



Summary

- Whilst there was a notable surge in supercore PCE inflation in July, this increase was mainly driven by temporary factors, and overall inflation remains relatively stable
- Commodity prices saw increases in July, as OPEC+ and Russia announced further production cuts
- Rising commodity prices led to upward pressure in both producer and import prices compared with the previous month
- Wage growth pressures showed encouraging signs as per the ECI report for Q2, despite stronger hourly earnings numbers in July
- Senior loan officer survey and consumer credit numbers continued to show tighter lending standards and weaker credit growth
- Money market inflows picked up in July as the push higher in yields continues to prompt households to take advantage

About this document

US Inflation Watch presents 18 charts comprising key inflation indicators grouped into five categories including consumer/producer price inflation, commodity prices, wage inflation, inflation expectations and monetary indicators.

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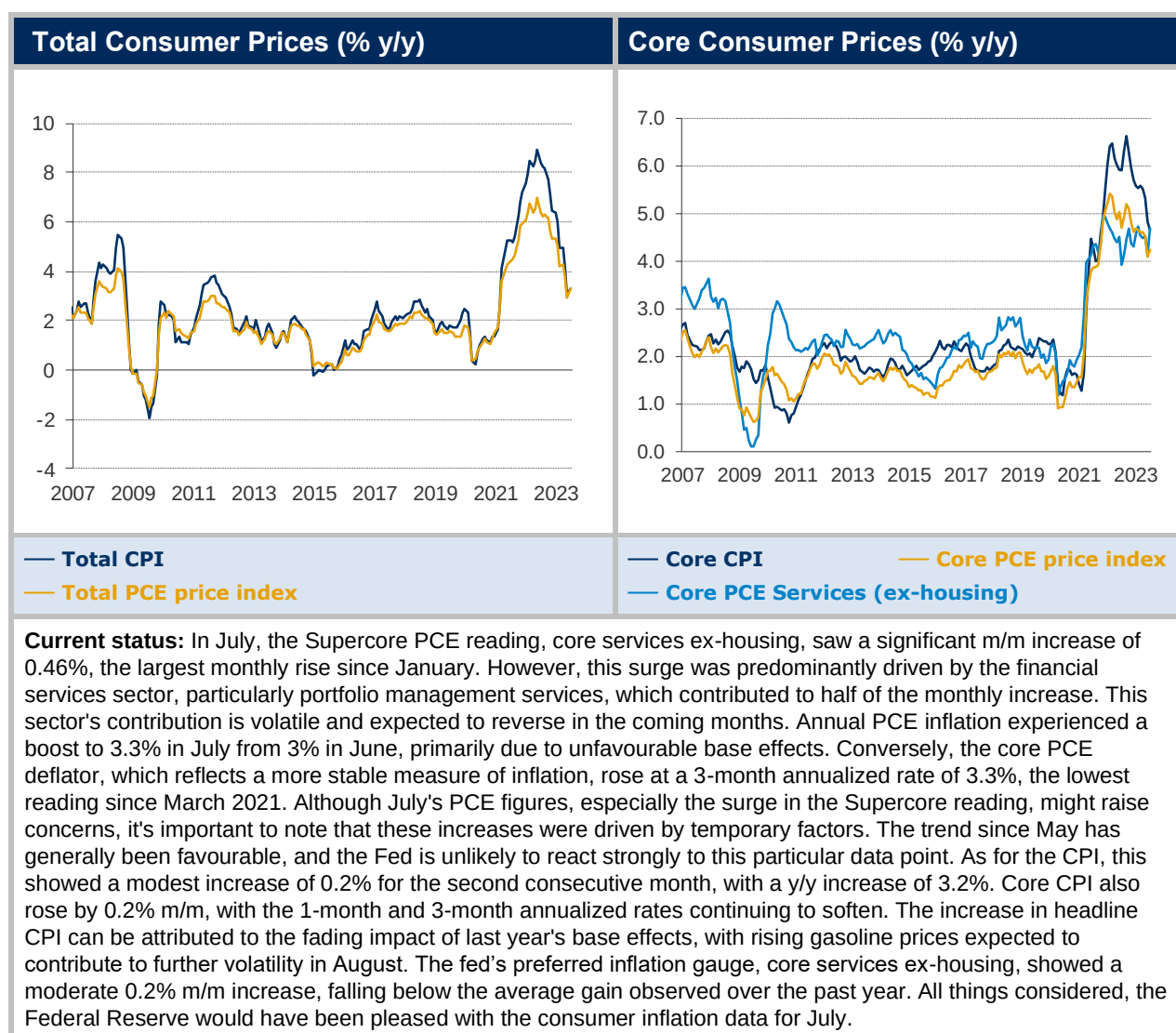
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The Importance of Inflation

