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Scorching hot US inflation portends March rate hike

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Consumer Price Index (monthly change, %)	Dec 2021	Nov 2021	Oct 2021	Sep 2021	Aug 2021	Jul 2021	Dec NSA YoY%
All items	0.5	0.8	0.9	0.4	0.3	0.5	7.0
Ex-food/energy	0.6	0.5	0.6	0.2	0.1	0.3	5.5
• Ex-food	0.5	0.8	0.9	0.3	0.3	0.4	7.2
• Ex-energy	0.5	0.6	0.6	0.3	0.1	0.4	5.6
Energy	-0.4	3.5	4.8	1.3	2	1.6	29.3
Services	0.3	0.4	0.6	0.3	0.1	0.3	4.0
Housing	0.4	0.5	0.7	0.5	0.4	0.4	5.1
Fuels & util.	-0.1	0.3	2.6	1.1	0.9	0.7	9.5
Food/beverages	0.5	0.7	0.8	0.9	0.4	0.7	6.0
• Food	0.5	0.7	0.9	0.9	0.4	0.7	6.3
Apparel	1.7	1.3	0	-1.1	0.4	0.0	5.8
Transportation	0.8	2.5	2.4	0.3	-0.1	0.6	21.1
Medical care	0.3	0.2	0.5	0	0.2	0.3	2.2
Recreation	-0.2	-0.2	0.7	0.2	0.5	0.6	3.3
Education, comm.	0	0	0.2	0.4	0.2	0.2	1.6
Other good, serv.	0.5	0.2	0.8	0.1	0.4	0.7	4.5
Commodities	0.8	1.4	1.5	0.6	0.6	0.8	12.1

Source: Haver Analytics.

- Inflation remained at a near four-decade high in the US in December, as it accelerated to 7.0% y/y. With energy prices having fallen on the discovery of omicron, it was core categories that provided the momentum, as core inflation was a tick hotter than expected at 5.5% y/y. That included sizable contributions from used car prices and shelter, with the former component still reflecting supply disruptions. Omicron is set to exacerbate supply chain issues in the coming months before fading over the rest of the year. With shelter inflation escalating and wage pressures showing no signs of flagging amidst the labor shortage, the Fed is set to raise rates in March, provided that the omicron wave is in the rear view mirror.
- The 3.5% m/m climb in used car prices contributed one quarter of the 0.6% m/m advance in core prices, and new vehicle prices also rose strongly at 1.0% m/m. Those price gains have been supported by a combination of strong demand for cars throughout the pandemic combined with Covid-induced supply delays. While there were early signs of supply issues abating prior to the omicron wave, they could intensify again in the coming months. As the year progresses and booster shots are administered globally, supply chains should begin to function more normally again which will result in downwards pressure on vehicle prices, and that will be a key driver of the expected deceleration in inflation during the second half of the year.

- Shelter, being the single heaviest weighted component in the index, contributed another quarter of the monthly core gain. That component's acceleration is tracking the return of activity to cities and therefore rent prices and has further room to run ahead, judging by the home price-to-rent ratio measure.
- There was some evidence of Covid impacting services prices, as car rental prices (-5.3% m/m) and recreation prices (-0.1% m/m) fell. Even though omicron suggests a weakening in services demand in the coming months, continued upward pressure on goods prices could still result in further acceleration in ex food/energy CPI ahead, especially as some weak monthly prints from a year ago are lapped.
- Oil prices have fully rebounded from the late November drop, and energy could be a contributor in the January report if gasoline prices make more progress over the balance of the month. However, an aversion for travel services during omicron could outweigh that factor in the index for airline fares. Although OPEC+ has faced challenges in meeting production quotas, we still expect softness in the price of oil further into 2022 once output is able to ramp up.

Implications & actions

Re: Economic forecast — Despite the transitory nature of supply chain disruptions that have been exacerbated by omicron, the Fed will be eyeing the continued strength in wages and shelter costs as a reason to raise rates at the March meeting, provided that omicron is in the rear view mirror, and working to contain inflation expectations.

Re: Markets — The slight upside surprise didn't see a material movement in yields given that it won't change the Fed's calculus, as Fed speeches have become increasingly hawkish lately.