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A reliable indicator of inflation moves

Written on October 5, 2017 by[Simone Wapler](Simone Wapler)|Central Banks,Simone Wapler

Is inflation set to prevail over deflation? Our indicator seems to prove that a major turnaround is taking place.

As you know, central banks and governments have a desperate need for inflation.

Not because it would be a sign of good economic health, as economists put it to their service. Simply because inflation allows them to gnaw their debts and mow the taxpayer without even noticing it.

Inflation - a widespread price increase, with no added value - is not a good thing for the purchasing power of ordinary citizens; honest capitalism is deflationary: it lowers prices through competition and productivity gains.

But as you know, dear faithful and patient reader, we do not live in a system of honest capitalism but in credibility.

The beginnings of credibility (1971, the end of the Bretton Woods agreement and the break between the dollar and gold) were difficult. People were skeptical about this purely fiduciary currency. The oil-producing countries brutally increased their prices. Enormous inflation took hold of the United States and contaminated the world.

Government inflation indices are useless

In order to convince that the currency backed by nothing was good, that the state debt backed by docile taxpayers was worth as much as gold, governments were cheating on inflation measures. The "baskets" included things of questionable utility but the price of which had the merit of falling, like the ping-pong ball in France, but forgot or minimized things whose price was flying.

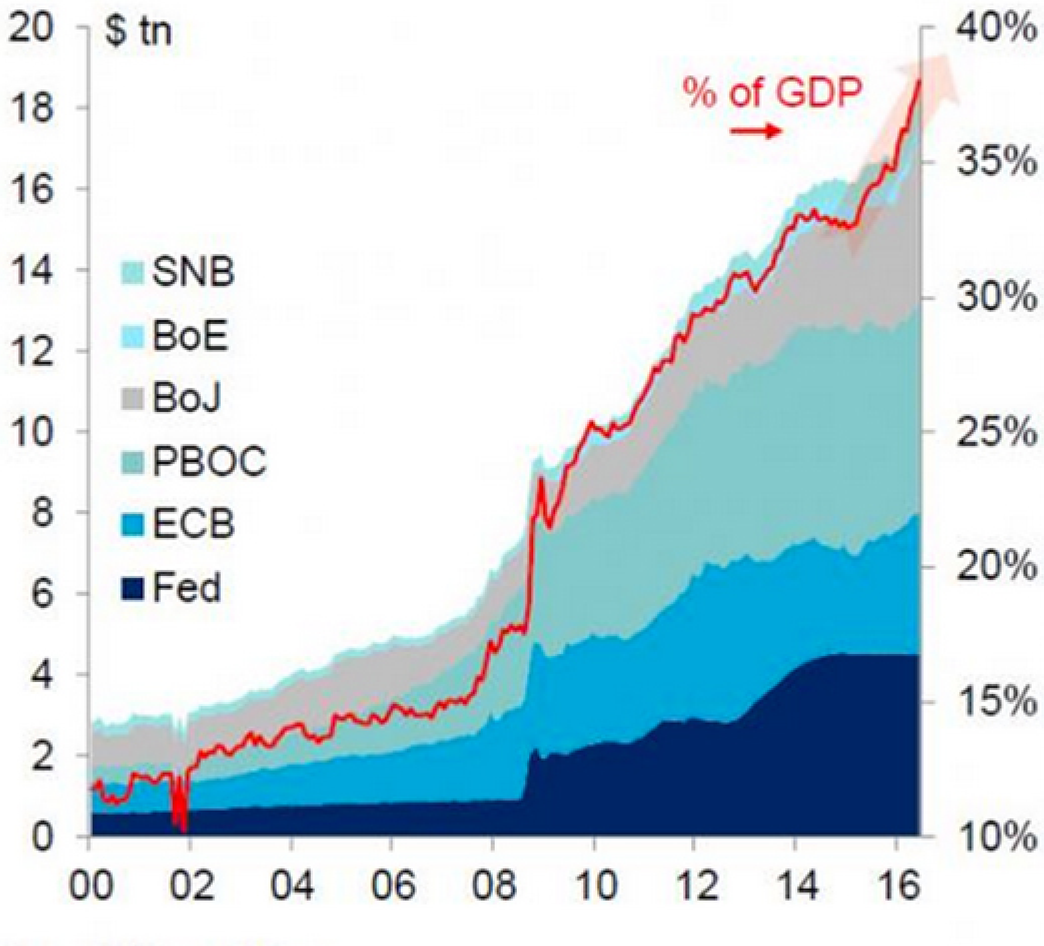
From manipulation to manipulation, states are now caught in their own trap: official indices indicate that inflation is under control, while anyone can see that its expenditures (many of which are increasingly constrained and compulsory) are increasing.

