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US inflation: Extending the good news

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Consumer Price Index (monthly change, %)	Dec 2022	Nov 2022	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Dec NSA YoY%
All items	-0.1	0.1	0.4	0.4	0.1	0.0	6.5
Ex-food/energy	0.3	0.2	0.3	0.6	0.6	0.3	5.7
• Ex-food	-0.1	0	0.4	0.3	0.0	-0.2	5.8
• Ex-energy	0.3	0.2	0.3	0.6	0.6	0.4	6.4
Energy	-4.5	-1.6	1.8	-2.1	-5.0	-4.6	7.3
Services	0.6	0.3	0.4	0.8	0.7	0.3	7.5
Housing	0.7	0.4	0.5	0.7	0.8	0.4	8.1
Fuels & util.	0.5	-0.7	-0.4	0.8	1.5	-0.3	13.5
Food/beverages	0.3	0.5	0.6	0.7	0.8	1.1	10.1
• Food	0.3	0.5	0.6	0.8	0.8	1.1	10.4
Apparel	0.5	0.2	-0.7	-0.3	0.2	-0.1	2.9
Transportation	-2.5	-1.1	0.7	-0.6	-2.3	-2.1	3.9
Medical care	0.1	-0.5	-0.5	0.8	0.7	0.4	4.0
Recreation	0.2	0.5	0.7	0.1	0.2	0.3	5.1
Education, comm.	0.1	0.7	0.0	0.1	0.1	-0.2	0.7
Other good, serv.	-0.1	0.7	0.5	0.3	0.7	0.4	6.4
Commodities	-1.1	-0.3	0.5	-0.3	-0.8	-0.5	4.8

Source: Haver Analytics.

- December was a step in the right direction on the inflation front for policymakers, as key core service categories outside of shelter showed relatively modest price pressures. Total prices fell by 0.1%, on a drop in gasoline prices, while excluding food and energy, core prices rose by 0.3% as expected. But the latter increase was concentrated in the shelter component, which hasn't yet picked up the impact of softer rents on new leases, and should decelerate sharply at some point in 2023. Assuming a moderation in that component, on-target core inflation is attainable later in the year, as past interest rate hikes continue to cool demand, suggesting that the Fed will be able to pause hiking after a final 50bps move in February.
- Gasoline prices have risen so far in January, as oil prices now have a floor under them as a result of China's re-opening, ongoing OPEC+ production cuts, and the need to replenish strategic oil reserves. There was better news on food prices in December, as the 0.3% monthly increase was the slowest pace seen since September 2021. That doesn't fully align with the outright drops being seen in food commodity price indices, and wouldn't be expected to given that there's still upward pressure on wages and other wholesaling and retailing costs. But still, it may well be that the biggest surge in food inflation is now behind us.

- The acceleration in core prices was due mainly to the highest-weighted core component, shelter, which gained momentum, rising by 0.8% m/m. The strength in that component hasn't been unexpected, given the lag with which new rental rates show up with in that measure, but it is poised to soften ahead, in line with on-the-ground developments in the housing market. The Fed understands that shelter will likely be the last component to turn softer, and they are more focused on services outside that category as a result. Core prices excluding shelter dropped by 0.1% for the third month in a row, a positive sign for the Fed, and other service categories were mixed, but generally showed modest pressure that wouldn't impede a return to on-target inflation this year if the current pace was sustained.
- The core reading also included a further easing in core goods prices as higher inventory levels have put downward pressure on goods, particularly used cars, and that should be compounded by higher interest rates adding to loan costs and squeezing discretionary consumption ahead.

Implications & actions

Re: Economic forecast — This report extends a trend of favorable news on the inflation front, but given the tightness in the labor market, the Fed is still likely to conduct a final 50bps hike at the next FOMC, before pausing over the rest of 2023.

Re: Markets — Bond yields were little changed, as the data was in line with expectations.

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