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Monetary Derealization

am FX

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Inflation distorts the value of money, and I am now sometimes getting confused as I look at the mishmash of real and nominal data on my screens. Throughout most of my life, inflation was steady and low, and the value of money depreciated a little bit slower than the risk-free rate. As such, the purchasing power of fiat money was positive, once you account for the fact it can be invested in risk-free products.

Now, this is not true. Inflation like this creates a ton of challenges for both consumers and economists. For example, Mastercard data today shows a lot of green numbers when we look at spending for June, as you can see in the table at right. On first glance, that paints a somewhat optimistic picture of a robust consumer.

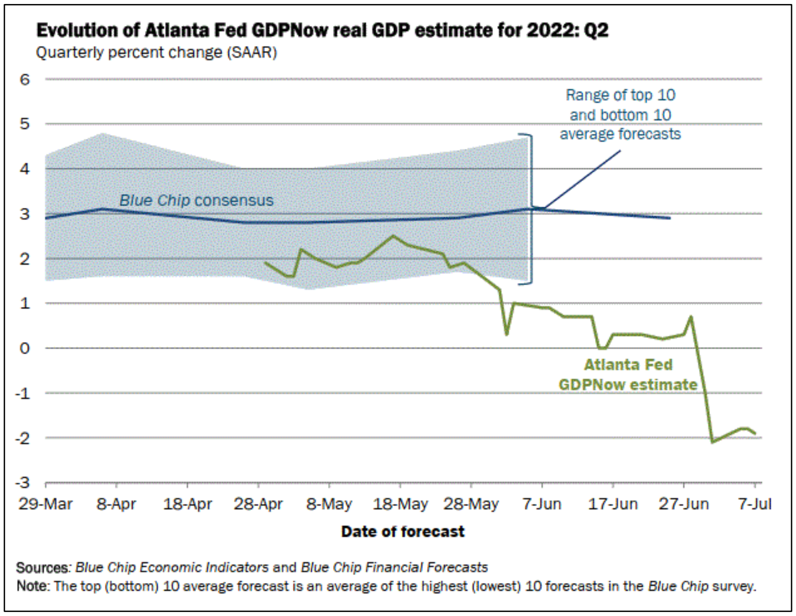
Mastercard SpendingPulse™
U.S. Retail Snapshot – June 2022

	Sales Growth Year-Over-Year June 2022 vs. June 2021	Sales Growth vs. Pre-Pandemic June 2022 vs. June 2019
Total Retail (ex. Auto)	+9.5%	+20.8%
Total Retail (ex. Auto & ex. Gas)	+6.1%	+17.1%
E-commerce	+1.1%	+97.6%
In-Store	+11.7%	+10.7%
By Sector		
Airline	+18.2%	+7.3%
Apparel	+13.1%	+27.5%
Department Stores	+8.6%	+21.4%
Electronics & Appliances	+4.6%	+16.1%
Fuel & Convenience	+42.1%	+55.7%
Furniture & Furnishings	+4.2%	+21.5%
Grocery	+14.0%	+24.8%
Hardware	+2.6%	+21.5%
Jewelry	+16.2%	+86.6%
Lodging	+33.7%	+30.4%
Luxury (excluding jewelry)	+4.0%	+54.0%
Restaurants	+11.6%	+30.3%

SpendingPulse™ **Source:** Mastercard SpendingPulse, which measures in-store and online retail sales across all forms of payment.

But when you consider these are nominal numbers, and that US CPI figures next week are forecast to show an 8.8% YoY rise in prices (not to mention PPI at 16.7% YoY) … It gets kind of confusing. What am I going to do, deflate every number by its respective increase in the CPI basket? Way too boring. But I can't just apply an 8.6% haircut across the board either, because that makes no sense. For example, Fuel and convenience spending is up 42%... Clearly, I can't just subtract 8.6% to get the real YoY change.

