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June 6th 2022
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Has Inflation Peaked?

The consumer price index (CPI) is reported every month. In the monthly report there are many numbers but most people focus on only these:

CPI Y/Y HEADLINE
CPI Y/Y CORE
CPI M/M HEADLINE
CPI M/M CORE

Y/Y means year over year, M/M means month over month, HEADLINE includes everything and CORE excludes food and energy.

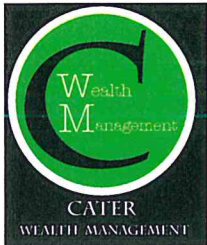
When they say inflation hasn't been this high for 30 or 40 years, they are using CPI Y/Y HEADLINE as their reference point, 8.3% proves it. This is a very scary number. But is this the number we should be looking at?

CPI YOY measures the average inflation over the previous 12 months, in this case May'21 through Apr '22. This tells us what happened last year, not necessarily what will happen this year. I am more interested in what is happening now, not yesterday. The number we focus on is CPI M/M HEADLINE. This tells us what inflation actually was in the most recent reporting period. Then we look at the recent trend, are we going higher or lower. The latest number (Apr '22) was .3%. The number before that (Mar '22) was 1.2%. The 3 months before that were .8%, .6%, and .6%. To us these numbers are encouraging. Current inflation seems to be Declining.

In the long run prices don't ever seem to go down. They either go up a lot or go up a little. Going up a lot is inflation, going up a little is dis-inflation and going down is deflation. Deflation does happen but it is rare.

Most people suffer from "Recency Bias". Whatever is happening today will probably continue. If we look at April's CPI Y/Y we see 8.3%, if we look at April's CPI M/M and annualize it we see 3.6% (.3 X 12 months). Two very different numbers derived from the same inflation report.

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CPI is well known but the Federal Reserve's preferred measure of inflation is the personal consumption expenditure index (PCE). PCE is "chained weighted". This means it tries to measure the price changes of the goods and services of what people actually buy as opposed to a fixed basket like the CPI. If beef prices rise too much some will substitute pork or chicken, Etc.

PCE comes in the same flavors as CPI; Y/Y, M/M, HEADLINE and CORE. PCE Y/Y HEADLINE, the official index the Federal reserve board has been watching since 2012 is currently 6.3%. As previously discussed, we believe M/M is a better indicator than Y/Y of inflation going forward. If we look at April's PCE M/M and annualize it we see 2.4% (.2 X 12 months), which is a lot closer to the official Federal Reserve target (2.0%) than 8.3%. 2.4% today, 8.3% yesterday. We believe the 2.4% is more relevant.

The current obsession with inflation is more political than economic. Expect to see scary headlines from both sides leading up to the midterms in November. As always we will be watching future economic releases and our opinions may change but it does look to us like inflation may have peaked in March'22. The bond markets seem to agree with us.

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