U.S. Inflation Insight: January 2024

MNI View: Services Strength Could Stall Near-Term Cut

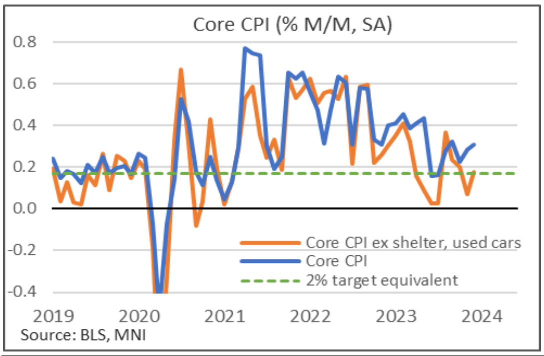
By Chris Harrison and Tim Cooper (January 12, 2024)

- Core CPI inflation came in marginally stronger than expected in December with 0.31% M/M, seeing as consensus was for a rounded 0.3% but with a clear skew to a ‘low’ 0.3%.
- There weren’t any particularly large drivers for the surprise compared to recent months.
- The report offers a worrying stalling in the moderation in CPI data although core PCE has been running lower than core CPI in recent months, and we suspect it should have continued to do so in December barring any PPI surprises today.
- The fading of volatility in the categories seen through Sep-Nov comes as inflation struggles in the “last mile” of its return all the way to target, and shouldn’t be particularly comforting for the Fed.
- With a relatively dovish FOMC member in Williams having already pushed back on March cut pricing after the December FOMC, we expect the hawks and possibly Chair Powell to lean into those points ahead, even if Cleveland Fed’s Mester didn’t jump at the chance in post-CPI commentary.
- The market briefly lowered the odds of a March FOMC cut although quickly reversed that and has about 70% priced. The 24 analysts reviewed below for the most part see a later start to cuts.

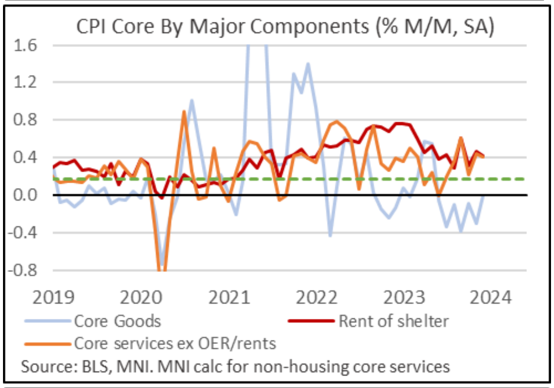
Core CPI Sees Less Goods Deflation, Still Strong Services

- Core CPI came in marginally stronger than expected in December with 0.31% M/M, seeing as consensus was for a rounded 0.3% but with a clear skew to a ‘low’ 0.3%.
- It leaves a very similar bottom line to the 0.285% M/M in Nov.
- Three-month inflation stands at 3.3% annualized (from 3.4%), six-month inflation at 3.2% (from 2.9%) and the year-ago rate at 3.9% Y/Y (from 4.0% Y/Y).
- There were fewer clear drivers behind the surprise than has been the case in recent months, led by used car prices pushing higher again despite wholesale prices declining further,
- Headline CPI saw a cleaner beat of consensus owing to energy prices coming in at the higher end of expectations.

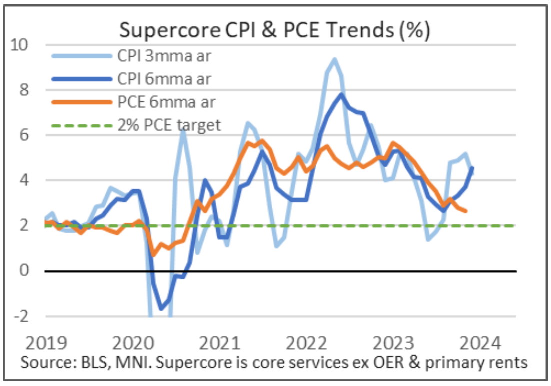
	Nov *actual*	Dec *actual*
Core	0.285%	0.309% (cons 0.3, av 0.25)
Headline	0.097%	0.303% (cons 0.2, av 0.21)
Core Y/Y	4.01%	3.93% (cons 3.8)
Headline Y/Y	3.14%	3.35% (cons 3.2)



Source: BLS, MNI



Source: BLS, MNI. MNI calc for non-housing core services



Source: BLS, MNI. Supercore is core services ex OER & primary rents

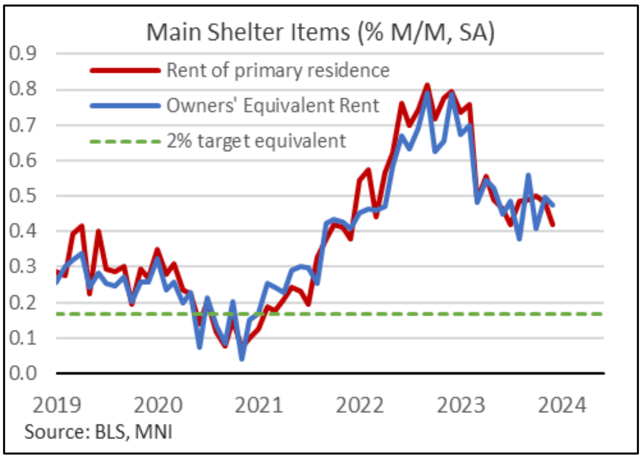
Relative to November, the main change was core goods prices no longer falling (0.00% after -0.30% M/M) following six monthly declines. Core services meanwhile saw very little moderation indeed (0.44% after 0.47% M/M), its third fastest month since Apr’23 and notably with both shelter (0.42% M/M) and ex-shelter (0.45% M/M) contributing strongly.

Supercore Running Above 5% Annualized In Past Three Months

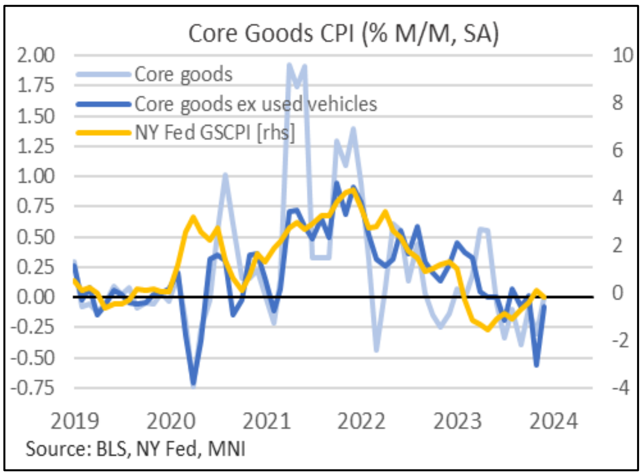
Core services ex OER & rents, or “supercore” was again on the higher side of analyst expectations at 0.40% M/M after 0.44% M/M, vs limited analyst estimates pointing to ~0.35% M/M. The three-month rate pulled back from 5.2% to 4.3% annualized, courtesy of the 0.6% M/M from Sep dropping out but with October’s 0.2% M/M set to drop out next month. Smoothing these out and as flagged in the CPI Preview, the six-month trend rate accelerated sharply from 3.7% to 4.6% annualized for its fastest pace since Mar’23. However, and crucially, the PCE supercore has been running at notably slower rates at 2.7% annualized on a six-month basis in Nov and potentially able to remain below 3% annualized on a six-month basis in December.

Key Rent Items Broadly As Expected
Owners’ equivalent rents (OER) proved stickier than tenants’ rents in December, rising at the higher end of analysts’ expectations compared to slightly softer than expected primary rents – OER carries more than 3x as much weight as rents in the basket. Rents meanwhile appear to have rolled over slightly in the past two months, but it doesn’t yet mark another shift back further towards pre-pandemic trends after the sharp moderation early in 2023.

- OER: 0.47% M/M vs analyst average 0.45% (range 0.33-0.51) after 0.50%
- Tenants’ rents: 0.42% M/M vs analyst average 0.45% (range 0.33-0.5) after 0.48%.



Core Goods Ex-Used Cars More In Keeping With Supply Side
Core goods prices excluding used cars bounced in a relative sense to -0.07% M/M after the -0.56% in Nov marked the sharpest decline since Apr’20 of the pandemic and prior to that one of the sharpest since at least 2000. Apparel helped drive this pattern, with a monthly profile of 0.1% in Oct, -1.3% in Nov and back to 0.1% in Dec, with the return to small positives seemingly confirming November’s slide was down to earlier discounts for the holiday shopping season. The latest modest level of goods deflation looks more in keeping with global supply chain pressures being back near historical averages.



Major Contributors To Core December CPI
Core goods had a flat contribution to the overall figure, with deflation in the ex-vehicle categories receding sharply from November (largely as November's sharp drop in apparel CPI faded), and used car inflation softening slightly. Within core services, housing contributed slightly less than in November, with lodging, medical services, car insurance, and airfares edging higher. Combined, all other services were flat on the month.

