



Alan Rohrbach <ar.rohr.intl@gmail.com>

ROHR ALERT!! FOMC Minutes Inflation Redux

1 message

ROHR Alert <rohralert@gmail.com>
Bcc: ar.rohr.intl@gmail.com

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Dear Subscribers,

Yep, we are right back here again after reviewing last week's agony and ecstasy (with apologies to Irving Stone for the glib take on his 1961 novel on the life of Michelangelo), as the agony is back again on what is seemingly inflation fears and current central bank inaction once again. And there is always a trigger for these market reactions, which in this case would seem to be this morning's UK inflation figures. However, as opposed to last week's bulge in both CPI and PPI, the combined UK reports this morning are more so troubling on just PPI.

While annualized PPI Output was +3.9% against a +3.5% estimate, the annualized Input figure was far worse at +9.9% versus a +4.4% estimate. Yet with annual Core CPI on target at +1.3%, it is easy to question why all the inflation fear at this time, and just what is driving that psychology? Well, after last week's strikingly higher US inflation numbers weighing on US equities and general 'risk-on' psychology it is easy to imagine there is a sense the central banks' still very accommodative approach may leave them behind the inflation psychology curve sooner than not.

As will likely be confirmed in this afternoon's FOMC April 27-28 Meeting Minutes (14:00 EDT), the Fed is still viewing the current 'supply disruption' inflation as temporary on the way back to a normal economy after the lifting of the extensive pandemic constraints. That's fair enough, and we extensively reviewed the difference between that and the more pernicious 'demand-pull' inflation in Tuesday's 'Inflation Conturbation' ALERT!! (repeated below for ease of review.)

That said, the current inflation concerns are exacerbated by the degree to which employers are finding it necessary to raise wages to attract workers from the sidelines many of them were happy to occupy during the pandemic lockdowns. That is raising the spectre of the sort of higher wage spiral that can indeed feed a 'demand-pull' inflation... with its threat that the key 'inflation expectations' will become unanchored from their decades-long bias toward steady and low.

This is exacerbated by a significantly higher (indeed historically atypical) US savings rate, creating the impression consumers have plenty of money to spend. Along with the anticipated future US infrastructure spending (even if somewhat less than the Biden proposals) this is creating a basis for the continued growth of the US economy. So why is there US equities angst along with some slippage in the other asset classes 'risk-on' indications? It would seem that the concern is that central banks' sanguine inflation perspective may leave them behind the curve if it turns out to be less 'temporary' than they are currently anticipating.

It has historically been the case central banks falling behind inflation are then required to tighten rapidly. It is likely that at least in part (also with a significant crypto asset price drop into this morning) that the current US equities concerns are not over the central banks

tightening prematurely... it might be more so on the fear that they might need to react with more aggressive rate hikes later if inflation remains too strong in the intermediate-term (over the next two quarters.)

That proposition will be tested in this afternoon's FOMC minutes release, where we have every expectation that they remained committed to the recently revised focus on full US employment as the goal. It was not just what Chair Powell had to say in his April 28th press conference. That sentiment has been repeated by every Fed governor and regional president in recent weeks. That assurance on the 'temporary' inflation bulge included Ms. Brainard and Mr. Clarida right into the teeth of the radical US equities selloff Tuesday and Wednesday of last week.

On the sheer Evolutionary Trend View (ETV) the June S&P 500 future drop back below the 4,120-00 area looks challenging for the bulls, as it represents a ding in the 'risk-on' psychology's armor which appeared to be back on last week's recovery back above that area. Yet as noted on Tuesday (and previous), the critical area below the market remains the early-April 4,021-15 UP Runaway Gap that was neared early last Thursday (weekly chart link below.) As such, and with the other 'risk-on' indications not nearly as weak today, that lower bull trend indication remains the key area if the market should even fall that far.

And of course, the counterpoint is any ability of the June S&P 500 future to recover on a more sustained basis back above the 4,100-20 range. We shall see.

Courtesy Repeat of Tuesday's 'Inflation Conturbation' ALERT!!

