

G7 Inflation Downturn Confounds Central Banks

ECRI's future inflation gauges anticipate inflation cycle turns, whereas central banks forecast inflation using Phillips curve models tethered to jobless rates that tend to decline during expansions.

A Big Misunderstanding Central bankers do not understand that inflation has its own cycle, distinct from the business cycle, leading to repeated policy delays and mistakes. ECRI's future inflation gauges are specifically designed to anticipate inflation cycles, offering early warning of inflation cycle turning points that fly in the face of central bank rate hike (or cut) plans. These contrarian calls open up opportunities to foresee when a central bank's plans will be negated by the cycle.

A case in point is ECRI's prediction of the Fed's recent policy U-turn. In October, after laying out the details of the cyclical slowdown in U.S. economic growth, we plainly stated in a *Bloomberg Daybreak: Asia* interview that the Fed's planned 2019 rate hikes were "not going to happen," on the basis of our U.S. Future Inflation Gauge (USFIG) having signaled a clear inflation cycle downturn the month prior (*USCO Essentials, September 2018*).

This is just the latest example of the Fed and other major central banks failing to realize that inflation cycles are distinct from other cycles, which ECRI co-founder Geoffrey H. Moore first recognized four decades ago. That insight led Moore to develop the first leading index of inflation, and is the basis for our 11 country-specific future inflation gauges.

Just last fall, with real-time data showing year-over-year (yoy) CPI growth for the Group of Seven (G7) economies at a 6½-year high (Chart 1, bottom line), the Fed, the Bank of Canada (BoC), and the Bank of England (BoE) all had multiple rate hikes on the

ECRI predicted in October that the Fed's planned 2019 rate hikes were "not going to happen" on the basis of the USFIG downturn, even as markets saw a 90% chance of at least one rate hike in 2019.

Chart 1: G7 Future Inflation Gauge and G7 Inflation