US: Contributions to % M/M Core CPI

	Nov	Dec	*chg*
Core CPI	**0.28**	**0.31**	**0.02**
core goods	-0.08	0.00	0.08
used cars	0.05	0.02	-0.03
new cars	0.00	0.01	0.02
other goods	-0.13	-0.03	0.10
core services	0.35	0.32	-0.02
housing	0.21	0.19	-0.01
OER	0.16	0.15	-0.01
primary rents	0.05	0.04	-0.01
lodging	-0.01	0.01	0.02
medical serv	0.05	0.06	0.01
car insurance	0.03	0.06	0.02
airfares	0.00	0.01	0.01
other services	0.07	0.00	-0.07

Source: BBG, BLS, MNI. Don't always add due to rounding

Volatility in pandemic-related categories subsided significantly in 2H23, reducing their importance in forecasting the M/M readings. The 6-month average standard deviations of M/M % changes are at multiyear lows for new car prices (which have risen between 0.0-0.1% for the past 4 months), car/truck rental, and almost so for used vehicles.

Some travel categories stand out: volatility remains elevated for airfares after summer gyrations, however, while lodging price volatility has picked up in recent months.
* In December, airfares rose by a 4-month high 1.0% M/M (vs -0.4% prior), lodging by a 3-month high 0.4% (-0.9% prior), and vehicle rental deflated less (-0.7%, -2.2% prior) while new cars (0.0%, 0.0% prior) and used car prices (0.5%, 1.6% prior) were flat/lower.
* Pandemic category price levels are settling both higher and lower vs overall core prices, which are up 17% since Feb-20: Airfares are 6% below pre-pandemic levels, with lodging prices also undershooting overall core CPI; new cars and vehicle rental prices are now only slightly above the development in core CPI.
* Used cars stand out at 38% above pre-pandemic levels and gaining again in recent months, but forward-looking wholesale price measures suggest that softening is likely in the pipeline.

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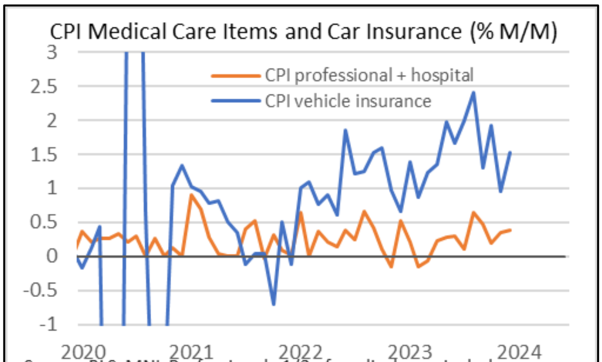
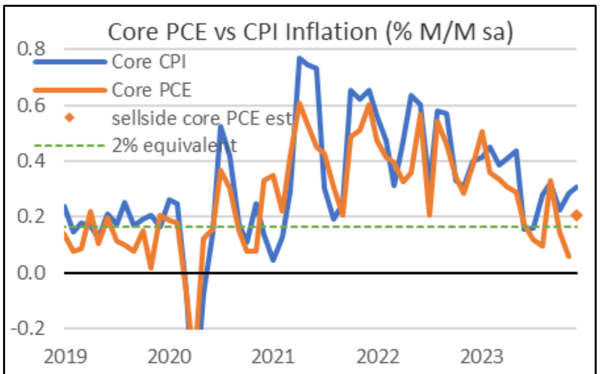
Further Details: Large Service Items Showing Persistence
Within medical care services, combined professional and hospital services saw another strong month, rising 0.38% after 0.35% M/M in a notable development for components worth a combined 7% of the core CPI basket. Motor vehicle insurance meanwhile surprisingly accelerated from 1.0% to 1.5% M/M, with the category worth 4% of the core CPI basket, contrary to expectations of a further moderation with premiums having nearly caught up to repair and replacement costs. Vehicle insurance in particular doesn't feed through to core PCE calculations (with source data instead from PPI), but these persistently strong readings nevertheless highlight an ongoing gap between strong services and weak goods inflation.



Source: BLS, MNI. Professional ~1/2 of medical care, includes physicians, dental and eye care. Hospital ~1/3 of medical care

Analysts See Return To More Typical Wedge With Core PCE
Due Jan 26, the below analysts see core PCE averaging 0.2% M/M in December after a particularly soft 0.06% M/M in November, although there is a wide range to the estimates. These will as usual be updated after PPI.

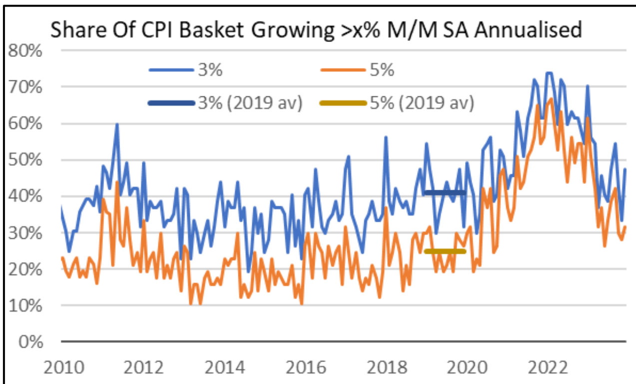
- BofA: 0.12-0.15% M/M
- GS: 0.20% M/M
- MS: 0.20% M/M
- JPM: 0.2% M/M, Y/Y down from 3.2% to 3.0%
- NWM: 0.2% M/M, didn't rethink prior estimate
- Nomura: 0.217% M/M
- Citi: 0.28% M/M
- Wrightson ICAP: round up to 0.3% vs down to 0.2% prior



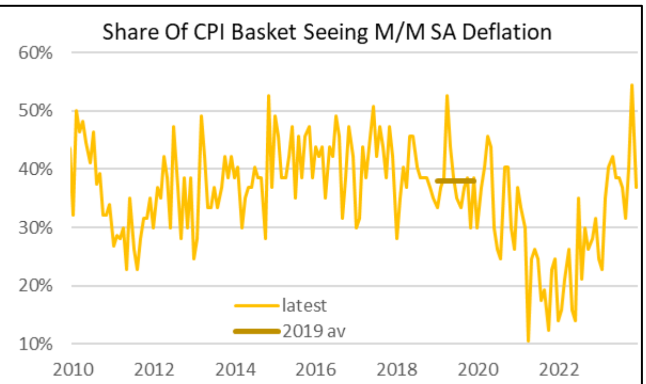
Source: BEA, BLS, MNI. Average of early sellside estimates

Broader CPI Dispersion Measures Show Notable Weakening
Our measure of dispersion looking at 57 items across the entire CPI basket suggests December saw a reversal of November's progress.

- The share of the basket rising more than 3% annualized on the month increased from 33% to 47% (2019 av 41%) and the share rising more than 5% annualized increased from 28% to 32% (2019 av 25%).
- At the other end of the spectrum, the share seeing outright deflation on the month dropped sharply from 54% to 37% (2019 av 38%) although that's only its lowest since September.
- These figures should all be caveated by the fact they can be noisy from month-to-month.



Source: BLS, MNI. MNI estimate for 57 items, taken predominantly at indent level 4 except level 3 for food & energy, level 5 for shelter

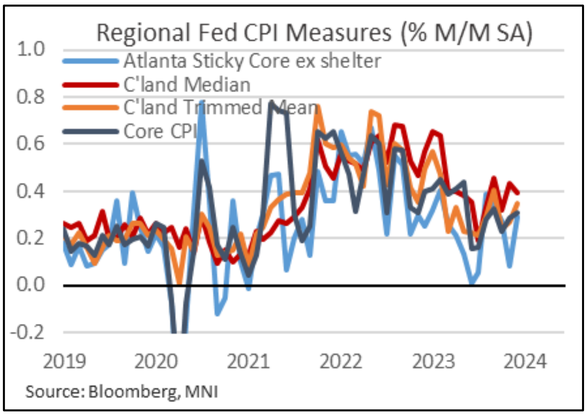


Source: BLS, MNI. MNI estimate for 57 items, taken predominantly at indent level 4 except level 3 for food & energy, level 5 for shelter

Regional Fed CPI Metrics See Limited M/M Progress In Dec

The Cleveland Fed and Atlanta Fed CPI metrics either showed little sign of progress or accelerated in M/M terms, although Y/Y measures mostly eased.

