



Summary

- January and February inflation data show mixed progress for the Fed, although seasonality effects mean we may be in for softer readings moving forward
- Despite supply disruptions, import prices remain stable; Chinese deflation and Yuan devaluation continue to push import prices from China lower
- The post-COVID surge in job openings created labour demand imbalances, driving wage inflation higher. However, since 2022, wage pressures have eased due to large increases in labour supply
- Financial markets are showing concern over the Fed's tolerance for higher inflation, as indicated by increased inflation volatility and rising breakeven rates
- The RRP has halved since the start of the year, driven by increased share of bill issuance.
 However, with negative bill issuance expected in Q2, liquidity may tighten
- Delinquency rates on auto and credit card debt have now surpassed pre-COVID levels. Financial strain is evident among younger and lower-income households

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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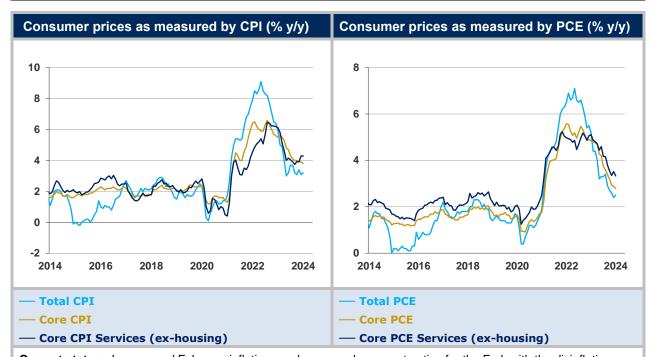
The Importance of Inflation

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

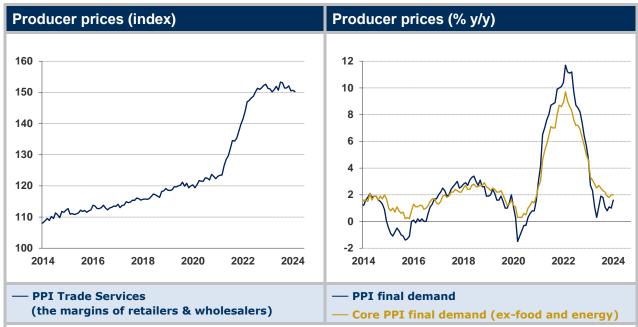
Altana Wealth is a specialist fund manager focused on delivering alpha where we have a competitive edge from niche strategies. As co-investors in all our funds, our interests are aligned with those of our investors. Altana was set-up by Lee Robinson, co-founder of highly successful Trafalgar Asset Managers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



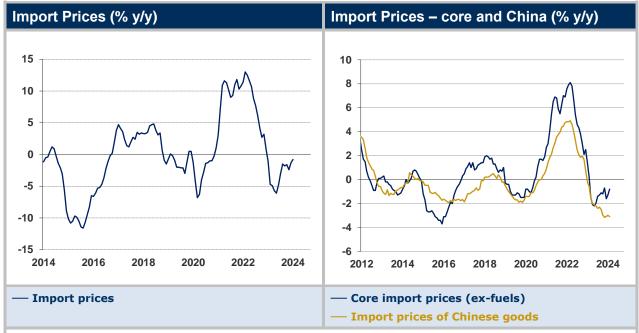


Current status: January and February inflation numbers were less constructive for the Fed, with the disinflation progress from the second half of last year encountering some bumps. Headline inflation looks to have bottomed for now as energy prices rise, whereas core CPI's decline has slowed. Supercore CPI has started to inflect upwards, indicating continued strength in the services sector, although supercore PCE does not reflect the same degree of strength. As a reminder, the Fed targets core PCE but also closely monitors core PCE services ex-housing for a better gauge of inflationary pressures in the more labour-intensive sectors of the economy. This measure continues to decline, albeit at a slow pace. Core PCE rose 0.42% m/m and 0.26% m/m in January and February respectively. These are strong numbers and not consistent with the Fed's inflation target. However, January and February numbers are affected by residual seasonality issues linked to the way new prices are set at the beginning of the year. Businesses typically use the new year as an opportunity to raise prices. As a result, we should expect March and April inflation numbers to come in softer. For the Fed to begin easing in June as the market currently anticipates, m/m core PCE readings would need to average 0.2%-0.25% m/m over the coming months. Anything higher than this would support the idea that the disinflation process has not only encountered obstacles along the way, but possibly stalled.





