

Inflation: Too Soon to Say Goodbye

a virtual presentation by

R. David Ranson

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HCWE & Co.

Popular Explanations for Inflation Come and Go

(a) Non-monetary causes

- Supply-chain disruptions and shortages
- Too much “demand” chasing too little “supply”
- Wage-price “spiral”

(b) Monetary Causes

- Too much money chasing too few goods
- Diminishing credibility of the monetary unit as a store of wealth

Why the Inflation News Varies Month to Month

year	month	% change in WTI oil price	% change in producer-goods prices	% change in CPI seasonally adjusted
2023	July	8.3	-0.3	0.2
2023	June	-1.9	0.1	0.2
2023	May	-9.9	-1.2	0.1
2023	April	8.4	-0.1	0.4
2023	March	-4.6	-0.6	0.1
2023	February	-1.7	-0.6	0.4
2023	January	2.2	0.9	0.5
2022	December	-9.4	-2.0	0.1
2022	November	-3.6	-0.7	0.2
2022	October	3.9	-1.1	0.5

11 ECORR MONINF-41

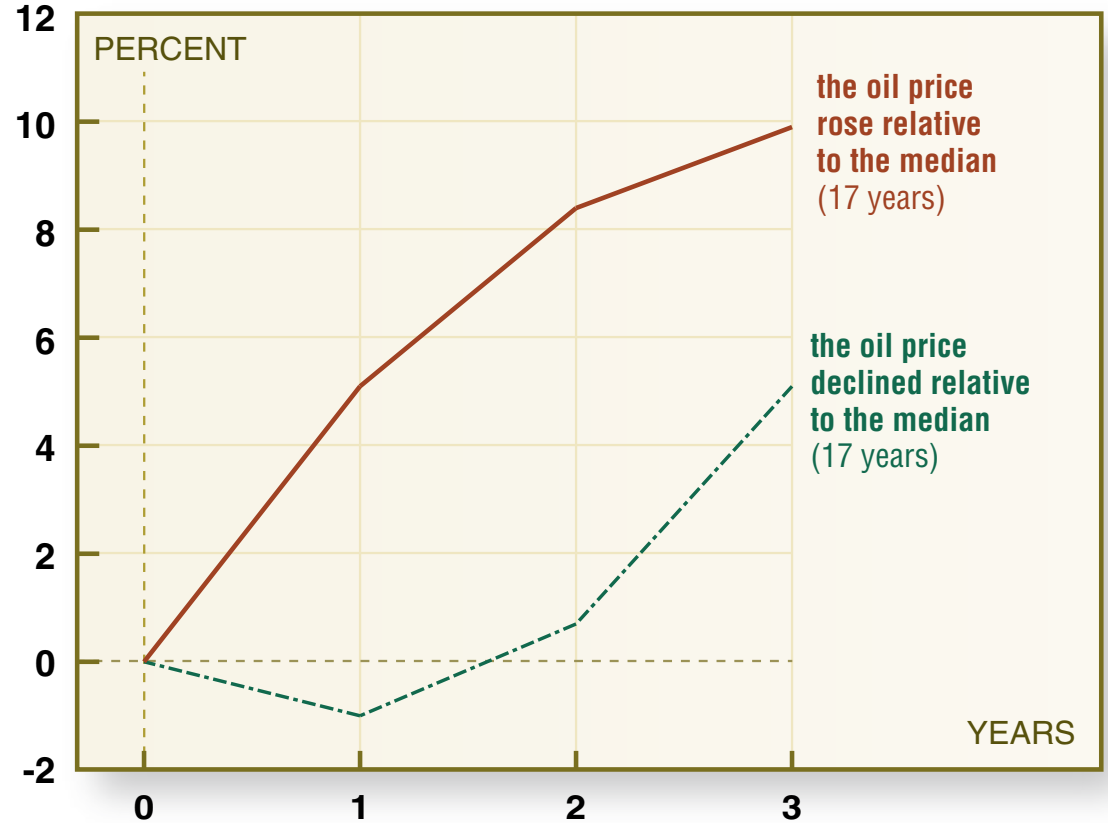
Oil-Price Movements as a Leading Indicator of Inflation

calendar-year average data
from 1986

Data: Producer price index for all commodities (Bureau of Labor Statistics) and the spot price of West Texas Intermediate crude oil (Energy Information Administration).

