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TRENDMACRO LIVE!

On November CPI – Inflation Definitively Peaks

Tuesday, December 13, 2022

Donald Luskin

Will Powell accept the good news? It doesn't matter. He's already pledged to slow down.

With this morning's November Consumer Price Index report, the good news is in – at least if you like deflation. As we've been expecting (see, among many, "Or How I Learned To Love September CPI" October 13, 2022), headline CPI excluding owners' equivalent rent fell 0.17% on the month (2.0% annualized), and core CPI ex-OER fell 0.07% (0.80% annualized – see "Data Insights: CPI/PPI" December 13, 2022). Fed Chair Jerome Powell himself told us to look through laggy OER (see "On Powell at Brookings" November 30, 2022). So now *all that remains is to see tomorrow, at the conclusion of the December FOMC, the extent to which Powell follows the data* and his own analysis. One can never be too confident about that, can one?

At the November FOMC, *Powell warned that the terminal funds rate would be higher than expected* (see "On the November FOMC" November 2, 2022). That warning was repeated in the FOMC minutes (see "Data Insights: FOMC Minutes" November 23, 2022), and in Powell's speech at Brookings two weeks ago (again, "On Powell at Brookings"). Except for a little bit for a few days right after the FOMC meeting, *markets have never believed it* – and after today's CPI, they definitely don't believe it. The money-market curve confirms what we've been saying – after tomorrow, there's probably just going to be two more small hikes, maybe just one (that's what we're betting, at most – please see the chart below).

- *Markets know the dots are trash*. Fine. Let tomorrow's Summary of

Update to strategic view

US MACRO, FEDERAL RESERVE: Excluding OER, both headline and core CPI were negative for the month of November. Now all major ways of measuring inflation, with or without OER, have definitively peaked. It makes sense analytically to remove OER because it is so laggy. Higher-frequency data on rents of houses have clearly rolled over. With the Powell Fed, we can have little confidence that they will allow this to change their narrative or actions at tomorrow's FOMC. The SEP may well raise the funds rate "dot" for 2023, as Powell has warned. But the dots are worthless …

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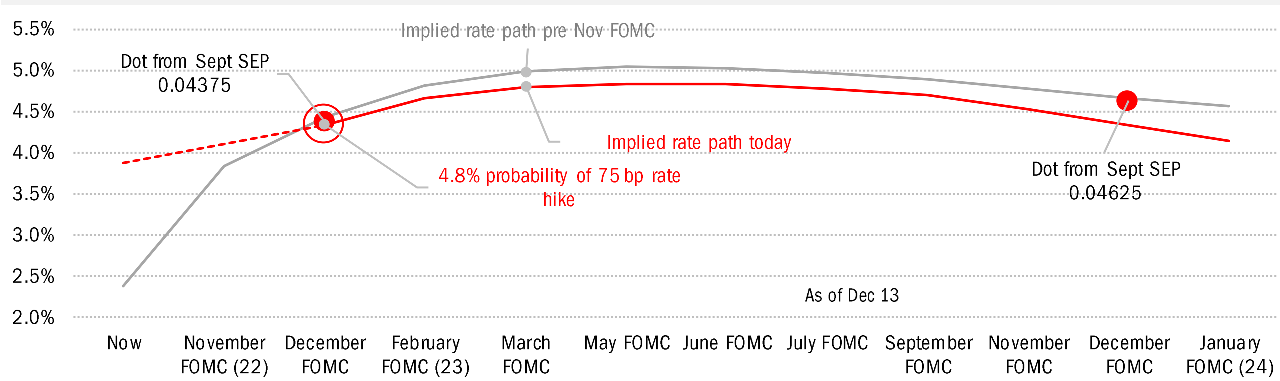
Futures-implied funds rate by FOMC meeting



Source: TrendMacro calculations

Economic Projections raise the dot for year-end 2023. Who cares? At [*last* December's SEP]() (see ["Data Insights: FOMC"]() December 15, 2021) the median dot for year-end 2022 was just 0.88%. It's just a prediction. A fantasy.