However, despite 10 years of unprecedented monetary creation, staggering, staggering, upsetting, the level of inflation is not that of the years 1971-1980. This monetary creation remains confined to financial assets and real estate. Imagine this as a huge reservoir of water (after all, it is called "liquidity").

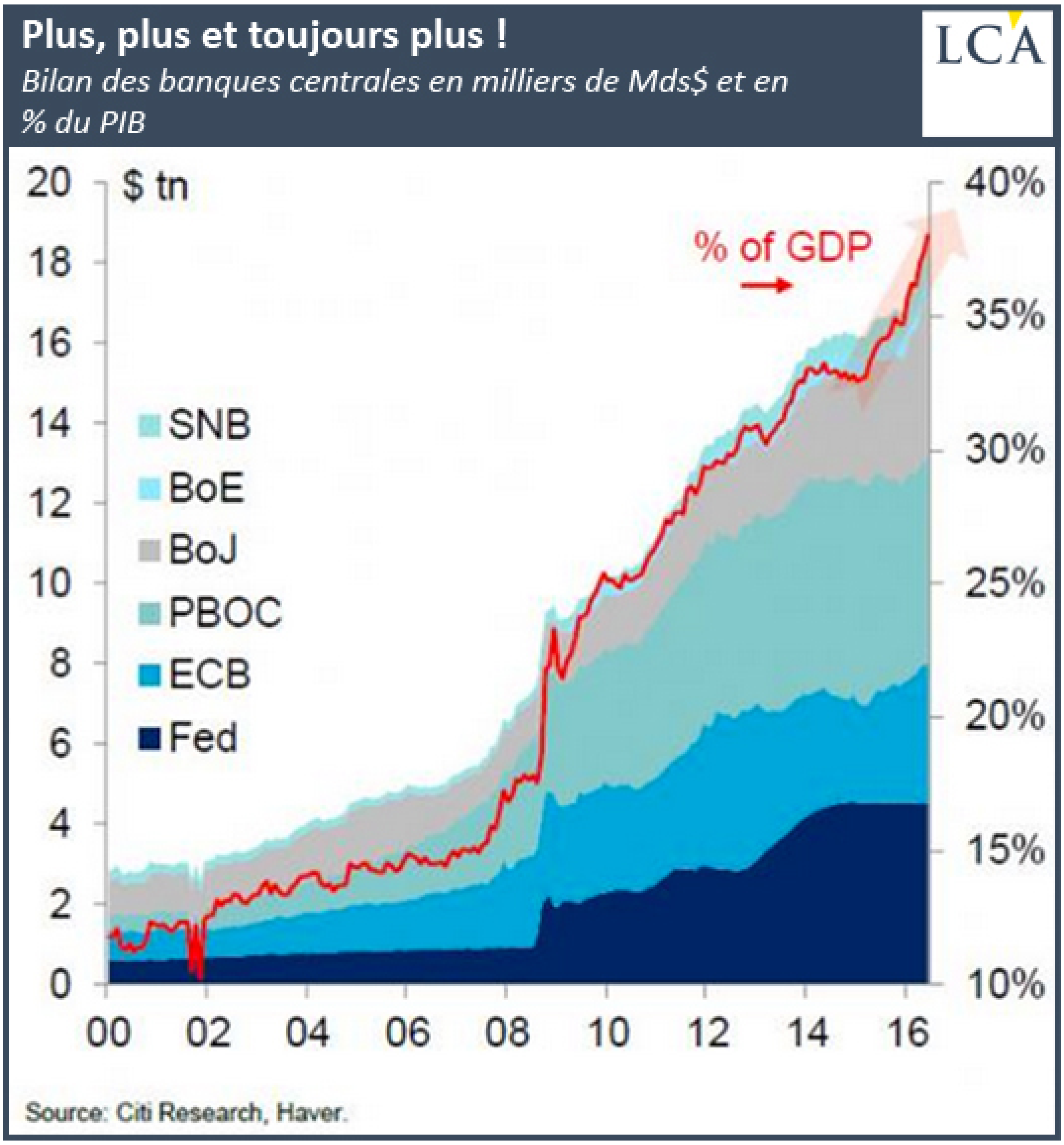
Yet monetary creation accounts for almost 40% of world GDP, the largest mass of liquidity ever created in history.