- Cleveland Fed median CPI: 0.40% M/M after 0.43%. 5.1% Y/Y
- Cleveland Fed 16% trimmed mean: 0.35% M/M after 0.27%. 3.9% Y/Y
- Atlanta Fed sticky core ex shelter: 0.29% M/M after 0.08%. 2.8% Y/Y



Bottom Line: Still Stubborn Service Inflation But Market Reluctant To Stray Too Far From March Cut

- Core CPI came in slightly stronger than expected in December at 0.31% M/M (cons 0.3 but skewed lower).
- There weren't any particularly large drivers for the surprise compared to recent months, although used cars led with a further 0.5% increase despite continued wholesale price declines.
- Heavily weighted rent measures showed no sign of further moderation and the supercore CPI was solid at 0.40% M/M (limited analyst estimates were closer to 0.35%) for minimal progress from the 0.44% in November.
- Trend growth rates are clearly stubborn: core CPI increased 3.3% annualized over three months (a rate, notably, near unchanged for the past three months as well) and has registered 3.2% over six months, whilst supercore CPI has been running at 4.3% and 4.6% annualized over the past three and six months.
- The report offers a worrying stalling in the moderation in CPI data although core PCE has been running lower than core CPI in recent months, and we suspect it should have continued to do so in December barring any PPI surprises today.
- Initial sellside estimates suggest core PCE could still be growing roughly in line with the 2% inflation target on a six-month basis, although supercore PCE could have increased closer to 3%.
- It's this resilience in service inflation, along with today's continued hawkish jobless claims data that helped trim market expectations of a Fed rate cut in March from circa 70% to 60%, although much of this move was then reversed with EU rates-related moves.
- The fading of volatility in the categories seen through Sep-Nov comes as inflation struggles in the "last mile" of its return all the way to target, and shouldn't be particularly comforting for the Fed.
- With a relatively dovish FOMC member in Williams having already pushed back on March cut pricing after the December FOMC, we expect the hawks and possibly Chair Powell to lean into those points ahead. That said, Mester ('24 voter) didn't particularly jump at the chance in post-CPI commentary although Goolsbee ('25) offered some near-term rate cut pushback - see below.
- Another factor going against the likelihood of a March rate cut is that it would likely need to be teed up by Chair Powell at the Jan 31 decision. That lands a week and a half before annual CPI seasonal adjustment revisions on Feb 9 (in turn before the January CPI report on Feb 13) which could alter recent trends.

FOMC-dated Fed Funds futures implied rates

Meeting	Latest			pre CPI (Jan 11)			*chg in rate*	pre NFP (Jan 5)			*chg in rate*
	%	step (bp)	cum. (bp)	%	step (bp)	cum. (bp)	*bp*	%	step (bp)	cum. (bp)	*bp*
Effective	5.33										
Jan'24	5.32	-2	-1.2	5.32	-1	-1	*-0.5*	5.31	-2	-2	*0.5*
Mar'24	5.14	-18	-19.1	5.15	-17	-18	*-1.4*	5.16	-16	-17	*-1.8*
May'24	4.89	-25	-44	4.93	-23	-41	*-3.5*	4.96	-20	-37	*-6.6*
Jun'24	4.62	-27	-71	4.67	-25	-66	*-5.5*	4.73	-22	-60	*-11.6*
Jul'24	4.38	-24	-95	4.46	-22	-88	*-7.7*	4.53	-20	-80	*-15.2*
Sep'24	4.14	-24	-119	4.23	-23	-110	*-9.0*	4.31	-22	-102	*-17.4*
Nov'24	3.96	-18	-137	4.06	-17	-127	*-10.0*	4.14	-17	-119	*-18.0*
Dec'24	3.80	-16	-153	3.90	-16	-143	*-10.0*	3.98	-16	-135	*-18.0*

Source: Bloomberg, MNI

Post-CPI Fedspeak

Barkin ('24 voter): December CPI data came in about as expected. He's paying close attention to 1-to-3 month PCE inflation and watching the gap between goods and services inflation, reiterating he won't prejudge the decision on a March rate cut.

Mester ('24 voter until retiring June): CPI hasn't really changed her view - we don't want to see inflation progress stall out but this report doesn't suggest that's happening, it just suggests we've got more work to do and we're committed to do it. Will assess conditions as they come in and really evaluate the risks around both parts of the mandate. When asked on rate cut timing, it is really going to depend on how the economy evolves. March is probably too early in her mind because we need to see more evidence… the Dec CPI report just shows there's more work to do which requires restrictive monetary policy. But as we see more evidence that seeing sustainable downward path to 2% inflation, we can have conversation of whether it's time to move the Fed Funds rate lower back towards a more neutral rate.

- On business contacts: Hearing mixed views on pricing expectations. Input pricing pressures have eased, along with their ability to pass higher costs on. Some firms have been able to maintain pricing power but not as many. Wages haven't come down that much but other input costs have. Not hearing much at all on firms letting people go - there isn't the kind of staff reductions you'd expect if the economy was slowing materially.

Goolsbee ('25 voter): Called 2023 a "hall of fame" year for disinflation in a post-CPI Reuters interview, but noted that he still needed to see more data to make determination of timing and pace of rate cuts: "I still think that the primary determinant of when and how much rates should be cut will be driven off what's happening to the inflation data, and are we meeting the mandate goals...when we have weeks or months of data to come, I don't like tying our hands ... We don't make decisions about March, June and whatever, in January."

- Said re December's data that vs his expectations, services inflation was less strong than he thought, while housing was stronger than he had expected.
- Also noted that he wasn't the lowest dot in the 2024 rate Dot Plot: ""I wasn't the lowest...I was closer to the median" (of 4.6% end-2024).

(Analyst reviews follow overleaf)

Analyst Reviews of December 2023 CPI Report

The 24 analysts below for the most part see Fed rate cuts starting later than the March (~70% priced) and less so May (fully priced) implied by Fed Funds futures.

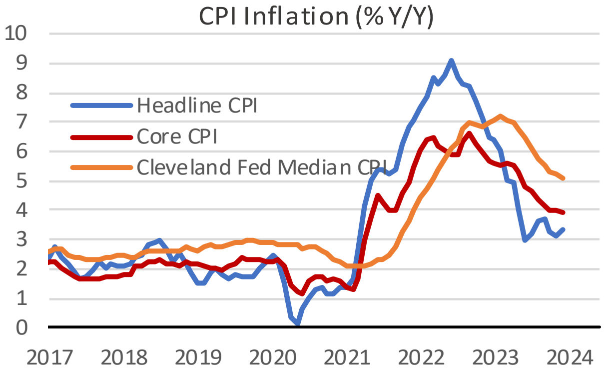
Select excerpts from each analyst included further below.

Analyst	Summary
Berenberg	Resilient Economic Momentum To Keep Fed On Hold Until May
BMO	Discouraging Enough To Keep Fed On Hold Longer Than Market Expects
BofA	Inflation Firmer Than Expected
CIBC	Reinforces Our Call That Fed Will Hold Until 2H24
Citi	Still-Strong Services Prices
Commerzbank	The Last Mile Gets Bumpier
Credit Agricole	CPI Shows Last Mile May Be Difficult
Danske	Risks Of More Persistent Underlying Inflation In 2024-25
Desjardins	Bringing Inflation To Heel Looks To Take Some Time, Cuts To Start Mid-2024
GS	Still Expect Three Consecutive 25bp Cuts Starting In March, Followed By Quarterly Cuts
HSBC	Supercore May Reinforce Idea That Services Inflation Not Yet Consistent With Target
ING	Fed Will Prefer To Wait Until May To Cut
JPM	Continue To Look For A First Cut At June Meeting
Mizuho	Stronger Than Expected
Morgan Stanley	Disinflation Ahead Will Be Gradual With Sticky Services Inflation
Nomura	Supercore Service Prices Remain Sticky
NWM	Recent Pace In Core Still Appears To Be Heading In Right Direction
Pantheon	Wait For Core PCE Before Rushing To Inflation Judgment
RBC	Underlying Details Don't Alter Disinflation Narrative, First Cut In Q2
Scotia	Core Inflation Remains Hot, Key Will Be PCE
SEB	No Dramatic Deviations But Fed To Wait Until May To Cut
TD	Semi-Charmed Print
Wells Fargo	Neither a Gift nor Coal
Wrightson ICAP	Reinforces FOMC Member Views That Fed Should Wait For Confirmation Of Downtrend

Source: Individual analyst notes, MNI. As of 12 Jan 2024

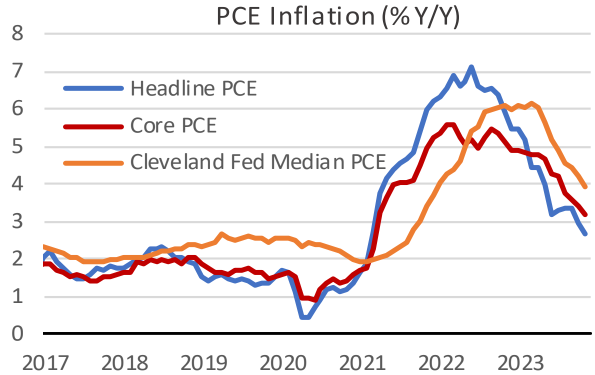
Inflation Overview

CPI Inflation (% Y/Y)



