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# **US INFLATION: FAIT PERSPECTIVE**

### 10Y Nom. (white); 10Y Real (blue); BE 10Y (green); BE 5Y (mauve)



- FAIT<sup>1</sup> is presented at the Jackson Hole Symposium on August the 27<sup>th</sup> 2020
- No market reaction for over 2M: FAIT does not induce higher inflation expectations. It tells the market the CB reacts to above target inflation readings after a while. In so doing the CB makes room for higher inflation expectations
- Market reacts to expansionary fiscal policy prospects <u>after</u> the Democrats secure the presidency (1<sup>st</sup> leg: Nov – Dec) and Congress (2<sup>nd</sup> leg: since Mid-Jan)



### BE 5Y (mauve); BE 5Y,5Y forward (blue)

- Despite 5Y BE inflation rose to historically high level, market is not pricing inflation spiraling out of control (unusually, 5Y,5Y forward BE inflation < 5Y BE inflation)</li>
- Positive base effect, rising commodity prices, bottlenecks due to value chains repatriation, government sponsored consumer demand lower price sensitivity are already priced in
- The time to decide if these adjustments are sticky and generate 2<sup>nd</sup> round effects is still a few months away







# US INFLATION: RELATIVE PRICES ADJUSTMENTS VS GENUINE INFLATION



## CPI (orange); Core CPI (blue); Trimmed CPI (yellow)

- Inflation is on the rise due to base effect and commodities' prices rise
- Core inflation confirms the peculiarity of the moment
- Trimmed inflation shows extreme changes are major contributors to core and headline rise
- The combination of these indexes and the large labor market miss in April squares with Fed's inflation "hump"
- Inflation worries call for tapering being hinted at by the Fed before 4q21<sup>(1)</sup>



#### Participation Rate (yellow, 6M Mav is bold); Prime Age Participation Rate (white, 6M Mav is bold)

### Topics for Discussion

Rate 25-54 Vrc S&) D

- FAIT regime implies the Fed acts on inflation and labor market improvements being measured. Will the labor market be tight enough by 4q21 to justify tapering talks?
- Does market weigh inflation too much and labor market too little?
- US is about 8mn workers short of pre-C19 level. Is the US economy flexible enough to entice discouraged workers back in the market by year end?



(1) BofA Global Research Fx and Rates Sentiment Survey shows market participants see hints of tapering more likely than not by the September Fed meeting and at 93% by the year end (39% sees tapering being hinted at in 4q21)

# **EURO ZONE INFLATION: NEED FOR MORE**

### 10Y US (yellow); 10Y Big5 USD-hedged<sup>(1)</sup> (white); EUR (green); EUR Trade Weighted (orange)



- Better economic prospects and tapering talks in US triumph stronger ECB's market print since the March GC Meeting
- EUR rise in synch with higher (currency-hedged) EZ yields
- Inflation expectations still low after a significant run upward.
  - Market is currently pricing almost constant inflation at 1.6% y/y over the next 10Y
  - HICP is at 1.6% y/y. Market is not pricing much out of monetary and fiscal policies boost

(creen) Last Price EUINFLSS U Index 1.64 EUSWITS Curncy 1.61 CPTFEMUY Index 1.60 1.64 1.00 0.00

2015-2019

Convright® 2021 Bloomherg Finance L P

2010-2014

Monthly 0110N2005-24M6V2021

BE 5Y<sup>(2)</sup> (mauve); BE 5Y,5Y forward (blue); HICP y/y

### **Topics for Discussion**

2005-2009

ITNELSS II Index (EU INEL SWAP 5.5)

- PEPP ends in March 2022 as anti-C19 vaccination rolls on and market expects EZ growth to take off later in 2021. A stronger EUR feeds on these elements. What would the ECB do to counter financial condition tightening? Larger APP, possibly?
- Priced inflation is way off record highs despite strong economic growth. Could FAIT be introduced in EZ too? Will core country accept that?
- How introducing housing services in the HICP basket makes ECB monetary policy more effective?









# **TOPICS FOR DISCUSSION: RECAP**

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- Does market weigh inflation too much and labor market too little?
- US is about 8mn workers short of pre-C19 level. Is the US economy flexible enough to entice discouraged workers back in the market by year end?
- PEPP ends in March 2022 as anti-C19 vaccination rolls on and market expects EZ growth to take off later in 2021. A stronger EUR feeds on these elements. What would the ECB do to counter financial condition tightening? Larger APP, possibly?
- Priced inflation is way off record highs despite strong economic growth. Could FAIT be introduced in EZ too? Will core country accept that?
- How introducing housing services in the HICP basket makes ECB monetary policy more effective?



# **CONTACTS**

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