



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.

Contents

Price Inflation

Consumer Price Inflation.....	2
Producer and Import Price Inflation.....	2-3

Commodity Prices

CRB Index.....	3
----------------	---

Wage Inflation

Employment Cost Index.....	4
Hourly earnings.....	4

Inflation Expectations

Consumer inflation expectations.....	4
Market inflation expectations.....	4

Monetary Indicators

Money Supply.....	5
Consumer Credit.....	6

Appendix

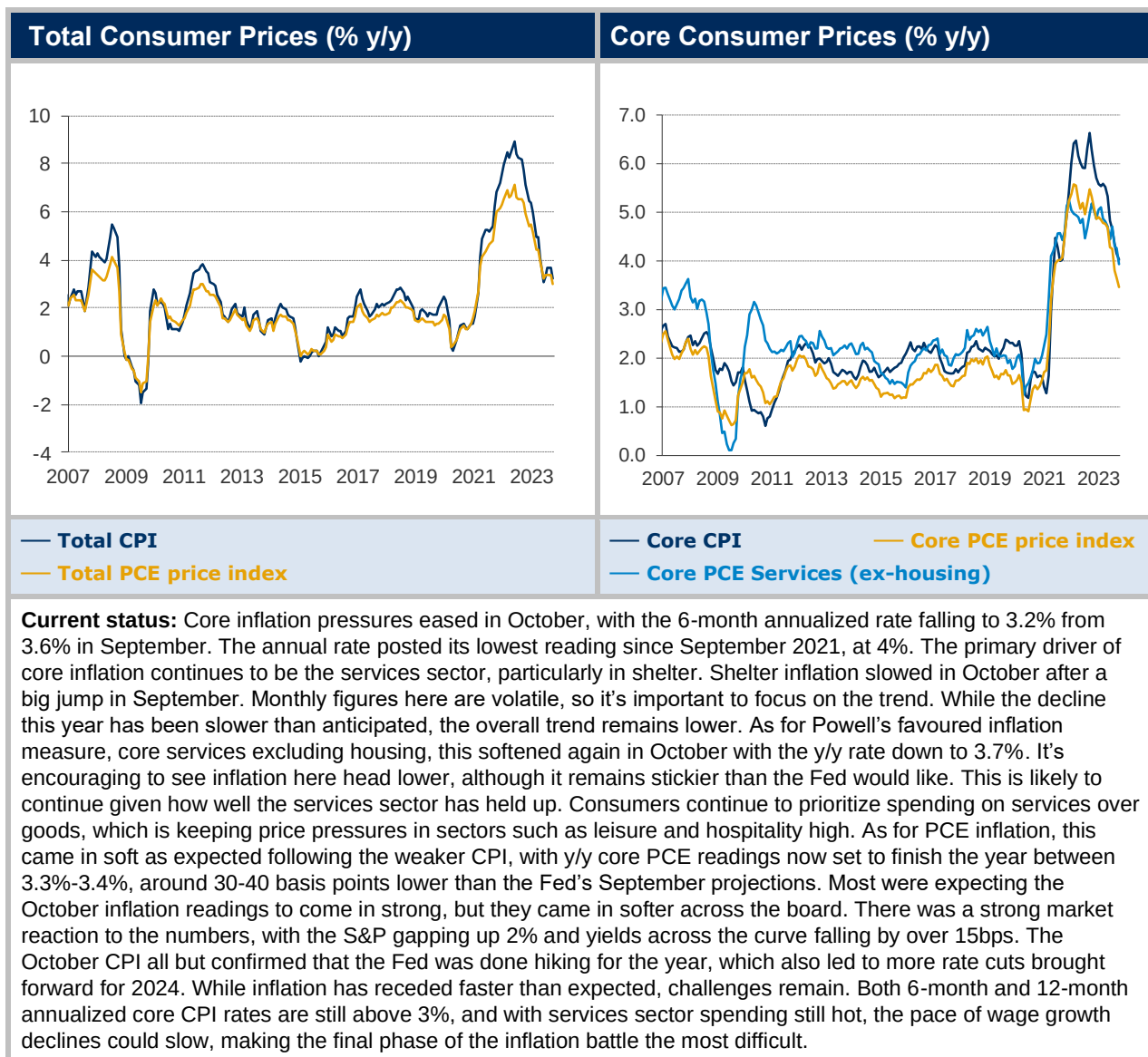
An explanation of money and the monetary framework.....	7-8
---	-----

