CIBC CIBC CAPITAL MARKETS

Economics

ECONOMIC FLASH!

economics.cibccm.com

November 10, 2022

US inflation: Not a clean bill of health

by **Katherine Judge** katherine.judge@cibc.com

Consumer Price Index (monthly change, %)	Oct 2022	Sep 2022	Aug 2022	Jul 2022	Jun 2022	May 2022	Oct NSA YoY%
All items	0.4	0.4	0.1	0.0	1.3	1.0	7.7
Ex-food/energy	0.3	0.6	0.6	0.3	0.7	0.6	6.3
• Ex-food	0.4	0.3	0.0	-0.2	1.4	0.9	7.3
• Ex-energy	0.3	0.6	0.6	0.4	0.7	0.7	7.0
Energy	1.8	-2.1	-5.0	-4.6	7.5	3.9	17.6
Services	0.4	0.8	0.7	0.3	0.9	0.8	7.2
Housing	0.5	0.7	0.8	0.4	0.8	0.8	7.9
Fuels & util.	-0.4	0.8	1.5	-0.3	2.5	2.9	14.2
Food/beverages	0.6	0.7	0.8	1.1	1.0	1.1	10.6
• Food	0.6	0.8	0.8	1.1	1.0	1.2	10.9
Apparel	-0.7	-0.3	0.2	-0.1	0.8	0.7	4.1
Transportation	0.7	-0.6	-2.3	-2.1	3.8	2.0	11.2
Medical care	-0.5	0.8	0.7	0.4	0.7	0.4	5.0
Recreation	0.7	0.1	0.2	0.3	0.3	0.4	4.1
Education, comm.	0.0	0.1	0.1	-0.2	0.2	-0.1	0.0
Other good, serv.	0.5	0.3	0.7	0.4	0.5	0.5	6.5
Commodities	0.5	-0.3	-0.8	-0.5	2.1	1.3	8.5

Source: Haver Analytics.

- While the October US inflation data appeared to provide some relief for policymakers, the improvement wasn't widespread, and as a result, the data still supports an outsized hike at the December FOMC. Excluding food and energy, core prices rose by 0.3% m/m, below the consensus expectation of 0.5%, representing a three-tick deceleration from the prior month's pace. That left annual core inflation three ticks lower at 6.3% (vs. 6.5% consensus). Both food and energy prices increased strongly over the month, which left total prices up by 0.4% m/m (vs. 0.6% expected), and the annual rate of total inflation at 7.7%, two ticks below the consensus expectation, and below the prior month's 8.2% pace. While we continue to expect supply chain improvements to feed through to the index more meaningfully ahead, the strength in core services suggests that further, outsized rate hikes are still needed to guide inflation to 2% by the end of next year.

- Looking at the detail of core categories, the downside surprise was largely the result of a sharp 3.6% drop in the cost of health insurance, seemingly reflecting a measurement quirk. A 2.4% drop in used car prices also contributed meaningfully to the downside, as supply chain improvements in that industry have worked to restore some balance in it, and that will likely start to feed through to new car prices ahead as well. Apparel prices dipped by 0.7%, likely reflecting weaker demand for discretionary goods amidst higher inventories.

- The highest-weighted core component, shelter, gained momentum, rising by 0.8% m/m. The strength in that component this year has not been unexpected, given the lag with which other measures of housing market activity, that looked hotter during the peak of the pandemic, translate into the CPI. The Fed understands that shelter could be the last component to turn softer, likely later in 2023. Interestingly, the acceleration in shelter prices in October was entirely the result of a 5.6% surge in hotel prices over the month, after a string of weak readings, while monthly price pressure in the rent and owners' equivalent rent indices decelerated over the month, but remained hot. The strength in hotel prices isn't likely to persist, as discretionary spending is being squeezed by higher interest rates.
- Higher gasoline prices, and another strong rise in food prices, squeezed consumers in October. With OPEC+ embarking on supply cuts, oil prices have a floor under them, but gasoline prices in November are so far averaging below October's level, and will be a limiting factor for price increases in November if sustained. The slowdown in food inflation compares to the drop in world food commodity price indices that has been underway for months. It's likely that food prices won't decrease at the retail level in the US, however, given domestic labor and transportation costs that feed into them.

Implications & actions

Re: Economic forecast — Although health care has a higher weight in the Fed's target PCE index relative to CPI, the PCE index includes expenditures on behalf of consumers by third parties, not just out-of-pocket expenditures made by consumers, and the drop in health insurance costs may therefore not translate through fully into the PCE index. Given that the downside was relatively contained to a few categories, the Fed will remain on track to conduct further outsized hikes ahead, and we expected the ceiling on the fed funds rate to peak at 5.0% in Q1 2023, and core CPI inflation to reach the 2% target in late 2023.

Re: Markets — Bond yields fell sharply and the USD depreciated following the downside surprise in core prices. While we are optimistic that inflation can return to 2% in late 2023, the market's reaction may not be accounting for the relatively narrow base of this downside surprise.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC