

There are signs that US inflation is starting to rise.

By Bruce Baker 16/8/16 (Updated on 30/9/16 and again on 9/10/16)
for clients of Puzzle Financial Advice.

Why would rising inflation in USA be important?

- Because over the last 80-odd years, inflation trends in USA have been a major driver of inflation trends across the entire West.
- Because rising inflation in USA usually leads to higher interest rates in USA, which over the last 80 years, has been a major driver of interest rates across the entire West.
- Rising US cash rates would normally be expected to cause rising US\$ index (rising value of the US dollar), which should lead to falling A\$ against the US\$.
- Rising US bond rates would be a major negative force for US share values, since US bond yields are used as part of the discount factor used to value shares.
- Rising US bond rates leads to falling values of US bond portfolios, and falling values of bond proxies like REITs, infrastructure and utility investments, and shares with very reliable dividend streams.
- The above effects would have various influences in markets around the world.

What happens after inflation in the US starts rising?

- Alan Greenspan's view 14/7/16
 - <http://www.foxbusiness.com/markets/2016/07/14/fmr-fed-chair-greenspan-inflation-is-starting-to-rise.html>
 - “We’re seeing the very early signs of a process of inflation rising” Greenspan
 - “What I’m talking about is not a return to some stability in practice. I think yes, if we’re starting to move on the price inflation area which remember, we have not yet seen and it’s still latent in the data. ***But when that starts, the presumption that it’s going to stabilize at some moderate rate is I think foolish. History tells us that we will get out of the deflation area but we will be in nirvana sort of speak for a very short period of time as we move into a fear of inflation.***”
- Federal Reserve Bank of San Francisco President John Williams 29/3/16
 - “U.S. inflation could get closer to the central bank’s target faster than expected and set the stage for a faster pace of interest rate increases, Federal Reserve Bank of San Francisco President John Williams said Tuesday.”
 - <http://www.wsj.com/articles/feds-williams-future-rate-increases-to-be-gradual-and-thoughtful-1459242900>
- <http://www.smh.com.au/business/markets/jp-morgans-seven-wildcards-that-could-shock-global-markets-20160504-gomomd.html> SMH 6/5/16
 - **US inflation**
 - The sharemarket has been pricing in a rise in inflation, but has discounted the possibility of the Fed reacting to it by raising rates faster than anticipated. "Almost everyone expect[s] higher inflation, but they also suspect the Fed has undergone a regime change that will ignore higher inflation," Mr Normand said. The lesson from the Fed's previous tightening cycle, in 2004 to 2006, though was that the Fed did not have "infinite patience" towards inflation overshooting estimates. ***A faster-than-expected tightening of monetary policy in the US would likely trigger a higher greenback, unsettling almost every global market and asset class, including currencies, commodities and equities.*** Fed member John Williams said overnight two to three rate rises in 2016 were "reasonable".

What are some of the signs?

Ronald-Peter Stoeflerle. 28/6/16

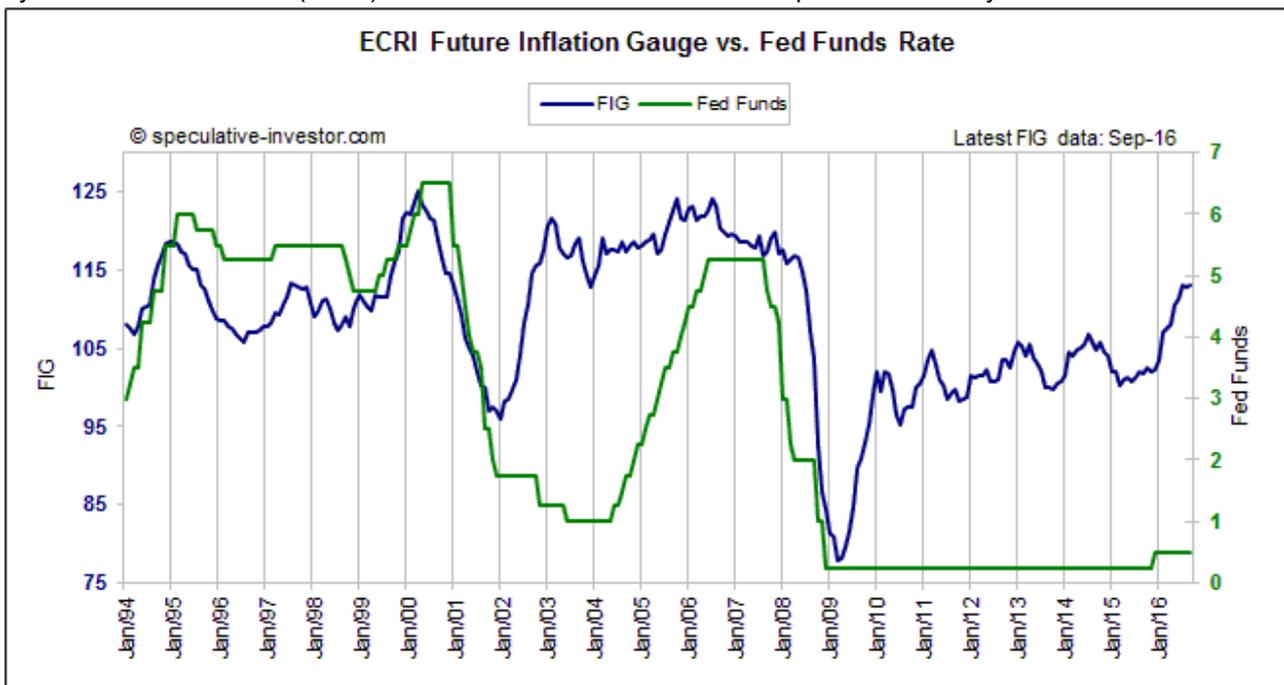
- [http://puzzlefinancialadvice.com.au/Gold/160726_Stoeflerle - In Gold we Trust 2016-Short_Version.pdf](http://puzzlefinancialadvice.com.au/Gold/160726_Stoeflerle_-_In_Gold_we_Trust_2016-Short_Version.pdf) Page 14 and related discussion starting on page 13.
 - <http://www.incrementum.li/en/research-analysis/in-gold-we-trust-2016/>

