

6% plus US inflation and still climbing

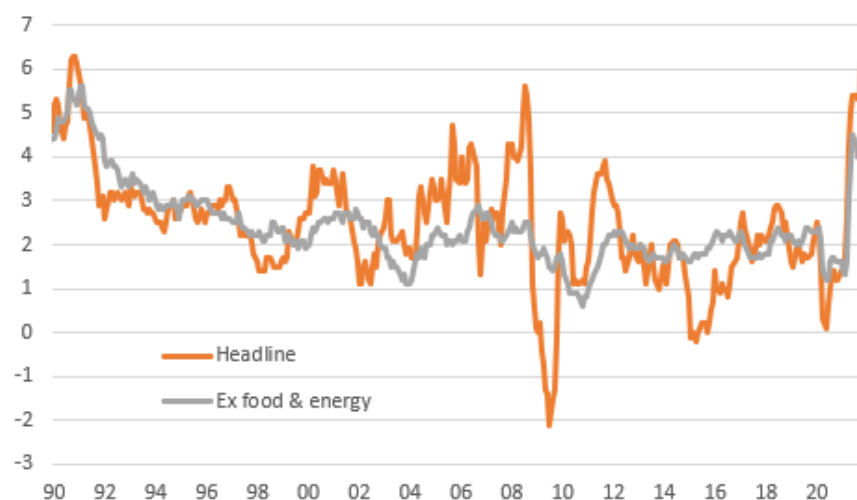
US inflation again exceeded expectations by a wide margin. Headline and core rates are now at 30-year highs with near-term momentum suggesting 7% is possible. Pipeline price pressures show little sign of abating and inflation expectations are climbing as well, leading us to conclude QE tapering will be accelerated and rate hikes will come sooner



Up, up and away

US headline consumer price inflation has come in well above consensus at 0.9% month-on-month/6.2% year-on-year with core inflation rising 0.6%/4.6%. The market had been anticipating 0.6%/5.9% and 0.4%/4.3%, respectively. This leaves annual CPI at its highest rate since November 1990 with core at its highest since August 1991.

US inflation at 30 year highs (YoY%)



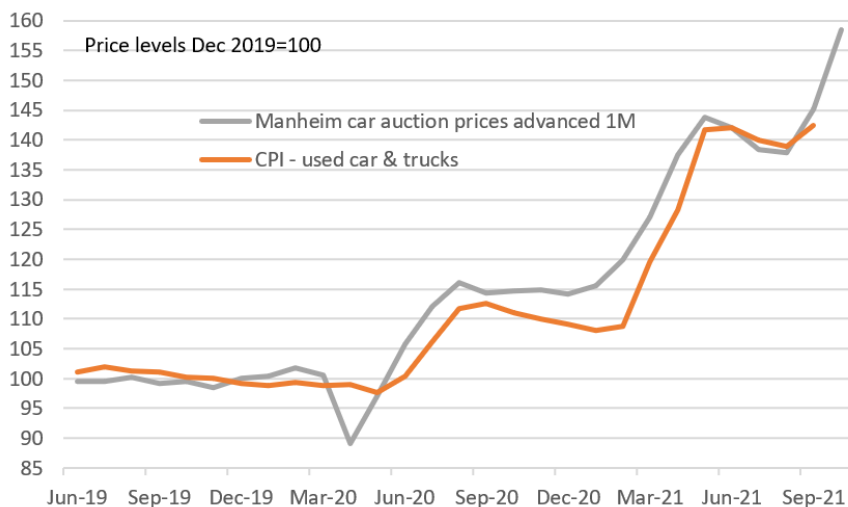
Source: Macrobond, ING

The details show the jump in gasoline was a big factor, having risen 6.1% MoM, but there are clear inflation pressures in most categories. Housing jumped 0.7% MoM, food was up 0.8%, used cars up 2.5%, medical care up 0.5% and recreation up 0.7%. Only 2 components recorded MoM readings below 0.4% – 0% for apparel and 0.2% for education. Remember consistent 0.2% MoM readings trend towards 2.4% YoY inflation and even that is above the 2% Federal Reserve's target.

7% CPI and a 1Q taper conclusion?

Inflation will rise further and at this point we can't rule out a 7% YoY reading in the next couple of months given housing, energy, second-hand car price developments. Meanwhile, retail inventories are at all-time lows so the need for seasonal discounts ahead of the key shopping season is simply not there. Furthermore, with the National Federation of Independent Business reporting the highest proportion of companies raising their prices in the survey's 46-year history and employment costs rising at rates not consistently seen since the early 1980s, the Fed's narrative on transitory inflation looks severely at odds with the data and pipeline price pressures.