To make matters more confusing, which number matters? Corporate earnings and stock prices are nominal. But then, there's been a lot of focus on Atlanta Fed GDPNow and the recessionary Q1/Q2 negative GDP, technical recession story as you can see here:



Current Views

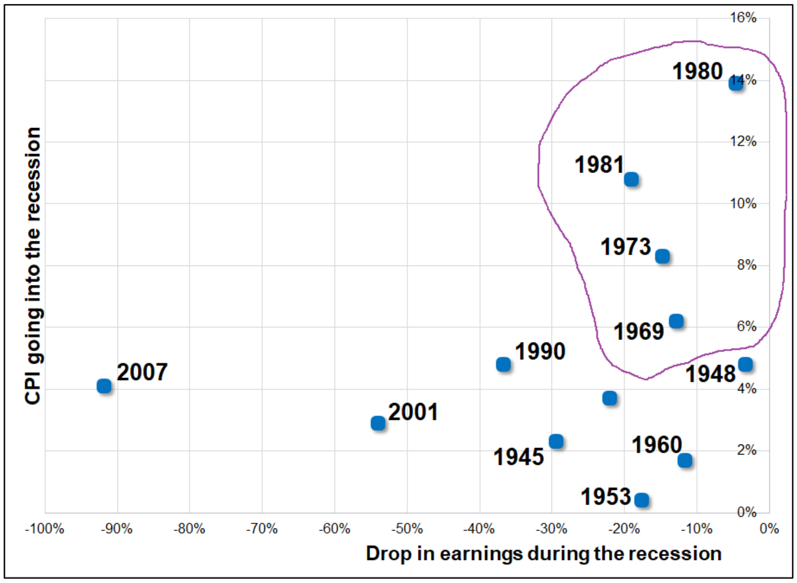
Short EURJPY @ 139.55
Stop loss 141.11
Take profit 136.66

Nominal consumer spending looks good by one measure, but then real GDP is dumping. Confidence is collapsing on falling real wages and falling real purchasing power. Nominal spending is up.

Meanwhile, earnings revisions have been a positive contributor to share prices so far this year, partly due to nominal inflation. Astute reader DD pointed out that the 1973 recession saw just 14.8% earnings decline for US companies, vs. recent recessions which saw earnings drop 30-90%.

I wondered if this applies across the board, so I went back and looked at the data since 1945. Yes, recessions that started with high inflation did see smaller drops in earnings per share. This makes sense, but note the effect is larger and looks to be way more nonlinear than I would have expected. This could be a product of the small sample size, but anyway, here's the chart (if CPI >6% at start of recession, circled with hand drawn oblong[1]).

Earnings Declines During Recessions vs. Headline CPI at the start of the recession



I got the earnings decline data here and the CPI data from Bloomberg

There is no direct call to action here other than: When you are consuming economic data from now on, make sure you double check in your head whether it's nominal or real, and what that means. The government reports most economic data in nominal terms but some data (like GDP) in real terms. It's not apples to apples so keep that in mind.

This sort of high inflation gives me more sympathy for Austrian views of money as I can see everyone around me kind of becoming deanchored on the whole real vs. nominal thing. We live in the nominal world, and yet each member of society lives a unique experience as real wages and purchasing power shrink.

Much of how you experience the real vs. nominal dichotomy is arbitrary and comes down to: how rich you are, whether you're long or short a primary residence, and whether you have bargaining power with your employer. This inflation is a massive tax on some segments and individuals, and barely noticeable to others. That seems bad to me.

Housekeeping

I am headed to Canada for a family visit (Ottawa, then St. Catharines)… am/FX returns 18JUL.

Final thought

RIP, legend. 1954-2022.

good luck ⥮ be nimble

[1] Fun fact: Oblong is an adjective and a noun. An oblong of grass, for example, is a thing.

Shinzo Abe as Super Mario at the Rio closing ceremonies


Shinzo Abe waves to reporters after dissolving parliament in 2017

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