Plus, plus et toujours plus !

Bilan des banques centrales en milliers de Mds$ et en % du PIB



Source: Citi Research, Haver.



If the psychological dam gives way, if some of this cash begins to flow in the rest of the economic activities, inflation will live up to the monetary creation that preceded it: gigantic, disheveled, unheard of ...

As states are over-indebted, raising rates will be impossible. It will be a frantic flight to the currency, the most serious monetary crisis of all time.

For the moment everything is calm, no liquidity seems to ooze along a crack of the dam. Really ?

An instrument adapted to anticipate inflation

But what instrument of control do we have since the measures have been distorted?

To answer this crucial question, my American colleague Graham Summers proposes a simple indicator.

His thesis is the following.

An increase in the price of long-term Treasury bills is an indicator of fear of deflation. Investors buy them when they think the economy will slow down and they want to park their money in safety.

The rise in the price of US Treasury bills indexed to inflation is an indicator of fear of inflation. Investors buy them to protect their money when they think inflation will take off.

For these two instruments, negotiated daily by millions of stakeholders, there are two*trackers*: TLT for long-term treasury bills and TIP for inflation-linked Treasury bills.

The ratio TIP on TLT therefore tells you the feeling of the Market about inflation. If it rises this indicates that people want to protect themselves against a return of inflation. If it drops it is that people want instead to protect themselves from a generalized decline in prices.

Three clarifications at this stage:

- This indicator is more than a "feeling"; it indicates where millions of institutional investors really put their money.
- It is new: no prior art before 1971.
- It is obviously much more advanced than the evolution of the price records and the various official indices.

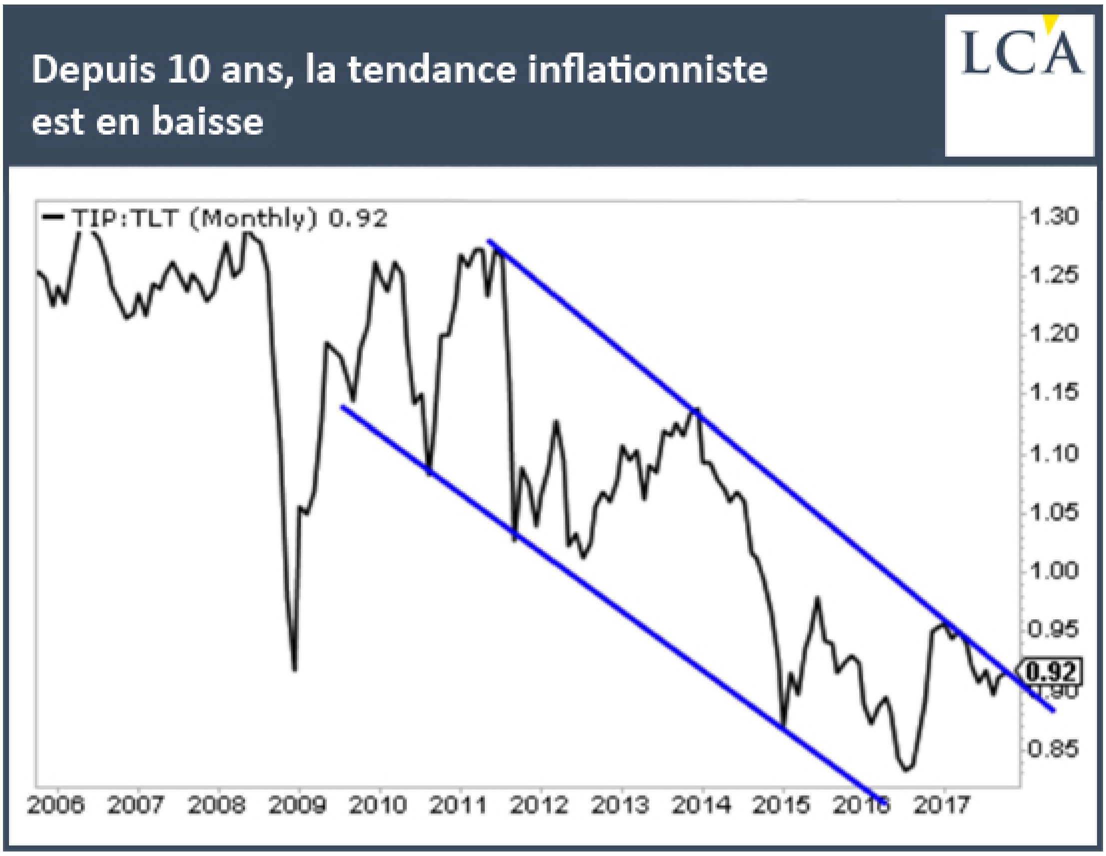
A tectonic movement begins?