11 ECORR INDINF-eD

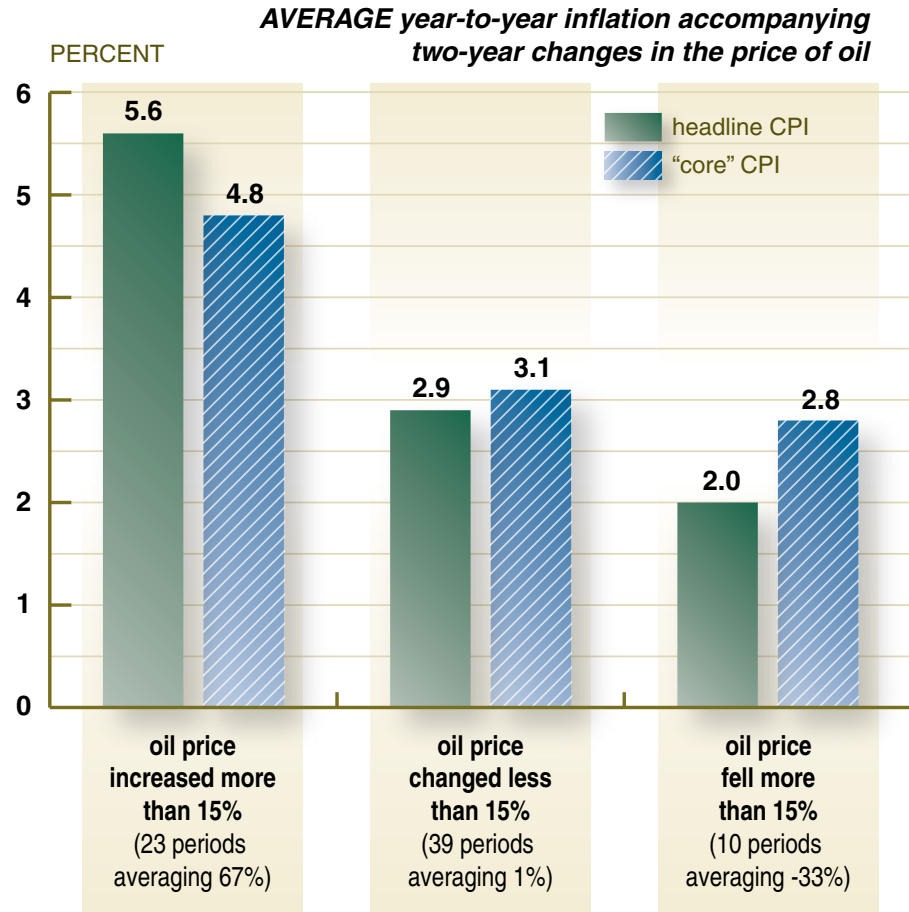
*AVERAGE cumulative increase in producer-goods prices
accompanying and following years in which:*



The “Core Index” Fails to Immunize Against Energy Prices

calendar-year average data
from 1957

Data: Headline and core consumer price indices, seasonally adjusted (Bureau of Labor Statistics), together with the month-end price of crude oil (Reuters Bridge Commodity Research Bureau until 1985) and the month-average price (Energy Information Administration).
Prog: 7 SUSTINF OILCORE



Relative Influence of the Fed and the Oil Price on Inflation

calendar-year average data from 1955

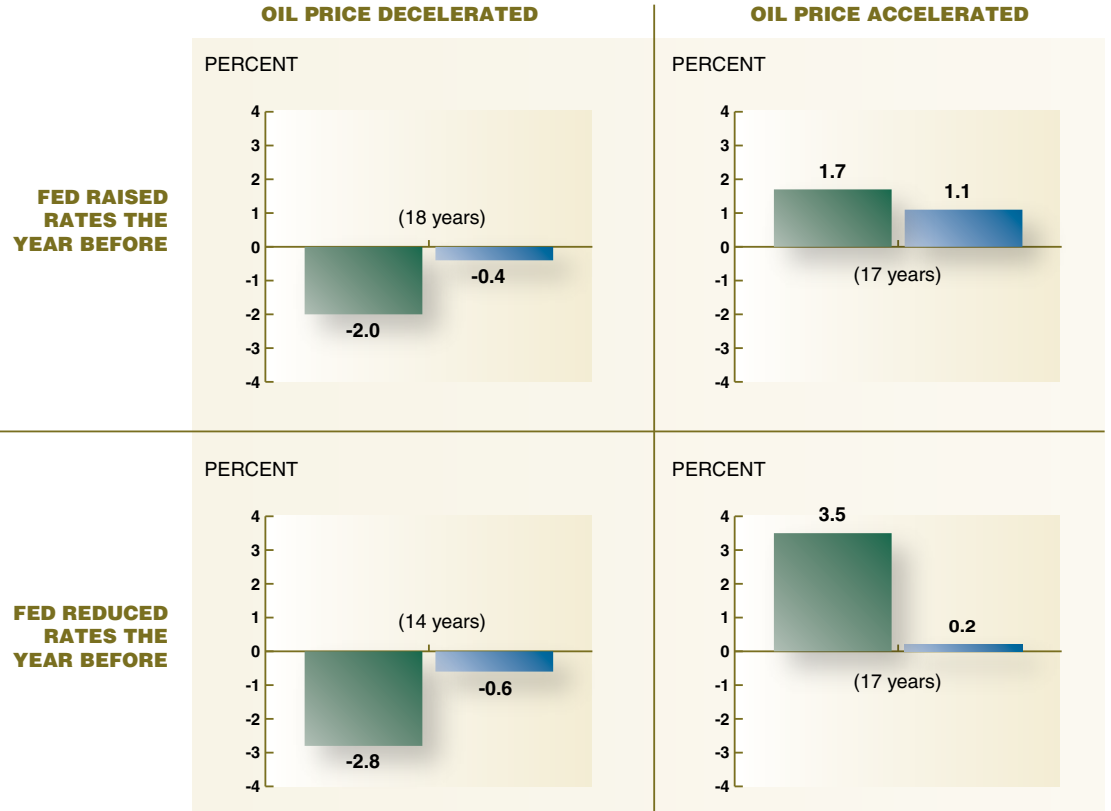
The immediate effect of the oil price on inflation is far more visible than the effect of Fed rate actions after a year.

Data: Price of West Texas Intermediate crude oil (Bridge Reuters Commodity Research Bureau), together with the producer price index for all commodities and the consumer price index for all urban consumers (Bureau of Labor Statistics).