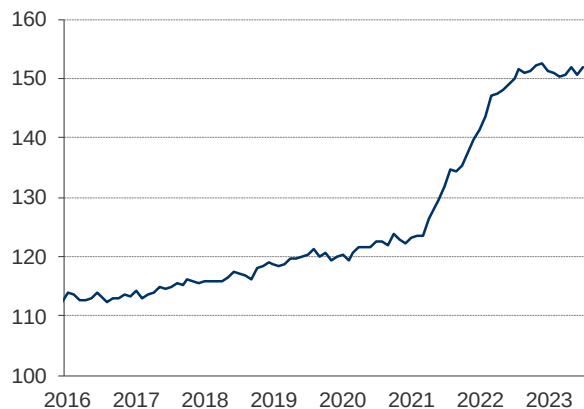
Inflation is the single most important indicator when measuring real wealth as it determines what wealth can buy i.e. purchasing power. If 'nominal' wealth doubles over 25 years but the level of prices also doubles, there is no net gain in 'real' wealth. It only takes annual inflation of 2.8% to cause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

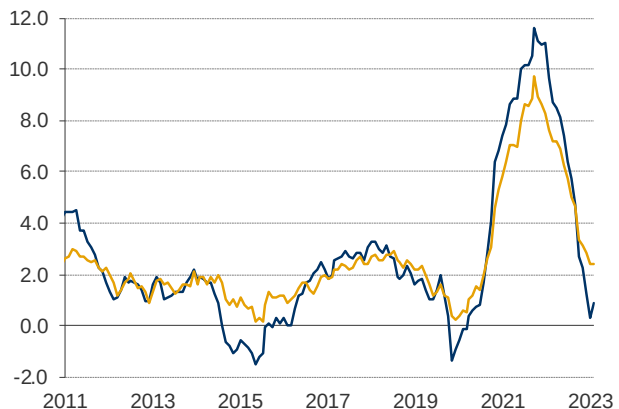


Producer prices (index)



— **PPI Trade Services**
(the margins of retailers & wholesalers)

Producer prices (% y/y)



— **PPI final demand**
— **Core PPI final demand (ex-food and energy)**

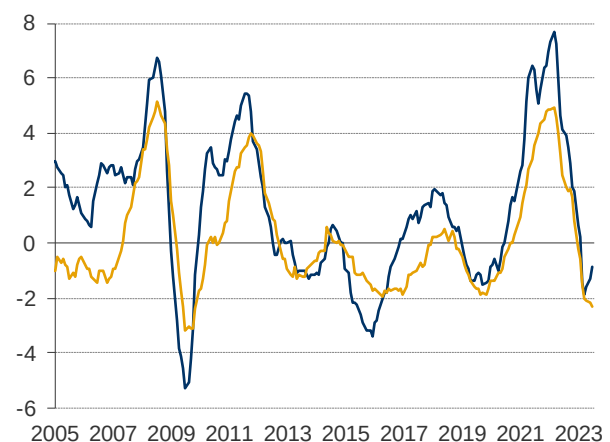
Current status: In July, there was a notable 0.3% increase in the core PPI, marking the largest rise since November 2022. Despite global supply chains normalizing and subdued foreign demand, inflationary pressures at the producer level have remained relatively low. However, the landscape is beginning to shift due to rising commodity prices. It's worth noting that the 3-month annualized core PPI reading has remained stable at around 1.5% since May, indicating a halt in the previous downtrend.

Import Prices (% y/y)



— **Import prices**

Import Prices – core and China (% y/y)



— **Core import prices (ex-fuels)**
— **Import prices of Chinese goods**

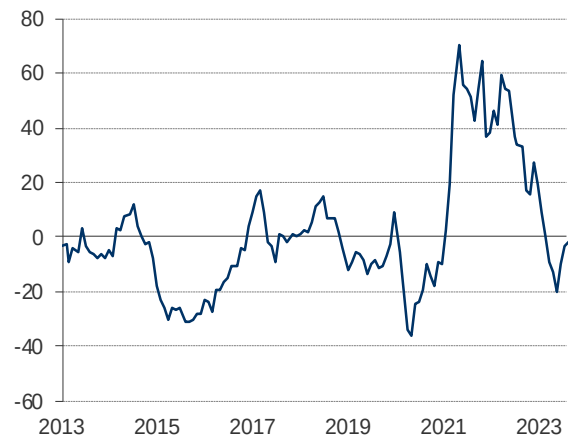
What is this data? Producer price indices refer to prices set by domestic producers only, so Import Prices are also monitored to gauge price pressures entering the system from abroad. Import price data excludes tariffs.