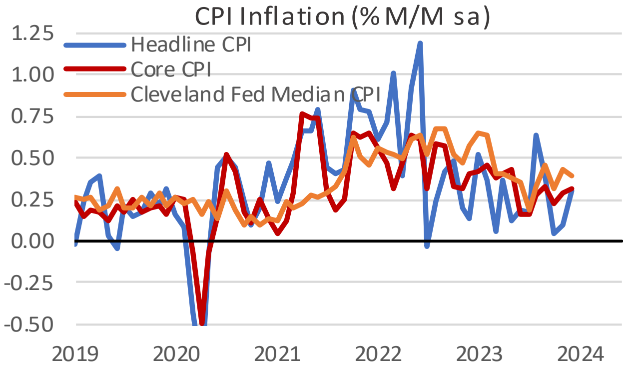
Source: Bloomberg, MNI

PCE Inflation (% Y/Y)



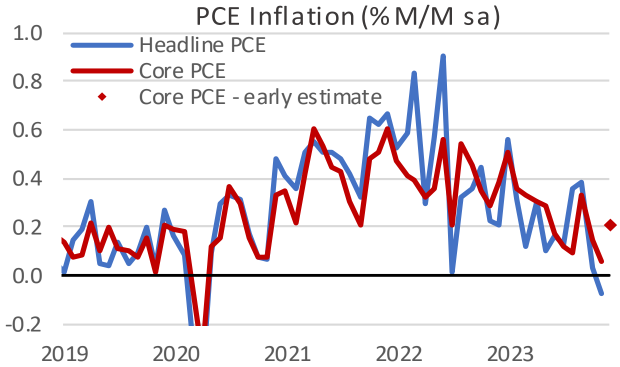
Source: Bloomberg, MNI

CPI Inflation (% M/M sa)



Source: Bloomberg, MNI

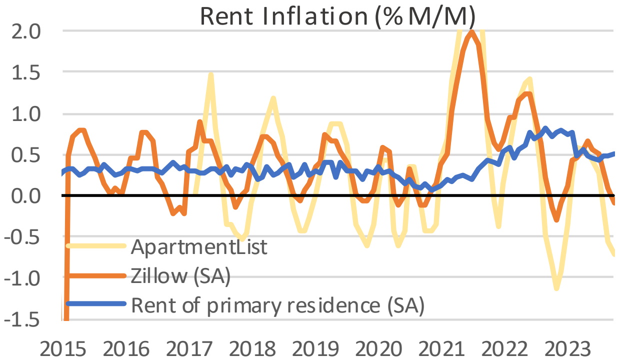
PCE Inflation (% M/M sa)



Source: Bloomberg, MNI and average of sellside post-CPI estimates

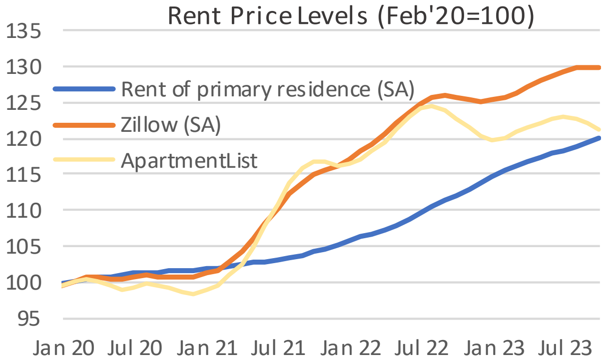
Moves In Select Categories

Rent Inflation (% M/M)



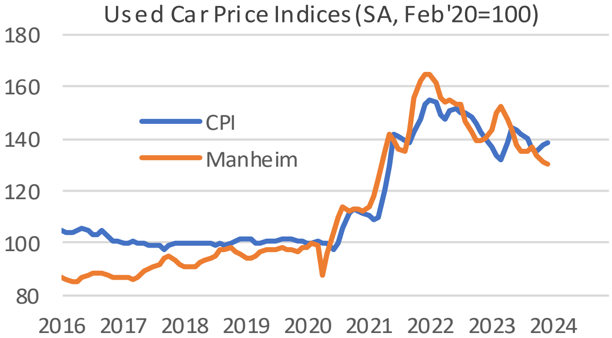
Source: ApartmentList, BLS, MNI, Zillow

Rent Price Levels (Feb'20=100)



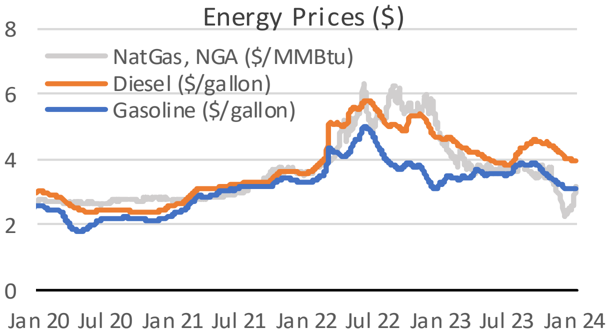
Source: ApartmentList, BLS, MNI, Zillow

Used Car Price Indices (SA, Feb'20=100)



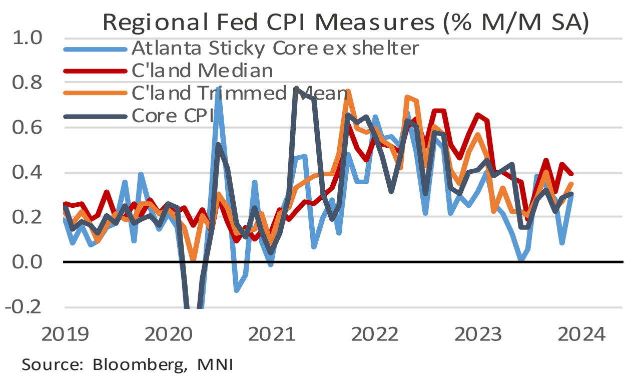
Source: Bloomberg, MNI

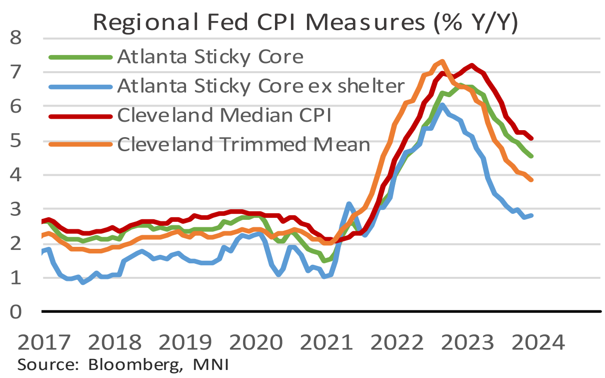
Energy Prices ($)