11 ECORR OILVFED

AVERAGE increase or decline in the year-to-year inflation rate for years in which:

producer goods prices
consumer prices



After Fed Rate Hikes, Inflation Keeps on Going

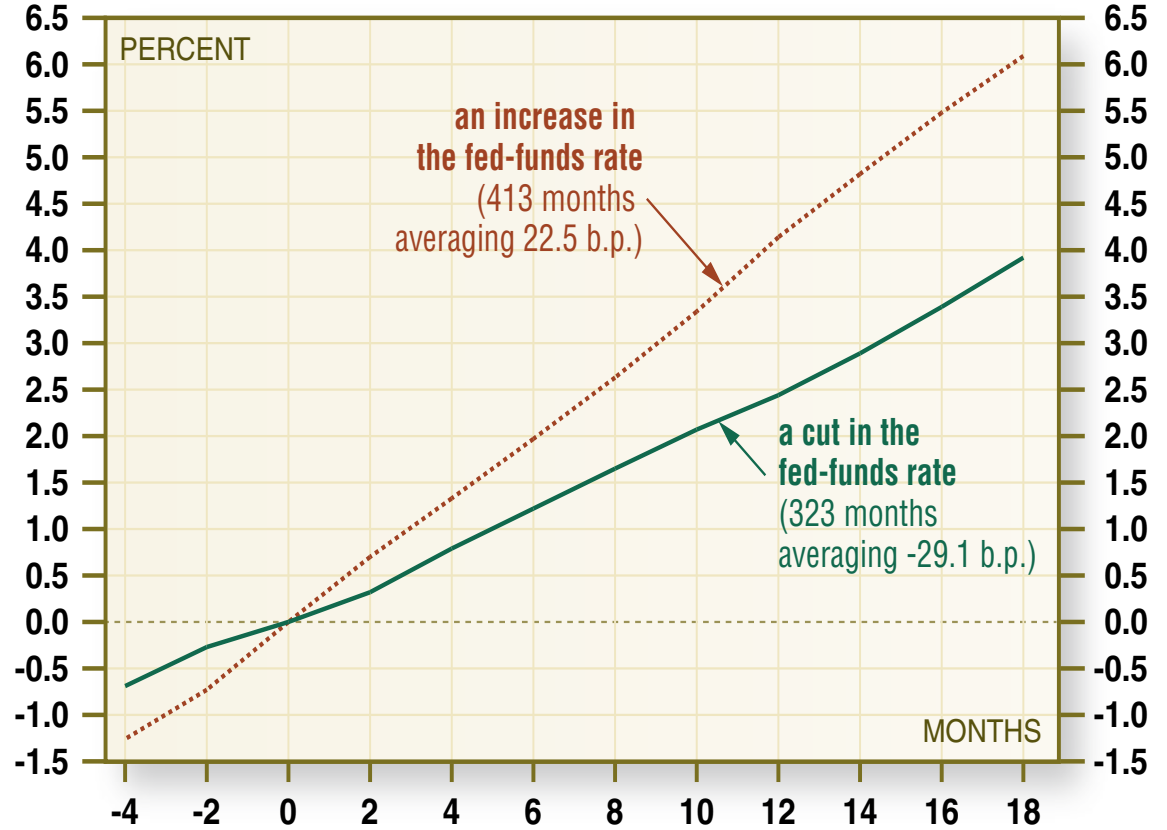
monthly data from August 1954

On average, Fed rate hikes and cuts are not accompanied or followed by perceptible change in the inflation rate.

Data: Monthly average overnight rate on federal funds (Federal Reserve Board) and producer price index for all commodities (Bureau of Labor Statistics).

11 ECORR INEFFECT-3

AVERAGE cumulative increase in producer-goods prices accompanying and following:



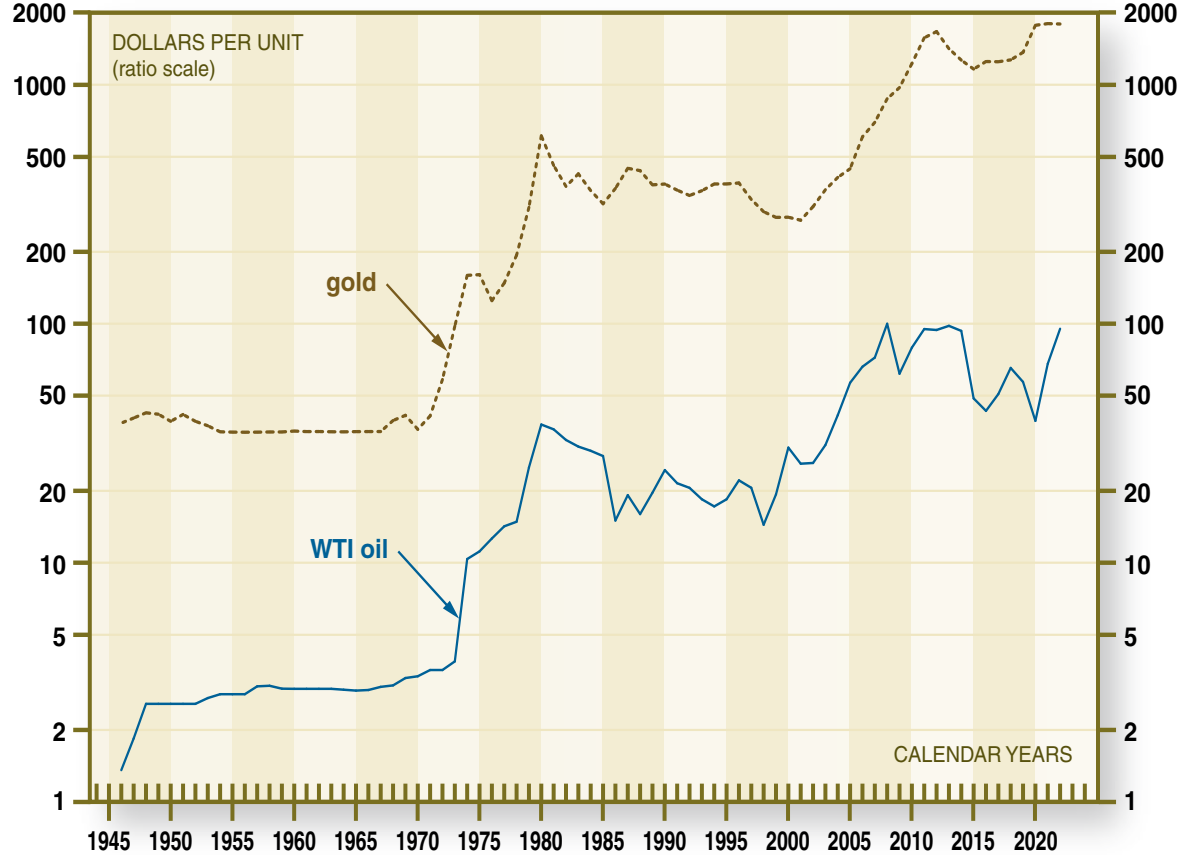
The Long-term Parallel between Oil and Gold Prices