Current status: In July, we observed a more significant increase in imported goods prices than anticipated, primarily due to a 3.6% monthly rise in fuel prices. However, when we exclude petroleum prices, import prices remained relatively stable in July, following a slight decrease of 0.3% the previous month. The y/y reading for core import prices, excluding food and fuels, remains negative at -1.1%. Importantly, for the broader trend, China's ongoing deflationary pressures at both the consumer and producer levels may continue to exert downward pressure on Chinese import prices in the near term.

CRB-TR/J Commodity Price Index



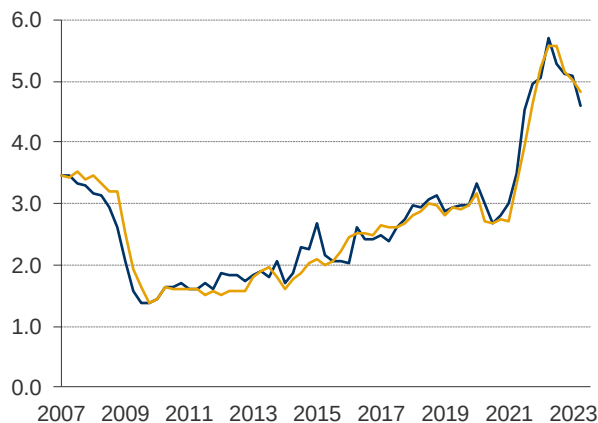
CRB-TR/J Commodity Prices (% y/y)



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

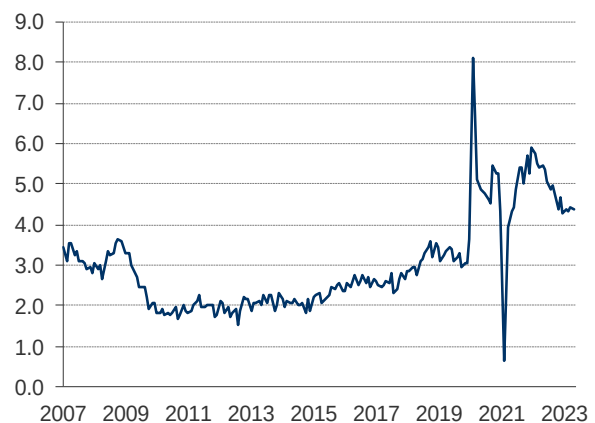
Current status: In July, commodity prices experienced significant upward pressure, primarily due to OPEC+ and Russia's decision to extend voluntary cuts to Brent production into August. The Fed will be very attentive to increases in gasoline prices, as they wouldn't want inflation expectations to get out of hand. A potential silver lining to higher oil prices is that consumers' excess savings have been significantly depleted compared to when oil prices were high last year. Increased spending at the pump may lead to reduced discretionary spending in other areas, which could help prevent broader inflationary pressures from building up.

Employment Cost Indices (% y/y)



— **Wage & Salaries** (private sector)
— **Wage & Salaries-ex incentives** (private sector)

