



Equities care about central banks—at least from time to time. But equity investors also get excited by earnings. (UBS)

Which inflation matters?

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Markets and the media have a regrettable tendency to treat “inflation” as a single concept.

Inflation comes in many forms—with a complexity worthy of analysis in a reasonably priced book, widely available from all good booksellers. The complexity of inflation means that different measures matter to different markets.

Bond markets will normally focus on consumer price inflation. This is what central banks focus on, and thus consumer prices influence shorter duration government bonds. Most government spending is formally or informally tied to consumer price inflation, which matters for bond supply.

Equities care about central banks—at least from time to time. But equity investors also get excited by earnings. However, most companies sell to other companies, not to consumers. The price measure that captures pricing power for most corporate sales is producer price inflation.

Over the past year, there has been a widening gap between consumer and producer price inflation rates. Profit-led inflation is concentrated at the end of supply chains; retailers’ margin expansion increases consumer prices, but not producer prices. Core producer price inflation has fallen significantly in the US, UK, and Europe. Core consumer price inflation has fallen only a little, or risen. Investors should not equate consumer prices with pricing power for all listed companies.

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