calendar-year average data from 1946

As the price of petroleum has varied it has, throughout its history, constantly moved back toward restoring a stable ratio to gold.

Data: Spot prices for gold (last London fix) and West Texas Intermediate crude oil (1946-85, Thomson Reuters Commodity Research Bureau; and from 1986, Energy Information Administration).

7 SUSTINF CHEAP-f3



Norm Reversion in the Ratio of Oil to Gold Prices

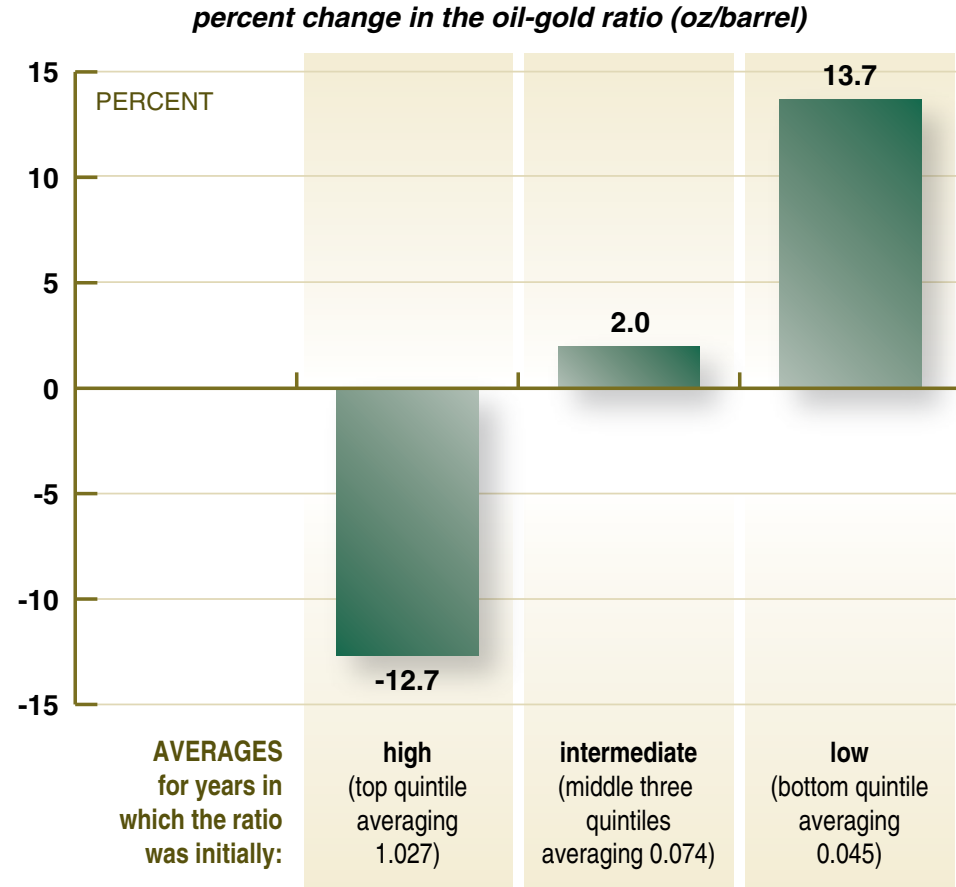
calendar-year average data
from 1946

The price relationship
between oil and gold is not
symmetrical.

Oil follows gold rather than
vice versa. It reverts toward
restoring a normal oil-gold
ratio.

