



Growth and Inflation—Not Surprising

December 29, 2016

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The financial markets flip-flopped from 2015 to 2016, and again from the first half to the second half of 2016, as my colleague [Simon Fennell explained previously](#). Are the financial markets reacting—correctly—to the economic environment?

I believe so. In cyclical terms, the expansion in the United States is well advanced. Consequently, inflation is back to pre-2008 crisis levels. We have not had inflation in several years, and as it has become more apparent this year, it has taken both equity and fixed-income markets by surprise.

Late-Stage Cyclical Expansion—Expected

Monthly new auto sales in the United States have averaged well above an annualized rate of 16.5 million units, their pre-crisis peak. While steady, there is little to suggest that auto demand has much room to grow from current levels.

Similarly, on the housing front, monthly housing starts have recovered to an annualized rate of roughly 1.3 million units, which is commensurate with net new household formation. This is decent growth, but we expect little acceleration from here.

In addition, wages are growing only marginally in excess of inflation, and thus real disposable income growth is slowing.

This picture of stable to slower growth is completely consistent with a late-stage cyclical expansion.

Inflation—Long Overdue

As the U.S. economy has moved further into expansion, inflation has picked up. Both core (which excludes food and energy) and services measures of inflation are back to their pre-2008 average levels and are still rising, as the chart below shows.

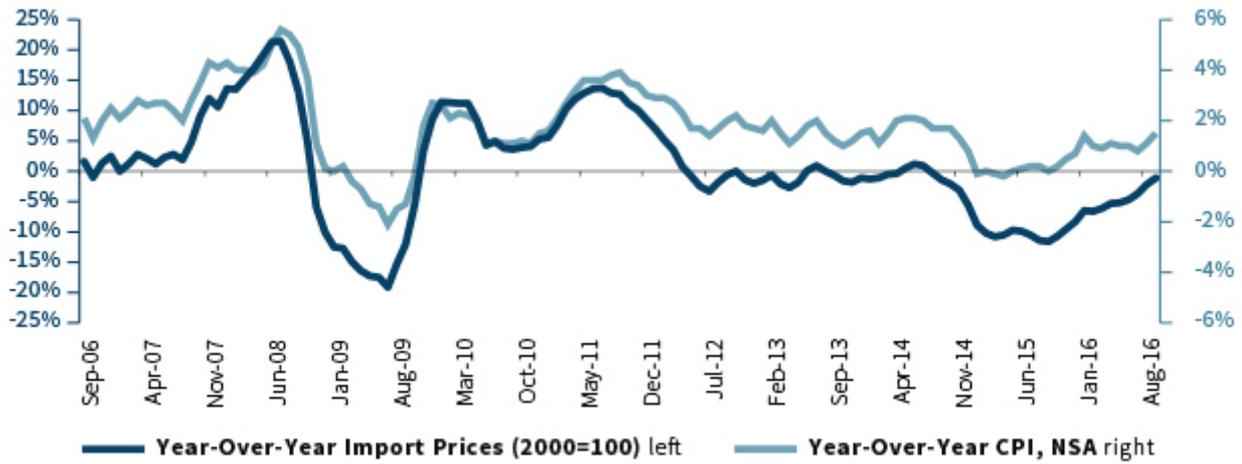
Services vs. Core Inflation (Year Over Year)



Source: Datastream, William Blair analysis as of 9/30/2016.

And, from early next year, import prices are likely to begin contributing to overall inflation, which will be a first since early 2014, the chart below illustrates.

Import Prices and CPI (Year Over Year)



Source: Datastream, William Blair analysis as of 9/30/2016.

But this is not the hyperinflation that many of you may have been thinking about; it is benign, long overdue, and cyclical. Later, I will explain why.

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