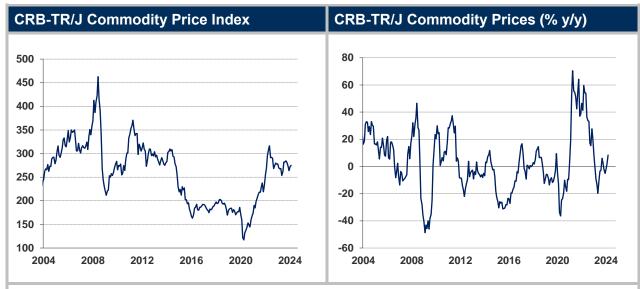
Current status: Headline PPI saw notable increases in January and February, mainly driven by goods prices, particularly in energy and food sectors. Energy prices increased 4.4% m/m, with gasoline prices leading the rise. On a three-month annualized basis, goods prices have risen above the Fed's 2% target. That said, core goods prices remained relatively stable, suggesting subdued supply disruptions. Core services also continued to moderate, indicating a slower pace of increase. However, travel accommodation services have seen strong demand, which points to continued strength in services consumption, potentially impacting consumer prices in coming months.



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.

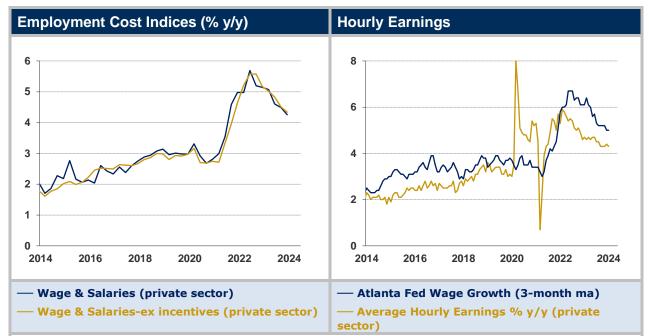
Current status: Import prices are not rising as much as feared given recent supply disruptions and higher shipping costs. Excluding fuel prices, all other price components saw slower monthly increases, notably in autos and consumer goods. Import prices of Chinese goods remain depressed, with Chinese deflation continuing to pass through into cheaper goods prices. China's currency devaluation against the dollar is also playing a role, making Chinese exports cheaper for foreign buyers and exerting downward pressure on prices of similar goods domestically or imported from other countries. This will help in maintaining low US goods inflation.





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

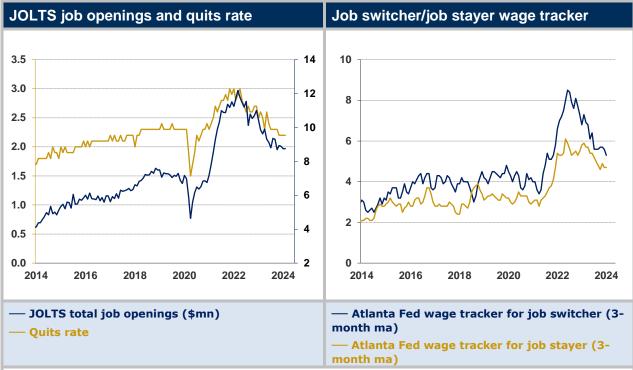
Current status: Commodity prices are now up 2% y/y and will likely continue to show strength over the coming months due to large negative base effects from Q2 2023. Most of the gains in commodity prices were led by oil, which rose 5% and 2% respectively in January and February. Ongoing geopolitical uncertainty, a tight supply backdrop, and bearish investor bets have acted as tailwinds to price action. Industrial metals on the other hand, remain under pressure. Copper prices were down throughout January and February, while iron ore saw a sizeable decline in February (-8.4%) as rising inventories coincided with disappointing Chinese construction and manufacturing activity.



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: Despite the uptick in overall inflation readings, there appears to be little upward pressure on wages. The Atlanta Fed wage growth tracker and average hourly earnings closely track each other, showing the continuation of easing wage pressures. However, as previously noted, the pace of decline has slowed, and annual wage growth remains above the Fed's 3% target.





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: For context, job openings, ie the demand for labour, rose sharply post-COVID as the boom in goods and services spending meant you had too many corporates chasing too few workers to facilitate the increased demand. We therefore saw a large imbalance in the supply of labour (availability of workers) and the demand for labour. This imbalance is what led to significant wage inflation as employers had to raise wages to attract workers back into the workforce. Since the peak in job openings and guits rates (% of people guitting their jobs) in 2022, labour demand has declined, helping to alleviate wage inflation. However, much of the moderation in wages has resulted from increased labour supply rather than outright job cuts or reduced hiring, as more workingage individuals have entered the job market. As a result, the imbalance in labour demand and supply has significantly improved. This can also help explain why we've seen the unemployment rate remain stable despite strong payroll growth. As for the quits rate, this is now back to pre-COVID levels, and we can see in the second panel above the impact this has had on the wage differential between job switchers and stayers. With fewer job openings, employers have less incentive to raise wages for new hires, causing a narrowing pay gap between job switchers and stayers. The Fed pay close attention to these dynamics and will welcome the progress. However, at 5.3%, the 3-month moving average of wages for job switchers remains too high. This averaged 4% pre-COVID, so there's still work to do in bringing this down. Further reduction in wages may well require some softening in demand, as supply effects may have reached their limit. Nevertheless, until now, the Fed has managed to bring down wage inflation while maintaining a robust and healthy labour market.