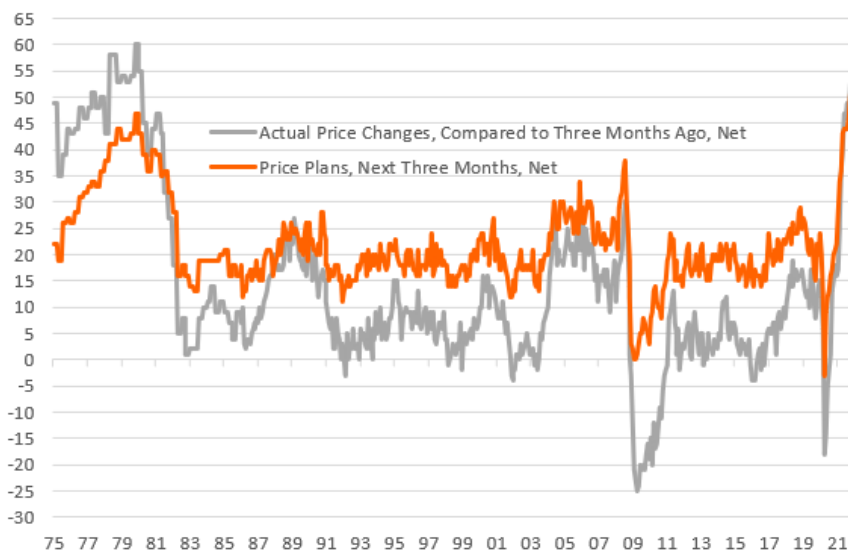
second hand car prices continue to surge



Source: Macrobond, ING

With the economy set to grow 6%+ annualised in this quarter and inflation set to persist at 6%+ through 1Q why does the Fed need to keep stimulating? The November FOMC statement said the committee “is prepared to adjust the pace of purchases if warranted by changes in the economic outlook” and if this backdrop doesn't justify QE taper concluding early we are not sure what will.

Price pressures are broadening and intensifying according to the NFIB



Source: Macrobond, ING

Higher for much longer

Then there is housing. Primary rents and owners' equivalent rent account for a third of the CPI basket with movements in these components tending to lag 12-18 months below house price changes. Given house prices are up 20% YoY this will continue to contribute to both headline and core inflation. Currently primary rents are rising "just" 2.7% YoY while owners' equivalent rate is up a mere 3.1% YoY.

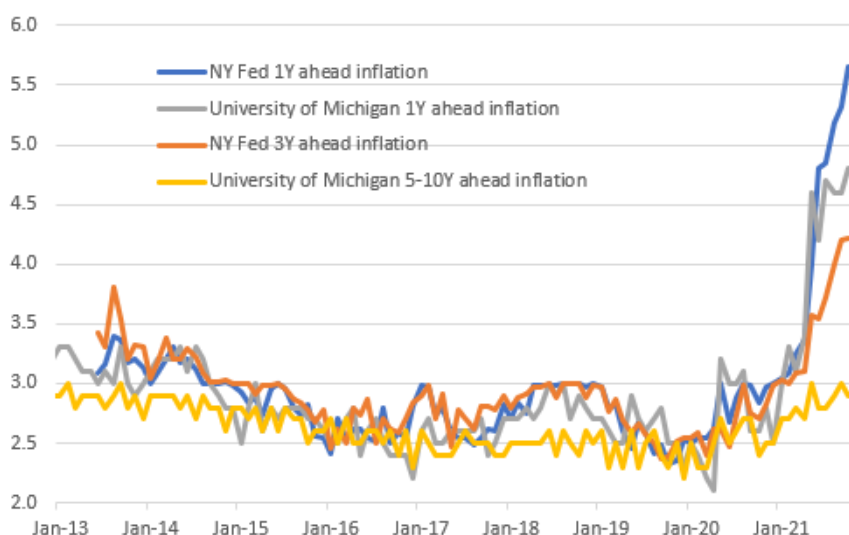
The Federal Reserve expect supply chain strains to ease through the second and third quarters, but given the lack of visibility we suspect that this is more a hope rather than a conviction call. Yesterday's PPI report showed pipeline price pressures remain strong with the annual rate inflation up at 8.6% for headline and 6.8% excluding food and energy. At the same time employment costs are surging as companies desperately compete to hire and retain staff. We now forecast inflation staying above 3% right through 2022, well above the 2% target.

Inflation expectations looking less anchored – Fed to respond

The Federal Reserve continues to assert that "longer term inflation expectations remain well anchored at 2 percent", but consumer survey suggest this is looking increasingly tenuous. The Federal Reserve's own survey (conducted nationally by the NY Fed), shows 1Y ahead inflation consumer expectations rising to 5.7% – not really surprising as it tends to track actual inflation. However, the 3Y ahead inflation expectations rose to a new all-time high of 4.2%. We wouldn't be surprised to see the University of Michigan 5-10Y ahead expectations break-up toward 3.5% in the next few months.

It is a similar story for market inflation expectations using Treasury index protected securities. They are now show 3%+ inflation out to 7 years maturity with even the 10Y up at 2.7%.

Inflation expectations continue to build



Source: Macrobond, ING

Given this backdrop of strong growth and high inflation that will only go higher in the near-term the case for an acceleration of Fed policy normalization is growing. Hence our view of 1Q QE

conclusion and a minimum of two rate hikes in the second half of 2022.

Author

James Knightley

Chief International Economist, US

james.knightley@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit <http://www.ing.com>.