It is clear now that fears of inflation can create some market disorder, yet that appears to be in the context of some inflation being expected within the current US economic reopening. And as such, while fears of overheating can weigh on the US equities and by extension the entire 'risk-on' psychology, the strength of the factors driving the higher consumer and commercial spending are going to be a positive factor overall unless and until inflation gets out of control.

It is much as noted in Friday's "From 'C.P.y-I-kes!!' to All Okay" ALERT!! on the 'macro' psychology creating a whiplash from near-term 'risk-off' right back to 'risk-on', and the drivers for those distinct influences are worth revisiting. This is in fact just as it evolved out of Wednesday's 'C.P.y-I-kes!!' into Thursday's 'Who's Afraid of the Big Bad Inflation?' ALERT!!, which was most telling insofar as it could have easily been 'PPI Too!' that morning... except for the fact US equities were rebounding nicely. And while we gave the immediate reasons for the bounce back then, they are worth revisiting as the context for the 'macro' psychology.

While the Colonial Pipeline ransomware shutdown 'exigent' event and its upward pressure on gas prices may have been a psychological factor early last week, that being substantially resolved was contributing to a sense of relief. And there was also additional inflation impact anticipation built into the PPI release Thursday morning due to the severe nature of Wednesday's CPI overshoot. That seems to have been a very classical instance of *"sell the rumor and buy the fact."*

However, US CPI rising a monthly 0.8% and 4.2% on an annualized basis with the equivalent PPI being +0.6% and +6.2% look like daunting levels of inflation. It is all well and good for the Fed (along with the ECB and other central banks) to shrug it off as 'temporary' distortions due to the post-pandemic reopening. Yet it is also at levels that might be disturbing across the time frame the Fed considers just temporary. In the current context that means quarters not just months.

On both an academic and practical level, how can the Fed and others remain so sanguine on this threat to future growth, and the potential for it to ultimately tighten up to a degree that might cause a contraction? The academic level is easy to understand, as the Fed can rightfully cite anticipated (and now real) production bottlenecks during such a rapid reopening where many mid-supply chain firms had to shut down so fully due to either lack of demand or pandemic quarantine health-based constraints. It takes a bit more time than many expect to reopen.

While the practical level may seem like it should be more straightforward, it is more so rife with contradictions which take some insight to understand. The fact is central banks have a sense of history, including previous economic phases. This sort of collective corporate intelligence seems to abide despite the partial replacement of some members from time to time. That is due to only selecting new members who are clearly knowledgeable on the bank and economic history.

That definitely applies to their knowledge of the drivers of inflation, and informs our view of why they are so focused on whether 'inflation expectations' remain well anchored despite any near term 'temporary' increases. Only if and when the average person sees a strong enough economy across time as well as prices rising on a sustained basis does inflation become the sort of 'ingrained' problem which requires central bank activity. That is due to a situation seeing higher wage demands with full employment creating pernicious 'demand-pull' inflation.

However, as strong as US employment has become over recent months, it is still only replacing jobs lost during the early-mid 2020 pandemic restrictions. And it is also the case that the higher prices for many of the intermediate goods in the PPI are based on industry constraints. Lumber is an excellent example where there is an abundance of raw material, but the mills having shut during the pandemic are finding it hard to reopen to a degree necessary to fulfill strong housing demand.

Even shortages of other items, like computer chips, are on a lack of production capacity for industries that have recovered faster than expected during the deep depths of the pandemic damage a year ago. There is also the fact that auto sales had remained strong once folks decided the expense for personal transportation was worth it once there was infection concern about using public transportation.

Yet all of this is still related to 'supply disruption' inflation. And the experienced folks at the Fed and other central banks know that this can be temporary, even if that extends over several quarters. Within sustained economic recovery it is assumed that businesses will want to take advantage of those higher prices by producing more of those goods. The problem now is so many of the intermediate goods being up in price also increase the price for creating the new production... like steel and lumber for construction and copper for plumbing and wiring.

