

## US inflation nears the peak, but it will be a long slow descent

US inflation has hit a new 40-year high, but we are approaching the peak. Unfortunately, the descent will be long and slow given lingering supply chain issues, significant tightness in the labour market and ongoing corporate pricing power. This means the Fed needs to raise rates rapidly, with a growing chance a sharp slowdown will result



High gas prices have contributed to the US March CPI reading

**8.5%** Highest annual inflation rate since December 1981

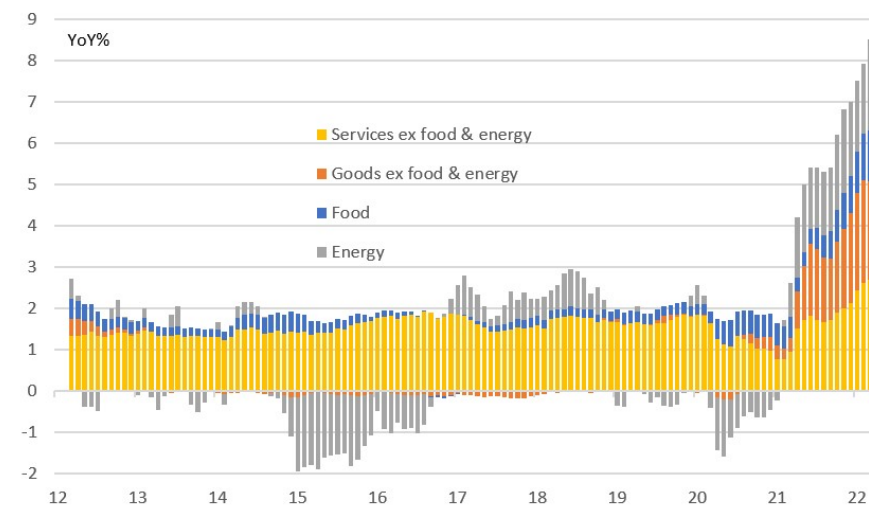
### New highs for inflation

The US consumer price index rose 1.2% month-on-month in March, which leaves the annual rate of inflation at 8.5%, the highest rate since December 1981. Energy prices rose 11% MoM, led by gasoline, while food prices increased 1% MoM. Stripping these out gives core inflation of 0.3%MoM/6.5%YoY, which was weaker than the 0.5%/6.6% consensus forecast. This appears to

have come as something of a relief for the bond market, with participants seemingly taking it as a sign that inflation pressures are peaking.

However, it is important to note that the core miss was due to just two components showing weakness. Used car and truck prices, which have a large 4.2% weighting within CPI, fell 3.8% while education costs fell 0.2%. All other core components posted solid gains with shelter (33% weight) increasing 0.5% and apparel rising 0.6% with medical care gaining 0.5%.

## Contributions to annual US inflation rate



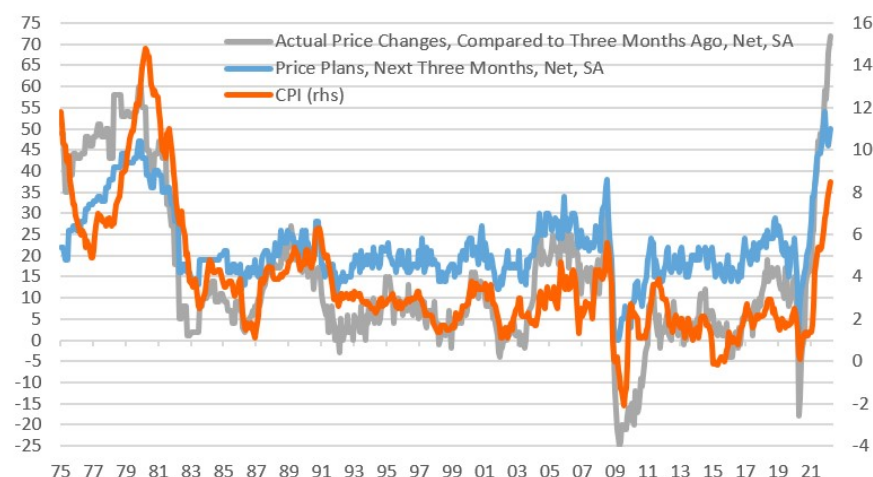
Source: Macrobond, ING

## Cost pressures remain intense and firms have pricing power

We think another small increase in the annual rate is possible next month, but we are hopeful that the peak in CPI is close. Mannheim used car auction prices are down 5.4% over the past two months so used vehicle prices should fall further in April, while as of yesterday, the national average gasoline price was down 5% from the 10 March peak of \$4.33/gallon. Nonetheless, we can't take anything for granted given the uncertainties over the Russia-Ukraine war and how this might impact commodity prices, while the Covid lockdown story from China continues to create huge problems for supply chains.

Moreover, the descent from 8.5%+ inflation is unlikely to be quick. This morning's National Federation of Independent Businesses survey reported that cost pressures are the biggest issue for small businesses and, for now, they are able to pass them on to customers. A net (those responding that they would raise prices less than those saying they would cut them) 72% said they raised prices over the past three months, with a net 50% expecting to raise prices further. We haven't seen this sort of pricing power for the small business sector before, as the chart below shows.

## NFIB survey shows firms are able to raise prices easily



Source: Macrobond, ING

The tight jobs market where there are more than 1.8 vacancies for every unemployed person, suggests wage pressures will continue to build as firms compete for staff. As such, we see little prospect of an imminent decline in cost pressures for business.

Then there is the housing component. House prices have risen more than 30% nationally since the start of the pandemic, with demand fueled by massive fiscal and monetary stimulus while housing supply has remained limited. This has pushed primary and owners' equivalent rents higher and there is still some upside to come in all likelihood.

## Aggressive Fed rate hikes to be followed by 2H23 cuts

It's clear that the Fed will act aggressively to get policy restrictive in order to regain control of the inflation narrative. We look for it to raise the fed funds rate 50bp at the May, June and July Federal Open Market Committee meetings, and once the proposed quantitative tightening gets up to speed we think it will then move to 25bp hikes.

This will come with an economic cost. Higher borrowing costs, a strong dollar and a potentially fraught political backdrop as we head towards the November mid-terms mean that the US economy will face intensifying headwinds. With consumer confidence already beaten down by concerns over squeezed spending power and supply chain strains also acting as a brake on activity, we recently revised lower our 2023 GDP growth forecast markedly to 1.8% from 3%.

A weaker growth environment and a hopefully more benign geopolitical backdrop in 2023 will help to ease price pressures and inflation could fall more quickly through the second half of 2023.

---

*We expect an interest rate peak in the first quarter of 2023 at 3%*

---

We expect an interest rate peak in the first quarter of 2023 at 3%, but the average period between the last Fed hike in a cycle and the first rate cut has only been eight months over the past 50

years. Given this history and the prospect of weaker economic activity in 2023, we are forecasting 50bp of rate cuts before year-end 2023 as the Fed finds itself needing to move to a more neutral footing.

## Author

### James Knightley

Chief International Economist, US

[james.knightley@ing.com](mailto: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 [www.ing.com](http://www.ing.com).