U.S. CPI Preview: December 2022

MNI View: Consensus Eyes Moderation Confirmation

By Chris Harrison

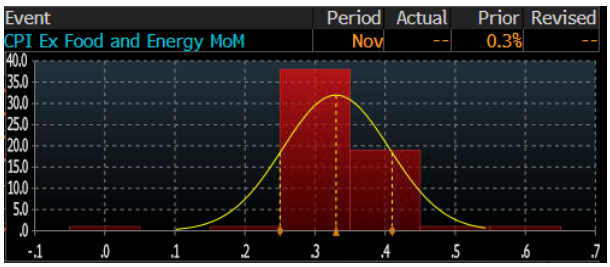
SUMMARY

- Core CPI inflation is seen broadly stabilising at a 'softer' 0.3% M/M in November after the surprise 0.27% in October, although analyst surveys suggest some upside risk.
- OER and rents of primary residence could see a modest renewed uptick whilst we also watch for the ongoing core goods disinflation/deflation trend and notably core services excluding shelter after particular emphasis from Chair Powell.
- Landing on day one of the two-day FOMC meeting, the report would have to be wildly different to consensus to see something other than the 50bp hike viewed as locked in for Wed but with two-way risk to the Fed rate path further out.
- Whilst a beat or miss compared to expectations might be a logistical challenge to change SEP forecasts and dots, it could however shape the language of the statement and perhaps notably Powell's presser.

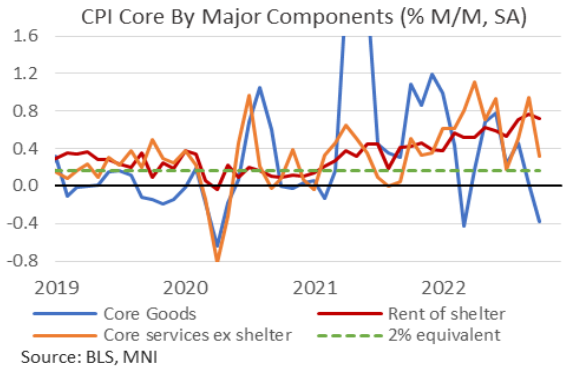
Core CPI Seen Up 0.3% M/M With Upside Risk

- Core CPI is seen rising 0.3% M/M in November after 0.27% in Oct in what would be the first consecutive print below 0.5% M/M since Sep'21.
- The Bloomberg analyst survey is skewed higher with 19 of 61 estimates seeing 0.4% M/M and the Cleveland Fed nowcast sticking with a robust 0.51% M/M. The latter overestimated core CPI to the largest extent since Apr'20 last month but tends not to be wildly too high two months in a row.
- If consensus is accurate, it will nudge core Y/Y inflation down two tenths to 6.1% for 50bps below the September cycle high of 6.6%, with continued large base effects lowering the headline to 7.3% Y/Y.

	Oct *actual*	November *consensus*
Core	0.27%	Median 0.3%, av 0.33%
Headline	0.44%	Median 0.3%, av 0.28%
Core Y/Y	6.3%	6.1% (off 6.6% peak)
Headline Y/Y	7.7%	7.3% (off 9.1% peak)



- Core sequential moves remain in focus, with three themes being watched:
  - *Do core goods continue to see deflation?* Used cars could drag the category lower again but latest PPI data suggested some resilience for other items. Nevertheless, the trend in core goods looks to be one of disinflation at a minimum, with supply chains on balance improving (although the NY Fed's GSCPI has recently stabilised) and continued FX passthrough from US dollar strength.
  - *Was the moderation in shelter inflation in October the start of a trend or a one off?* Analysts think it's a one off for now as strength in renewing leases offsets weaker new leases.
  - *Does core services excluding shelter bounce back?* This category, which generally carries a heavier weight in core PCE than core CPI, received particular attention from Powell in his Brookings speech – excerpt below. It will be watched for signs of strength after slowing in October on an idiosyncratic health insurance drag plus weakness in airfares.