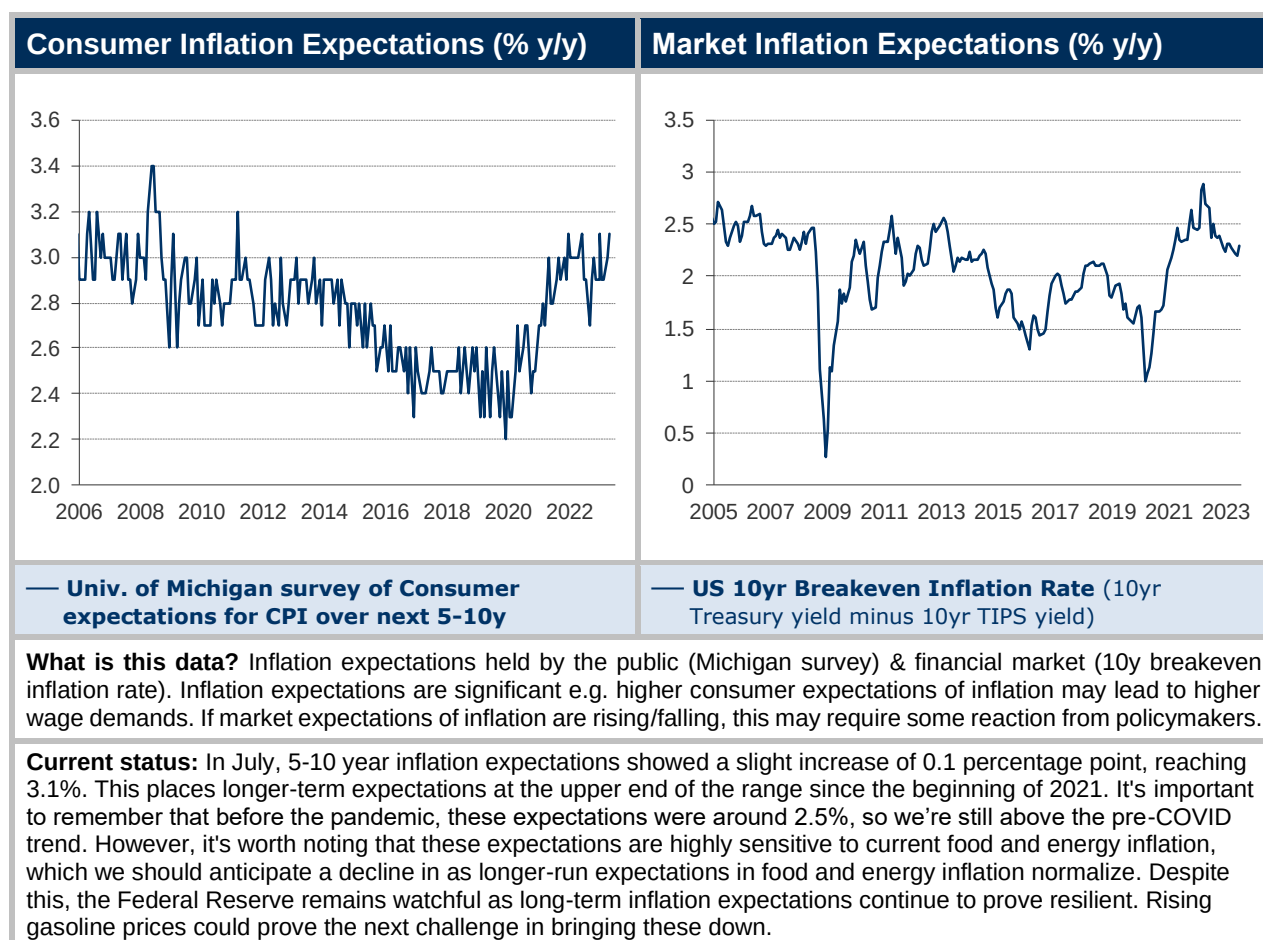
Hourly Earnings (% y/y)



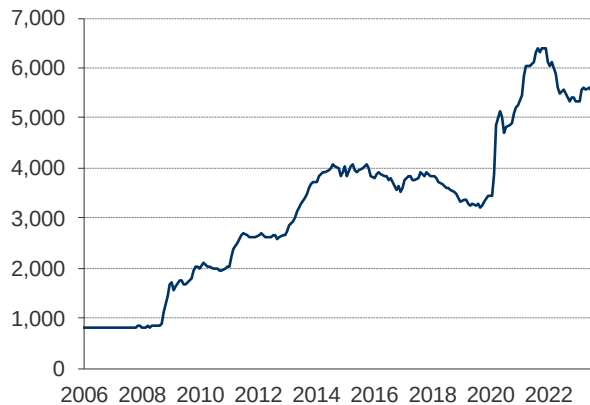
— **Hourly Earnings** (private sector)

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.

Current status: In Q2, the Employment Cost Index (ECI), the Federal Reserve's preferred gauge of wages, showed an encouraging trend with a 1% increase. This marks a clear slowdown from the 1.2% increase observed in Q1. Wages showed a notable deceleration in their annualized quarterly change, with growth of 4.1% for private-sector workers, down from 4.9% in Q1. Business surveys indicate the potential for more rapid progress in the second half of the year. Moderation in private sector wage growth suggests that the stickiest components of inflation are showing signs of stabilization. Average hourly earnings ticked up by 0.4% m/m, with a small revision to prior data. Although the Fed would have been disappointed by this, as long as average hourly earnings do not begin accelerating, the Fed is unlikely to be concerned.

