



Summary

- October saw a significant easing in core inflation, prompting the market to call an end to the Federal Reserve's hiking cycle
- Inflation expectations surged in October. The Fed may be uneasy about the uptick, but market breakeven rates remain stable
- Growing bank reserves from rapidly declining RRP balances stabilized the monetary base, supporting overall liquidity conditions
- The Q3 Loan Officer Survey showed a slowdown in the pace of decline in banks tightening commercial credit. However, consumer credit growth decelerated considerably in October
- . Commodity prices in October saw slight declines, driven by falling copper prices and volatile oil
- Q3's Employment Cost Index showed steady private sector wage growth. Despite encouraging trends, there's a risk of a slower decline due to the resilience of the services sector

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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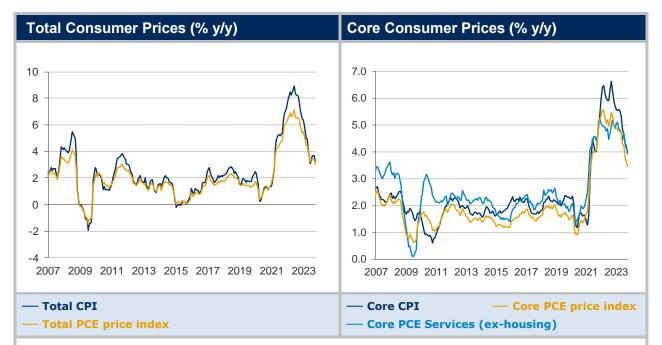
The Importance of Inflation

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

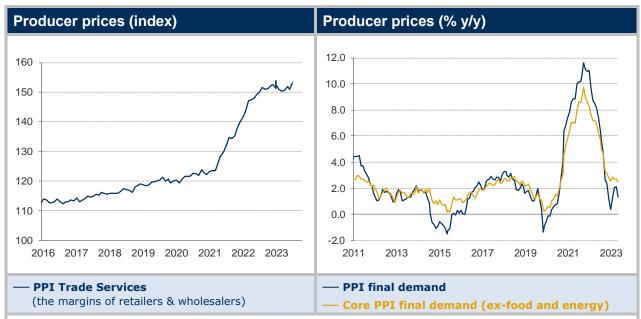
Altana Wealth is a specialist fund manager focused on delivering alpha where we have a competitive edge from niche strategies. As co-investors in all our funds, our interests are aligned with those of our investors. Altana was set-up by Lee Robinson, co-founder of highly successful Trafalgar Asset Managers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





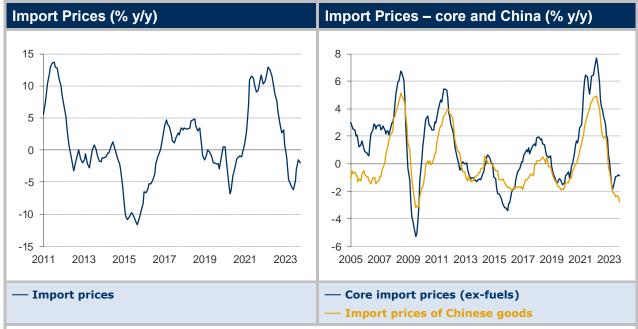
Current status: Core inflation pressures eased in October, with the 6-month annualized rate falling to 3.2% from 3.6% in September. The annual rate posted its lowest reading since September 2021, at 4%. The primary driver of core inflation continues to be the services sector, particularly in shelter. Shelter inflation slowed in October after a big jump in September. Monthly figures here are volatile, so it's important to focus on the trend. While the decline this year has been slower than anticipated, the overall trend remains lower. As for Powell's favoured inflation measure, core services excluding housing, this softened again in October with the y/y rate down to 3.7%. It's encouraging to see inflation here head lower, although it remains stickier than the Fed would like. This is likely to continue given how well the services sector has held up. Consumers continue to prioritize spending on services over goods, which is keeping price pressures in sectors such as leisure and hospitality high. As for PCE inflation, this came in soft as expected following the weaker CPI, with y/y core PCE readings now set to finish the year between 3.3%-3.4%, around 30-40 basis points lower than the Fed's September projections. Most were expecting the October inflation readings to come in strong, but they came in softer across the board. There was a strong market reaction to the numbers, with the S&P gapping up 2% and yields across the curve falling by over 15bps. The October CPI all but confirmed that the Fed was done hiking for the year, which also led to more rate cuts brought forward for 2024. While inflation has receded faster than expected, challenges remain. Both 6-month and 12-month annualized core CPI rates are still above 3%, and with services sector spending still hot, the pace of wage growth declines could slow, making the final phase of the inflation battle the most difficult.