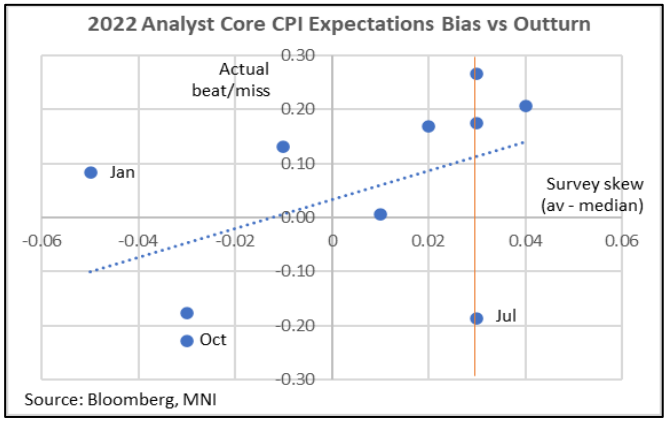
Source: BLS, MNI

Analyst Expectations Of Key Sequential Drivers (vs prior month M/M)

- **Rents (small +ve):** The key rent measures are generally seen nudging higher after finally surprising to the downside in October. The heavily weighed OER is on average seen only slightly under 0.7% M/M by analysts below (ranging 0.62-0.73) having slowed from a record 0.81 to 0.62 in Oct, whilst rent of primary residence is seen increasing a little over 0.7% M/M (ranging 0.64-0.78) after slowing from 0.84 to 0.69.
- Note here that total shelter might be closer to unchanged sequentially as lodging away from home is not expected to repeat its 4.9% surge.
- **Medical care (small +ve):** Medical care service inflation last month saw a significant, mechanically driven step down as source data for the health insurance sub-component had their annual reset. That remains in place until Sep'23 but other more heavily weighted components were weaker than expected in October and could have bounced in November, although MS see total medical care services unchanged at -0.6% M/M.
- **Airfares (mixed, perhaps small +ve):** Airfares slipped -1.1% M/M in Oct and whilst most analysts don't provide explicit forecasts, Morgan Stanley expect -2.3 vs increases of 2 (Goldman) and 3 (NWM).
- **Autos (mixed, perhaps small -ve):** Used car prices are still nearly 50% above pre-pandemic levels and have a long way to fall. Their decline started to accelerate more notably in Oct with -2.4% M/M but there are mixed views for November: some see a smaller decline on the month, but others see an accelerated decline (ranging -1.4 to -3%). New cars are however more broadly expected to slow slightly from the +0.4% M/M in Oct, which could bias the overall autos contribution as slightly more negative on the month.
- **Non-core: Energy (-ve):** Headline CPI is likely weighed on by energy prices falling in the region of 1-2% after rising 1.8% in October. Food could see a similar monthly rate but with upside risk from PPI revisions.

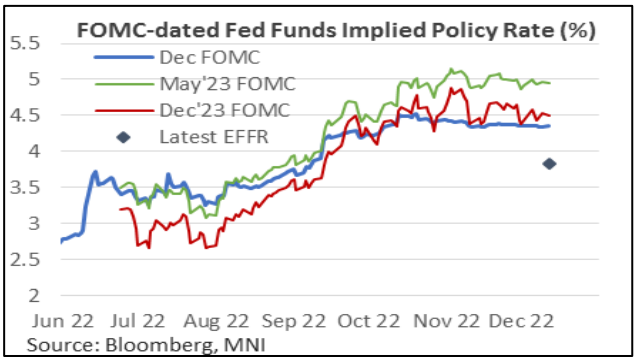
Analyst Survey Points To Slight Upside Risk

- The median analyst response to the Bloomberg survey is 0.3% but the average is 0.33% M/M, indicating a risk of a higher outturn.
- Looking at releases in the year to date, a skew towards a higher print has more often than not preceded a beat of the survey, whilst equally a skew lower has seen a miss, notably so in last month's October report.
- This quick rule is clearly not completely reliable and was comprehensively wrong when July core CPI missed by 0.2pps after large declines in travel-related components, but at the margin would indicate a chance of a beat this month.



Potential Implications: Downside Bias To Survey And Post-NFP Rally Opens Scope For Hawkish Reaction

- As has largely been the case since last month's CPI, the market sees a 50bp hike on Wed as locked in (52bp currently priced) after four 75bp hikes.
- It would take a huge surprise in either direction to change this decision at such late notice with no clear way of guiding the market beforehand.
- Landing on day one of the two-day FOMC meeting, participants will have already submitted their SEP forecasts on Friday, but they will still be able to revise them until Tuesday night.
- Whilst still possible, it leaves little time to formally change any projections although language in the statement and more likely press conference could be massaged in either direction to reflect any surprises.

