Weekly Commentary by Professor Jeremy J. Siegel

Stronger dollar points to Lower Inflation and Higher Spending

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Although the headline numbers for the PPI and CPI are near forecast, there is clearly downward pressure on inflation. Even the core inflation in the "pipeline" PPI reports, those "crude" and "intermediate" goods have turned negative over the past two months. The CRB Commodity index is down 11% year to date and more than 20% from its high in April. Brent oil at $104 is still up about $10 from January levels, but down more than $15 a barrel from April when the disturbances in Libya and other Arab countries sent to the price of crude soaring.

A major reason for the recent decline in commodity prices is the slowdown in Europe and the resulting fall in the euro, which sank below $1.30 this week. As readers of this commentary know, I am bearish on the euro and expect it to decline below $1.20 and perhaps all the way to parity the U.S. dollar.

The downward pressure on inflation opens up the possibility that the Fed may ease again early next year. The "buzz" on the Fed is that they are going to improve their "communication strategy" at the January meeting which will involve a commitment to keep rates low for a longer period of time than now indicated. In a future commentary I will discuss this aspect of policymaking in more detail. In any case, the slowdown in inflation will likely increase real incomes in the U.S. and spur spending consumer spending. Most estimates of GDP growth for this fourth quarter are in the 3.5% to 4% range, but could go higher.

With inflation under control and a huge amount of "hedge" buying of long-term U.S. treasuries (guarding against another "Lehman event") the 10-year Treasury yield has sunk to 1.85%. Yet with the economy gaining strength, these yields have made dividend-paying stocks even more attractive.