Current status: Producer prices weakened in October. PPI for final demand fell 0.5% from September, a slowdown reflective of a decline in gasoline prices. A fall in gas prices also helped to alleviate wholesale cost pressures. Core PPI readings were flat for the month, with the y/y rate falling to 2.4% from the previous month's 2.7%. The soft PPI numbers across the board were welcome after two consecutive months of strong prints.

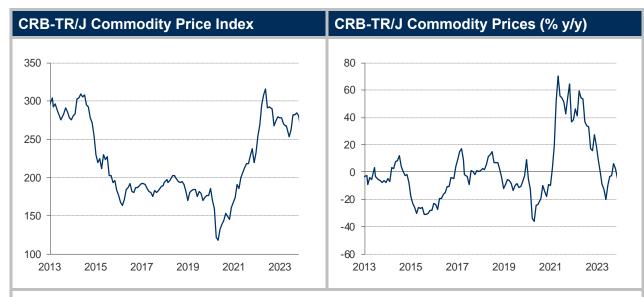




What is this data? Producer price indices refer to prices set by domestic producers only, so Import Prices are also monitored to gauge price pressures entering the system from abroad. Import price data excludes tariffs.

Current status: Pass through from a stronger dollar throughout the summer continued to drag the price of imports lower, particularly those from China. The US import price index for goods made in China was down 2.8% y/y through October. This decline has helped in bringing down the US core CPI goods inflation rate from a peak of 12.2% y/y during February 2022 to just 0.1% y/y in October. It's important to note however that imported deflationary momentum from China is beginning to slow. Import prices, excluding petroleum, remained stable, but momentum is firmly to the downside, with the 3-month annualized rate falling from -1.3% to -1.9% compared to the previous month.

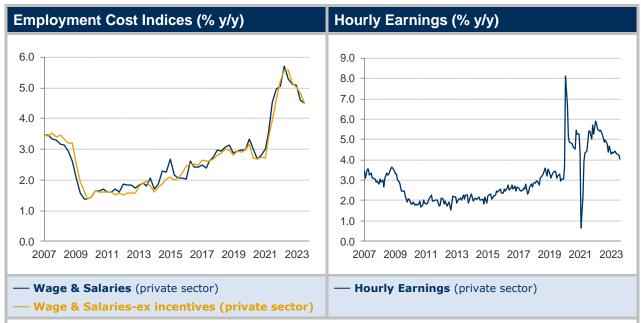




What is this data? CRB Index is a basket of commodity prices - a timelier indication of Crude PPI.

Current status: Commodity prices were down slightly in October, led by declines in oil and coal prices. Oil was very volatile in October. We saw a sharp sell-off in the first week as the upward trend looked slightly overdone from a technical and positioning point of view. Following Hamas's invasion of Israel on October 7th, there was a temporary relief rally in oil prices. However, as the month progressed, it became evident that the risk of a broader regional conflict was low. Oil prices subsequently struggled. As for metals, copper prices recorded their third consecutive monthly decline. Weakness in Chinese property and domestic demand indicators in October, coupled with a stronger dollar influenced by the Federal Reserve's commitment to a prolonged period of higher rates, exerted additional downward pressure on industrial metals.

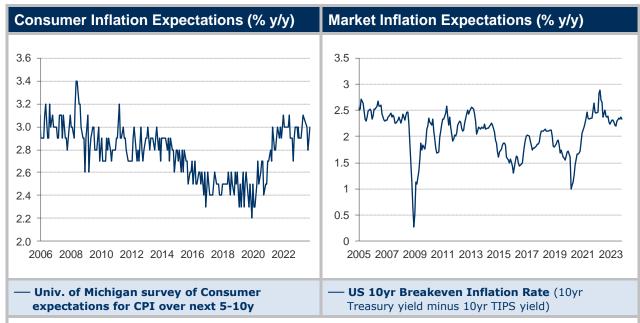




What is this data? The Employment Cost Index (ECI) is the total cost of employing workers (wages, salaries, benefits) and is quarterly – just wages and salaries components are shown above; 'hourly earnings' is monthly.

Current status: Wage growth continued to slow in October, with average hourly earnings increasing by 4.1% from a year earlier. This marks the slowest pace since June 2021, with the 3-month annualized rate at 3.1%. The monthly change of 0.2% was the slowest rate of increase since February 2022. The Q3 employment cost index (ECI) showed steady wage growth in the private sector, rising by 1.1%. The ECI is preferred to other earnings metrics as it's not distorted by shifts in the composition of employment among occupations or industries. If we were to exclude incentive paid occupations, which is the Fed's preferred ECI component due to its lower volatility, wage growth showed a slowdown throughout Q3. Overall, the trend in wage growth throughout Q3 has been very encouraging. There is, nonetheless, a risk that the rate of decline may slow given the sustained strength in the services sector of the economy.