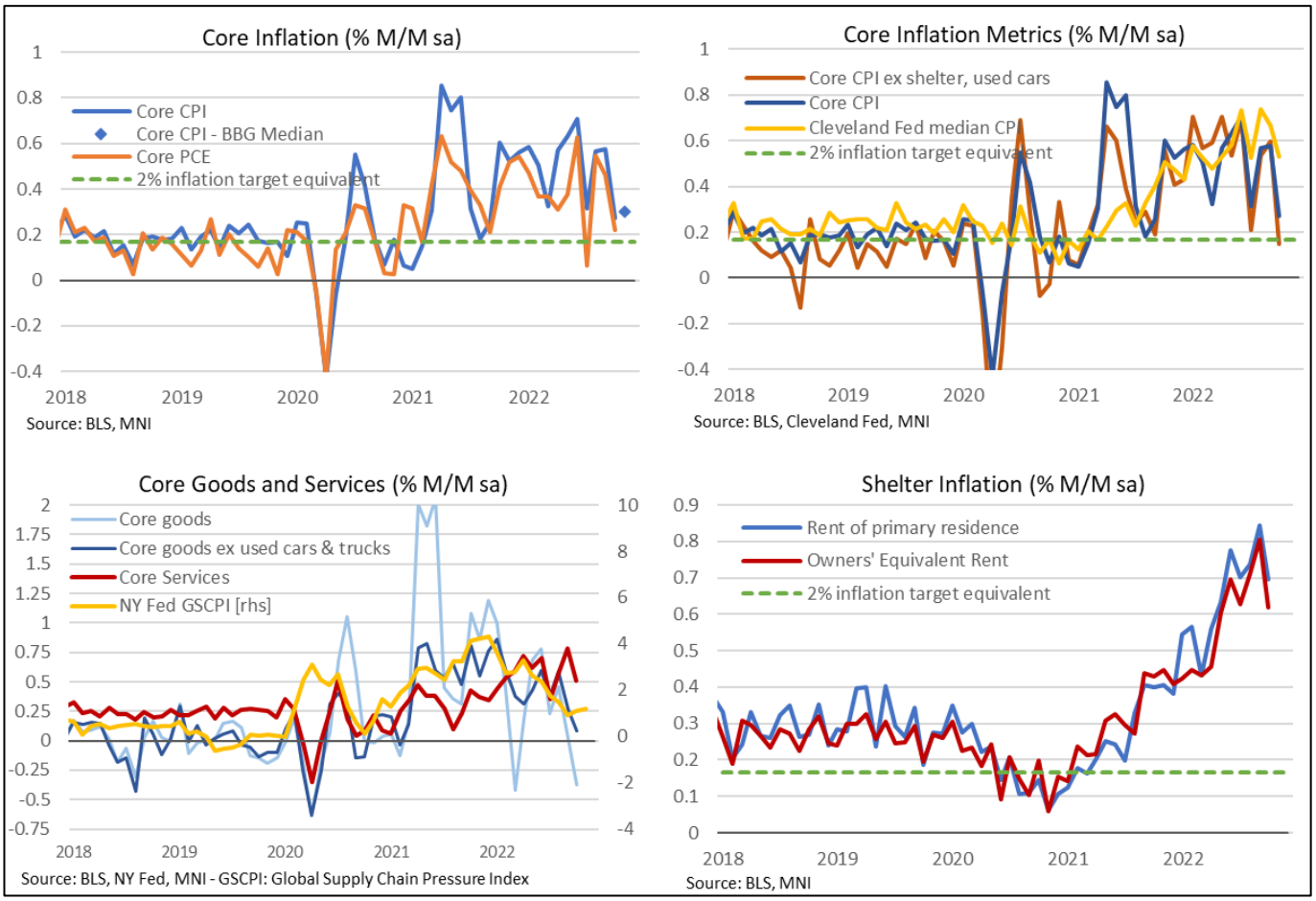


- Last week's build up saw heightened sensitivity to surprises in either direction: lower ULC data for Q3 helped 2YY rally 10bp whilst a US PPI beat saw a 7bp spike higher albeit then retracing some of the move.
- Despite Wednesday's FOMC landing so close, we expect similar heightened sensitivity to any surprises in this report, with two-way scope for the terminal currently at 4.95% for May (+112bp from here) and end-2023 rate of 4.5%, plus the usual associated implications for the DXY.
- 2s10s last week touching fresh multi-decade lows of -84bps doesn't rule out further flattening on a beat but equally it provides scope for solid steepening in the event of a miss.