- *What's real is that, as of the November FOMC, the Fed has committed to taking more cognizance of the long lags between monetary policy and macroeconomic outcomes. At Brookings, Powell made it crystal clear that this means that the furious pace of rate hikes would slow down. [Just as in Aesop's fable](), the hare – so far out ahead of the tortoise – has slowed down. That buys a gift of time for the tortoise – gradually moderating inflation – to keep plodding along and get over the finish line first.*

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… forecasts, as history has shown. More important is the slowing pace of rate hikes that give the gift of time for inflation to keep moderating before the Fed can cause an unnecessary recession.

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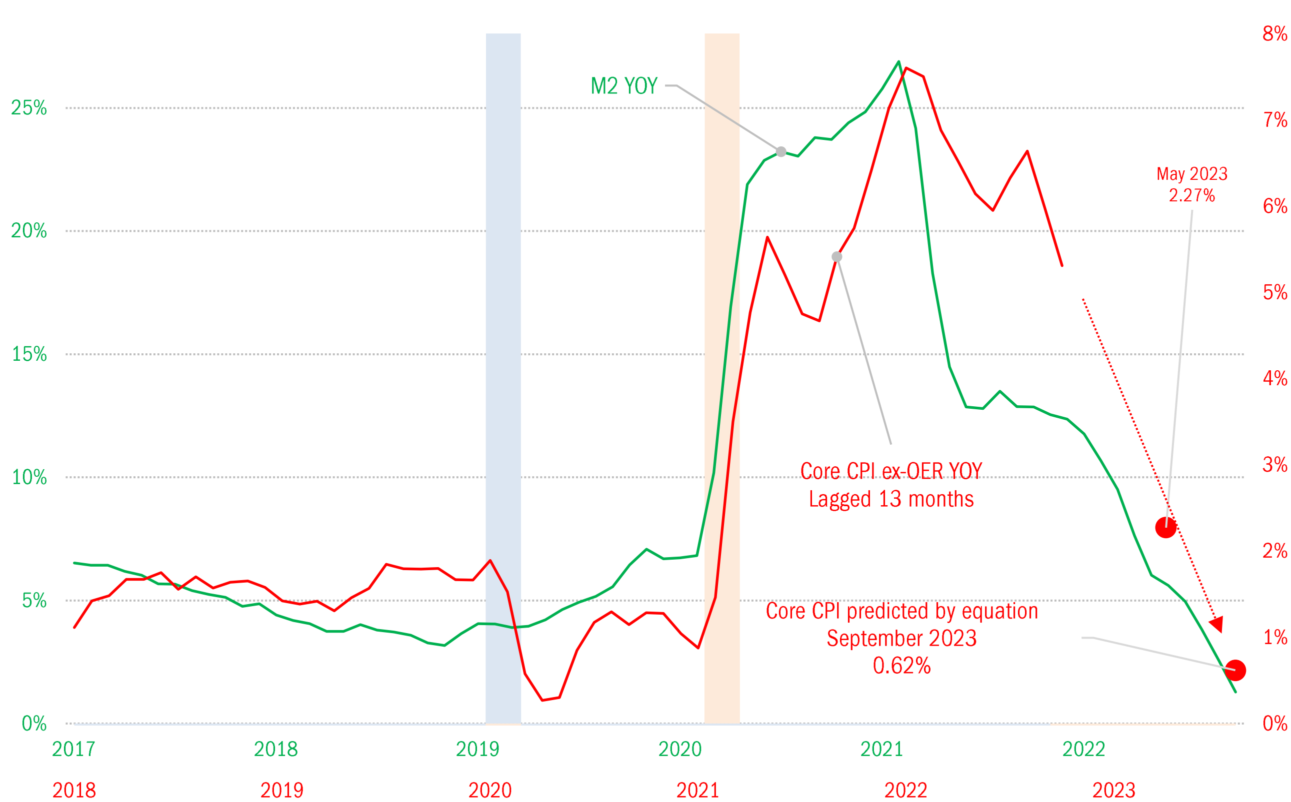
