

DAILY GLOBAL COMMENTARY

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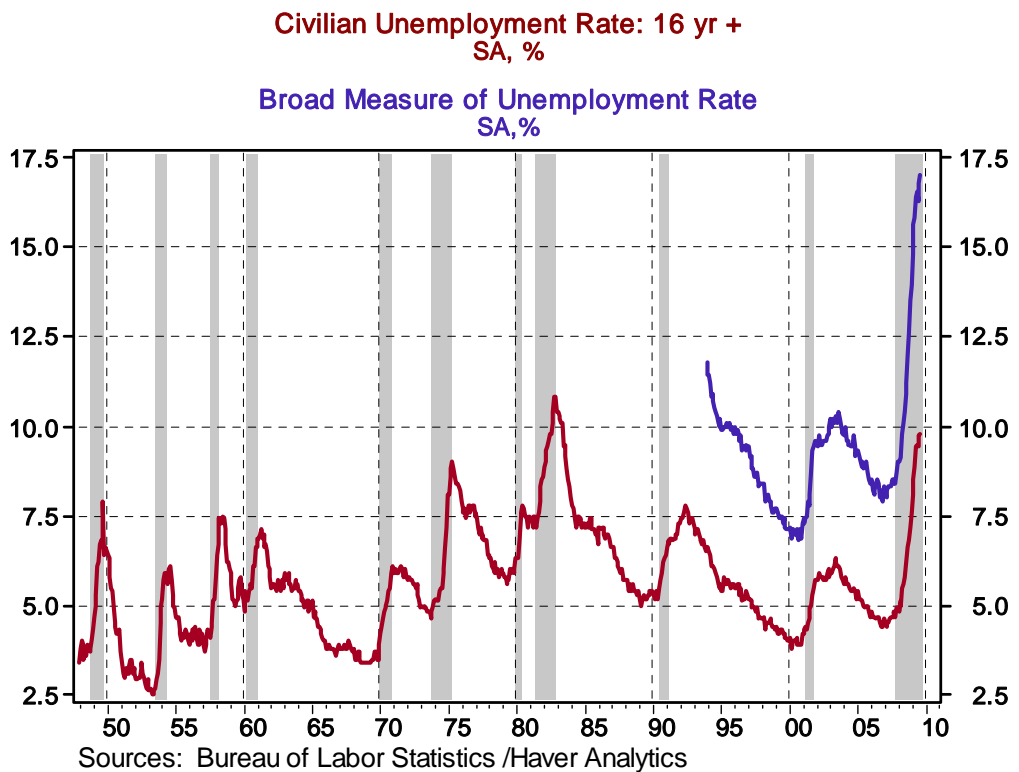
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The Inflation Story – What is the Evidence?

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There is a growing concern about an inflationary threat in the U.S. economy given the enormous monetary accommodation the Fed has put in place. As expected, there are differing opinions about this issue. Putting the available information in perspective, a strong case exists for inflation to be a few notches down on the Fed's priority list in the short term. The important phrase here is "short term." There are many compelling aspects in the recovering economy that point to contained inflation in the near term. First, the unemployment rate in September was reported as 9.8%; the all inclusive unemployment rate is 17% (see chart 1).

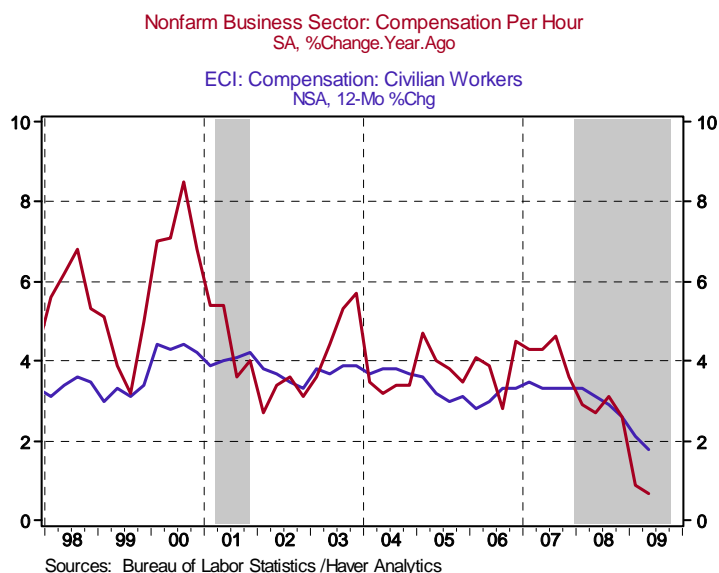
Chart 1



Wages are unlikely to be the cause for a large increase in inflation in the near term because widely used measures of wages pressures are trending down (see chart 2), given the lack of demand in the labor market. By the way, the Federal Reserve tracks these variables to form its assessment of inflation.