Latest Fedspeak on inflation:

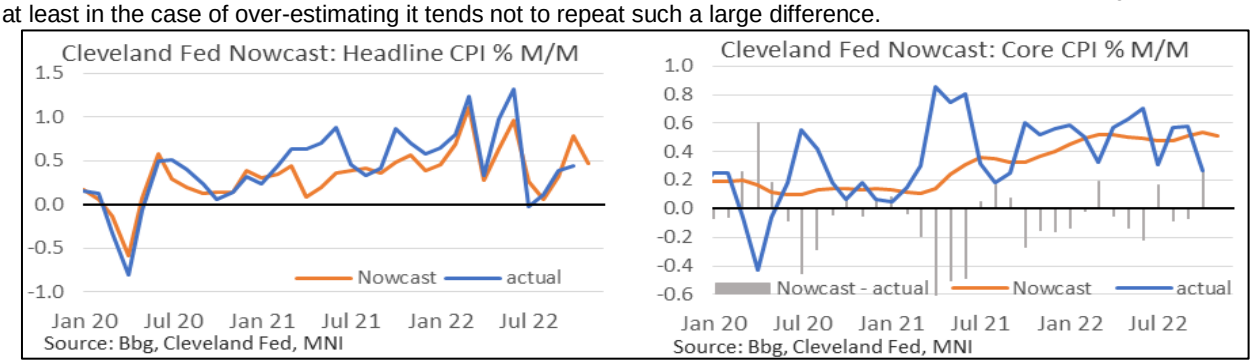
Powell	Brookings	"Core services other than housing… may be the most important category for understanding the future evolution of core inflation. Because wages make up the largest cost in delivering these services, the labor market holds the key to understanding inflation in this category…It will take substantially more evidence to give comfort that inflation is actually declining…the truth is that the path ahead for inflation remains highly uncertain."
VC Brainard	Nov 14	"The most recent CPI inflation print suggests that maybe the core PCE measure that we really focus on might be also showing a little bit of a reduction. That would be welcome."
Williams	Dec 1	""We're seeing some forward-looking indicators that inflation is turning…we're moving now, and into next year, with a lower inflationary trend."
Cook	Nov 30	"Given the tightening already in the pipeline, I am mindful that monetary policy works with long lags…thus, as we get closer to that uncertain destination, it would be prudent to move in smaller steps…how far we go, and how long we keep rates restrictive, will depend on observed progress in bringing down inflation"
Mester ('22)	Nov 28	"We had one good October CPI report. I would need to see several more of those and more moderation and perhaps even a reduction in core services prices."
Collins ('22)	Nov 18	"The latest data have not reduced my sense of what sufficiently restrictive may mean, nor my resolve."