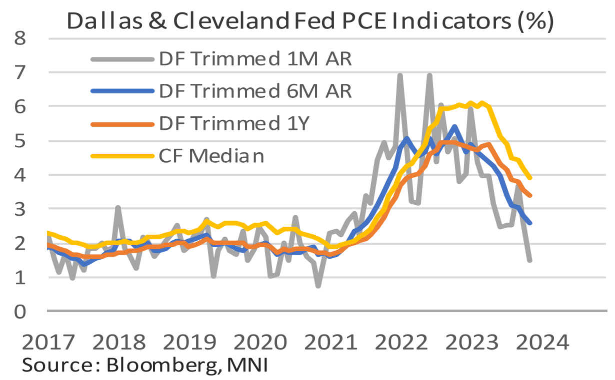


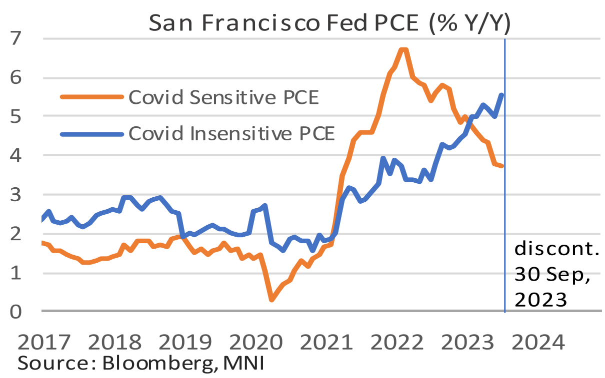
Source: Bloomberg, MNI

Regional Fed Inflation Indices



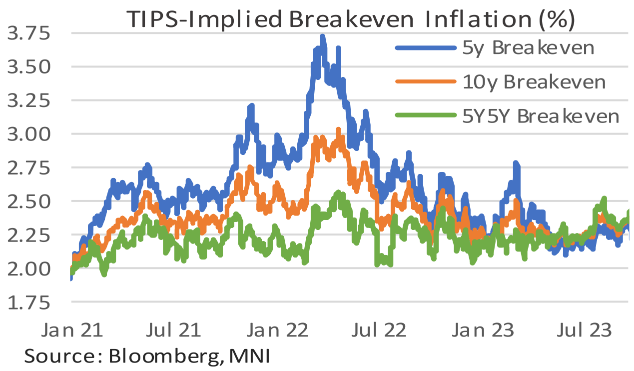


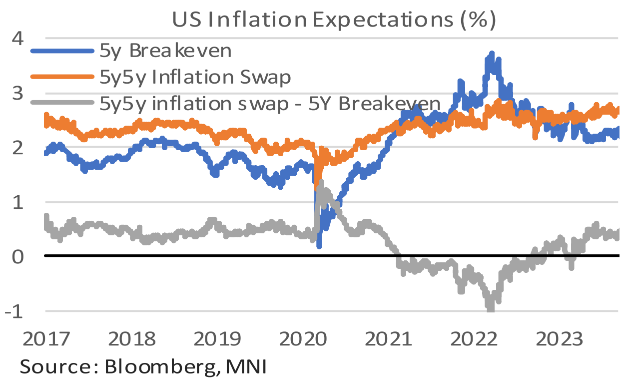


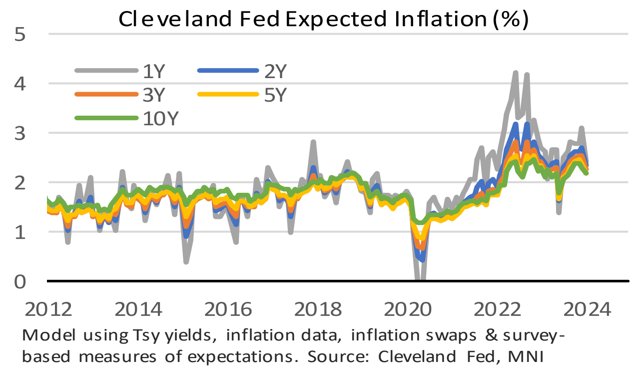


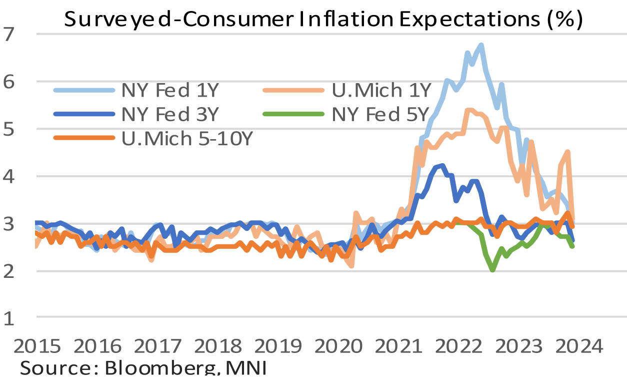
(The PCE measures will typically lag CPI by one month in this publication)

Inflation Expectations









Select excerpts of analyst summaries of this month's CPI report:

Berenberg: Resilient Economic Momentum To Keep Fed On Hold Until May

- "Have price pressures cooled enough in case the Fed needs to cut in a hurry? Probably yes."
- "In our view, still resilient economic momentum, tight labour markets and some stickiness in the CPI measure of core prices will probably keep the Fed on hold until May – when we expect the first 25bp cut after price pressures have eased further."
- "However, in case of clear evidence of a recessionary slump, current inflation rates could allow cuts without stoking serious risks of a sudden re-emergence of inflation."
- "While CPI inflation provides important information about US price trends, for a host of reasons the Fed prefers the PCE measure of inflation." Headline PCE averaged 2% annualized in the six months to Nov whilst core PCE averaged 1.9% - consistent with the target.
- "Although inflation expectations have come down materially, they remain elevated and possibly vulnerable to upside inflation surprises."

BMO: Discouraging Enough To Keep Fed On Hold Longer Than Market Expects

- "The CPI report is not a game changer for the Fed, which is widely expected to remain on the sidelines at its next policy meeting at the end of the month. But the report also was not that comforting to a market that is looking for a first-quarter rate cut."
- "It is probably discouraging enough to keep the Fed on hold longer than the market currently expects. We need to see more capitulation in services and shelter inflation before we can sound the all clear on the inflation mandate."

BofA: Inflation Firmer Than Expected

- "The slightly stronger number reflected core coming in a few basis points above our expectations (0.31% versus 0.27%) and a larger increase in energy prices than we expected. That said, the report still suggests that inflation is cooling as core inflation on a three-month annualized rate edged down a tenth to 3.3% and the y/y rate fell below 4%. Moreover, some drivers of the strength this month, particularly used cars, should fade in coming months."
- "The ongoing divergence between goods and services inflation should keep the Fed from declaring victory on inflation. It likely cannot take much credit for the decline in goods inflation. Until we see further progress on services inflation, the Fed will likely be worried about upside risks to inflation.
- "That said, the overall progress towards the 2% target is undeniably encouraging and should allow the Fed to begin easing policy rates."
- "Overall, the report leaves us comfortable with our expectation for the Fed to cut rates by 25bp in March."
- "We estimate that core PCE inflation could come in at 0.12% -0.15% m/m in December. If core PCE were to come in at these levels, then the likelihood of the first cut in March would increase, in our view."

CIBC: Reinforces Our Call That Fed Will Hold Until 2H24

- "Today's report reinforces our call that the Fed will be hold until the second half of 2024. There continued to be progress on core inflation today, but a slower pace. The substantial progress on core inflation achieved in the second half of 2023 sets the Fed up to be less willing to tolerate a material slowing of the economy."
- "The stickiness in shelter costs supports our view that the Fed will not ease policy until 2H24, at least partly to prevent stoking the housing market. But it is also important to note that the weight of shelter in CPI is substantially higher (35%) than in the Fed's preferred inflation gauge PCE (15%)."
- "Over 2010-2019, core CPI inflation momentum was on average 0.3 percentage points higher than core PCE inflation momentum. Since April of 2023, this gap has widened to 1 percentage point."
- "Shelter inflation momentum (three-month annualized change) has been range bound between 5-6% since the summer. Our model of shelter inflation based on recent work by the SF Fed and Fannie Mae, shows in a dynamic simulation that shelter inflation should have gradually moderated since the summer and be running at about half the pace it is currently at given how rental and house price indices have evolved."

Citi: Still-Strong Services Prices

- "Core CPI has been rising by a roughly 3-4% annualized pace for five consecutive months, with similar dynamics underlying the details of monthly inflation data, including in December. Core goods prices remain on the softer side while services – both shelter and non-shelter services – remain consistently stronger."

- "Ultimately extreme weakness in goods prices in November was likely idiosyncratic and will not repeat consistently. While there are downside risks to some goods in January inflation data, we see factors such as flat to modestly rising core goods prices in PPI as evidence that much further disinflation in core goods prices is likely limited. One exception could be used car prices, where wholesale values still suggest falling prices into 2024."
- "We continue to expect a monthly range of OER around 0.35-0.50%MoM over the next 3-4 months and possibly beyond depending on the leading trend of new rents....core non-shelter services prices, while volatile, also remain persistently elevated."
- "Based on our preliminary tracking of core PCE inflation for December, we pencil in a 0.28%MoM increase. This includes a likely substantial increase in portfolio management fees and an average increase in medical services prices."
- "On the margin, still-strong details of inflation, which may be more evident in the release of December core PCE inflation just ahead of the January FOMC meeting, could limit how dovish Fed officials may reasonably be able to sound. We continue to think the March meeting is too soon for the first rate cut from the Fed."

Commerzbank: The Last Mile Gets Bumpier

- December's inflation readings were "slightly more than expected, but does little to change the gradual downward trend in inflation. What is important for the Federal Reserve is that the last mile in bringing inflation back to target appears to be more difficult.... It is still primarily services prices, which are strongly influenced by wage costs, that are rising relatively strongly."
- "We therefore feel confirmed in our assessment that the Fed will not cut interest rates in March, as the market expects, but only in May."

Credit Agricole: CPI Shows Last Mile May Be Difficult

- "While today’s report is not enough to prevent the Fed from easing later in the year, it does throw a bit of cold water on market pricing of a March cut."
- "Details were on the firmer side as well, with core goods breaking a string of six consecutive MoM declines and core services coming in a bit higher than we had expected. Core services less shelter, a key focus of the Fed, also remained relatively firm, and the YoY pace for this component has moved largely sideways since June."
- "For the Fed, there has been enough progress in the inflation fight to help drive a pivot towards a more dovish tone at the December FOMC. That said, the timing of the first cut remains uncertain, and inflation remains high enough that we continue to expect that market pricing of almost 140bp of easing in 2024 with a cut as soon as March is too aggressive, especially given the upside surprise in today’s report. Still, we acknowledge that risks are tilted towards an earlier start to the easing cycle than our current base case of July, though today’s report would not suggest that the Fed will be in a rush to cut."

Danske: Risks Of More Persistent Underlying Inflation In 2024-25

- "Core goods prices were unchanged, while services development was mixed.”
- “Housing and health care inflation accelerated but broader core services inflation cooled down, which is a positive signal for the Fed."
- "That said, the recent signs of easing financial conditions, uptick in wage sum growth and a rebound in housing markets could increase risks of more persistent underlying inflation in the US in 2024-2025."

Desjardins: Bringing Inflation To Heel Looks To Take Some Time, Cuts To Start Mid-2024

- "Bringing inflation to heel is looking like it will take longer to materialize than what was implied by some of the aggressive bets some traders placed late last year. We retain our call for the Fed to begin lowering rates around the middle of 2024, somewhat later than what the market currently has priced."

