More room for Fed flexibility as US inflation fears recede

Thursday's CPI report offered hope that inflation is moving in the right direction, while PPI suggested pipeline price pressures remain modest. The University of Michigan sentiment index indicates households are less fearful of inflation so the past two days of data offer reasons for optimism that the Fed doesn't need to hike interest rates further

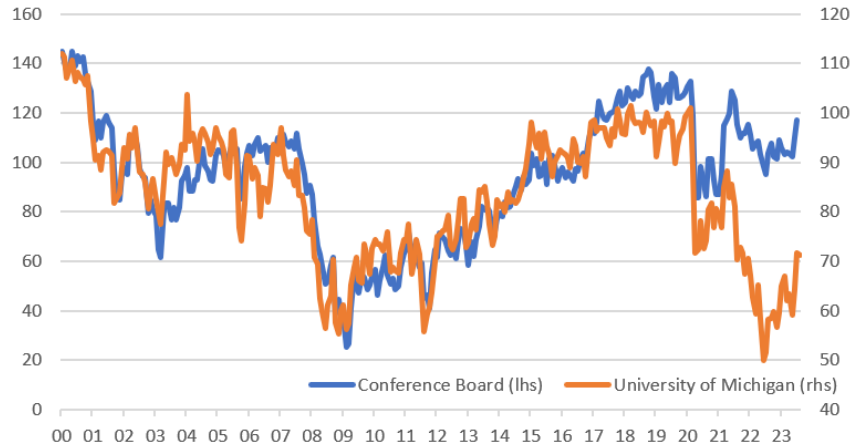
Fed Chair Jerome Powell and US Treasury Secretary Janet Yellen pictured in Washington last month

Sentiment holds firm

Rounding out the US data for this week, we have the August preliminary reading of the University of Michigan measure of consumer sentiment. It dipped ever so slightly to 71.2 from 71.6, and it's exactly in line with market consensus expectations. The current conditions index improved to 77.4 from 76.6 (likely due to the strong jobs market), but the expectations series fell to 67.3 from 68.3 (probably because of the recent equity market weakness and higher gasoline prices).

What you ask yields different results

University of Michigan versus Conference Board sentiment

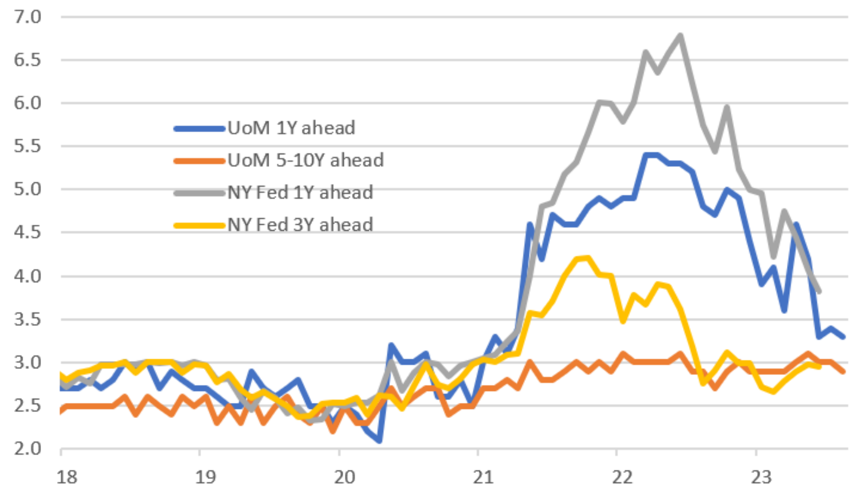


Source: Macrobond, ING

As the chart above shows, the University of Michigan sentiment index has reported weaker confidence readings relative to pre-pandemic levels than the Conference Board measure of consumer confidence has. This highlights that what you ask determines what you get in these sorts of surveys. The Conference Board puts greater emphasis on labour market-related responses, while the University of Michigan survey reflects more the consumer finance environment and the impact of higher inflation. Nonetheless, both are off their lows, even if they don't paint an especially upbeat picture for consumer spending prospects.

Consumer inflation expectations

YoY %



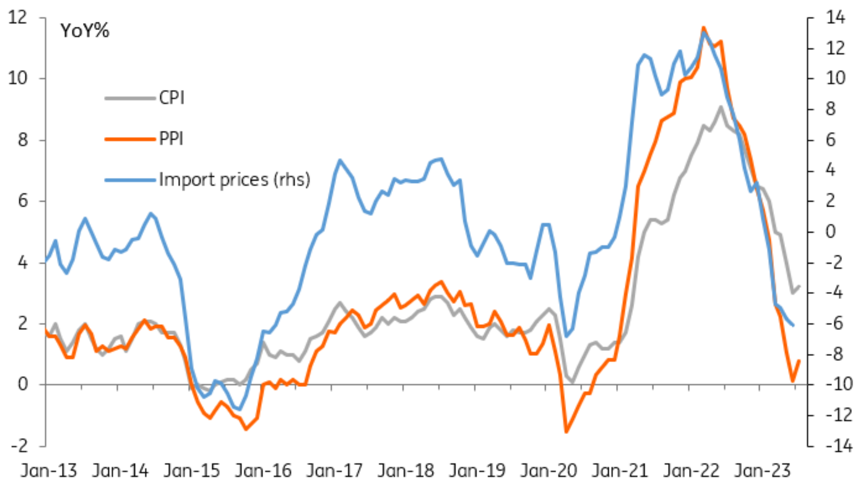
Source: Macrobond, ING

Consumer inflation expectations edge lower as price pressures moderate

We also closely watch the price expectations series, and there was some encouraging news here with 1Y ahead expectations slowing to 3.3% from 3.4% (the market had looked for it to rise to 3.5% given those gasoline price increases) while the 5-10Y expectation dropped to 2.9% from 3%; the market had expected it to hold at 3%. We have to acknowledge that the population sample size used for these price expectations series is pretty small, but it is a data point that does get noticed and any slowdown is going to be viewed as good news by the Federal Reserve.

US import price, producer price and consumer price inflation

YoY %



Source: Macrobond, ING

With the PPI report earlier in the day suggesting pipeline price pressures remain modest, coming after yesterday's better-than-expected CPI report, we believe it right that the market remains doubtful that the Fed will carry through with the final interest rate hike they predicted in their June forecast update. With the headwind from higher borrowing costs and tighter lending conditions set to intensify economic headwinds and the restart of student loan repayments in October set to squeeze the finances of millions of households, we expect the Fed will leave rates on hold through early 2024 with a strong chance of a rate cut as early as next March.

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