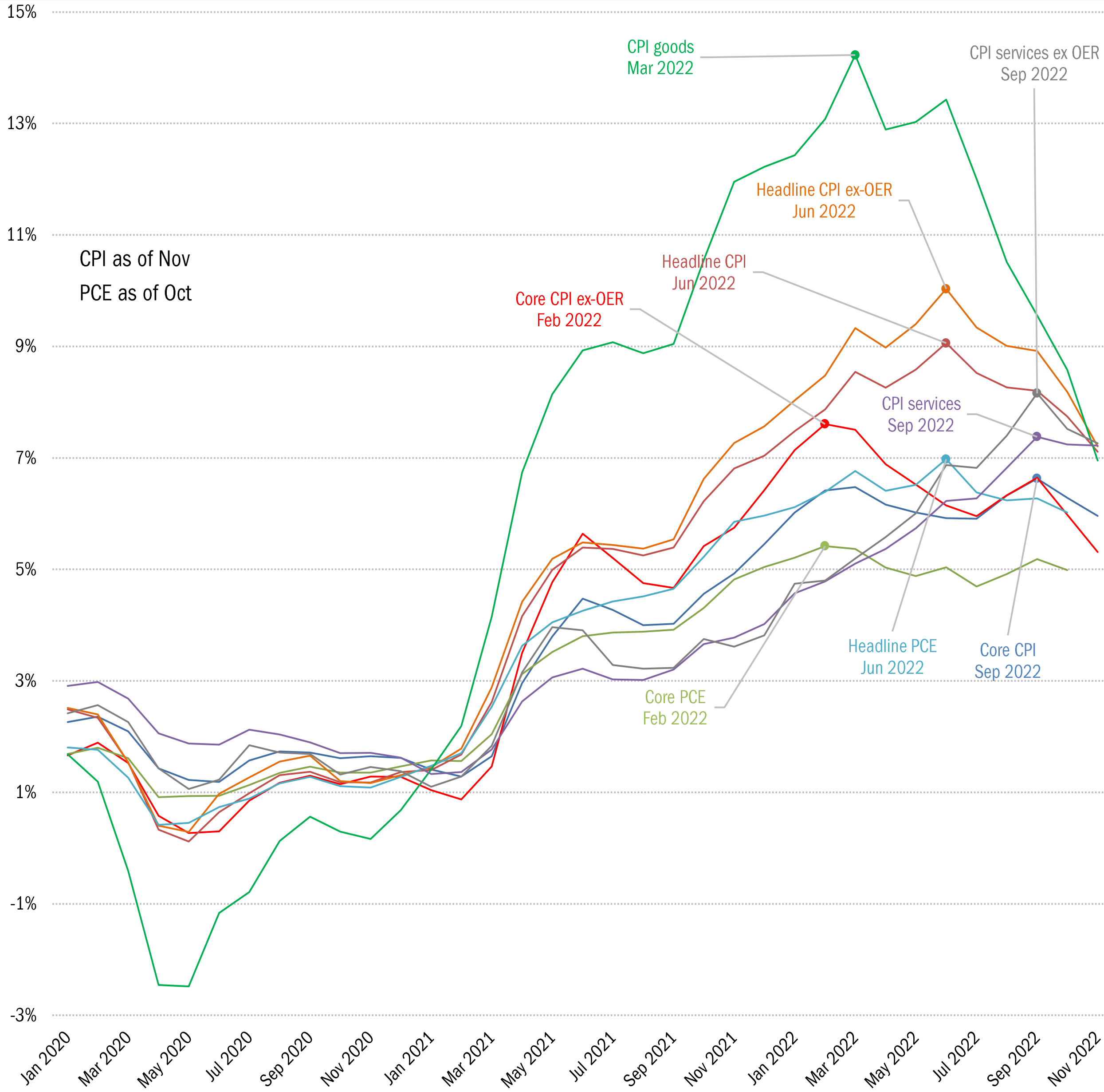
For us, moderating inflation is a matter of predetermination. It was driven as night follows day by the history-making surge in the growth of the money supply, powered by $6 trillion in concentrated stimulus spending. The spending has stopped, and money supply growth has stopped, too. Because of that fiscal dynamic, inflation was inevitable, and now its moderation is just as inevitable (please see the chart below page, and ["Why Inflation Is on the Way Down"]() July 25, 2022). *It would have made no difference whether or not the Fed executed its series of high-magnitude high-velocity rate hikes. That may yet trigger a recession – we don't think it will, but we are positive it will have nothing to do with inflationary*