GS: Still Expect Three Consecutive 25bp Cuts Starting In March, Followed By Quarterly To 3.25-3.5%

- “The composition [of core CPI] was mixed, as shelter measures slowed meaningfully (rent +0.42% and OER +0.47%, mom sa) but medical services (+0.7%) and car insurance (+1.5%) prices accelerated. All three are persistent categories, though we believe the strength in the latter two reflects the final innings of catch-up to the post-pandemic cost environment—and are somewhat backward-looking as a result.”
- “We tentatively expect core PCE prices rose 0.20% in December (mom sa). We will update our estimate after tomorrow’s PPI data.”

- “The December CPI report did not have significant implications for the inflation outlook, and we continue to expect three consecutive 25bp cuts in the Fed funds rate in March, May, and June, followed by quarterly cuts to a terminal rate of 3.25-3.5%.”

HSBC: Supercore Reading May Reinforce Idea That Services Inflation Not Yet Consistent With Target

- “While reduced supply-demand imbalances in the auto sector have been a key part of the slowdown in core goods inflation (though vehicle prices increased in December), price trends have also slowed for some goods other than motor vehicles. The decline in core goods inflation has partly reflected disinflation in housing-related categories such as furniture and appliances. The disinflation in these areas partly reflects slowing demand, given the decline in home purchases over the past year.”
- “However, services inflation is proving to be stickier than goods inflation.” … “In a speech on 10 January, New York Fed President John Williams described core services as the "third layer" of inflation, something that has shown some disinflationary progress but not as much as the other two layers (globally traded commodities and core goods).”
- “Therefore, the latest core non-housing services CPI reading points to some stickiness and may reinforce the idea that services inflation has yet to fall to levels that would be consistent with overall inflation at the FOMC's 2% target.”

ING: Fed Will Prefer To Wait Until May To Cut

- “In the wake of the Federal Reserve's dovish shift in December, financial markets had moved to price an interest rate cut as soon as March.”
- “However, the tight jobs market and today's firmer-than-expected inflation numbers suggest this is unlikely, barring an economic or financial system shock.
- “This backdrop [with supercore posting another 0.4% M/M] remains too hot for the Fed to want to cut rates imminently, especially with the economy likely posting 2-2.5% GDP growth in the fourth quarter of last year and the labour market remaining as tight as it is.” “We continue to think the Fed will prefer to wait until May.”

JPM: Continue To Look For A First Cut At June Meeting

- “While core inflation is continuing to trend in the right direction, we don’t see the Fed in a rush to cut rates.”
- “With all the key data now in hand, it’s hard to see how the January FOMC meeting would result in guidance to ease at the subsequent meeting in March (as markets apparently still expect).”
- “Perhaps the Committee could soften the guidance toward a neutral bias, but that would be more consistent with easing further on in the year. We continue to look for a first cut at the June meeting.”

Mizuho: Stronger Than Expected

- "While the top-line numbers were a bit higher than estimates, the details of the report were even firmer, suggesting underlying inflation bottoming out near 3% rather than 2%. In particular, services inflation that continues to run hot should temper some of the dis-inflation enthusiasm in the market and at the Fed."

Morgan Stanley: Disinflation Ahead Will Be Gradual With Sticky Services Inflation

- Key drivers of December’s core figures: “Rent inflation is proving sticky as we expected, it only came down 3bp from last month upward surprise (0.46%M vs 0.49% in Nov)....less core goods deflation with positive apparel and car prices, increasing from a very weak print in November...high and sticky car insurance inflation that is likely to continue in 1H24...an upswing in airfares keeping public transportation elevated.”
- “This print is aligned with our view that disinflation ahead will be gradual with sticky services inflation. We think the Fed will start easing monetary policy in June this year.”
- “Incorporating inputs from CPI, we preliminarily forecast core PCE inflation increased 0.20%M in December vs. 0.06%M in November. New and used vehicles were a source of upside in core CPI, but hold a smaller weight in PCE than in CPI. Headline PCE is preliminarily forecasted at 0.20%M vs. -0.07%M in November. Core services ex housing translation points to 0.34%M in December vs. 0.12% prior."

Nomura: Supercore Service Prices Remain Sticky

- "Another decent increase in core CPI prices, uneven progress between core goods vs. supercore services, and a pick-up in underlying inflation measures reduces the possibility of a March rate cut, in our view."

- "In particular, sticky supercore components pose the risk of last mile inflation issues. Also, higher shipping costs due to renewed geopolitical risks and recent fluctuations in exchange rates increase uncertainty around the outlook for core goods prices."
- "Based on the relevant components of CPI and our assumptions for PPI data, our tracking estimate for m-o-m core PCE inflation for December now stands at 0.217% (or an annualized rate of 2.64%), up from 0.058% in November. Although core CPI inflation remains relatively elevated at 0.3% m-o-m, some strength in CPI such as medical care services does not feed into core PCE inflation. Moreover, the weights assigned to non-auto core goods prices are larger in the core PCE price index than core CPI, suggesting that core goods prices likely remain a drag on monthly core PCE inflation."
- "Taking all into account, we think that the Fed needs some time to assess the sustainability of the recent disinflation trend. We maintain our Fed call that a rate cut is unlikely to happen until June this year."

NWM: Recent Pace In Core Still Appears To Be Heading In Right Direction

- “We are reluctant to make too much of the upside surprise, as the monthly numbers are noisy and the trend is what really matters. The recent pace in the core still appears to be heading in the right direction.”
- “Three core services components that led the strength in the core services CPI in December—namely MVI, airfares and medical care services—will not feed into the core PCE deflator in December. The three measures together accounted for a tenth of the gain in the core CPI and will have no impact on the core PCE deflator since they are sourced from the PPI not CPI. Moreover, we expect price gains in many of these core services components to moderate over the course of the year.”
- NWM didn’t rethink their earlier 0.2% M/M estimate for core PCE due Jan 26.
- On the goods side, “It is probably worth noting that while recent developments in the Red Sea region and the subsequent increases in shipping costs pose some scope for upside risk to core goods prices, we expect the fallout on core inflation to be mostly contained.”

Pantheon: Wait For Core PCE Before Rushing To Inflation Judgment

- “These numbers don’t change the big picture. Core goods prices are flat or falling, rent gains are slowing but remain elevated, and core services inflation is still sticky. Note, though, that the Fed cares more about the core PCE than the core CPI, and the two numbers often diverge month-to-month.... it’s unlikely that the core PCE rose as much as the core CPI” in December.
- “The 1.0% increase in airfares looks odd given the plunge in fuel prices, but these data are wildly erratic and our immediate expectation for January is a reversal of this increase.”
- Re CPI rents vs Zillow numbers, “The recent overshoot in the CPI measure won’t last indefinitely, but we have no way of knowing when the two measures will re-converge.”
- “The trend in the auction numbers points clearly to further declines in the [used cars] CPI measure over the next few months as dealer margins re-compress after their unprecedented pandemic-driven surge.”
- “Overall core non-rent services prices rose 0.40%, in line with the recent trend. This measure of core services inflation fell sharply from mid-22 through mid-23 but has since stabilized. A combination of margin re-compression and slower wage growth likely will pull it down over the course of this year.”

RBC: Underlying Details Don't Alter Disinflation Narrative, First Cut In Q2

- "Bottom line: U.S. inflation readings surprised to the upside in December upon a larger than expected increase in some services components. Still, underlying details should do little to alter the narrative of easing inflation pressures in the U.S. - goods inflation ground to a halt by end of 2023, and the scope of price pressure was also left largely unchanged in December from already-narrow level a month ago."
- "The Fed in December made the first important step to signal that potential interest rate cuts are on the horizon. Still, the central bank is expected to stay on a cautious path, especially against a still solid consumer backdrop and persisting resilience in the labour market. We expect the first cut to the fed funds target range in Q2."

Scotiabank: Core Inflation Remains Hot, Key Will Be PCE

- “US core CPI confirmed expectations that underlying inflationary pressures in the US economy remain too hot for the Fed’s liking which leans against market pricing for a cut as soon as the March meeting. The underlying details reinforced this takeaway.”
- “Powell will retain a show-me-the-proof bias and until he gets convincing evidence that underlying inflation is settling in toward 2%. Until he sees such evidence that that it is staying there I just don’t think he’s going to seriously entertain cutting along the market’s timeline.”

- “The core PCE measure has been undershooting core CPI with 0.1% m/m SA prints in October and November. The Cleveland Fed’s ‘nowcast’ for core PCE suggests this could end with the December reading, although it can be off in either direction.”

SEB: No Dramatic Deviations But Fed To Wait Until May To Cut

- “US CPI inflation was a bit higher than expected in December but without any dramatic deviations from forecasts.”
- “The more important measure for the Fed, the core PCE, will be less affected by the key drivers in the CPI and may remain close to the target for the monthly changes. Still, the report supports our view that the Fed will wait until May before initiating rate cuts.”