Recent Inflation Developments

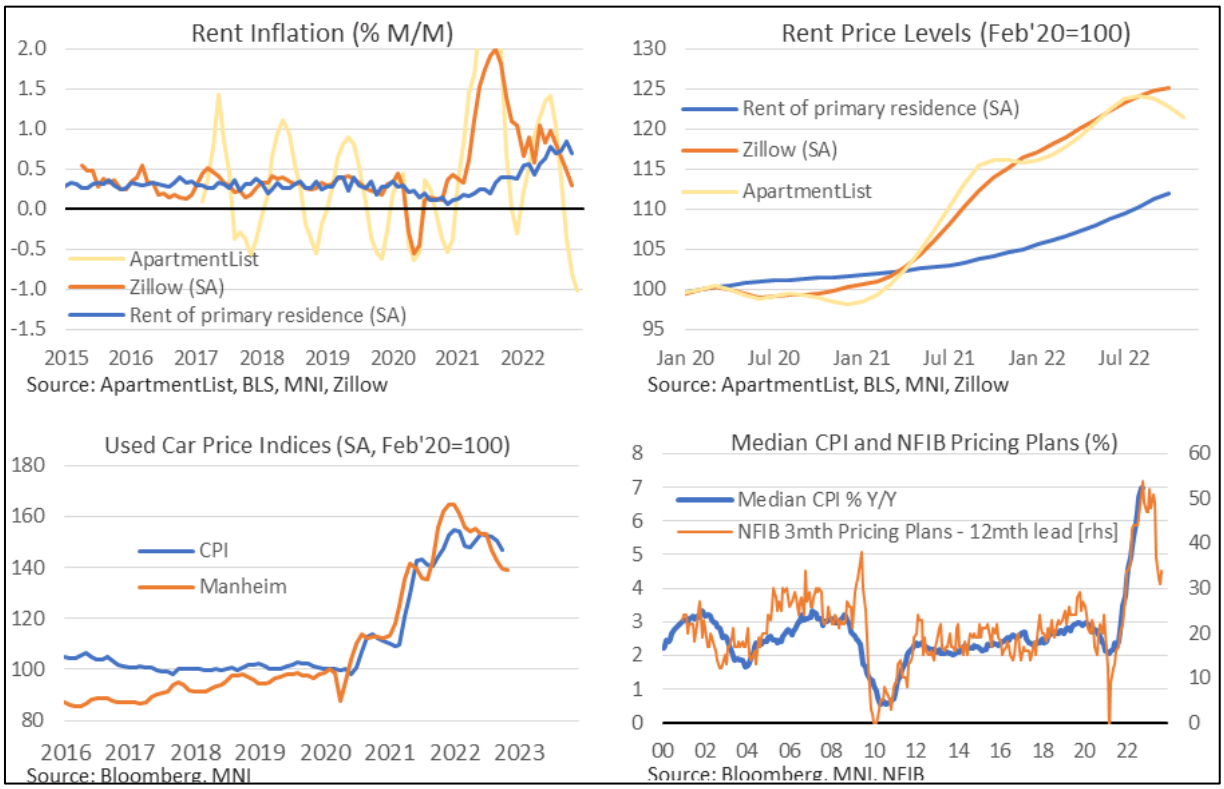


Full recap of Oct CPI report here: https://marketnews.com/markets/pdfs/mni-us-inflation-insight-nov-22-progress-but-too-soon-to-declare-victory

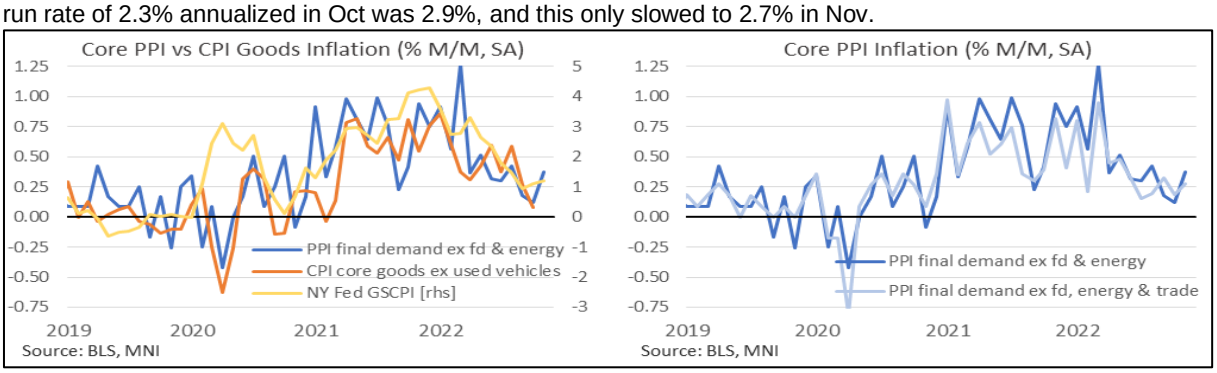
The Cleveland Fed Nowcast remains robust at 0.51% M/M. The 0.27pp overestimation in October was the largest since Apr'20 but, at least in the case of over-estimating it tends not to repeat such a large difference.



New measures of rental inflation continue to moderate/turn lower but conitnued pressure from renewing leases remains. Manheim auction price suggest further downside to used car prices although they are still substantially higher than pre-pandemic levels. From a trend sense, CFIB pricing plans continue to indicate future downward momentum to median CPI inflation but it could take a few months to materialise.



US PPI inflation surprised to the upside in Nov. Final demand ex food & energy PPI inflation increased +0.38% M/M (cons 0.2) from an upward revised 0.12 (initial 0.01) plus some tiny upward revisions to Aug-Sep data. What was thought to have been a 3-month run rate of 2.3% annualized in Oct was 2.9%, and this only slowed to 2.7% in Nov.



November 2022 CPI Report: Analyst Previews

(In order of strongest to weakest for core inflation):

BMO: PPI Beat Could Limit Reaction

- Expectations for the figure are toggling around a non-descript headline rise of 0.3% M/M, which would clip the annual inflation rate to roughly 7.3% Y/Y.
- The risk is for a slightly meatier core result of 0.4% M/M, only shaving the annual pace a tick to 6.2% Y/Y.
- Given a mild high-side surprise on the PPI, markets would likely readily digest this outcome, and move on to the Fed the next day, but the past two years have certainly taught us to never take the CPI for granted.
- With beats the norm since early 2021, it would be an important development if the U.S. managed a second consecutive low-end result. Suffice it to say, we doubt that will be the case, especially for core.

