Easing pipeline price pressures boost hopes for lower US inflation

Last week's lower-than-expected core CPI reading raised hopes that the Federal Reserve's tightening cycle was entering the end phase. Today's PPI report has offered further succour to the notion that the Fed will actually be in a position to cut rates if, as we fear, the US enters recession in 2023

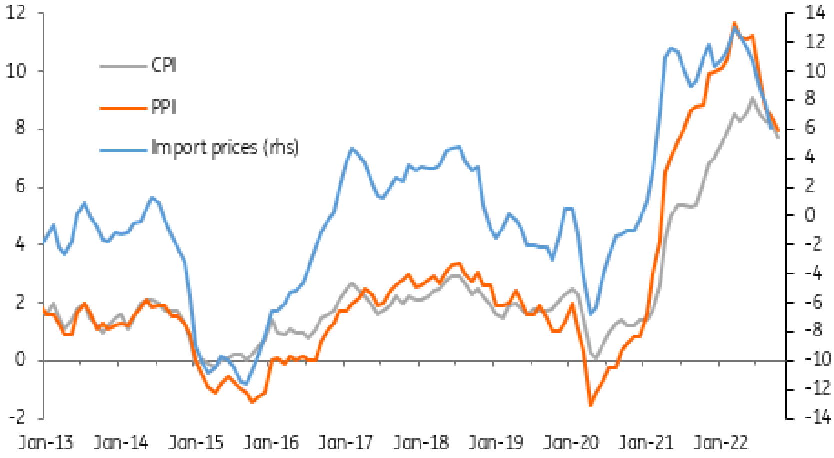
The headline producer price index rose 0.2% month-on-month in October, which was lower than expected

PPI surprises on the downside

With core CPI rising only 0.3% month-on-month last week, rather than the 0.5% expected and the 0.6% MoM prints seen in previous months, the market saw evidence that inflation pressures may finally be abating after the most aggressive Fed tightening cycle since the early 1980s. While it is certainly very helpful to our view that inflation can get back to the Federal Reserve's 2% inflation target next year, we warned that nothing can be taken for granted and that the 0.3% figure was still nearly double the 0.17% MoM figure we need to average over time to be confident that the 2% year-on-year inflation target will be hit.

Today's PPI report has given us confidence that inflation can fall more quickly than the market had been expecting. In turn, this will give the Federal Reserve the flexibility to respond with stimulus should a 2023 recession materialise, as we fear.

Annual inflation rates are slowing



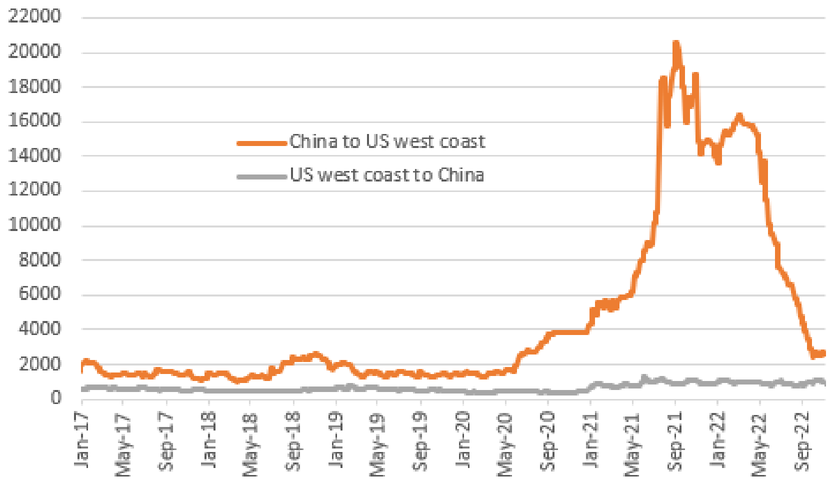
Source: Macrobond, ING

The headline rate rose 0.2% MoM, lower than the 0.4% expected, while September's MoM rate was revised down to 0.2% from 0.4%. The details show that food +0.5% MoM and energy +2.7% MoM continue to run hot, but goods ex food and energy fell 0.1% MoM and services fell 0.1%. Consequently, the more important core figure (ex food and energy) was unchanged on the month versus the 0.3% MoM expected, leading the YoY core PPI rate to slow to 6.7% from 7.1%.

Lower input costs reduce the pressure for consumer price rises

Falling commodity prices and the effects of earlier energy price falls have been very helpful and together with the strong dollar and falling freight costs has meant imported prices are receding quite rapidly now. Indeed, freight costs from China to the US are now pretty much back to pre-Covid levels, suggesting supply chain frictions caused by logistic issues have abated to a large extent. This is all very helpful to reduce corporate input costs, which in turn reduces the pressure for companies to raise prices for consumers. Moreover, in a weakening economic environment it could allow companies greater flexibility on the pricing to respond to weaker demand without such an aggressive squeeze on profit margins.

Freight costs for a 40-foot container



Source: Macrobond, ING

Federal Reserve has greater scope for flexibility

Nonetheless, it is far too early for the Fed to signal the all-clear with Federal Reserve officials continuing to signal that while this is encouraging it is only one month. They will need to see consistent readings for core CPI coming in around 0.1% or 0.2% and we are still some way off from that, while we have to remember that the jobs market remains hot and wages continue to rise at a rapid clip. Consequently, we continue to have a 50bp rate hike in for the December Federal Open Market Committee meeting and look for a further 50bp hike in the first quarter of 2023, but that should mark the top. Recessionary forces are intensifying and lower inflation will give the Fed the scope to reverse course with rate cuts in the second half of 2023.

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