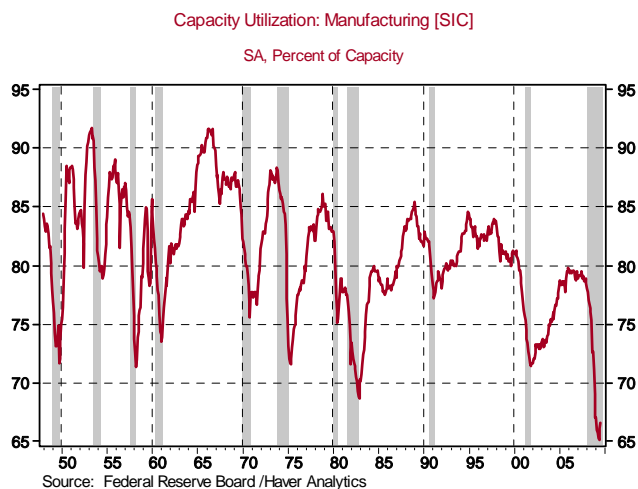
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Chart 2



Second, the operating rate of the nation's factory sector was 66.6% in August, close to the record low mark of 65.1% registered in June 2009.

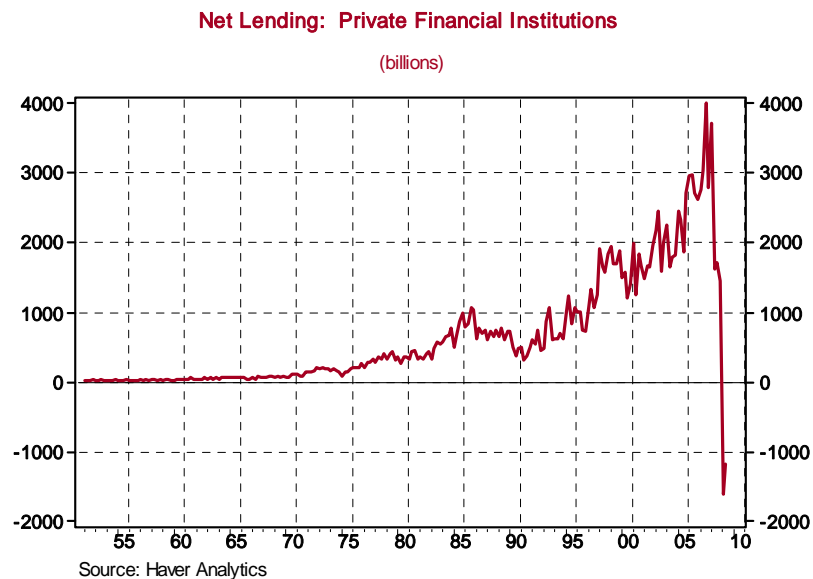
Chart 3



Third, financial institutions are not lending (see chart 4) implying that a stalled credit machine supports expectations of a non-inflationary environment in the near term.

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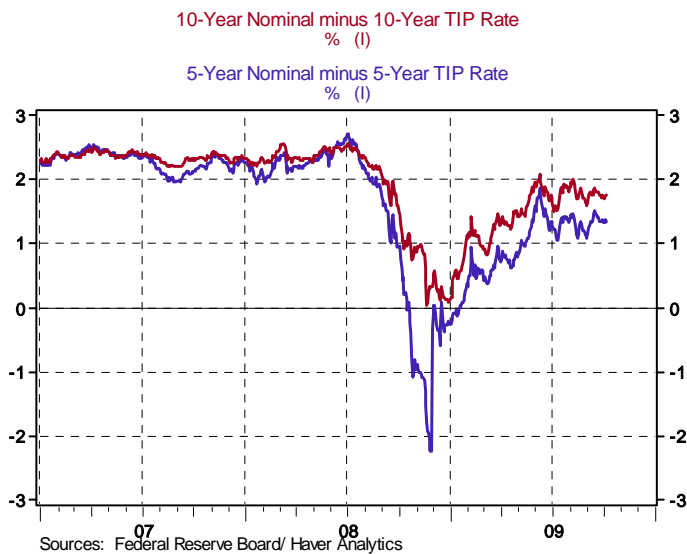
Chart 4




What is the indication from the market based measure of inflation expectations? Inflation expectations as measured by the difference between the yield on Treasury securities and TIPS are below the pre-crisis levels (see chart 5).

Chart 5

Inflation Expectations



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In sum, the overwhelming evidence presented here points to a Fed worrying about inflation in the early part of the next decade. It is important to note that concern about inflation is the long term story. Paul Kasriel has published a detailed analysis of the long-term outlook for inflation ([Greater Risk over the Next Five Years - Inflation or Deflation?](#))

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