Scotia: Cleveland Fed Suggesting Upside Risks

- Scotia see both headline and core CPI rising 0.4% M/M.
- The Cleveland Fed's nowcast points to 0.5% M/M – it overestimated last time around but the measure often performs well and when it overestimates it tends to underestimate the next time.
- Among the expected drivers are resilient gains in OER, broad service prices and another hot gain in food prices. Vehicle prices—both new and used—did not change enough in seasonally adjusted terms to influence the estimate. Gas prices and other energy drivers probably knocked about a tenth off CPI.
- An added consideration is the degree to which mildly greater than seasonally normal discounting of some products during holiday season sales toward month-end may drag. It may somewhat, but the categories that are typically discounted at this time of year have modest weights in CPI compared to other drivers and the discounting mostly occurred late in the month. CPI takes average prices throughout the month.

SEB: Mixed Core Inflation Outlook, Service Inflation To Recover After Medical Care Hit

- SEB see core CPI at 0.4% M/M (6.2% Y/Y) with a mixed oulook.
- Goods price inflation is easing and the prices on used cars are expected to decline slightly in November.
- Rents inflation is likely to continue to be high and even increase slightly in the near term, while service inflation is expected to recover after being lowered by medical care services in October.
- Headline see at 0.4% M/M (7.4% Y/Y). Energy prices have declined and the upward pressure on food prices seems to be abating.

NatWest: Steady Gains In Shelter Costs And Firmer Transportation Services

- Core CPI seen rising 0.38% M/M (6.15% Y/Y) after 0.27% in Oct but below the Jan-Sep average of 0.53%.
- Expect a partial reversal of the Oct weakness in apparel, used cars & household good prices, plus steady gains in shelter costs and firmer transportation services prices.
- Core goods seen 0.0 after -0.4% in Oct, with used cars seen -1.5% after -2.4%, new cars +0.4%.
- Core services seen 0.6% after 0.5%, with both rent for primary residence and OER 0.7% M/M, whilst lodging away from home 1.3% after 4.9% surge in Oct as hotel likely raised prices amidst increased demand for holiday booking.
- Airfares seen rising 3.0% M/M after -1.1% whilst medical care costs likely continued to drag on core, reflecting last month's annual update to the data source.
- Headline seen 0.2% M/M (7.2% Y/Y) with energy reversing its 1.8% gain and food seen 0.5% M/M.

JPM: Core CPI To Nudge Higher but Still Trending Lower

- JPMorgan see core CPI rising 0.36% M/M (6.1% Y/Y), technically up from Oct but the trend is softening.
- While we believe rental inflation will moderate over time, we think the BLS's rent measures will remain sticky and that Nov will be firmer than the Oct: tenants' rents 0.78% M/M while OER 0.73% M/M. Lodging prices have been noisy in the CPI data lately, and we forecast a 2.5% drop in prices in November to reverse a portion of the 4.9% jump reported for October.
- Used cars seen declining -2.5% M/M and they also think the trend for new vehicle prices will moderate over time, and expect a flat reading in Nov after recent gains.
- Public transportation prices seen rising 0.9% M/M.

- Medical care CPI seen -0.1% M/M after -0.5% in Oct. Health insurance prices will continue to fall in Nov reflecting an update to related source data, but other components of medical care prices will not be as weak in November as they were in October.
- Headline seen 0.3% M/M (7.3% Y/Y) with energy -1.1% M/M and good +0.5% M/M.

MS: Ultimately Paving Way For Stepdown To 25bp Hike In Feb, Pause In March

- Morgan Stanley see core CPI rising 0.31% M/M (6.1% Y/Y) as continued core goods deflation (-0.06%) and decelerating shelter inflation confirm the October signal of a turn in the inflation data.
- Used cars seen falling -1.4% M/M after -2.4% in Oct whilst their auto analysts see substantial room for further price drops over the coming year. Further deceleration in new car prices (0.1% M/M).
- Other goods prices could show a bit more of a bounce back but deflation should set in across it in coming months as large inventory build-ups and weaker demand take their toll.
- Core services seen easing from 0.51 to 0.44% M/M, with rents (0.70) and OER (0.65) accelerating slightly.
- Other core services seen weaker, with medical services unchanged at -0.6% M/M and airfares -2.3%.
- Headline seen 0.23% M/M (7.3% Y/Y) on a renewed turn lower in energy prices.
- If core inflation remains around 0.3%M for the next few meetings, the Fed can focus its full attention on labor market developments to determine if and when to end the tightening cycle. Under our current forecasts, payrolls should slow substantially over the coming months, setting up a step down to a 25bp hike in February. As payrolls trend towards 100k, a pause is likely to be appropriate by the March meeting.