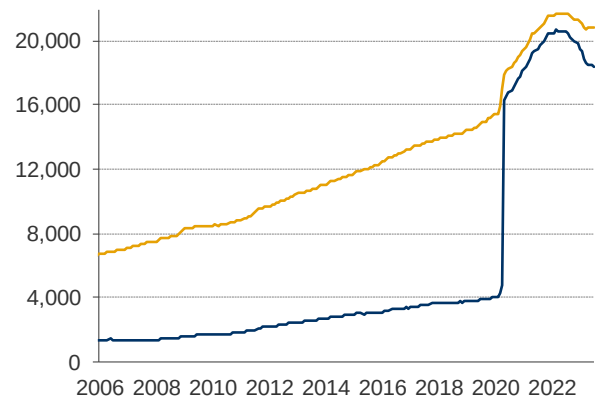


Monetary Base



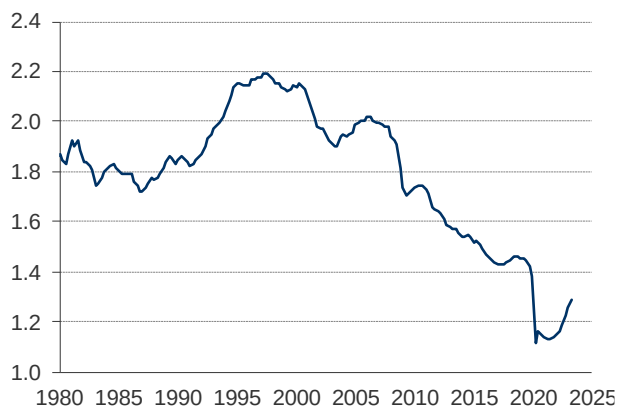
— **Monetary Base** (level outstanding \$bns)

M1 & M2



— **M1** (level outstanding \$bns)
— **M2** (level outstanding \$bns)

M2 Velocity



M2 (% y/y)



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*

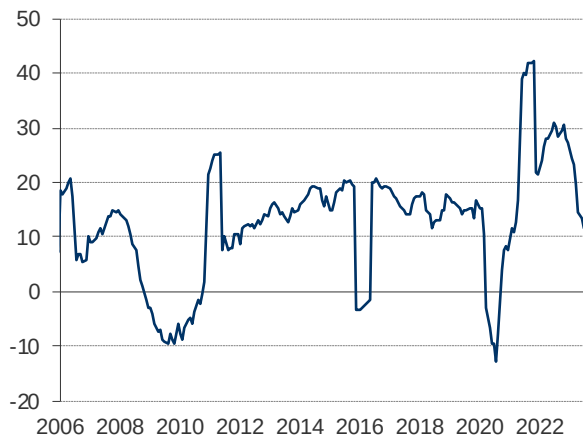
M1 = M0 + demand deposits + other checkable deposits (inc savings deposits previously in M2 – recently revised)

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: Last month we saw the Fed's senior loan officer survey for Q2 released, which continued to show further credit tightening. The percentage of respondents reporting tightening standards for commercial and industrial loans to large and medium sized firms rose to 50.8% in Q2, up from 46% in Q1. Looking ahead, the prospects for the remainder of the year remain sombre, with 40% of respondents planning to tighten lending standards further. While this represents a decrease from the 55% reported in Q1, the figure is still notably high. As for bank assets, with strong economic data coming out of the US in July, the push higher in yields has been met with a re-acceleration in money market inflows. M1 continues to decline, whilst the velocity of M2 continues its recovery. As for yields, the acceleration in treasury issuance over the coming months, as well as renewed inflation fears from higher oil prices, will help provide support for the long-end. As a result, we should watch for more aggressive money market inflows and falling bank deposits.

Consumer Credit



— Consumer Credit (6mth MA of m/m \$bn change)

Consumer Credit (% y/y)



— Consumer Credit

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: In July, consumer credit increased by \$10.4 billion, falling short of the consensus estimate of a \$16 billion increase. Additionally, there were significant downward revisions to consumer credit figures for previous months, particularly in the revolving credit category. Broader consumer credit growth decelerated to 4.9% in July, down from 5.3% in June on a y/y basis. Both revolving and non-revolving credit also experienced declines in y/y growth rates. The expectation is for consumer spending to cool down over the coming months, leading to a further slowdown in consumer credit growth. Tightened lending standards for credit cards and auto loans are likely to constrain credit expansion. An important factor to consider is that student loan repayments are set to resume in October. This is expected to have a significant impact, not only on consumer spending as disposable incomes decrease, but also on the growth of non-revolving credit.

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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