Monetarist model: inflation forecast based on M2 growth



Source: BLS, NBER, FRB, TrendMacro calculations

Inflation measures, year-on-year change ● Peak month



Source: BLS, BEA, TrendMacro calculations

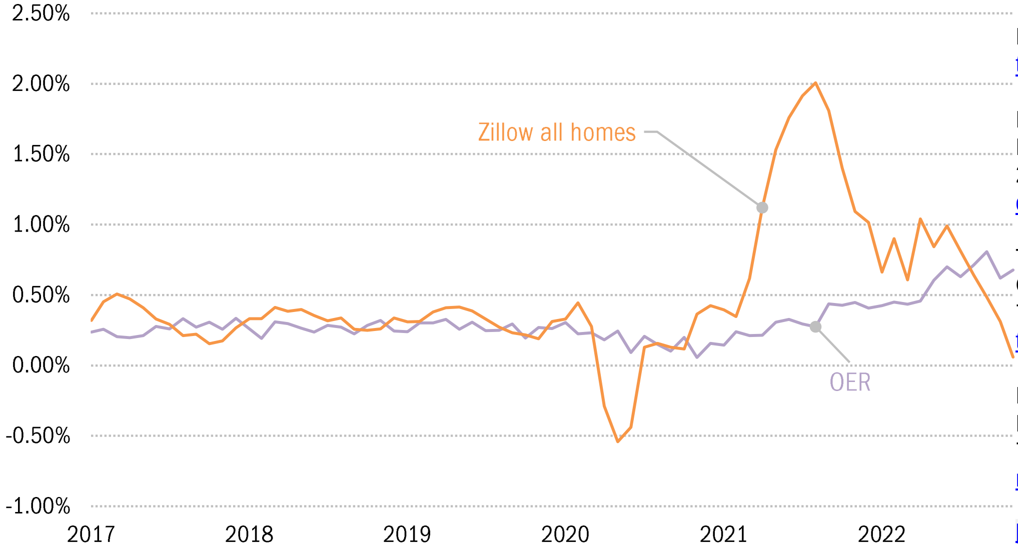
<u>*outcomes, which were on predetermined rails before the Fed even lifted off from a zero policy rate last March*</u>.

<u>*No matter how you measure it now (and there are lots of ways – please see the chart above), inflation has visibly peaked*</u>. Depending on the measure, the peak was as early as January or as recent as September. But the measures are unanimous.

We are comfortable leaving owners' equivalent rent out, by the way. We want to get at the "signal" of inflation, not the "noise" – so we are happy to throw out the too-volatile stuff (like gasoline) and the not-volatile-enough stuff (like OER). Furthermore, less laggy indications of home rent than

OER have aggressively rolled over anyway (please see the chart below). But all that aside, OER or no OER, all the inflation measures have peaked.