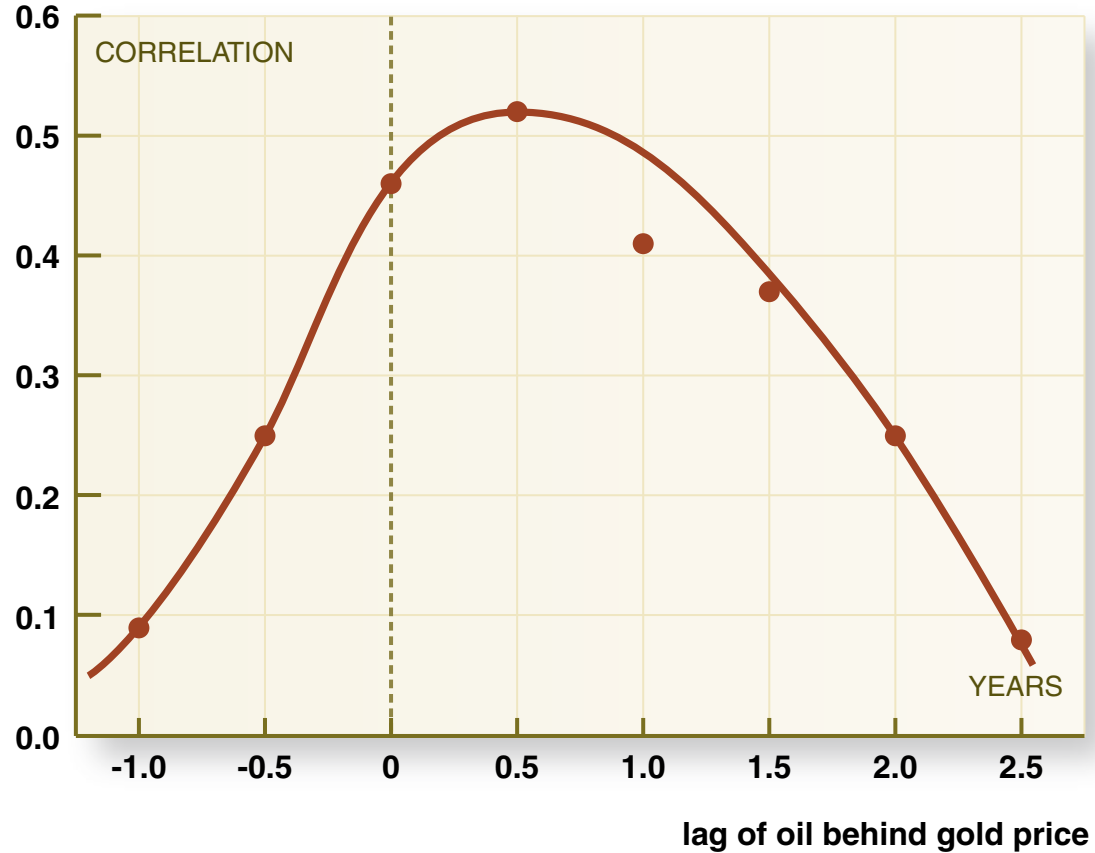
Data: Prices of spot gold (last London fix) and West Texas Intermediate crude oil (Thomson Reuters Commodity Research Bureau/Energy Information Administration).

7 SUSTINF TRIANG-f4



Causation Runs from Gold Prices to Oil Prices

calendar-year average data
from 1949

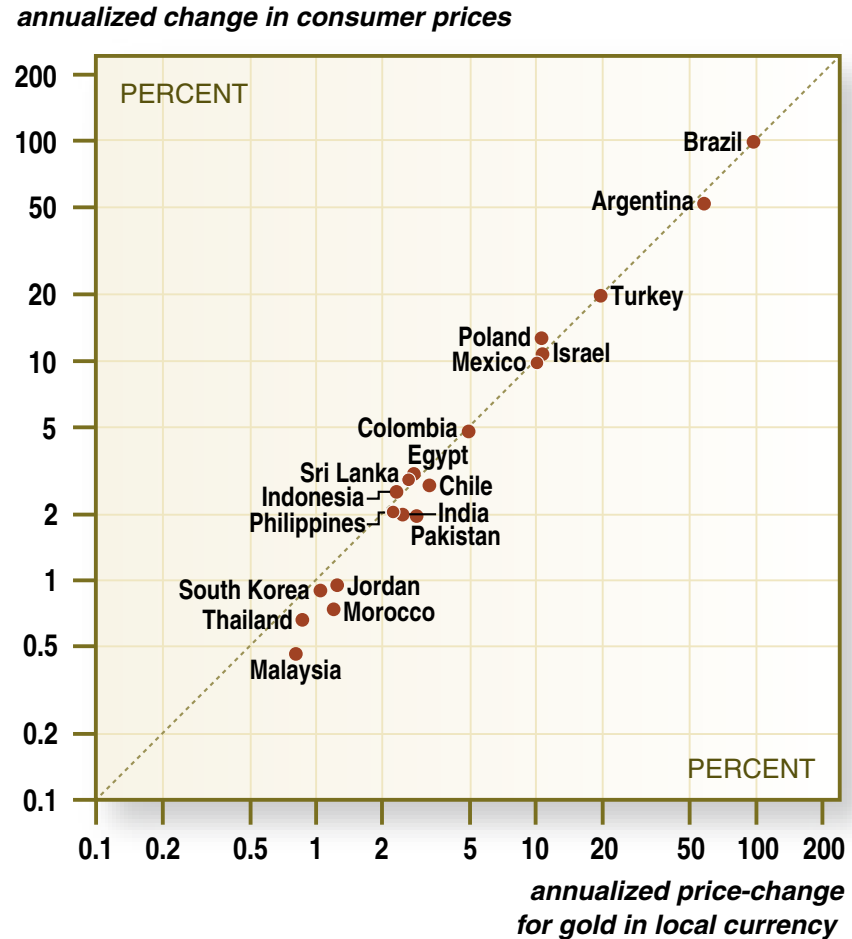


Data: Month-end spot prices for gold (last London fix) and West Texas Intermediate crude oil (1946-85 Thomsen Reuters Commodity Research Bureau; and from 1986, Energy Information Administration).

7 SUSTINE TRIANG

Inflation in Emerging Markets is Inversely Proportional to Currency Depreciation

cumulative inflation vs. cumulative change in the local-currency price of gold
 nineteen emerging countries, 1980-2012



Data: Calendar-year averages of daily U.S. gold prices (Metals Week) converted to local currency at current exchange rates (Federal Reserve Board and Oanda.com) and of monthly consumer price indices (International Monetary Fund).

The Oldest Theory of Inflation as Re-expressed by Modern Economists

“[Robert A.] Mundell reminds us of a mechanism of transmission of inflation ...

... a general loss of confidence in money, a psychological mood that can be transmitted across national boundaries.

A general loss of confidence in money will lead individuals to try to convert their assets into physical form: goods or housing or real estate.”

↪ Richard Cooper, Yale University, 1975.