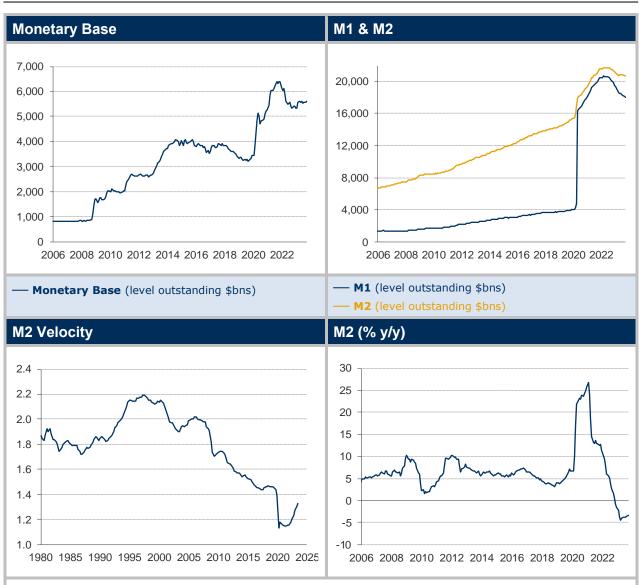




What is this data? Inflation expectations held by the public (Michigan survey) & financial market (10y breakeven inflation rate). Inflation expectations are significant e.g. higher consumer expectations of inflation may lead to higher wage demands. If market expectations of inflation are rising/falling,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

Current status: Concerns around inflation resurfaced in October, with 49% of consumers reporting that high prices are eroding their living standards, up significantly from 39% in September. Over 80% of respondents expressed that inflation would cause greater hardship than unemployment in the year ahead. In terms of inflation expectations, both short-term and long-term expectations shot higher. Year-ahead expectations rose from 3.2% to 4.2%, whereas long-run inflation expectations rose to 3% from 2.8%. The biggest concerns centred around higher costs of groceries and fuel, a risk heightened by the surge in oil prices over the summer. It remains to be seen whether this uptick in inflation expectations is sustained, but the Fed won't like this development, especially given how well-anchored expectations have been over the last few months. Despite survey expectations moving higher, market breakeven rates have remained stable, showing no major concerns about persistently elevated inflation levels.





About the data

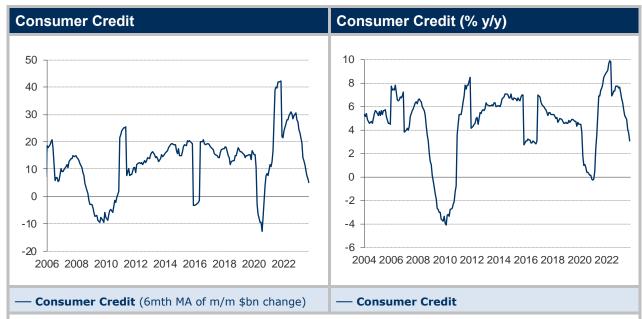
Monetary base = M0 (or notes & coins in circulation) + notes & coins held by banks and the central bank + bank reserves held by the banking system at the central bank. **Note:** the last two items are *not in circulation*

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: M2 and M1 both declined in October, with the rate of decrease in M2 being more subdued. This was largely due to money market funds seeing net outflows, the first time we've seen this since October last year. As for the monetary base, this has remained steady in recent months, helped by three consecutive monthly increases in bank reserve balances. Balances at the overnight reverse repo facility (RRP), utilized by institutions like money market funds to park money with the Fed, have been decreasing rapidly. Money market funds are withdrawing money from the RRP and using them to purchase bills, as the rate on T-bills now exceeds the overnight rate at the Fed. The continued decline in the RRP has been offsetting the fall in the Fed's balance sheet, which has helped support reserve balances and overall liquidity conditions.





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: The October Senior Loan Officer Survey On Bank Lending showed stronger results than expected. While banks persisted in tightening commercial credit throughout Q3, the pace of tightening slowed. The proportion of US banks tightening standards for commercial and industrial loans for medium and large businesses fell to 34% from 51% in Q2. We also saw improved demand for credit, with weaker demand for commercial and industrial loans among large and mid-sized firms falling to 31% from 52% in Q2. However, we did see a notable decline in consumer demand for credit, particularly for auto loans and other consumer loans. Despite the current resilience in consumer demand, it's unlikely to remain as strong, especially with banks further tightening standards for consumer loans. This could pose challenges to consumption in the coming quarters. Despite a more upbeat picture from the SLOOS, tighter lending standards continue to weigh on credit growth. Consumer credit growth slowed in October, with the annual growth rate at 1.2%, down from 3% in September. Economists at Oxford Economics noted that credit card debt as a share of household incomes is lower than pre pandemic levels. The reluctance to take on additional debt, influenced by higher rates, suggests that the downward trend in consumer credit is likely to persist in the coming months.



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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