Monthly changes in rent of homes



Source: Zillow, BLS TrendMacro calculations

- Yet that's only to say that the tortoise of moderating inflation is on the track. It's not saying the tortoise is moving fast enough to win. Ideally, we would like it to speed up – if for no other reason than because inflation is bad, and we'd like to be rid of it as soon as possible.
- Powell, and many modern Fed observers, think another reason to wish the tortoise could move faster is because, if inflation lingers too long, consumers will build it into expectations. If that happens, then – the story goes – inflation will be a self-fulfilling prophecy as consumers bring forward their purchases in time in order to get ahead of it (thus causing it).
- A moment's thought should expose the logical weakness in that very prevalent narrative. Suppose high gasoline prices lead consumers to expect higher gasoline prices. It's not like they can fill up their gas-tanks twice.
- Even at that, after they've filled up once at the higher prices, they have less money left over for whatever else they want to buy more of.
- As Milton Friedman said, inflation is "always and everywhere a monetary phenomenon." If you don't have extra money – that is to say, if your pandemic stimulus checks have stopped – then you have no way to act on your expectations, no matter how aggressive they may be.
- So we're not worried that the frustratingly slow pace of moderating inflation contains the seeds of its own defeat.
- No, the issue here is the hare – the Fed. The Fed can move as fast as it wants. It can create a recession if it wants – but whatever

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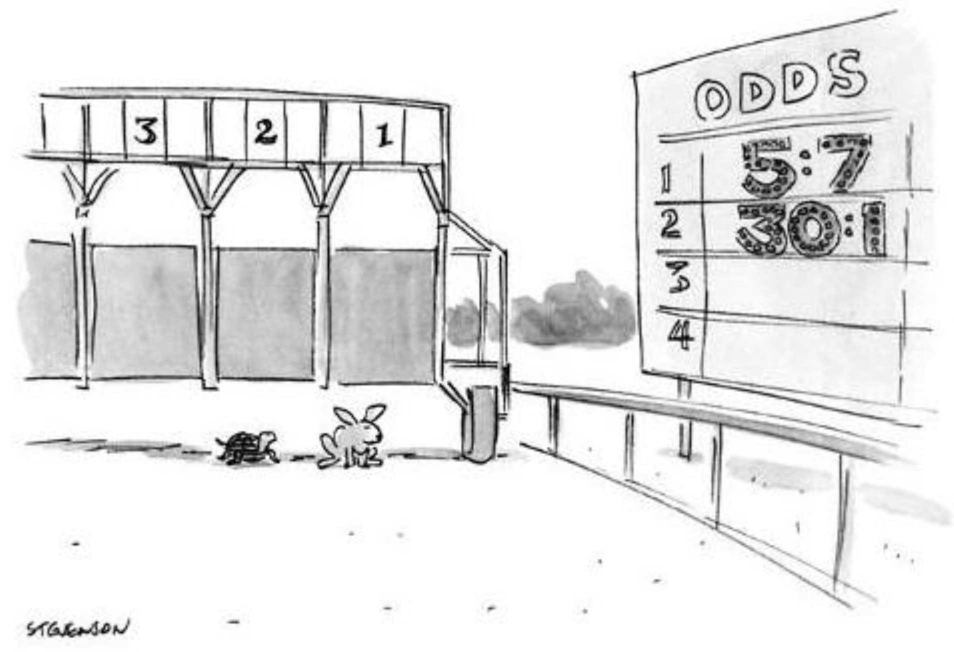
[About us]

speed it moves, at this point it will have no effect on moderating inflation. That’s baked in the cake.

- So the very good news is that the hare has slowed down, just like in the fable.
- We think we’ll survive this mess. No hard landing. No soft landing. No landing at all. Or you insist on labeling the outcome a landing of some kind, how about a happy landing?

Markets in everything



Source: *The New* Yorker, collection of Donald Luskin

Bottom line

Excluding OER, both headline and core CPI were negative for the month of November. Now all major ways of measuring inflation, with or without OER, have definitively peaked. It makes sense analytically to remove OER because it is so laggy. Higher-frequency data on rents of houses have clearly rolled over. With the Powell Fed, we can have little confidence that they will allow this to change their narrative or actions at tomorrow’s FOMC. The SEP may well raise the funds rate “dot” for 2023, as Powell has warned. But the dots are worthless forecasts, as history has shown. More important is the slowing pace of rate hikes that give the gift of time for inflation to keep moderating before the Fed can cause an unnecessary recession.