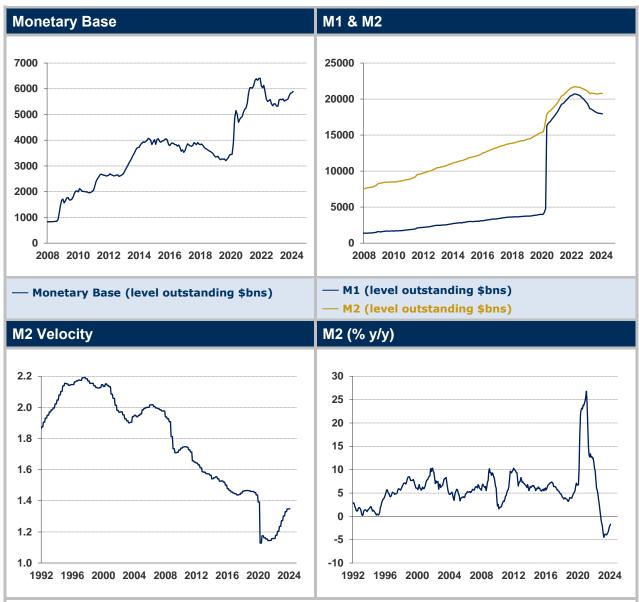




What is this data? Inflation expectations held by the public (Michigan survey) & financial market (10y/5y breakeven inflation rates). Inflation expectations are significant e.g. higher consumer expectations of inflation may lead to higher wage demands. If market expectations of inflation are rising/falling,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

Current status: Consumer inflation expectations continue to fluctuate within the 2.8%-3% range they've been in since 2021. Despite rising gasoline prices, the Fed will be encouraged to have not seen a recent pickup in consumer inflation expectations. However, financial markets have shown some apprehension. Recent strong inflation readings, coupled with a dovish Fed stance, have served to increase inflation volatility. As a result, 10yr and 5yr breakeven inflation rates have edged up by 30bps and 15bps respectively since the start of the year. 5yr breakeven rates are now at their highest level since March 2023. Markets are growing concerned at the Fed's unwillingness to push back against reflation risks, possibly signalling a willingness on behalf of the Fed to tolerate a higher inflation level.





About the data

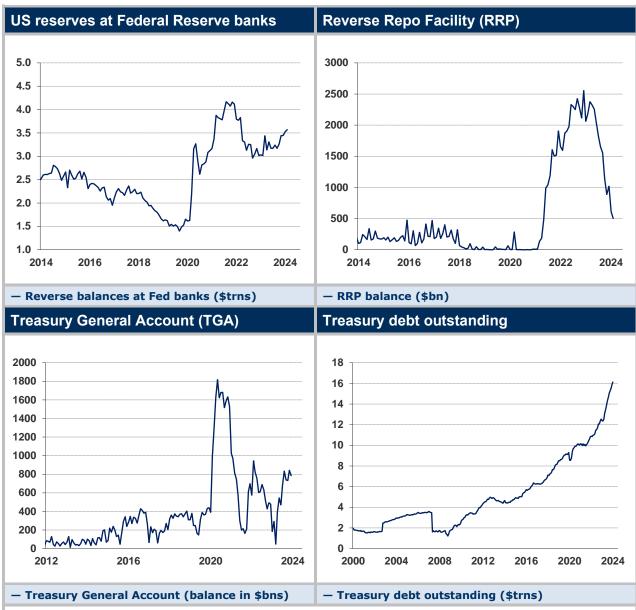
Monetary base = M0 (or notes & coins in circulation) + notes & coins held by banks and the central bank + bank reserves held by the banking system at the central bank. **Note:** the last two items are *not in circulation*

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: The monetary base continues its uptrend as liquidity conditions improve, thanks to the buildup in bank reserves caused by the drawdown in excess cash held at the RRP. However, this will face some resistance in Q2, as mentioned in the next section. The decline in M2 now looks to have stopped, confirming the good financial position of households, who currently have less of a need to draw down on savings. The US personal savings rate as a percentage of personal income is now down to 3.6%, the lowest level since December 2022. Inflows into money market funds continue, albeit at a much slower pace than seen throughout the first half of 2023. US bank lending remains strong, with broad credit growth across all loan types, particularly in real estate and consumer loans. Loan extensions for residential real estate were particularly strong, as lower mortgage rates are helping stimulate housing activity in the existing home market.