TD: Semi-Charmed Print

- "The unrounded figure at 0.309% was much higher than our 0.14% projection, as we were looking for broad softness in the goods segment (particularly from used vehicles, which was likely postponed to January)...we expect housing inflation to continue trending lower in the months ahead, but the recent sticky price increases in rents may mean that the deceleration process might be more gradual than expected."
- [This] "report should remind market participants that the path toward inflation normalization is likely to be prolonged, with ups and downs along the way. In terms of policy, Fed officials will likely be inclined to stay patient as they continue to assess the likely near-term path for inflation. Barring a meaningful deterioration of the economy and labor market this quarter, the Committee won't be easing policy until they're certain inflation is on a clear and "sustainable" path toward the 2% objective. Today's report is unlikely to provide that certainty just yet."
- "We believe that the first cut will be in May and remain in SFRM4-M5 flatteners as we expect that the market will not price out the cuts that are currently priced in for March, but rather move them out to later meetings."

Wells Fargo: Neither a Gift nor Coal

- "The final CPI report of 2023 offered few surprises...we look for inflation to slow further over 2024 amid improved supply dynamics and more tepid demand from consumers."
- "A more balanced labor market with greater labor supply, less turnover and slower wage growth should also help reduce inflationary pressures this year. However, improvement is likely to be slower in the year ahead than over 2023. We look for headline CPI to slow to around 2.3% year-over-year by this time next year, with core CPI easing to a little under 3%."

Wrightson ICAP: Reinforces FOMC Member Views That Fed Should Wait For Confirmation Of Downtrend

- “This morning’s CPI report wasn’t terrible news from the Fed’s perspective, but it will reinforce the views of those FOMC members who think the Fed should wait for more confirmation of the downtrend in inflation before cutting rates.”
- “While the core was a bit firmer than we expected, the composition was not particularly alarming.”
- “This morning’s report had only a modest impact on our forecast for the PCE price index at the end of the month. We now think the overall PCE price index will round up to 0.3% rather than down to 0.2%. Our forecast for the core PCE price index remains at 0.3%, and our forecast for the year-over-year growth is still 3.0% for now. However, those estimates could change after tomorrow’s PPI report.”

MNI Policy Team Insights

MNI INTERVIEW: Fed To Ease Modestly In '24 -Ex NY Fed's Benigno

By Pedro Nicolaci da Costa (Jan 10, 2024)

(MNI) WASHINGTON - Federal Reserve officials will reduce interest rates several times this year – likely more than policymakers are letting on but not as many as the six cuts markets have priced in, former New York Fed economist Gianluca Benigno told MNI.

“It will probably be somewhere in between – three might not be enough cuts but maybe six is too many,” Benigno, who used to lead the New York Fed’s International Studies Department, said in an interview.

The market pivot to expectations of an imminent rate cut prompted by the dovish tone of the Fed’s December decision has made the central bank’s job more difficult, he said.

“Financial conditions have eased, which is a bit of a problem,” Benigno said. “My impression is they are trying to push back on March, but it’s a difficult call because market pricing is pretty aggressive.” (MNI INTERVIEW: Bullard Says March Is Too Early For Fed To Cut)

SOFT LANDING CUTS

The Fed will be cutting borrowing costs in order to keep pace with falling inflation, which he thinks could dip as low as 2.5% in the first half of 2024, rather than as a result of any economic downturn, he said.

“I don’t see a recessionary development given what we are currently seeing. I see a soft landing, further moderation in inflation and a consequent adjustment in real rates,” said Benigno, now a professor at the University of Lausanne.

“This is also helped by the fact that inflation expectations have come down further,” he said, pointing to an across-the-board decline in the latest New York Fed survey, which Benigno said has become more of a guidepost inside the central bank than other measures.

SURPRISED BY LACK OF R* ADJUSTMENT

Benigno said he was surprised policymakers did not pencil in a higher neutral rate of interest in their December projections, something that might have countered some of the dovishness in the rates portion of the SEP and Chair Powell’s press conference remarks.

“I was very surprised in the last policy meeting by the R* projection – that added a further dovish element,” he said. “There is some evidence that R* at least in the short run is actually higher. The economy is very resilient to interest rates because there is less exposure to interest rate movements, the fact that many have locked in mortgage rates very low for a long time makes it less sensitive to interest rates.”

One factor that makes it hard to envision the country slipping into recession is the sheer size of the fiscal impetus reflected in a budget deficit which hit USD1.7 trillion last year.

“It’s very hard to see a recession when you have such a big push to aggregate demand in terms of fiscal policy,” Benigno said.

The main risk to the outlook could be some sort of unforeseen financial crisis, Benigno said, which usually takes markets by surprise almost by definition. That’s one reason he believes the Fed will ultimately decide to renew its Bank Term Funding Program, created to address the regional banking turmoil in March 2023.

“That facility to me has been very important in addressing the financial vulnerabilities coming from higher interest rates. I don’t think they will eliminate it,” Benigno said.

MNI INTERVIEW: ISM Chief Sees Bumpy Start To 2024 For Services

By Evan Ryser (Jan 5, 2024)

(MNI) WASHINGTON - The vast U.S. services sector is set to sustain modest growth in coming months despite a surprisingly poor end to last year, with possible Federal Reserve rate cuts helping to stimulate demand later in the year, Institute for Supply Management chair Anthony Nieves told MNI Friday.

"I expect the PMI to still be probably in the low 50s next month, then the low to mid 50s, and then starting to pick up again towards the latter part of the second quarter," he said.

"This is a steady, incremental growth that we'll continue to see and and a little more growth in the latter part of 2024 than in the first half," adding that the prospect of Fed rate cuts could help stimulate demand. (See: MNI INTERVIEW: Fed Could Cut More Than SEP Anticipates)

Nieves sees a rebound in January and February with the index settling around the low 50s, after an unexpectedly sharp 2.1ppts drop in December to 50.6. He pointed to a similar decline a year ago in the December PMI that subsequently bounced to 55.2 in January: "I don't foresee it coming back as strong like it did last January because it was a big swing but we should increase."

December's softness was driven by a 7.4ppt plunge in the employment index to 43.3, its weakest reading since mid-2020, and a 2.7ppt slip in the new orders index to 52.8.

SLOWING JOB GROWTH

In stark contrast to the Labor Department's employment report released earlier Friday, the ISM employment sub-index cratered but Nieves pointed to holiday lulls.

"This is not just seasonality. Typically, companies just don't hire as much in December. You get that dead space from Thanksgiving to Christmas and even now things won't ramp up until probably next week," he said. "We're measuring directional change, and what the respondents are indicating is that they didn't bring on as many jobs as the month before."

"We'll see a pickup and activity will happen more toward the latter part of this month," Nieves said. "We're going to be back in the low 50s if not in January then probably February."

But employment growth is slowing and is expected to remain tame through the first half of the year, he said. Companies "had difficulty backfilling positions because they couldn't find the applicable worker, or they're controlling the variable expense."

"Labor does look flat. It's only forecast to go up 0.8% year over year. That's not strong at all," Nieves said. "People are trying to do more with less and that continues to be the trend."

MNI INTERVIEW: ISM Manufacturing Seen Contracting Until March

By Evan Ryser (Jan 3, 2024)

(MNI) WASHINGTON - U.S. manufacturing is likely to remain in contraction for several months but growth appears likely in the second quarter after the Federal Reserve signaled interest-rate cuts, survey chair Timothy Fiore told MNI Wednesday.

Three out of four respondents in December still indicated positive sentiment, Fiore said, even before the Fed's last meeting where it indicated three 25 basis point cuts by the end of this year. "The manufacturing community is saying they are going to be moving forward. They're not waiting for the sky to fall," he said.

The ISM manufacturing index rebounded slightly more than expected to 47.4 in December, also just above the trailing 12-month average of 47.1. The composition of the report was softer with a decline in the forward-looking new orders component.

FED PIVOT

The ISM new orders gauge fell 1.2 points to 47.1 in December. Fiore said he is expecting new order levels to surge starting in a few months.

"Given the situation with interest rates improving in 2024, what does that mean to our business? Anybody who supports capital equipment is going to build," Fiore said. "It's going to take a couple of months and then people are going to put in new plans with the current economic environment that shows a three step reduction in interest rates."

"That's going to open up the gates here on new orders and we're going to see that new order index come up," he said. "Things were already starting to get there on their own. The Fed cutting interest rates is just pure tailwind. I'm not going to say it's a gale force but it's pretty good tropical storm."

"Given things where they were without Fed acting and consistent with the forecasts, I would expect that the new order numbers are going to get into into the 50s by March but less than 55," Fiore said. "With interest rates coming down, we could be looking at something in the 55 to 60 range."

INFLATION RISK

The December ISM report also showed the prices subindex tumbling 4.7 points to 45.2, largely due to energy and reversing the jump the previous month.

Continued disinflation isn't a sure thing and market pricing of nearly 150 basis points of Fed cuts could be foiled, Fiore said. (See: MNI INTERVIEW: Bullard Says March Is Too Early For Fed To Cut)

"The biggest risk to 2024 is the return to unacceptable levels of inflation," he said. "If prices go up again, the Fed will withdraw those three rate reductions."