Barclays: Watching Core Services Ex-Housing, With Potential CPI vs PCE Distortions

- Barclays see core CPI at a 'soft' 0.3% M/M (6.0% Y/Y), based on core services of 0.42, of which shelter 0.6% M/M (OER and rents in 0.6-0.7 range), whilst core goods remain in modest deflation (-0.16% M/M).
- Medium-term CPI forecasts reflect very heighted uncertainty regarding the path of domestic inflation, but they forecast ore at 5.8% Y/Y Dec'22, 2.9% Dec'23 and 2.4% Dec'24.
- Service inflation of 0.42% M/M would be slower on the month but, outset of the pandemic, still the fastest since 2005.
- Post-Powell's focus, Barclays expect a notably heightened focus on core services ex-shelter, which could see softness led by health insurance -0.4% M/M. However, core services ex-housing only represents 31% of the core CPI index vs more than 50% of the core PCE index.
- Given the different relative importance of core services ex-housing in PCE versus CPI, over-analyzing the CPI side alone could lead to analytical distortions, and may represent a communication challenge for Chair Powell and other Federal Reserve officials in the coming quarters.
- Headline seen 0.2% M/M (7.2% Y/Y) with food 0.6% M/M and a modest decline in energy prices.

BofA: Sticky High Shelter Won't Slow Until Sometime Next Year

- BofA see core CPI at 0.3% M/M with the dynamics beneath core goods underscoring the points Chair Powell made last week in his speech at Brookings points, falling again owing to unseasonably high holiday discounting, a weaker holiday shopping spree, and a decline in used car prices.
- Shelter inflation should remain sticky high despite ongoing moderation in asking rents that won't be captured in CPI until sometime next year.
- We expect core services ex shelter inflation, which is inextricably tied to wages and the labor market, to remain elevated.
- Headline seen 0.2% M/M with energy likely providing some relief from gasoline.
- The November CPI report should be on the softer side.

CIBC: Shelter To Offset Any Relief In Core Goods

- Core CPI seen 0.3% MM (6.0% Y/Y) in Nov as strong demand for services, and continued increases in the shelter components, likely offset any relief in core goods prices on improvements in supply chains.
- Overall, core monthly prices likely maintained a 0.3% pace in November, which is still too fast to achieve a 2% annual pace of inflation.
- Strong demand for services and the strength in the labor market suggest that the Fed will want to take the ceiling on the fed funds range up to 5.0% to quell inflationary pressures.
- Progress towards meeting the 2% inflation target looks plausible in 2023, as the impact of past rate hikes materializes, commodity prices soften, and slower increases in new rents are picked up by the shelter component of the CPI in the latter part of next year.
- Headline also seen 0.3% M/M (7.3% Y/Y) with food prices inflation still elevated.

NAB: Some Downside Risks To Consensus

- There was a notable slowing in core inflation last month and the consensus is that it continues this month at 0.3% M/M and 6.1% Y/Y.
- Some hefty falls on the goods side could skew the risks to a below consensus print – strong discounting was reported in the weeks leading up to Black Friday/Cyber Monday, while used car values continue to decline according to Manheim – now -14.2% Y/Y.

SocGen: Inflation Is Moderating, But Rents Are High And Disappointment Still The Risk

- SocGen see core CPI of 0.3% M/M (6.1% Y/Y) and headline also 0.3% M/M (7.4% Y/Y).
- Used auto prices should continue to fall in Nov and for many months to come, but the biggest challenge remains in rents.
- Energy prices should decline, with motor fuels seen -1.3% in Nov and possibly two to three times as high in Dec, but with food prices offsetting the Nov decline.

TD: Shelter Likely Remained The Key Wildcard

- TD see core CPI of 0.3% M/M (6.1% Y/Y), likely maintaining a firm pace.
- Shelter inflation likely remained the key wildcard, though we look for goods deflation again as an offset.
- Headline seen 0.2% M/M (7.3% Y/Y), with importantly, gas prices providing some relief.

Unicredit: Falling Core Goods and Medical Services Price To Have Smaller Impact on PCE

- Unicredit see core CPI at 0.3% M/M (6.1% Y/Y) with main upward contributions from shelter and airfares.
- The main downward contributions likely came from medical services and core goods (used cars & apparel).
- Falling prices for core goods and medical services are likely to have a smaller impact on PCE than CPI inflation, due to differences in weighting and methodology.
- Headline seen 0.3% M/M (7.3% Y/Y) with stronger food offset by weaker gasoline and nat gas.

