Inflation Pressures Downshift

U.S. Long Leading Index growth is now easing as well, pointing to dimming prospects for overall economic growth.

Faith-Based Fed Policy  The Fed risks being blindsided by a cyclical downturn in inflation. That is the clear and present danger as monetary policymakers continue to dismiss the recent dip in inflation due to “one-off” factors, while clinging to their conviction that the Phillips curve will prevail.

Because of the dips in our International Long Leading Future Inflation Gauge and 11-Country Future Inflation Gauge, six weeks ago we wrote that, “especially in the context of the global industrial growth downturn that is now at hand ... they bear watching for early signs of a potential reversal in the global reflation cycle that we flagged last summer” (ICO Focus, May 2017). The monthly U.S. Future Inflation Gauge (USFIG) then dipped noticeably in May (EWU, June 2, 2017). And with data already available through early June, the U.S. Weekly Future Inflation Gauge – the USFIG’s weekly version – looks to be approaching a one-year low (Chart 1). If so, a full-fledged cyclical downturn in the USFIG could soon become evident. We will therefore monitor it closely in the weeks ahead.

In typical fashion, the fixed income markets have extrapolated the recent dip in core inflation into expectations of a protracted period of soft inflation. However, as we observed a couple months ago, “While coincident indicators like core inflation are useful because they reduce noise, they do not really have predictive powers,” especially since, in this case, the weakness was driven by “a confluence of disparate factors” (USCO Essentials, April 2017). Fed Chairman Janet Yellen concurred in last week’s press conference, warning against overreaction to a few “lower readings on inflation ... driven significantly by ... one-off reductions in certain categories

Chart 1: U.S. Weekly Future Inflation Gauge (1992=100)