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Weekly Commentary

Issue **No. 16** | **APRIL 18, 2022**

Macro View

By Hubert Marleau

Watch the Money Supply

- Inflation May Have Peaked

Submitted April 16, 2022

The Weekly Snapshot of the Market:

The Consumer Price Index increased 1.2% in March, 0.8% in February and 0.6% in January, accelerating U.S. inflation to an annual rate of 8.5%, a new four-decade high. As it turns out, inflation is on everybody's mind, consuming the Fed's bandwidth and pre-occupying investors.

High inflation is the customary downside of booming growth. As a rule, inflation turns when the economy finds a new footing as the Fed tightens its monetary stance to re-balance an appropriate relationship between supply and demand. Unfortunately, Russia's invasion of Ukraine and the rise of Covid in China pose risks that the normalization process will take longer to materialize than it usually does. Crude oil surged above $100 a barrel in March; gasoline prices rose 18.3%, accounting for over half of the increase in overall inflation; while the food index at home rose 1.5%, accounting for the rest.

Given the unrealistic prospects for an immediate amelioration in the supply chain, the balancing of the economy will have to fall on consumers. Put simply, the burden of rising prices is producing a sticker shock as people see how much more it costs to buy essentials like gas and food. Surging energy and food prices are hitting consumers hard. Essential expenses are stretching budgets as real average earnings are falling. Moreover, the huge gap between headline and core inflation is changing the terms of trade, putting many components of the economy under stress. Consumers are resisting by changing their spending habits and/or reducing their expenditures. In fact, shipping rates are down and available capacity is rising, reflecting cooling

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demand for goods, retail sales having grown only, modestly in March. Adjusting for inflation, consumers are clearly buying less than they were a few months ago.

Last month, however, one indicator of building inflationary pressures moderated. A March survey conducted by the NY Fed showed that consumers' median inflation expectations for 3 years from now fell to 3.7%, down from 3.8% in February. One data point is not a trend, but it's a signal. Stripping out volatile fuel and food, so-called core prices climbed 6.5%, but slowed down on a monthly basis, rising only 0.3% compared to 0.5% in February and 0.6% in January, registering the smallest gain in 6 months. According to Daily Shot, talk of a wage-price spiral is grossly exaggerated, the bulk of the recent rise in wage rates being due to disproportionate layoffs of low-paid workers. Investors should also take note that big monthly moves up in inflation occurred in the April-July period of last year. Starting next month those big gains will no longer be part of the year-over-year equation.

All of this is happening while base money and base rates are reducing the availability and increasing the cost of money in the U. S. and abroad. Over the past 3 months, the U.S. money fell at an annualized rate of 0.5%, while the dollar value of the world money supply has fallen at an annualized rate of 0.6%. History shows that business and inflation cycles can move very fast when yearly increases in the money supply are around 5%. In monetary terms, a 5% y/y increase is neutral, and that is where we are.

On Wednesday, speculators pared back their bets on an aggressive series of interest rates from the Federal Reserve. The yield on 2-year notes, which is highly sensitive to monetary expectations, is now near the estimated 2.75% neutral rate, precisely the level that the Fed wants the policy rate to be. Futures markets show that traders now expect them to raise rates 2% by the end of the year, down 25 bps from earlier expectations. On Thursday, however, Amazon announced that it will introduce a 5% surcharge. The fixed-income market crumbled and bond yields rose back to where they were at the end of last week.

In the past week, the S&P 500 decreased 96 points or 2.1% to 4393, capping off a second straight losing week, but stayed within what appears to be an established trading zone - 4300 to 4800 - as pointed out in previous reports. By the third quarter, when evidence of slower growth and inflation become clearer, the Fed will likely modify its hawkish stance, which should ease market conditions. Indeed, the economy is slowing on its own, which is exactly what is needed to relieve inflationary pressures. The Atlanta Fed's NowCasting model has a 1.0% real growth factor for Q1.

Recession talk is everywhere, but the usual suspects, like stress in the financial system, are not building a credible recessionary case. The risk profile is low because there are no obvious financial signs other than re-

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adjustments. Credit spreads are normal, banking stress tests are good, real rates are negative, bankruptcies are low, and creative destruction has destroyed marginal enterprises. Both corporate and consumer balance sheets are solid. Wells Fargo's Chris Harvey in a note to investors wrote: "Corporate cash is 33% higher than it was in 2019 and the debt/equity ratio has been trending down for S&P 500 firms." Meanwhile, household net worth has rapidly risen in these 2 years to an all-time high of $150 trillion. I agree with his notion that the risk of recession is more fear than fact. The April Empire State Manufacturing Survey showed that output activity picked up markedly and business conditions surged, while plans for capital and technology spending were solid.