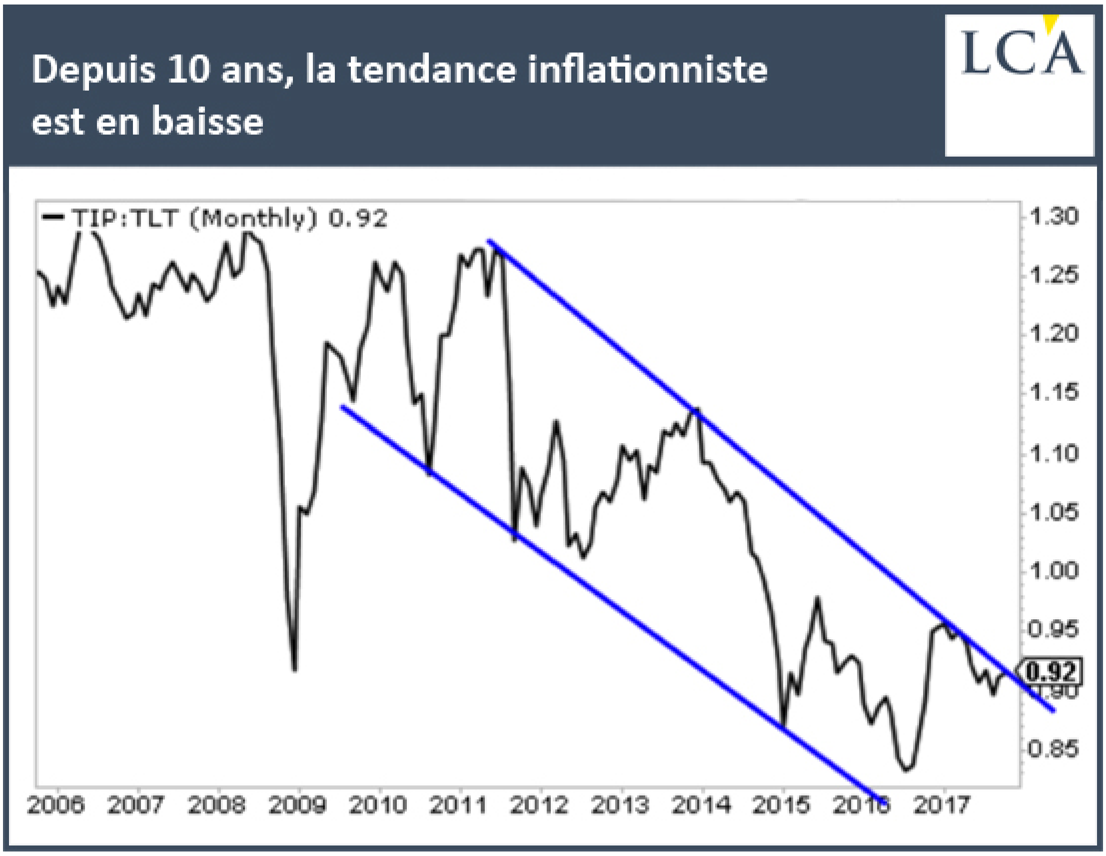
Graham says:

*"Since 2011, the financial system has been in a broadly deflationary trend. As a result, oil and other commodities, emerging markets and precious metals fell during this period. US stocks were an exception,*quantitative easing*having raised their price.*

This trend is returning for the first time in the decade. If this is confirmed, it is a tectonic movement of the financial system. "

Here is a long-term chart that reproduces these words. The blue channel shows the fall of this inflation index.





Now, let's see a shorter term graph. He pointed out that market participants now favor the inflation scenario.

Would the dam be cracking?

If so, it is*now*that you must protect yourself, too. You know the method, dear reader: gold which is the debt of no and has always kept its value in these cases.

Because do not forget: the method "rising rates" can not be implemented to fight against the influx of inflation. We will have a crisis in fiduciary currencies.

And if you're looking for leverage, to gain capital gains when everyone gets washed, here too we have the solution.Now you have to place your bet, not when the dam has already yielded.