

Economics

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US CPI: Fed likely to be pleased by further progress

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Consumer Price Index (monthly change, %)	Oct 2023	Sep 2023	Aug 2023	Jul 2023	Jun 2023	May 2023	Oct NSA YoY%
All items	0.0	0.4	0.6	0.2	0.2	0.1	3.2
Ex-food/energy	0.2	0.3	0.3	0.2	0.2	0.4	4.0
• Ex-food	0.0	0.4	0.7	0.2	0.2	0.1	3.2
• Ex-energy	0.2	0.3	0.3	0.2	0.1	0.4	3.9
Energy	-2.5	1.5	5.6	0.1	0.6	-3.6	-4.5
Services	0.3	0.6	0.4	0.3	0.3	0.3	5.1
Housing	0.3	0.6	0.3	0.4	0.3	0.2	5.2
Fuels & util.	0.2	0.7	0.6	0.2	0.3	-1.1	-1.3
Food/beverages	0.3	0.3	0.2	0.2	0.1	0.2	3.3
• Food	0.3	0.2	0.2	0.2	0.1	0.2	3.3
Apparel	0.1	-0.8	0.2	0	0.3	0.3	2.6
Transportation	-0.9	0.3	2.6	-0.1	0.2	-0.2	0.8
Medical care	0.3	0.2	0.2	-0.2	0	0.1	-0.8
Recreation	0.1	0.4	-0.2	0.1	0.1	-0.1	3.2
Education, comm.	-0.2	0.1	0	0	-0.2	-0.2	0.9
Other good, serv.	0.6	0.6	0.4	0.1	0.2	0.5	6.2
Commodities	-0.4	0.1	1	-0.1	0.1	-0.2	0.4

Source: Haver Analytics.

- Today's October CPI report fell short of expectations with slowing shelter costs and easing goods prices keeping core inflation around the Fed's target. Core inflation rose by 0.2% m/m in October, one notch below expectations. In year-over-year terms, core inflation edged down to 4.0% from 4.1%. Headline inflation was flat in monthly terms given weak energy prices and fell to 3.2% in year-over-year terms from 3.7% in September. Core services inflation rose 0.3% in October, down from 0.6% in September as shelter inflation eased. However, the Fed's preferred measure of prices tied to underlying demand, non-housing services, stayed at a steady 0.4% m/m. Supply chain normalization and falling used car prices kept core goods in slightly deflationary territory with prices dropping 0.1% in the month. Despite still elevated non-housing services, the Fed will likely be pleased with this additional bit of progress as core inflation has remained steady in a range close to target since June. As a result, we are removing our call for the Fed to hike in December. While there remains a risk the Fed could reassess its stance in early 2024, today's data, combined with evidence of a softening labour market and most importantly, the change in tone of the FOMC to show greater patience suggests December is likely off the table. The FOMC has time to wait to assess the emergence of further price pressures.

- Core service inflation came in at 0.3% m/m, down from 0.6% in September. Owner's Equivalent Rent (OER) increased by 0.4% in October after a 0.6% rise in September. The surprise step up in OER last month seems like a blip as it has returned to its elevated range pre-September. Further shelter disinflation is likely given the dramatic slowdown in rents in the US. However, with limited turnover in the housing market, we would not be surprised if this progress of normalization continues to be slow and uneven from here on out. Assessing rental equivalence is going challenging in this environment and with house prices edging back up, it will complicate the BLS' job in making this assessment even further.
- The core services ex. shelter group reported a third consecutive month of strength, rising 0.4% m/m after 0.5% increases in the prior two months. However, the increase was led by transportation services with other categories mostly moderating or staying unchanged in the month. The FOMC has paid less attention to this measure of underlying inflation recently suggesting a degree of tolerance for demand-induced inflation given the sharp improvements in supply. However, the recent softening in the household survey should be encouraging that the labour market could slowly begin to ease.
- Core goods prices continued to be weak in October as normalization of supply chains and more restrictive monetary policy are working to feed through into prices. This was the fifth consecutive negative monthly reading. Used car prices dropped by 0.8% m/m, and have averaged about -1.3% over the past five months. Judging by the New York Federal Reserve's Global Supply Chain Pressures Index, further weakness in core goods prices is likely in the coming months even if the peak impact from monetary policy has passed.
- Energy prices fell sharply in the month, declining by 2.5% as oil prices have pulled back since their late September peak. Weak energy prices also likely fed into some elements of core inflation such as the volatile airfare category. Food prices picked up to 0.3% after having remained in a range closely around 0.2% since about May.

Implications & actions

Re: Economic forecast — The underlying detail in today's report suggest that the Fed has more time on its hand to decide as inflation has stayed in a range slightly above its target since June. While demand-side price pressures remain, the FOMC will likely be pleased with the progress. This data, combined with signs of labour market cooling, and Powell's desire to be more patient has us changing our call and now believing the Fed will hold at its December meeting. While there remain risks the Fed could reassess its stance in early 2024, it has very likely reached terminal.

Re: Markets — Both bond yields and the greenback paired back after today's below consensus core inflation number, reinforcing the likelihood of the Fed staying on hold.

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