Citi: Weakness Largely Concentrated In Various Goods Prices, Upside Risks From Non-Shelter Services

- Citi see core CPI of 0.29% M/M, the first consecutive sub-0.5 since Sep'21.
- The details of inflation data will become much more important. Weakness for now should largely be concentrated in various goods prices, particularly with another ~2.3% drop in used car prices.
- Goods prices excluding autos should also remain on the softer side, although with some increased uncertainty around the size of usual holiday season discounts relative to expected seasonal patterns
- After slowing from ~10% annualized in Sept to ~8% in Oct, we would caution that near-term risks are for still-strong shelter increases. Primary rents seen 0.74% M/M OER 0.69%, although expect a further slowing into the start of 2023. In Nov however, and especially over the coming months, upside risks to core inflation stem primarily from non-shelter services prices.
- We have penciled in solid increases in components like medical services (excluding insurance) and recreation, with risks still tilted towards the upside. Some travel services such as airfares and car rental prices could moderate slightly, but we still expect a stronger trend in transportation services into next year.
- Headline CPI should rise a more modest 0.2% M/M on falling energy prices. Food prices should remain strong overall despite some moderation in October, partly given very strong food prices in PPI that also present upside risks to food prices in coming months.

GS: Not Expecting A Rebound In Shelter

- Goldman see core CPI of 0.28% M/M (6.03% Y/Y), with main outright declines in used cars (-3%), apparel (-1%) and hotel prices (-1%).
- They don't expect a rebound in the monthly pace of shelter, rents +0.64%, OER +0.62% as weakness in new rentals offsets the continued upward pressure on renewing leases.
- Elsewhere, see airfares rebounding (+2%) and another gain in car insurance as carriers push through price increases to offset higher repair and replacement costs.
- Headline seen rising 0.20% M/M (7.21% Y/Y) on lower gasoline but higher food prices.

MNI Policy Team Insights

MNI INTERVIEW: Real Rate To Climb In 2023 Even As Fed Cuts

By Jean Yung *(published Dec 9)*

(MNI) Washington – Slowing inflation will allow the Federal Reserve to cut interest rates next year without taking monetary policy out of restrictive territory, according to Marc Giannoni, who recently served as the Dallas Fed's research director.

The fed funds rate will likely peak around 5.1% early next year while core CPI slows from 6.3% to 3% by the end of 2023, said Giannoni, now chief U.S. economist for Barclays. That inflation slowdown means an even bigger rise in the "real" interest rate, he said.

With tighter policy biting and demand cooling, the FOMC will likely find it appropriate to deliver a couple of quarter-point cuts by the end of next year, he said.

"A year from now, it'll be very painful for them to maintain a target range of 5% to 5.25%, because if things go according to our forecast, you'll have a mild recession, some increase in unemployment, inflation quite a bit lower than now and the real rate notably higher," Giannoni said.

"In that set-up, it'll be difficult for them to maintain their rate where it is."

2023 DOTS

It's unfortunate the December dot plot won't include a mid-2023 dot, as it is unclear whether policymakers will write in a true year-end 2023 projection or use it to indicate their projection of the peak fed funds rate, Giannoni said.

Market pricing indicates investors expect between 35 and 50bps of cuts by the end of 2023. Fed officials are loathe to signal any willingness to dial back rates because that may lead to a premature loosening of financial conditions, he said.

"It'll be a complicated exercise," he said. "The 2023 dot should be an end-of-the-year dot, but a few members may be inclined to communicate something else."

LABOR MARKET RESILIENCE

Prices in the U.S. services sector continue to accelerate faster than policymakers want, driven by labor shortages and wage pressures that are fueling strong household income and spending, Giannoni said. To rein that in, the Fed is keen to see declines in labor demand. (See: MNI INTERVIEW: US Wage Pressures Likely To Be Longer Lasting)

Average hourly earnings jumped 0.6% last month, the most in nearly a year and double Wall Street estimates. Consumer spending gained another 0.8% in October, with inflation-adjusted spending on goods still running significantly above the pre-pandemic trend.

"They want to slow down the labor market without creating a recession that's worse than it needs to be, and in order to do that they need to indicate they'll keep policy tight for a long period of time so they can convince every CEO that it's not the time to expand," Giannoni said.

"But the message is not quite getting through. Demand is still strong, and they may need to do a little more. That's where much of the debate in 2023 is going to be."