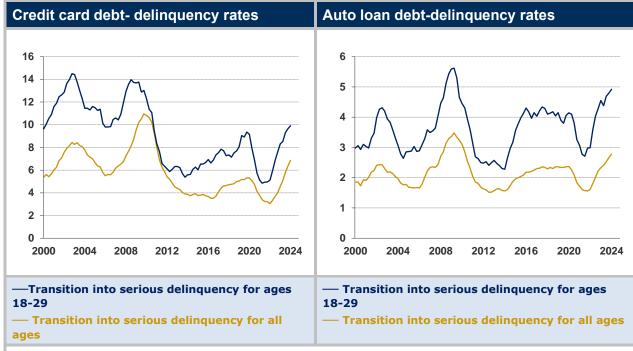




What is this data? Covers most short and intermediate-term credit extended to individuals, excluding loans secured by real estate. Consumer credit growth will directly influence money growth and monetary velocity.

Current status: Consumer credit growth in March rose by only \$6.3bn, well below the consensus expectation of \$15bn. Within this, we are seeing a faster decline in revolving credit growth, trending towards pre-pandemic levels. This is evidenced by credit card borrowing rising only 0.1% in March, the smallest monthly gain since April 2021. While caution is warranted in interpreting one month of data, when we also see the weakness in retail sales figures, there may be some early warning signs around the health of the US consumer. More data is needed to declare a fundamental shift, however.

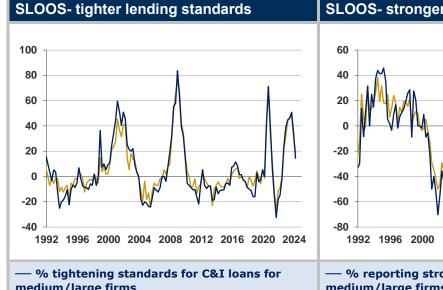




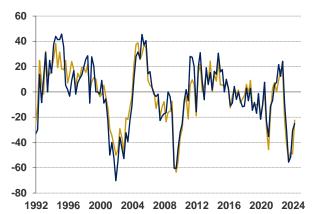
What is this data? Quarterly data provided by the NY Fed provides insight into the credit health of consumers, showing the percentage of debt transitioning into serious delinquency, ie over 90 days due.

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 prepandemic 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 maxedout 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.









medium/large firms

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

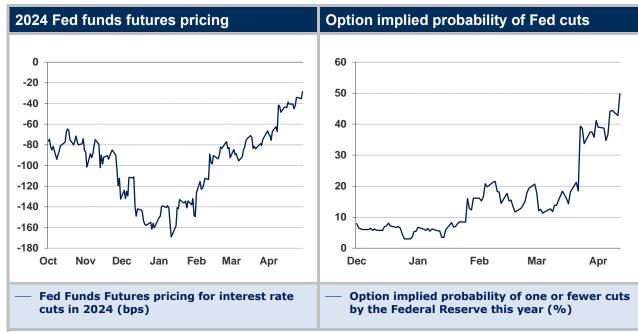
- % reporting stronger demand for C&I loans for medium/large firms

- % 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.





What is this data? Fed fund futures pricing reveals market expectations for the outcomes of upcoming FOMC meetings regarding the fed funds rate target. This pricing can be expressed as probabilities of rate hikes or cuts of a given size at those meetings. Option-implied probabilities use the options market to price these expectations instead of the futures market.

Current status: The market entered 2024 expecting over 160bps of cuts by the Fed. This was owed to the disinflationary momentum seen in Q3 and Q4 last year, and the Fed's pivot in November towards easing policy. However, with momentum stalling in Q1, we've seen a significant repricing in rate expectations, with only a single 25bps cut priced for the entirety of 2024 as of the end of April. The options market also began pricing over a 50% chance that the Fed would only cut once or not at all this year. The bar for rate pricing to become more hawkish from here is high, especially as the Fed will have four more inflation readings to analyse before the September FOMC meeting. As discussed at the beginning of the report, with May and June inflation numbers set to come in at a softer pace than in Q1, it's more likely we see more rate cuts priced in.



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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