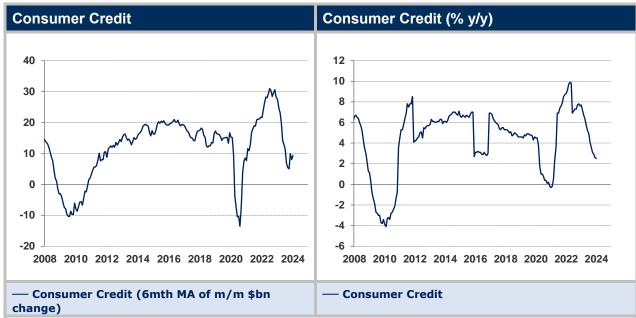




What is this data? This data helps to track broader liquidity conditions by examining reserves across the Federal Reserve banking system, the amount of money parked in the Fed's overnight repurchase facility (RRP), total cash balances at the Treasury, and outstanding marketable Treasury debt.

Current status: The RRP at the end of February stood at \$500bn, down from just over \$1trn since the start of the year. A large share of bill issuance in Q1 has once again prompted money market funds to pull money out from the RRP to buy bills, helping keep bank reserves on an upward trend as the Treasury General Account (TGA) remains stable. This has supported overall liquidity conditions. However, the most recent Quarterly Refunding Announcement by the US Treasury points to negative bill issuance in Q2, meaning the RRP likely stabilizes between \$400-500bn during this period. This also comes at a time when the TGA likely increases thanks to the collection of corporate tax receipts from tax season. Much of this is likely to be financed through a reduction in bank reserves rather than money market fund outflows. This, combined with the Fed's continued balance sheet reduction, should lead to a tightening in liquidity conditions this quarter.

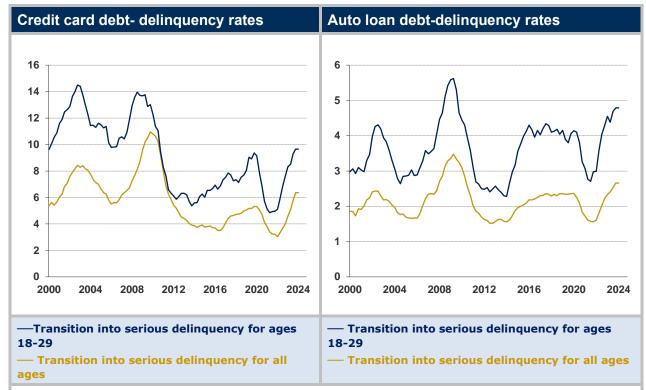




What is this data? Covers most short and intermediate-term credit extended to individuals, excluding loans secured by real estate. Consumer credit growth will directly influence money growth and monetary velocity.

Current status: After strong consumer credit growth in January, we saw a moderation in February. Both revolving and non-revolving credit continue their downward trend, although much of January's strength was concentrated in revolving credit (credit card usage). Revolving credit was up 9.2% y/y in February, compared to the pre-COVID average of 4%, reflecting ongoing strength in consumer spending and spending fatigue among lower-income households. Consumer credit tends to lag changes in lending standards by around 12 months. Based on what we're seeing, consumer credit growth should continue to slow over the next 6 months before picking back up towards the end of this year as banks' loosening in lending standards filters through to credit growth.





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: Total household debt and aggregate delinquency rates increased by 1.2% and 3.1% respectively in the fourth quarter of 2023. Delinquency rates continue to rise for most debt types, but what's ominous is that serious delinquency rates for both credit and auto loan debt have now surpassed pre-COVID levels. The percentage of credit card debt transitioning into serious delinquency for all ages now stands at 6.36%, up from 4% in Q4 2022. For auto loan debt, financial stress seems concentrated in younger and lower-income households. As of Q4 2023, auto loans transitioning into serious delinquency for ages 18-29 stood at 4.8%, surpassing dot com levels and nearing the 5.5% seen during the 2008 financial crisis. We clearly see how rate hikes have affected the more rate-sensitive consumers, particularly younger and lower-income households. We should therefore anticipate reduced spending amongst this cohort in 2024, which we may already be seeing reflected in weaker Q1 consumer spending data, such as retail sales.





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 loan, and other factors influencing credit availability.

Current status: Reiterating the message from the previous report, the most recent Senior Loan Officer Survey for Q4 showed that fewer banks are tightening credit standards on commercial and industrial loans for all businesses. Though standards remain tight, the rate of change is what matters most, with the net percentage of banks reporting tighter C&I loan standards down to 14.5% from 34% in Q3. Not only is the availability of credit improving, but the demand for credit is also picking up. The share of banks reporting weaker demand for commercial and industrial loans among large and medium-sized firms fell to 25% from 31% in Q3. For smaller firms, the decline was even more pronounced. Here, the share of banks reporting weaker demand for C&I loans fell to 22% from 49%. We will get the Q1 numbers by the next report, but it's likely to show continued easing in credit conditions as the US economic outlook improves.



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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