

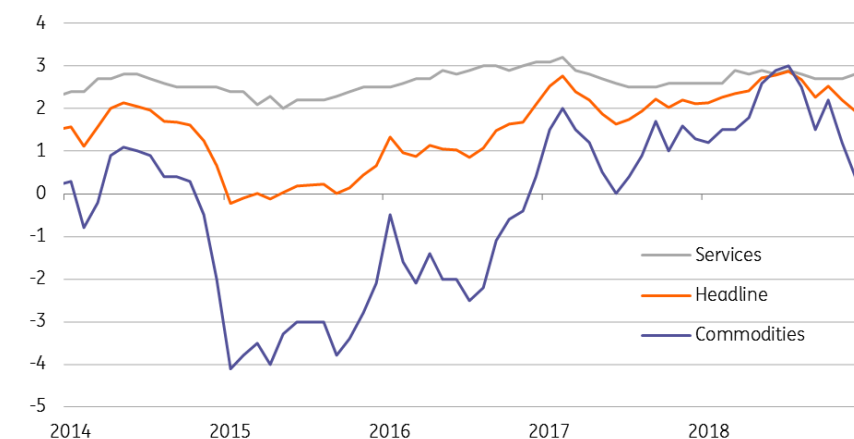
## US inflation and the squeeze on spending power

US inflation was a touch softer than expected in December, but with headline and core CPI still running at 2.3% year-on-year, and wage growth having moderated to 2.9%, there is a squeeze on household spending power. This will likely limit the upside in consumer spending and GDP growth this year



December US consumer price inflation rose 0.2% month-on-month at the headline level and 0.1% at the core (ex food and energy), both of which were a tenth of a percentage point lower than expected. The main surprise is the softness in the housing component, which rose just 0.1% despite the more positive newsflow on residential property in recent months. Note also in the chart below the slowdown in the core goods component, which suggests the inflation impulse from tariffs has already faded. Most other components were broadly in line with their recent trends although medical care remains an outlier with another strong gain (0.6% MoM) to leave prices for this component up 4.6% YoY.

## Goods and services inflation measures

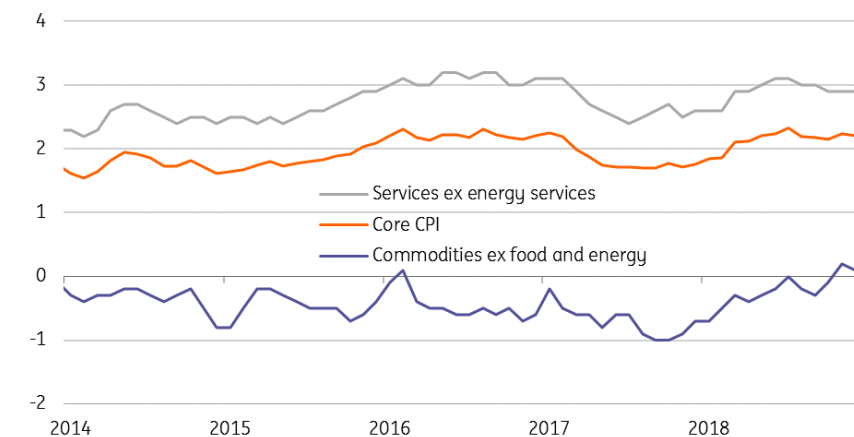


Source: HCSO, NBH

This means the annual rate of headline inflation is now 2.3% versus 2.1% in November, while the core rate remains at 2.3%. Headline inflation is going to be volatile as a result of the fluctuations in energy prices, but in general we expect these annual inflation rates to largely be rangebound between 2-2.4% this year. A strengthening residential property market could see inflation rates in the key housing component rise, but the slowdown in wage growth should keep broader service sector inflation in check, as business cost increases remain muted.

Moreover, while there has been a slight tick up in market expectations for inflation, consumer expectations continue to moderate and are at record lows for 5-10Y ahead, according to the University of Michigan sentiment index. This gives the Federal Reserve plenty of flexibility to adjust to any shocks in the economy.

## Inflation expectations remain muted



Source: HCSO

We are a little more wary about what this all means for consumer spending. Given unemployment is at 50-year lows and firms continue to talk of a lack of skilled workers to fill vacancies we should really be seeing wages move higher. Instead, last Friday's jobs report showed wage growth of just

2.9% - the weakest since July 2018 - after having been as high as 3.4% just 11 months ago. In consequence, with real wage growth being squeezed lower and employment growth also expected to moderate after a decent run in mid-late 2019, we think it unlikely that consumer spending will be a particularly strong growth driver this year. As such, we continue to have a tendency to be a little less optimistic than the market on GDP growth (1.7% for this year) and have a bias to lower Treasury yields in the medium term.

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