MV CAPITAL MANAGEMENT

Weekly Market Flash

Too Early To Call Stagflation

April 26, 2024

When inflation began rising three years ago, eventually reaching levels not seen in a couple generations, the chatter among market personalities was full of oldspeak calling up the 1970s. Among the words and portmanteaux dusted off for re-use was stagflation, last observed in the wild in the days when Carter administration staffers danced under the disco ball at Studio 54. With the Consumer Price Index touching nine percent in the summer of 2022, fears of a combination of higher inflation and tepid growth mounted. Then inflation started coming down steadily and growth kept on, well, growing, and talk of stagflation subsided, packed back into the old steamer trunks alongside bell bottoms and lava lamps.

Thursday Troubles

Until Thursday of this week, that is, when a Bureau of Economic Analysis report on US economic growth in the first quarter delivered two unwelcome pieces of news. Growth, as measured by Gross Domestic Product, came in at an inflation-adjusted 1.6 percent (quarter on quarter, annualized), well below economists' consensus estimates. The deceleration follows a stronger than expected gain of 3.1 percent in 2023. It wasn't really a bad result – the main drivers of the deceleration were reduced business inventory investments, weaker exports relative to imports and a reduction in durable goods spending (e.g. on automobiles). Lower inventory spending, probably the main factor causing the headline growth number to come in below forecast, is in part a reflection of more normalized supply chain flows and in part an outcome of cautionary planning among manufacturers in projecting near-term demand trends.

But the growth number is not what caused some consternation in financial markets on Thursday morning; it was another number in the BEA report that showed price trends for personal consumption for the first quarter. The Personal Consumption Expenditures price index is the BEA's main inflation metric (the Consumer Price Index, the metric more familiar to most Americans, is put out by the Bureau of Labor Statistics). That number came in hot, with the core (ex-food and energy) PCE showing a 3.7 percent appreciation for the quarter as compared to the consensus forecast of 3.4 percent, and seemingly the latest in a growing series of data points suggesting that inflation is stuck on a plateau above where the Fed (and most of the rest of us) would like it to be. Stock indexes tumbled and bond yields shot up. "Stagflation" made the rounds as financial news jockeys kibbitzed about the events of the day.

Not So Hot, After All

The market's malaise (to use another 1970s-era buzzword) was relatively brief and restrained, with both stock prices and yields well off their worst levels by the end of the day. That hot PCE price index number, remember, was for the entire first quarter, and we already know that at least the first two months of the year saw higher inflation relative to the trend late last year. The bigger question for inflation was whether that trend was going to be continuing on a month by month basis. The PCE was hot for the quarter, but what about for just the month of March?

Fortunately, we did not have to wait very long to find out. The BEA published the March Personal Income and Outlays report this morning, which contains among other items of interest the PCE price index for March. That showed a month on month gain of 0.3 percent, which translates to a 2.8 percent year-on-year increase and, importantly, is basically in line with what was forecasted. We'd still like to see that

number be a bit lower; month-on-month increases of 0.1 or 0.2 percent would give the Fed more confidence that inflation is moving towards its target level. But nothing in the March PCE report gives a strong indication that inflation might be moving in a way that would require the central bank to consider another rate increase (which is something that was being talked about in bond market circles earlier in the week).

There is still much that remains to be seen about how the economy is going to fare in 2024. For now, at least, we are not inclined to see the specter of stagflation as a meaningful cause for concern.

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