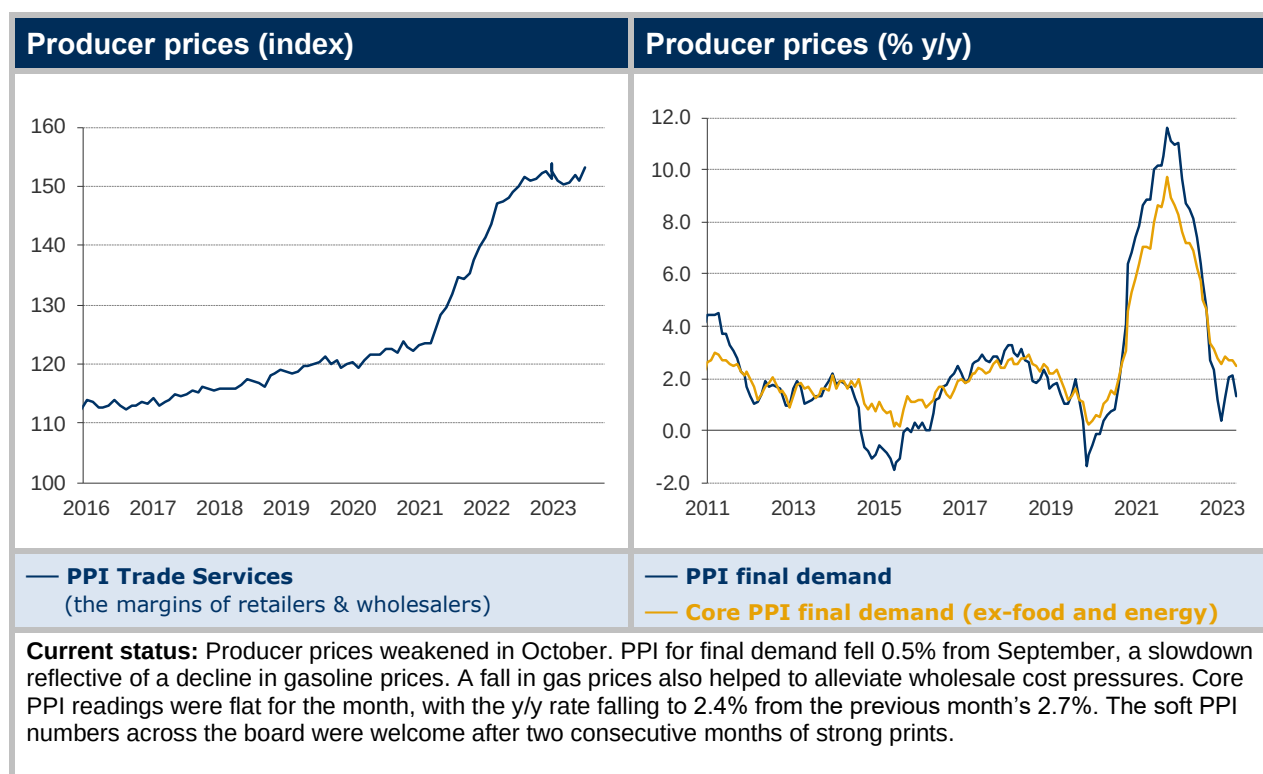
The Importance of Inflation

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.

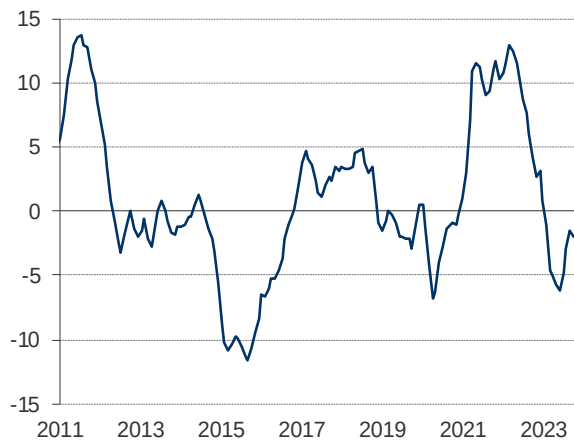
About Altana Wealth

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.