This creates a hurdle for companies looking to take advantage of higher prices for their products. Yet that will likely be overcome across time, and the supplies will come online and prices will weaken to some degree. We feel that is the Fed's (and other central banks') calculus now in not moving more strongly to restrain the current round of inflation... as long as they see the need for further economic expansion during the post-pandemic recovery, and not 'demand-pull' inflation.

What is the point of this little central bank economics lesson for the markets? Well, that should be obvious from last week's 'macro' whiplash: inflation can seem bad enough to

create a scare. Yet to the degree it is to be expected in the context of an economic reopening after a severe disruption, economic growth will likely still carry the day for the US equities and the overall 'risk-on' psychology.

Unless and until there are more signs of 'demand-pull' inflation, the Fed will likely tolerate what would normally be historically unacceptable levels of inflation. It is more so whether there are any signs that labor conditions are strong enough for workers to go out on strike. If that were due to consumer inflation anticipation being so strong that they felt they had no other choice, it could create the sort of vicious circle the US and world saw from the late 1970s into the early 1980s.

Even though there seems to be somewhat of a US worker shortage at present, whether encouraging folks to get back to work will require high enough wages to assume that inflation expectations have become 'unmoored' (to use a term made famous by Alan Greenspan) is problematic. And from a market perspective, the US equities along with other currencies against the US dollar are seeing it more so of a continued 'risk-on' environment at present. Especially note the June S&P 500 future recovery from so near the critical early-April 4,021-15 UP Runaway Gap early last Thursday (chart link below), moving back above the 4,100-20 area.

This is the critical consideration (updated prior to the FOMC Minutes)

On previous form, the March S&P 500 future stalled into its old all-time high, and then US equities struggled to sustain activity above the 3,959.25 previous all-time high by more than \$10 (both a natural rule of thumb and key weekly Oscillator level) through all of that week. That is clear on the front month S&P 500 future weekly chart (<https://bit.ly/3eY9k5q> updated through Friday.)

There was even atypical weakness into the mid-March FOMC announcements and Chair Powell's press conference. Even a March S&P 500 future push back above the old 3,960 area high, saw various factors conspire to drop it back to 3,960 area. June S&P 500 future (front month since March 19th) also fell sharply below the previous week's 3,942 weekly Close. That was important insofar as it established a 3,942 weekly DOWN Closing Price Reversal (CPR), nominally a real top.

Of note that had a Tolerance at the previous week's high, most interestingly 3,958.50, right near 3,960 again. However, after overrunning that the previous Friday, a strong US Employment report pushed it up into higher 4,010 and 4,035 resistances. The following Monday there was a 4,015-21 UP Runaway Gap, where the Objectives are 4,193 with a higher one not until 4,316. As such, whether a push generally above 4,200 can be maintained is a key indication on that front.

It is also the case there is an early-April weekly Oscillator threshold into 4,230 on the back of a \$25/week rise in weekly MA-41. It appears the market anticipated this previous by leaving a 4,211 new all-time trading high the previous week (when that was going to be the Oscillator threshold into early April.) This made that level that much more critical a technical threshold on any attempt to extend the rally, and it was overrun despite the weak April Employment report.

A really interesting part of the overall equation is whether generally overrunning the 4,200 area (including that lower 4.193 Objective), just means a likely test of the higher (weekly Chart) 4,316 Runaway Gap Objective? Yet on the recent sharp selloff it revolved around the degree to which the June S&P 500 future could hold the 4,100 Tolerance of the 4,120-10 support, or needed more of a correction.

Much below the 4,100 area the overall up trend corrected back near the early April 4,021-15 weekly UP Runaway Gap, as expected. While that was a significant further slide, it is actually very reasonable based on the straight up surge from the gap into the upper-4,100 area prior to stalling in mid-April. Having recently been above 4,100-20 again of late and now back below it sets up another potential test of that key 4,021-15 gap, with the key factor being whether it remains open.

Also of note is the front month S&P 500 future weekly MA-13 moving up from last week's 4,030 area to 4,044, further reinforcing the importance of the 4,021-15 UP Runaway Gap as an Evolutionary Trend View area and psychological indication.

Thanks for your interest.

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Contact: rohralert@gmail.com

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