

## The top is in sight as US inflation eases

Soft US inflation will reinforce the view that the interest rate peak is in sight, but having been hurt by the 'inflation is transitory' narrative, the Fed will be wary about a conviction call in this environment. 50bp is still the call tomorrow, but there's less chance of a rate above 5% in 2023. Recessionary forces will mean rate cuts are on the agenda in 2H23



**0.2%** MoM increase in core CPI

### Inflation undershoots expectations thanks to transportation and medical care

Headline consumer price inflation rose 0.1% month-on-month in November while the core reading – excluding food and energy – came in at 0.2%. The market had been expecting 0.3% MoM readings for both, although there was a wide range of expectations from 0.0 to 0.6% for the core.

This means the annual rate of headline inflation has slowed to 7.1% from 7.7% while the core rate is now 6% having been 6.3% in October.

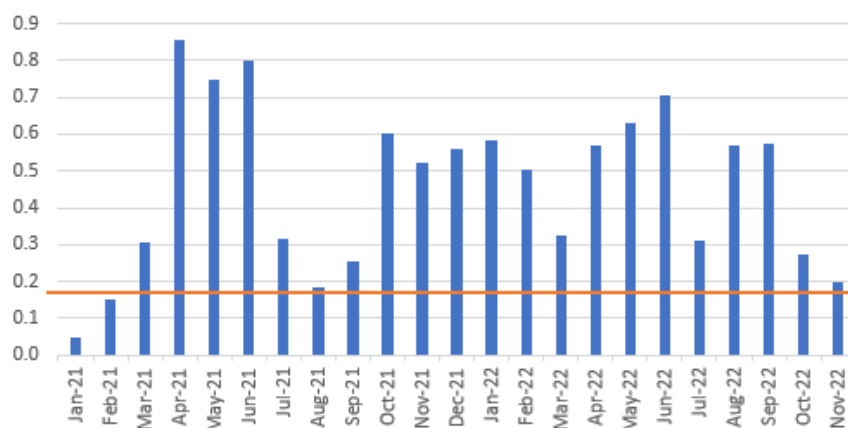
The details show the big downside contributors were energy (-1.6% MoM), with used car prices falling for a fifth consecutive month (-2.9%) while airline fares fell 3% MoM and medical care fell 0.5% for the second month in a row. Shelter inflation slowed from 0.8% MoM to 0.6% MoM. On the upside food (+0.5%), recreation (+0.5%) education/communication (+0.7%) continue to see strong price growth.

## 0.2% is good, but more evidence needed before the Fed relaxes

This doesn't alter the outlook for a 50bp rate hike tomorrow, but it does bring into question how much further rates will rise in 2023. This is a tricky situation for the Fed which has been telling us to expect a higher peak in rates than it was signalling in September. Core CPI came in at 0.3% MoM and the core PCE deflator was at 0.2% MoM for October, which could be shrugged off as just one month of data, but core CPI now coming in at 0.2% in November could lead to a bit of a rethink.

Moreover, the Fed's reputation has been tarnished by its pronouncements last year that inflationary pressures are "transitory". Having been proven wrong, we suspect they will be much more careful about calling the top and will want to see substantial evidence that inflation is slowing. In this regard, to get inflation to 2% YoY over time we need to see MoM readings average 0.17% MoM. We are not there yet as the chart below shows. We suspect the Fed will want to see at least three or four months where it gets below that key orange line to be confident the inflation fight is being won.

## MoM readings for core CPI and the 0.17% threshold



Source: Macrobond, ING

We had doubted that the Fed funds rate would get above 5% and today's data supports that call but we still expect a further 50bp of hikes in 1Q 2023 (to 4.75-5%) with current activity data holding up OK and rising wages still a source of inflationary pressure. Indeed, the plunge in Treasury yields and the dollar are undermining the Fed's policy tightening efforts to bring demand into better balance with supply, which to us justifies one more 50bp at the February FOMC meeting.

## Rate cuts on the agenda for 2H 2023

Longer term, we expect inflation pressures to ease meaningfully. Corporate pricing power already appears to be waning based on survey evidence, especially from the National Federation of Independent Businesses and recession concerns will help dampen price and wage pressures further. The composition of the US inflation basket, which is heavily skewed toward housing and vehicles – accounting for more than 40% by weight – is also important for our call that inflation will hit 2% by the end of the year. With unemployment likely to rise during mid-2023 this would open the door to rate cuts from 3Q 2023 onwards.

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