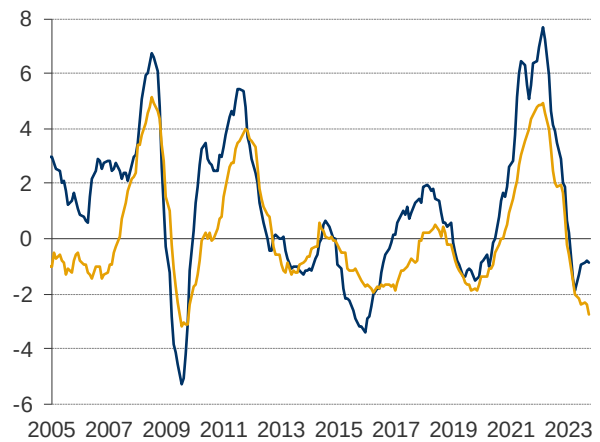


Import Prices (% y/y)



— 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: 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.

CRB-TR/J Commodity Price Index

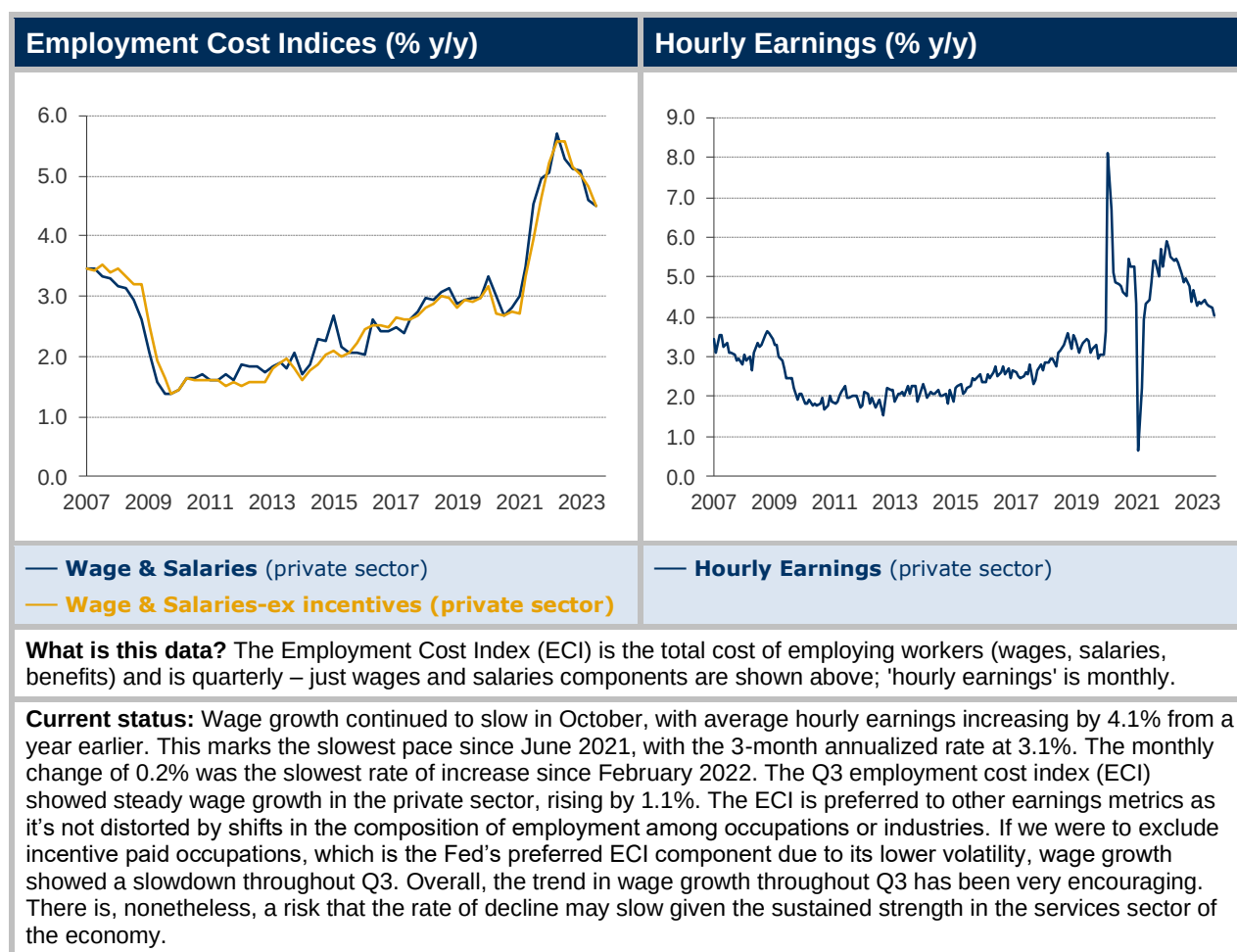