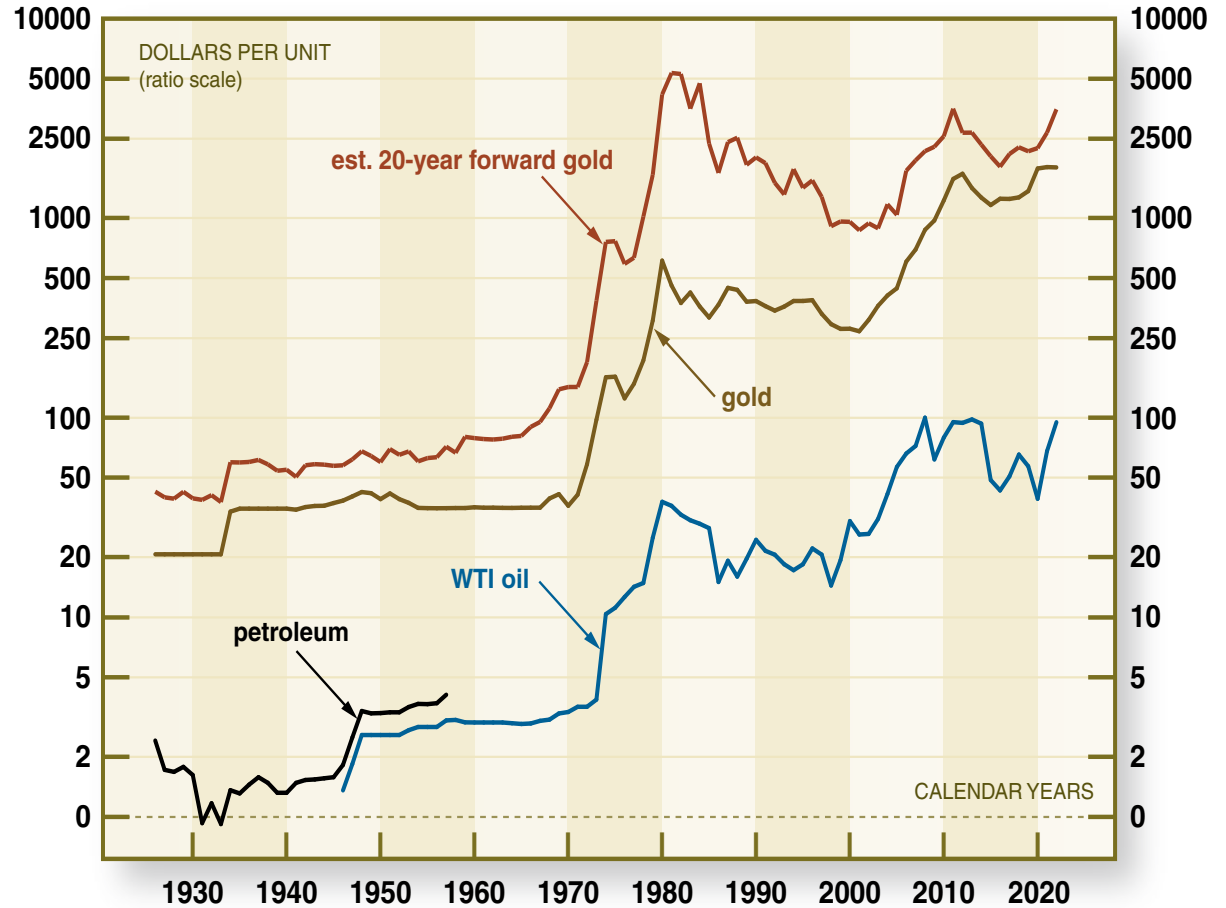
Long-term Price Parallels among Gold, Forward Gold, and Oil

calendar-year average data from 1926

Historically, the prices of both spot gold and crude oil move in parallel with, and gravitate toward, the price of gold in forward markets.

Data: The annual US price of petroleum (Resources For the Future, preferred series), the price of West Texas Intermediate crude oil (1946-85, Thomson Reuters Commodity Research Bureau; 1986-date, Energy Information Administration), together with the price per troy ounce of gold bullion (The Golden Constant/last daily London fix). The monthly forward gold price is estimated using the mid-year yield on 20-year Treasury bonds, converted to annual compounding (Ibbotson Yearbook/US Treasury).