MNI INTERVIEW: Bullard Says March Is Too Early For Fed To Cut

By Pedro Nicolaci da Costa (Dec 19, 2023)

(MNI) WASHINGTON - Federal Reserve officials are likely to begin cutting interest rates around the middle of next year to ensure monetary policy does not tighten as inflation falls, though market bets on March cuts are overdone, former St. Louis Fed President James Bullard told MNI.

“On the idea of March as a possible timing for a rate cut, I think that’s probably premature,” Bullard said on MNI’s FedSpeak Podcast.

“I just don’t think there will be enough information at hand to really make that kind of a decision because once you move you’re going to be very reluctant to go back in the other direction. So you probably want inflation to come down precipitously even from where it is today, certainly with a two-handle, maybe even two-and-a-half, is where you’d want to be when you start this process.”

The Fed’s preferred PCE inflation measure rose 3% in the 12 months to October and was up 3.5% excluding food and energy.

A strong economy that appears on track for a soft landing, where employment growth remains fairly robust as inflation eases, gives the Fed a cushion before it needs to reduce borrowing costs, Bullard said.

“You might as well just wait for good news to continue to come in on inflation and make sure you have a bird in hand before you start to cut the policy rate. That would argue for something later in the year,” he said. (See MNI INTERVIEW: Fed Could Cut When Core PCE Reaches Around 2.8%)

THREE RATE CUTS

Some rate cuts will be necessary over the coming year to prevent monetary conditions from becoming tighter as inflation declines. “You wouldn’t need the policy rate to be nearly as high with inflation coming down closer to 2%,” Bullard said.

He thinks an ebullient market reaction to the Fed’s dovish message last week is understandable, but also believes market pricing of as many as six rate cuts in 2024 is excessive.

“The three projected by the committee is about right for a soft landing,” he said. “Sometimes markets get carried away in various dimensions but the general story is a very positive one.” (See: MNI FED WATCH: Interest Rate Cuts Begin To Come Into View)

Speculation that an election year will force the Fed to move sooner rather than later is also misguided, he said.

“I don’t think that the politics really affects any decision making. I really never noticed it around the table,” said Bullard, now Dean of Purdue University’s Daniels Business School.

LINGERING INFLATION RISK

Investors could be underestimating the possibility that disinflation stalls or reverses, Bullard said, adding he sees about a 30% risk of such an outcome.

“That leaves a 70% chance that it will continue to decline, which is great, but that 30% is not being priced into markets and I don’t think markets are being careful enough,” he said. “There should be some measure of caution about policy not turning the corner too fast.”

The biggest challenge for the FOMC would be a resurgence of inflation that brings up the “specter of the 1970s” and forces a fresh reassessment of the policy stance.

Back then, the committee pulled back too quickly and inflation resurfaced and took a long time to extinguish.

“It took another eight years to get inflation back to normal. You don’t want to get into that scenario.”

Still, Bullard said getting inflation all the way back to 2% from current levels should not be especially difficult: “I don’t think there’s any evidence that the last part is harder.”

MNI INTERVIEW: Fed Could Cut More Than SEP Anticipates-Evans

By Pedro Nicolaci da Costa (Dec 15, 2023)

(MNI) WASHINGTON - The Federal Reserve might need to cut interest rates by more than officials indicated this week in the December SEP because holding steady amid further expected drops in inflation would make policy more restrictive, former Chicago Fed President Charles Evans told MNI.

“As you think about next year, the setting of monetary policy is well into restrictive territory, and with inflation improving, the SEP foreseeing core PCE at the end of next year at 2.4%,” Evans said in an interview Friday. "That’s tremendous progress."

"That means that any fixed setting of the nominal funds rate is going to get more and more restrictive if you don’t make adjustments," said Evans, who led the Chicago Fed from 2007 until his retirement earlier this year.

The FOMC left interest rates on hold for a third consecutive meeting this week and the median official penciled in 75 basis points of cuts for 2024. Markets are more ebullient about the prospect for looser policy, rallying across assets as investors price in as many as six cuts.

“It’s not surprising that the first take on rate cuts this close to 2024 is only three and then when you get to next December it could be that they do much, much more,” he said. (See: MNI INTERVIEW: Fed Could Cut Rates As Early As March-Hoenig)

TAYLOR RULES

The Fed expects inflation to improve by around a full percentage point between now and the end of next year, Evans noted.

“That’s worth a lot in terms of rate cuts according to most Taylor rules. That’s why I think markets are pricing in scope for further rate cuts,” he said. “There are plans and then there’s reality.” (See: MNI INTERVIEW: Five Fed Cuts In 2024 Are 'Plausible'-Wilcox)

He said a median SEP of three cuts would simply maintain a quite restrictive setting even as the economy softens.

“It takes more rate cuts along the lines of what’s priced in markets right now in order to move that down a little bit more towards neutral,” he said.

Even so, reducing nominal rates in order to keep real rates more or less constant could still result in a more tentative pace of rate cuts than past monetary easings that came with more weakness in the economy.

“Relative to past cycles it would be much more measured because past cycles are almost always a reaction to a deteriorating economic outlook,” he said.

This scenario today assumes the economy remains fairly robust and unemployment does not rise significantly, as the Fed SEP implies.

“I have pretty decent confidence that the economy is going to continue to be reasonably good,” Evans said. “There seems to be a lot of resilience in the economy.”

GETTING CLOSER

One key matter of debate is just how close to 2% the Fed needs to get. “They’re always going to be worried about getting inflation all the way to 2% even when a lot of other people in markets are saying 2.5% looks pretty good,” he said.

“Tensions are probably going to be in the last mile and how much confidence they have then. They have more confidence that the worst of the inflation is indeed behind us and we’re probably headed to below 3% PCE inflation before too long.”

Evans said adopting a higher inflation target could be beneficial in theory but unlikely in practice because central bankers tend to be conservative about making major shifts.

“If you were starting fresh, and you didn’t have all the restrictions all other central banks are at 2% and you understood the limitations of the zero lower bound, you could certainly support 3 or even 4% really,” he said. “If you always hit 3% steady year after year, wages would reflect that, interest rates would reflect that. It’s really the volatility that really hurts everyone.”

MNI INTERVIEW: Fed Could Cut Rates As Early As March-Hoenig

By Pedro Nicolaci da Costa (Dec 15, 2023)

(MNI) WASHINGTON - The Federal Reserve could cut interest rates in the next few months if inflation continues to fall, former Kansas City Fed President Thomas Hoenig told MNI, adding that the central bank’s pivot is premature and risks undermining progress in reducing price pressures.

“If inflation comes down, March is not out of the realm of possibility at all. If it doesn’t come down further they may postpone it,” Hoenig said in an interview. Chair Powell not only refrained from pushing back against dovish market expectations this week but if anything embraced them, implying that the Fed may not be cautious in the way it reduces borrowing costs despite recent high inflation, he said.

“I might have believed that if they’d had a stronger pushback at this meeting,” Hoenig said. (See MNI INTERVIEW: Five Fed Cuts In 2024 Are 'Plausible'-Wilcox)

SETTING EXPECTATIONS

“They’ve set that expectation, and one thing they don’t like to do is upset expectations.”

Markets rushed to price in six rate cuts for 2024 after the overwhelmingly dovish message from the Fed’s forecasts as well as Chair Powell’s remarks at the press conference, in which he said he’s all too cognizant of the risk of waiting too long to reduce rates.

The central bank is “anxious” to reverse course on monetary policy after an aggressive tightening cycle that saw rates rise 525 basis points, because it worries that waiting too long will push the economy needlessly into recession, Hoenig said. “What they’re doing is confirming their shift from 2% as the goal to 2% and no recession as the goal – that broadens the scope of the goal,” he said.

Yet Hoenig worries the FOMC's change of tune, which led to risk rallies in financial markets around the world, is a risky gambit that could threaten some of the improvement seen on inflation.

“If they had CPI inflation down to 2.5% and shown continuous declines, I would have agreed with that. But inflation has been 3% for months, core inflation has been 4% or higher for three months,” he said.

CPI rose 3.1% in the year to November while core prices were up 4.0%, the Labor Department reported this week.

LAST MILE

“The last mile of getting inflation down to 2% is a long one,” Hoenig said, noting that house prices have continued to rise despite the sharp increase in rates and that wages could be sticky following union negotiations that led to substantial gains for workers. “Policy really hasn’t tightened since May. Wages stopped coming down in August.”

Hoenig is still skeptical of a soft landing that looks too good to be true.

“From the time the Fed stopped raising rates in 2006 – it was two years until Lehman,” he said. (See MNI INTERVIEW: U.S. Demand Still Too Hot For Soft Landing)

Fed officials will also have to cut short plans to reduce the balance sheet at some point this year because the budget deficit is getting too large for the central bank to continue withdrawing bonds from the market at a rapid clip, Hoenig said.

“Watching the reverse repo balances tells you (the timing). When those go away somebody has to fund the debt,” he said.