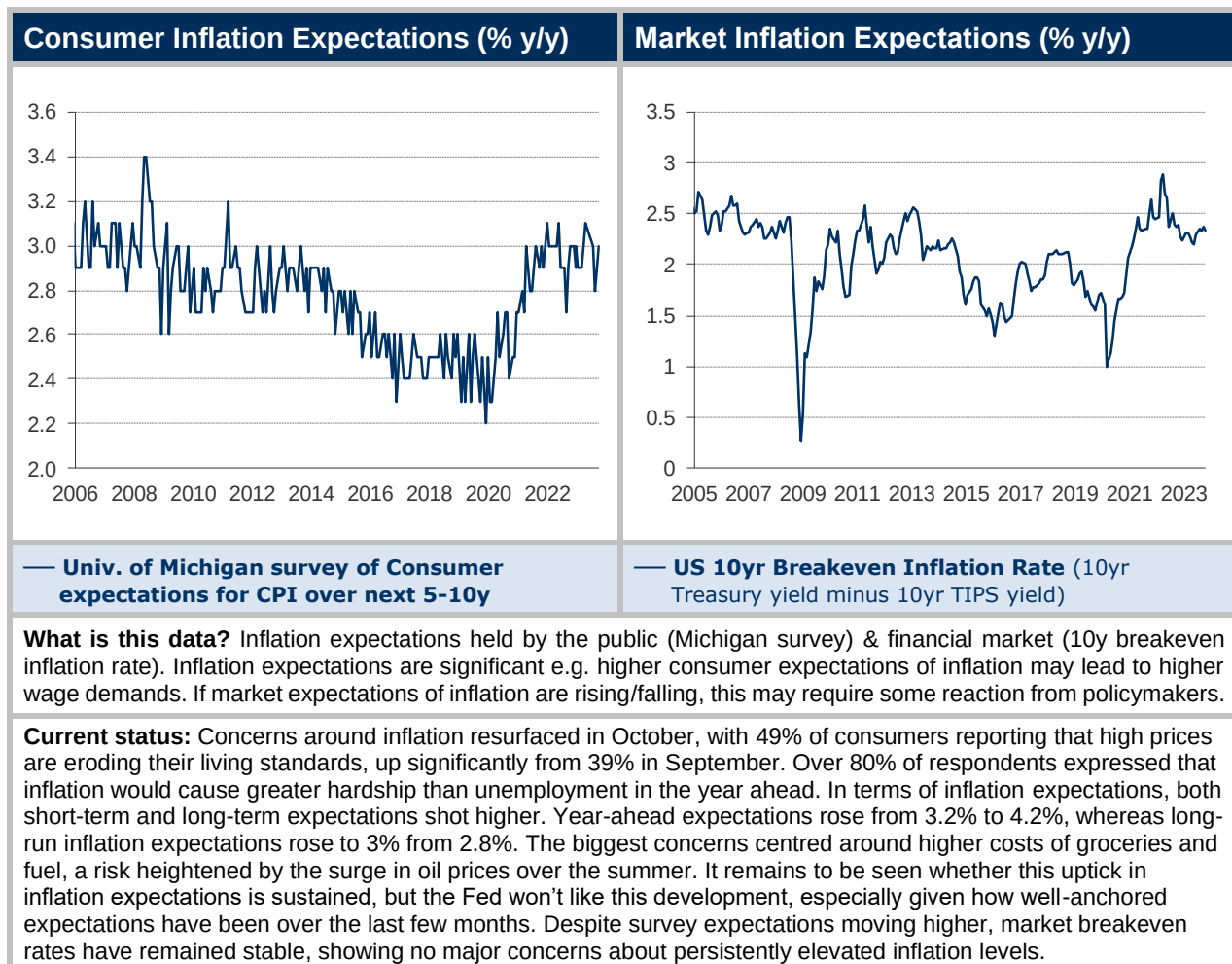
CRB-TR/J Commodity Prices (% y/y)



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

Current status: Commodity prices 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.