11 FORGOLD FORGOLD-f6



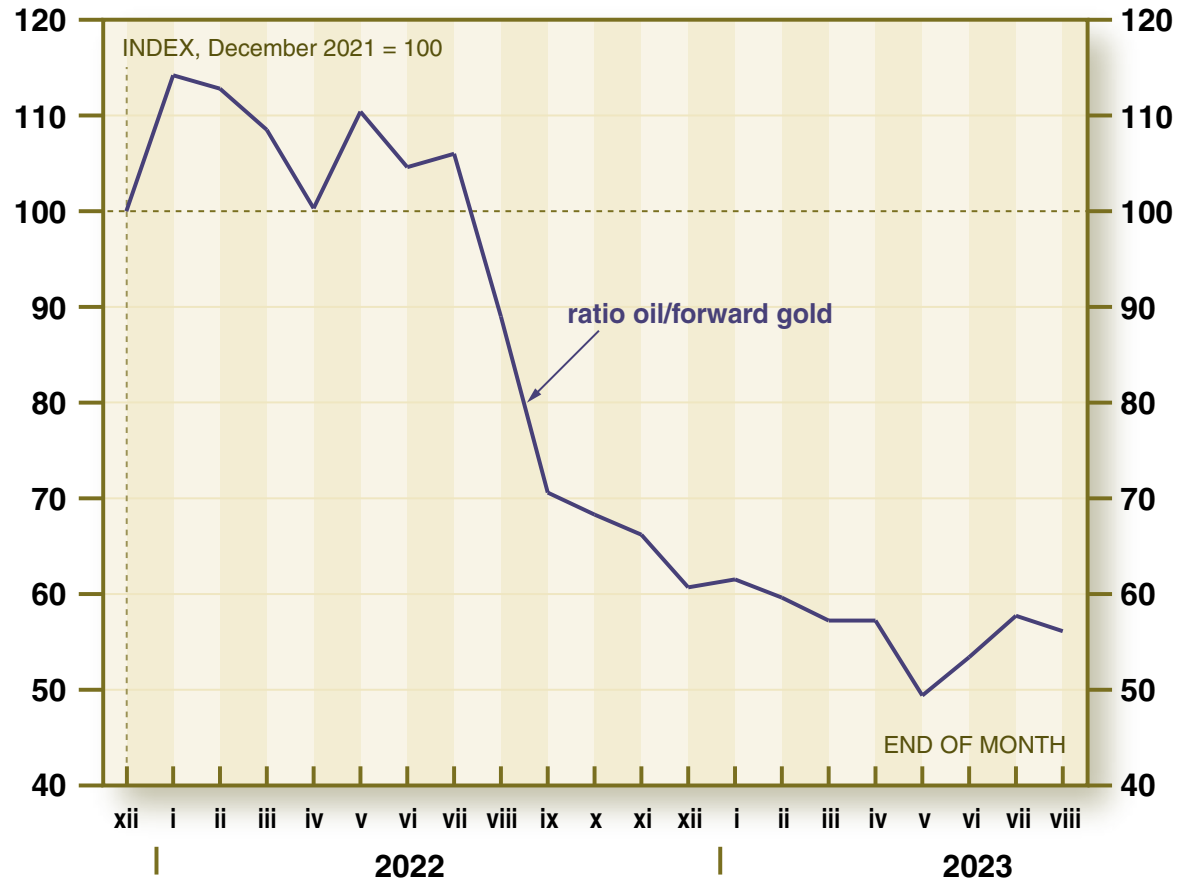
Plunge and Recovery in the Price Ratio between Oil and Forward Gold

month-end data from
the end of 2021

The ratio of oil to forward gold was quite stable until the summer of 2022, after which chaos in the global oil industry caused it to plunge.

Data: Prices of West Texas Intermediate crude oil (Energy Information Administration), spot gold (last London fix) and 30-year zero-coupon Treasury bonds (InterContinental Exchange).

7 SUSTINF CHEAP-f5



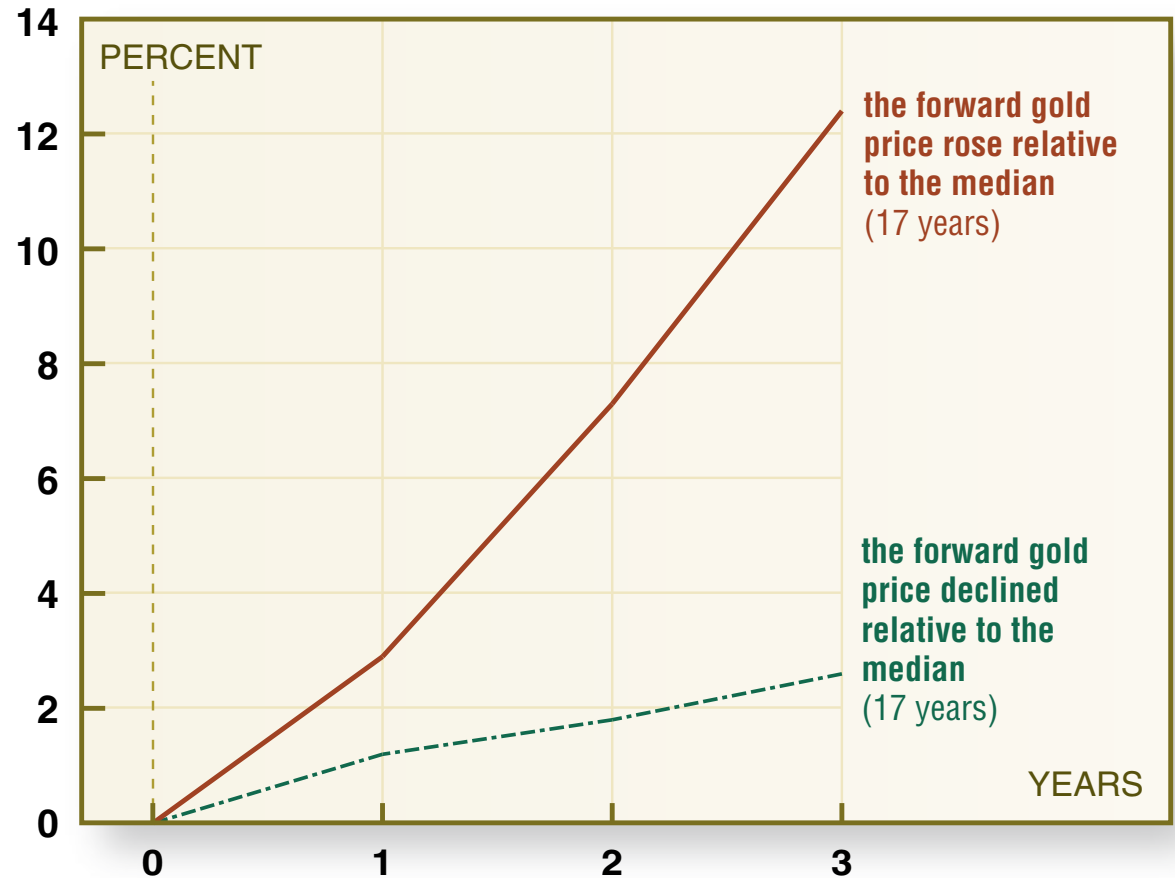
Price Movements in Forward Gold as a Leading Indicator of Inflation

calendar-year average data from 1986

The forward price of gold is a stronger leading indicator of inflation than the spot gold price

