# Simmering Inflation Pressures

## An end to the economic slowdown remains elusive. Yet, underlying inflation pressures — though relatively restrained — have started perking up.

**Stagflation Lite** With U.S. economic growth sluggish and slowing, and inflation low but rising, the Fed is faced with what we might call "stagflation lite." Given its dual mandate, this presents quite a policy conundrum.

The growth rate cycle (GRC) downturn that began at the end of 2014 remains intact, with U.S. Coincident Index growth dipping to a 28-month low in February (not shown). Moreover, the downturn is set to worsen in the coming months. Indeed, with U.S. Long Leading Index growth sliding to a 56-month low *(↗USCO Index Pages, March 2016)*, this slowdown is poised to persist.

However, as we noted last month, based on the U.S. Future Inflation Gauge (USFIG), "inflation is scarcely set to surge, but a relatively mild upswing remains likely" *(↗EWU, February 19, 2016)*. This followed last fall's recognition of a cyclical upturn in the USFIG *(↗EWU, November 20, 2015)*, notwithstanding our earlier observation that structural lowflation would linger *(↗USCO Focus, October 2015)*.

Now, the promptly-available weekly version of the USFIG, in a steepening cyclical upswing, has climbed to a 7½-year high, after having troughed last March (Chart 1, top line). Following that upturn, year-over-year (yoy) growth in the core Personal Consumption Expenditures (PCE) deflator bottomed last summer, and has since risen to its highest reading in nearly three years (bottom line). While some expect this measure to slack off in the months ahead, the message from the forward-looking USFIG is unambiguous: with underlying inflation pressures in a cyclical upswing, this metric is likely to approach the Fed's 2% inflation target, defined in terms of yoy growth in the headline PCE deflator.

**Faced with slowing U.S. and global growth, the Fed is falling behind the inflation cycle.**

**Chart 1: U.S. Future Inflation Gauge** (1992=100) **and Core PCE Inflation** (%)