Macroeconomic review: global indicators and future inflation in the U.S.

1. Economic indicators dashboard

Russia

- **Daily average COVID-19 cases for the last 7 days, thousand**

yesterday	change for 7 days	change for month
12.7	-1.5	-8.9

- **Unemployment rate** went down to **5.8%** in January over 5.9% in December
- **Manufacturing** fell by **2.5% (YoY) in January** as compared to 2.1% (YoY) rise in December
- **Retail** dropped by **0.1% (YoY) in** January as compared to 4.1% (YoY) fall in December
- **Paid services rendered to population** fell by **9.4%** (YoY) in January as compared to 17.1% (YoY) fall in December

USA

- **Daily average COVID-19 cases for the last 7 days, thousand**

yesterday	change for 7 days	change for month
70.7	-8.4	-104.5

- **CB economic sentiment index** grew to **91.3 in February** over 88.9 in January.
- **Services PMI** grew to **58.9 in February** over 58.3 in January.
- **Manufacturing PMI** was **58.5 in** February over 59.2 in January.

Short-term indicators

- **Redbook index** grew in week ended **February 21: -0.8% (MoM) over -0.9% (MoM) a week earlier.**
- **Number of unemployment benefit applications in week ending February 14: 861 thousand** over 48 thousand a week earlier.

Russia

Indicators associated with consump on of both services and goods go up in Russia. Labor market is recovering gradually. Both can be explained by ease of restric ons and decline in coronavirus incidence rate.
Produc on sector's movement is much less posi ve. The contrast between December and January changes cannot be logically explained, so the data will most probably be revised by Russian Federal State Sta s cs Service (Rosstat).

USA

Both services and manufacturing sectors are recovering quickly in the U.S. Posi ve business expecta ons become stronger being a ected by the prospect of approval of $1.9 trillion relief package. However, there is a problem: the faster U.S. economy is recovering, the lower is the probability of relief package being approved. If it is rejected, this will adversely a ect both real economy and equi es market.

2. Future inflation in the U.S.

There is much talk today about the risk of high infla on or even galloping infla on in the U.S. If infla on really accelerates signifi antly as many investors predict, this will impact the whole securi es market, and public debt market in par cular. Let's assess probability of high infla on in the U.S.

U.S. Government Bond yields have already begun to grow. For instance, 10-year UST yield rates rose **from 1%** to **1.4%** within a month**.** The reason is growing infla on expecta ons. The best indicator of investors' infla on expecta ons is the di erence between yields of government bonds with and without protec on from infl on. This di erence has already reached 2.2% while FRS in a on target is 2%. This is the maximum since 2014.

Spread between 10-year UST yields with and without protec on from in a on

Source: Board of Governors of the Federal Reserve System (US)

Despite the fact that wide an cipa on of infla on growth had started a couple of weeks before, there was no new informa on which could change percep on of U.S. infla on. Prices grew **by 1.4%** within January as compared to **1.3%** growth a month earlier. Infl on in fact increased, but there is nothing dangerous in this so far.

U.S. In a on rate, % (YoY)

Source: U.S. Bureau of Labor Statistics

Amazingly, there was no new economic data predic ng high infla on rates in the U.S. released during the recent months. We already wrote about the risk of infla on outburst in the U.S. a er the pandemic in a special review about six months ago. Concerns are associated with FRS using the prin ng press or, in other words, star ng quan ta ve easing (QE) i.e. buying and adding securi es to its balance sheet. **FRS assets have grown by 3.4 trillion or 80% since pandemic onset and continue to grow.**

FRS assets, trillion USD

Source: Board of Governors of the Federal Reserve System (US)

QE led to a record growth of monetary stock. Monetary stock grew by more than **25% (YoY)** — the highest level on record (i.e. since 1981). Previous record high levels are **12% (YoY) in 2001** and **10% (YoY) in 2009.**

U.S. monetary stock movement, % (YoY)

Source: Board of Governors of the Federal Reserve System (US)

Why the record growth of monetary stock did not entail high inflation? If all the money were spent at once, prices would rise due to high demand. However, the major part of the amounts injected to the economy s ll remains in the stock market. There are 3 reasons:

1. A signifi ant part of the money was injected to the economy via benefi s and subsidies. People are generally more reluctant to spend free money than money they have earned.

2. There were two lockdowns in the U.S. which considerably restricted spending opportuni es.

3. The popula on lives in crisis for almost a year. In crisis, people tend to save more for a rainy day due to lack of confi ence in the future.

Therefore, the share of earnings set aside hit all-time high growing by more than 30%.

Share of savings in personal income, %

Source: U.S. Bureau of Economic Analysis

During the pandemic, FRS printed record amount of money, and population made unprecedented savings. When shall we expect high inflation? It depends on what kind of infla on we expect. **High inflation in the U.S. at around 3-4% is likely to occur within the nearest year or two for the following reasons:**

1. Business ac vity begins to recover in the U.S. The be er the prospects are, the more money will be spent eventually leading to infla on.
2. Annual infla on got as low as 0.3% at mes during the pandemic. Hence, infla on rate will defi itely exceed 2% in 2021 due to low base e ect.

Two-digit inflation rates are not too likely. On one hand, we have never seen such huge numbers in terms of monetary stock, so we cannot know the consequences beforehand. On the other hand, however, similar QE measures never caused hyperin a on. For example, in 2008 crisis, FRS grew its assets by $1 trillion or twice (this money was worth more than today, a er 12 years of deprecia on due to infl on). S ll, there was no outburst of infl on 3.8% being its maximum.

Conclusions:

- USD infl on around 3-4% is likely to occur within the nearest 2 years.
- Two-digit infl on is possible but unlikely because there are no specifi indica ons as yet.
- Star ng from April, infl on will most probably exceed 2%, but this will be due to low base e ect.
- Government bond yield is likely to con nue to grow, so one should be careful with long-term bonds.
- Precious metals should be considered for protec on from infla on.

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