# Where did the inflation go?

By Buttonwood
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The strength of the global economy is one reason why the stockmarket has started 2018 in a buoyant mood (with the Dow passing 25,000). At some point, in any expansion, businesses find it harder to recruit workers or get the materials they need; these bottlenecks cause wages and prices to rise. Central banks then start to tighten monetary policy, a process that can eventually turn the market (and the economy) down.

After many years of ultra-low interest rates, the Federal Reserve has started to tighten monetary policy. There were three rate rises in 2017, and three are expected this year. The idea is to tighten gradually and keep ahead of the curve so that inflation does not accelerate so fast that a very sharp monetary tightening is needed.

The problem is that inflation remains hard to spot. Core inflation in America is 1.7% and thus below the 2% target. The latest non-farm payrolls show that, even with unemployment at 4.1%, wages are growing at just 2.5%.

The economists at ING, a bank, think that core inflation will pick up, citing special factors:

> *Apparel prices have been surprisingly low, while mobile phone charges have dragged the headline rate lower temporarily. These factors will unwind this year*

ING also points out that the New York Fed's inflation model sees the core rate accelerating this year.

Britain is suffering from above-target inflation but that is largely due to the decline in sterling after the Brexit referendum; some of this weakness (against the dollar, but not the euro) has been unwound so inflation should drift lower. Euro zone inflation is only 1.5%; Japanese inflation is 0.5%.

The uptrend is really occurring in emerging markets; Capital Economics, a consultancy, reckons that inflation in emerging markets hit a multi-year low of 3.3% last July but is now at 3.7% and is likely to average 4% in 2018. Indian inflation hit 4.9% in November and Capital Economics thinks it will go higher; China is also likely to see a surge in the headline rate in early 2018 thanks to higher food prices. Higher oil prices may push up the headline rate in many countries round the world.

As yet, however, there is nothing so alarming that might force central banks to take a more aggressive line. For that to happen, the balance would need to shift in favour of workers with skill shortages prompting employers into a bidding war for staff. Such a development would put the squeeze on profits. In other words, bad news for the stockmarket might be good news for everybody else.