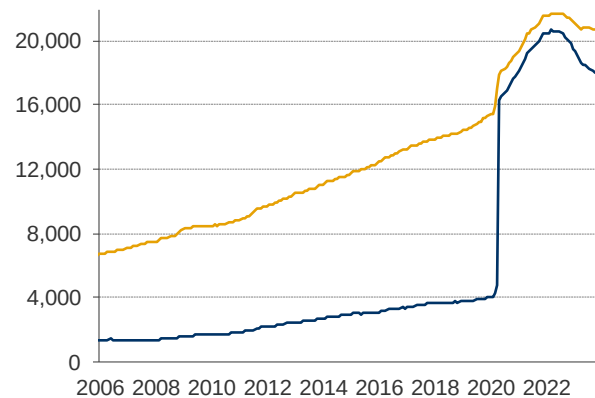


Monetary Base



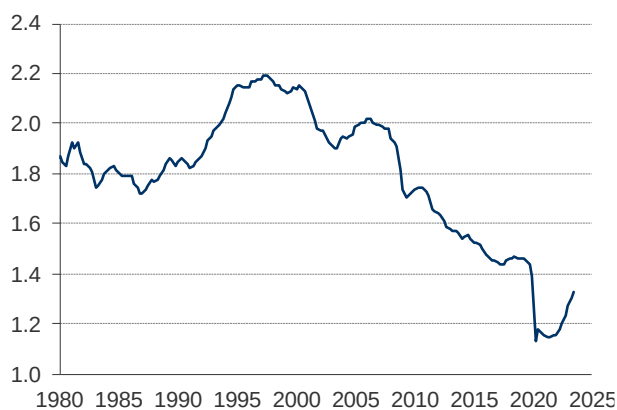
— **Monetary Base** (level outstanding \$bns)

M1 & M2



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

M2 Velocity



M2 (% y/y)