Data: Producer price index for all commodities (Bureau of Labor Statistics) and the prices of spot gold and 20-year Treasury bonds.
11 ECORR INDINF-eH

AVERAGE cumulative increase in producer-goods prices accompanying and following years in which:



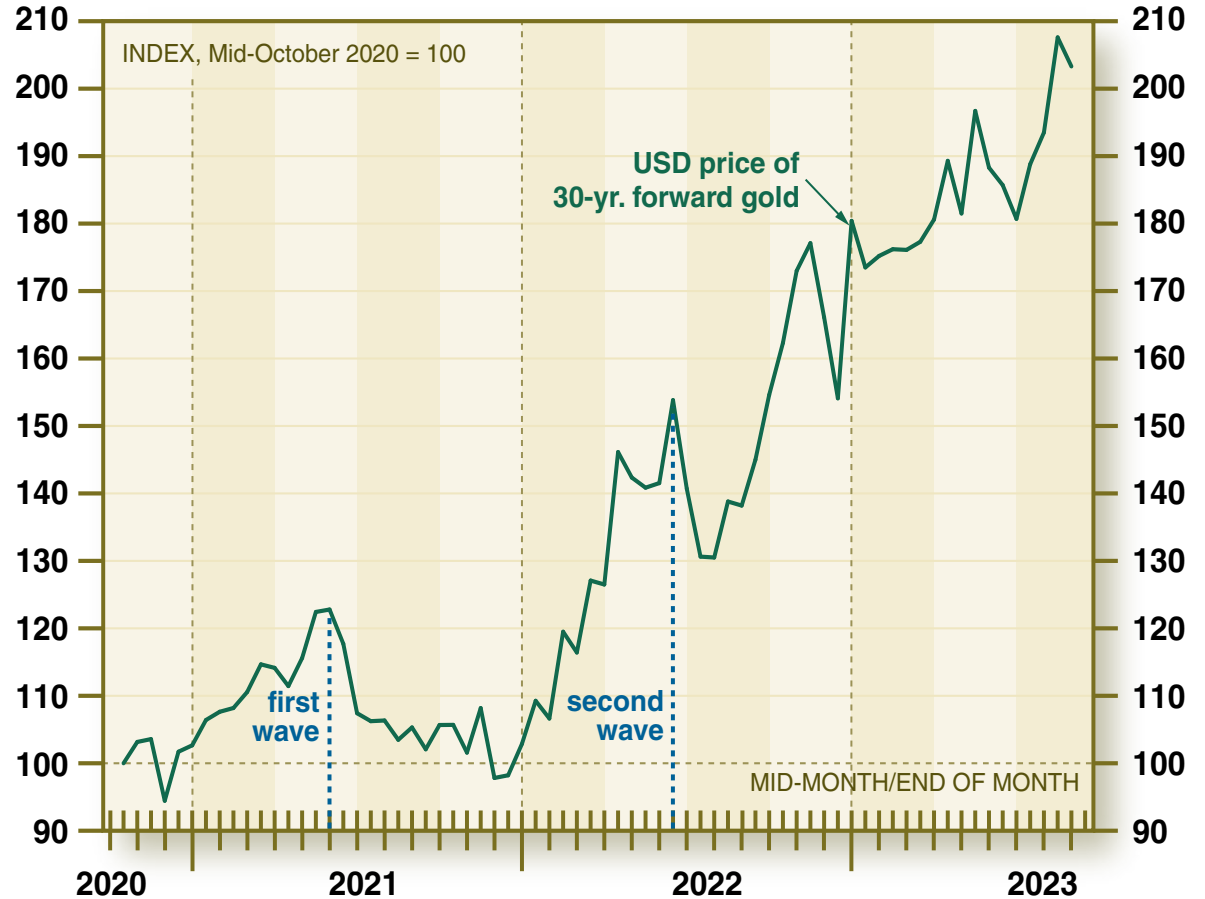
Waves of Inflation and Disinflation as the Dollar Fluctuates

mid-month and month-end data since the 2020 election

The force behind inflation is now fully into its third wave

Data: Mid-month and month-end prices for spot gold (London last fix) and 30-year Treasury principal strips (Merrill Lynch/InterContinental Exchange).

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How Mundell Diagnosed the 1970s Inflation

- **There is widespread disillusion with the attempt to regulate the quantity of money instead of the exchange rates.**
- **The error ... was in not understanding the control function of gold convertibility. As long as currencies are convertible into gold, inflation is impossible beyond a certain point.**
- **Once ... the currency value of gold is allowed to rise, the system becomes inflation-unstable.**
- **It is this phenomenon, and the international anarchy to which it is conducive, that has left in shambles the concept of international price level stability.**

How Mundell Diagnosed the 1970s Inflation

- **But a fixed rate system by itself will not prevent all countries from harmonizing to a hyperinflationary rate of price increase. It is only asset convertibility that can achieve that.**
- **For this reason, the extra degree of freedom in the system should be devoted to making one or more currencies convertible into a commodity.**

© Robert A. Mundell, “Gold: the ‘final asset’ problem and its resolution,” *The International Economy*, HCWE & Co., first published February 27, 1980; reprinted November 30, 1999.

Conclusion

Even economics cognoscenti are finding inflation hard to cope with. They look on it as a devious and complicated enemy which they have not been able to predict, explain satisfactorily, or rein back in.

In all fields, a malfunction is hard to predict, explain, or stop, if it has been mis-diagnosed. Could that be the problem here?

There is strong evidence that inflation results from instability in the value of the currency, and will cease when that is fixed.

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See us on YouTube at:

<https://www.youtube.com/channel/UCrtQLdiTXFFTT0znMlafchg>

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Phone +1(978)468-4575 · www.hcwe.com

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