Incrementum Inflation Signal



Source: Yahoo Finance, Incrementum AG

Steve Saville 9/10/16 – looking at 'Future Inflation Gauge (FIG) reported each month by the Economic Cycle Research Institute (ECRI). This indicator leads trends in US "price inflation" by 9-11 months.'



Steve Saville's assessment of this chart is *'This chart's message is that "price inflation" will soon begin to pick up and that the Fed is now so far "behind the curve" that "the curve" cannot even be seen from where the Fed is positioned. If the FIG is correct then the T-Bond yield will be a lot higher in a year's time than it is today.'*

In due course, this should start showing up as a rise in US Bond yields.

US Bond yields have been in a bull market (rising prices, falling yields) since 1982, and in the 6/8/16 edition of EWI's forecasts, EWI says that we have now seen the top of US bond prices (bottom of US bond yields).

US 10yr Treasury Bond Yield (USGG10YR INDEX) 1.5576 0.04

2016-08-15



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It is possible that the August/16 rise in Japanese bond yields (in response to the major fiscal package announced by the Japanese government) may be a related event.



Appendix A. EWI's Financial Forecast 6/8/16

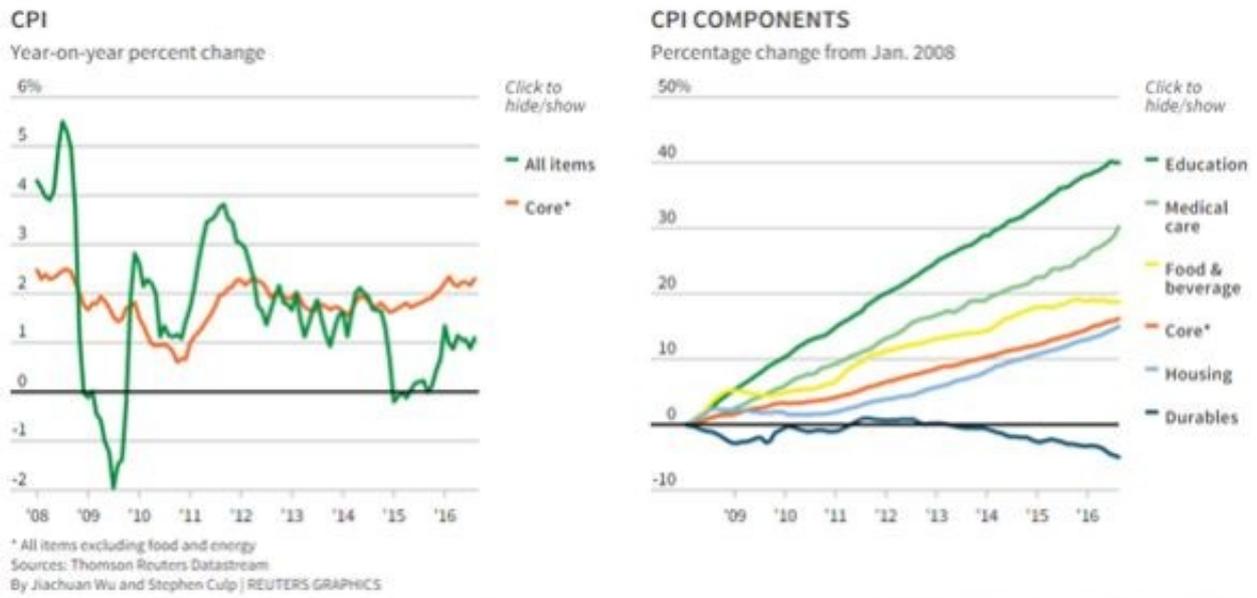


Last month, EWFF pointed out the near-record number of long futures and options contracts on 30-year U.S. Treasury bonds accumulated by Large Speculators (trend-followers) and highlighted a similar extreme on the short side by the smart-money Commercials (insiders). Our forecast said: “These optimistic extremes are consistent with the wave labels shown on our chart and indicate that a fifth wave is terminating: a trend reversal is nigh.” Four trading days later, on July 8, bond futures made their closing high at 177-03.

Appendix B. Developments post 16/8/16

FatProphets 19/9/16

U.S. inflation



In my 17/9/16 circular, I included the following points:

In the Chris Joye article circulated earlier (end of bond market bull), Chris Joye said:

- One of his latest chart packs highlights that most measures of US core inflation are above the Fed's 2 per cent target at 2.5 per cent "and trending higher".
- <http://www.afr.com/personal-finance/low-interest-rates-for-not-so-long-20160915-grgwf5>

Today Jon Pain also confirms this when he said:

- A slight uptick in US core CPI, now running at an annual rate of 2.3%.

So inflation seems finally to be coming.... and that is what bond markets are responding to. And share markets are responding to to the bond markets.