A Fed-induced recession is the only way we are going to get one and that is very unlikely. The Fed is aware that shocking exogenous factors like war and pandemics bring economic convulsions, making inflation numbers statistical fictions. In a commentary in the WSJ, Reuven Brenner, a venerable economic thinker, made the astute observation, based on what had occurred during the late 40s and early 50s, that present inflation numbers are unreliable: too many disturbances. Put simply, the BLS gave no consideration to rapidly changing consumer patterns and didn't adjust its weights. In this regard, the Fed is likely to take mismeasured inflation numbers with a grain of salt as interest rates approach neutral.

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Macro View cont.

By Hubert Marleau

(An English message follows)

Bonjour Hubert Marleau,

Le Département de science économique et la Faculté des sciences sociales de l'Université d'Ottawa vous convient le jeudi 28 avril 2022 au **diner-conférence Marleau** qui aura pour thème : **« Le changement climatique et la macroéconomie »**.

Cette conférence explorera les conséquences possibles de l'échec de la mise en oeuvre de politiques climatiques efficaces en temps opportun et les implications de cet échec pour d'autres aspects de la politique monétaire et fiscale.

Inscrivez-vous aujourd'hui!

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La conférence Marleau sera donnée par le **professeur James H. Stock**, vice-recteur chargé du climat et de la durabilité à l'Université de Harvard et membre du Conseil des conseillers économiques du président Obama en 2013-2014.

Nous aurons également le plaisir de compter sur la participation de **Mark Carney,** envoyé spécial des Nations unies pour l'action climatique et les finances, et conseiller financier du Premier ministre britannique Boris Johnson pour la conférence COP26 à Glasgow.

- **Date :** Jeudi 28 avril 2022
- **Heure** 11h45 – 14h30 HNE
- **Où :** Pavillon Faculté des sciences sociales, Pièce 4007, 120 Université Privée, Ottawa, ON, K1N 6N5
- **Titre :** « Le changement climatique et la macroéconomie»

La participation est gratuite et sur invitation uniquement. Deux choix de repas vous sont offerts. La capacité est limitée, inscrivez-vous dès aujourd’hui pour réserver votre place.

L’événement se déroulera en anglais.

Inscrivez-vous aujourd’hui!

Nous avons hâte de vous accueillir!

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By Hubert Marleau

Catherine Deri Armstrong

Directrice du Département de science économique, Université d'Ottawa.

Remerciements: La Série de conférences Marleau sur la politique économique et monétaire a été créée en 2019 grâce à un généreux don de **M. Hubert Marleau** (Palos Management). Veuillez **consulter notre site web** pour en savoir plus sur la série.

Hello Hubert Marleau,

The Department of Economics and the Faculty of Social Sciences of the University of Ottawa invite you on Friday, April 28th, 2022, to the **Marleau Signature Lunch Lecture** on **"Climate Change and the Macroeconomy".**

This lecture explores the possible consequences of failing to enact efficient climate policies in a timely way and the implications of that failure for other aspects of monetary and fiscal policy.

Register today!

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The **Marleau Signature Lecture** will be delivered by **Professor James H. Stock**, Vice Provost for Climate and Sustainability, Harvard University and Member of President Obama's Council of Economic Advisers in 2013-2014.

We will also have the pleasure to welcome the participation of **Mark Carney,** UN Special Envoy for Climate Action and Finance, and Finance Adviser to UK Prime Minister Boris Johnson for the COP26 conference in Glasgow.

- **Date:** Thursday, April 28th, 2022
- **Time:** 11:45 a.m.- 2:30 p.m. EST (5 p.m. – 7:30 p.m. UTC)
- **Location:** Faculty of Social Sciences Building, Room 4007, 120 University Private, Ottawa, ON, K1N 6N5

Participation is free and on invitation only. Capacity is limited, register today to save your seat.

Register today!

We look forward to welcoming you to our event!

Catherine Deri Armstrong

Chair of the Department of Economics, University of Ottawa.

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By Hubert Marleau

Acknowledgement: The Marleau Lecture Series on Economic and Monetary Policy was established in 2019 through the generous contribution of **Mr. Hubert Marleau** (Palos Management). Please visit our website to learn more about the series.

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