About the data

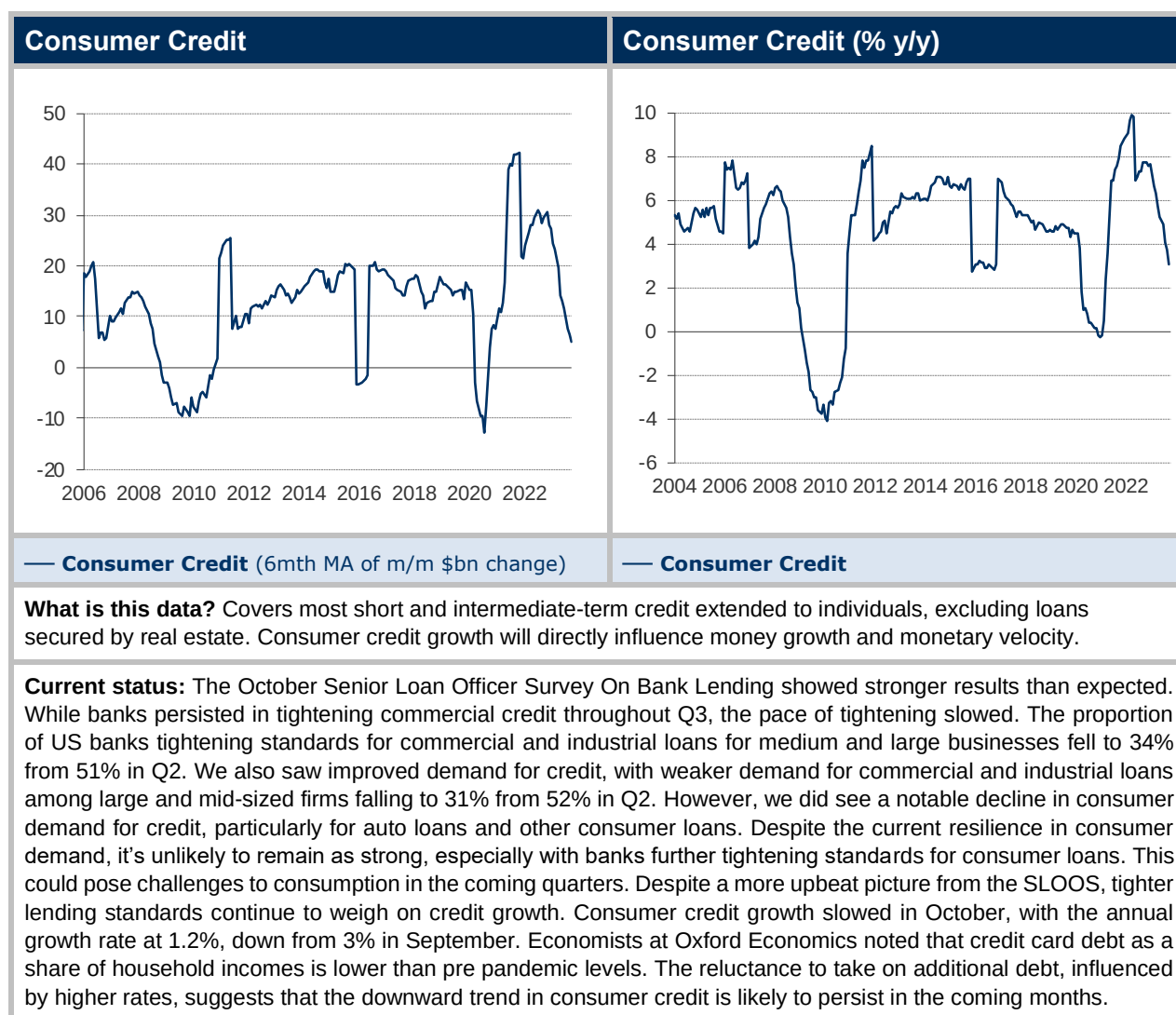
Monetary base = M0 (or notes & coins in circulation) + notes & coins held by banks and the central bank + bank reserves held by the banking system at the central bank. **Note:** the last two items are *not in circulation*

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: 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.



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.

Disclaimer

This report is prepared by Altana Wealth Ltd ("Altana") authorised and regulated by the Financial Conduct Authority in the United Kingdom (FRN: 532912). The investment products and services of Altana are only available to persons who are professional clients and eligible counterparties as defined in FCA's rules. They are not available to retail clients. The distribution of this report may be restricted in certain jurisdictions and it is the responsibility of any person or persons in possession of this document to inform themselves of, and to observe, all applicable laws and regulations of any relevant jurisdiction.

This report is based upon information that Altana believes to be reliable. Altana does not represent that this report is accurate or complete and it should not be relied upon as such. Nothing in this report shall constitute tax, financial, or legal advice given by Altana to any party. Performance information for the month of the report is preliminary estimated data net of all fees and expenses and is subject to change. The estimate and other performance data disclosed is not audited. Stock or other indexes are included for comparison purposes only. Where information provided in this report contains "forward-looking" information including estimates, projections and subjective judgment and analysis, no representation is made as to the accuracy of such estimates or projections or that such projections will be realised. Certain assumptions used in formulating such "forward looking" information may differ materially from actual events or conditions. The funds referred to in this report are registered as Regulated Mutual Funds pursuant to Cayman law but otherwise have not been registered under the securities laws, or authorized or approved by any regulatory authority, of any other jurisdiction. This report shall not constitute an offer to sell or a solicitation of an offer to buy shares or interests in any of the funds described in this report. No such offer or solicitation will be made prior to the delivery of an offering memorandum for the relevant fund. Before making an investment in any of the funds referred to in this report, potential investors should read carefully the private offering memorandum for the relevant fund, including the description of the risks, fees, expenses, liquidity restrictions, and other terms of investing in the funds, and consult with their own tax, financial, legal and other professional advisors. Hedge funds are speculative and involve risk of loss. This report is confidential and may not be reproduced in whole or in part, or delivered to any other person, without the prior written consent of Altana. Past performance is not a guarantee of future results. Issued by Altana Wealth November 2023.