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TRENDMACRO LIVE!

# A Bad Month for Gasoline Won't Fuel the Fed

Wednesday, September 13, 2023

**Donald Luskin**

**They already knew about it when they made all those dovish remarks. Hiking cycle over.**

The August Consumer Price Index reported this morning at 0.60% for the month, or 7.84% at an annual rate. *Gasoline alone contributed 0.34%, with national retail prices having risen about 7% over the month. The elimination of that one item out of hundreds would have put August at 3.17% at an annual rate, just 0.67% from the Fed's CPI target* (see "Data Insights: CPI/PPI" September 13, 2023).

Despite a rough August, headline inflation year-on-year is now at 3.67%, up from 3.18% in July – both because August was a bad month, and

**Update to strategic view**

**US MACRO, FEDERAL RESERVE:** One item out of hundreds – gasoline – explains the whole August bump in headline CPI…

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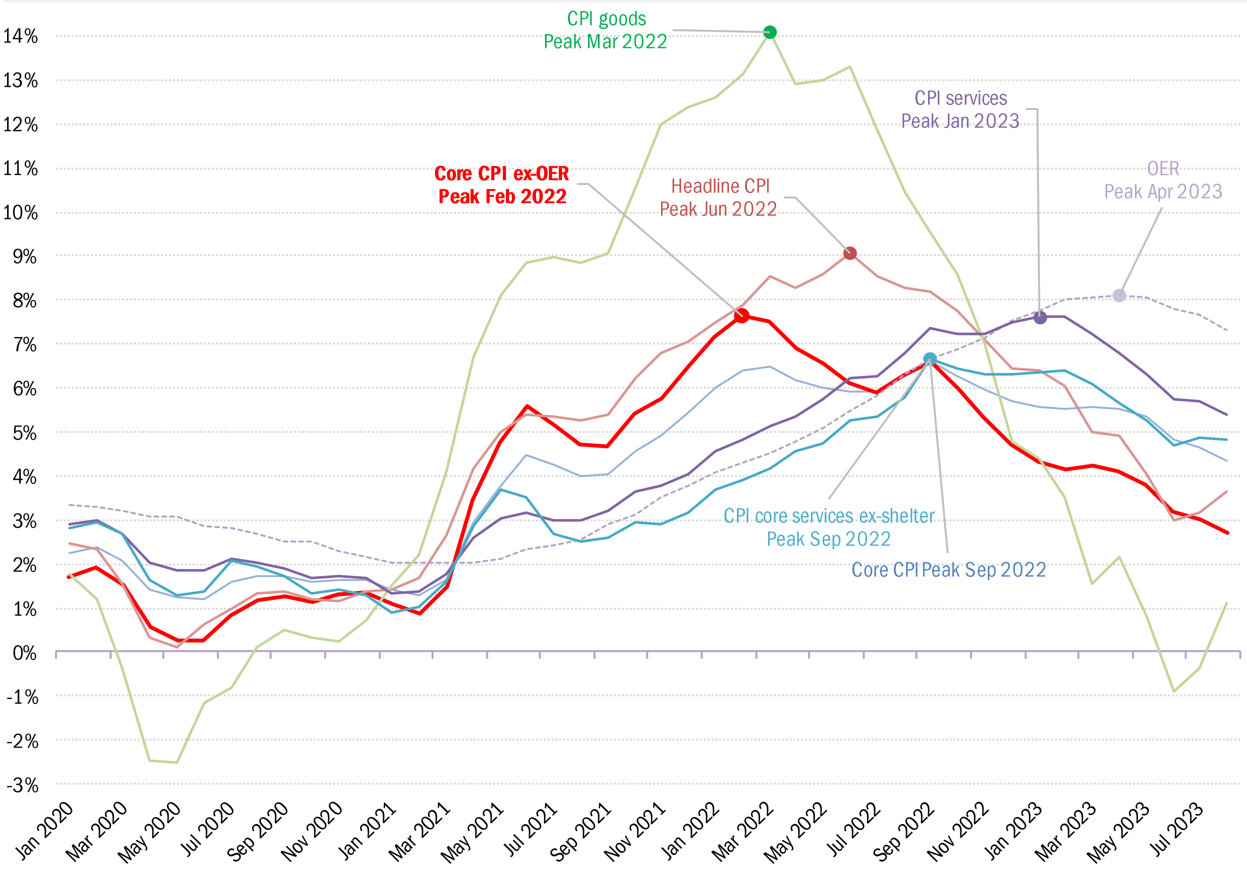
Consumer Price Index, year-on-year




Source: BLS, TrendMacro calculations

because the prior August rolling off was a very good month, at just 0.10%. *All that said, starting from the peak of 9.06% in June of last year, headline CPI is now 82% of the way back to the Fed's target.*

- All this is completely in line with consensus expectations. Indeed, as of this writing, market implied expectations for the Fed policy path have eased somewhat despite hot headline data, with the 2-year Treasury yield falling by 2.1 bp from yesterday (please see the chart below).

Our favorite measure of inflation is core CPI excluding owners' equivalent rent (we don't want gasoline to add volatility to the underlying inflation signal, nor home rentals to suppress the signal). It came in at 0.22% for the month, or 2.63% at an annual rate – basically the Fed's target. It's now at 2.69% year-on-year. *As far as we're concerned, it's mission accomplished on restoring inflation to target – and the risk now is that the lagged effects of all the Fed has done will lead straight away to outright*

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… Despite it, from peak in June 2022, it is now 82% of the way back to the Fed's target. Our preferred measure, core excluding OER, is virtually all the way back to target already – mission accomplished, and now comes deflation thanks to the lagged effects of all the Fed has done. At Jackson Hole Powell said headline can be "misleading," and that he will focus on core. Last week Waller said there is nothing driving…

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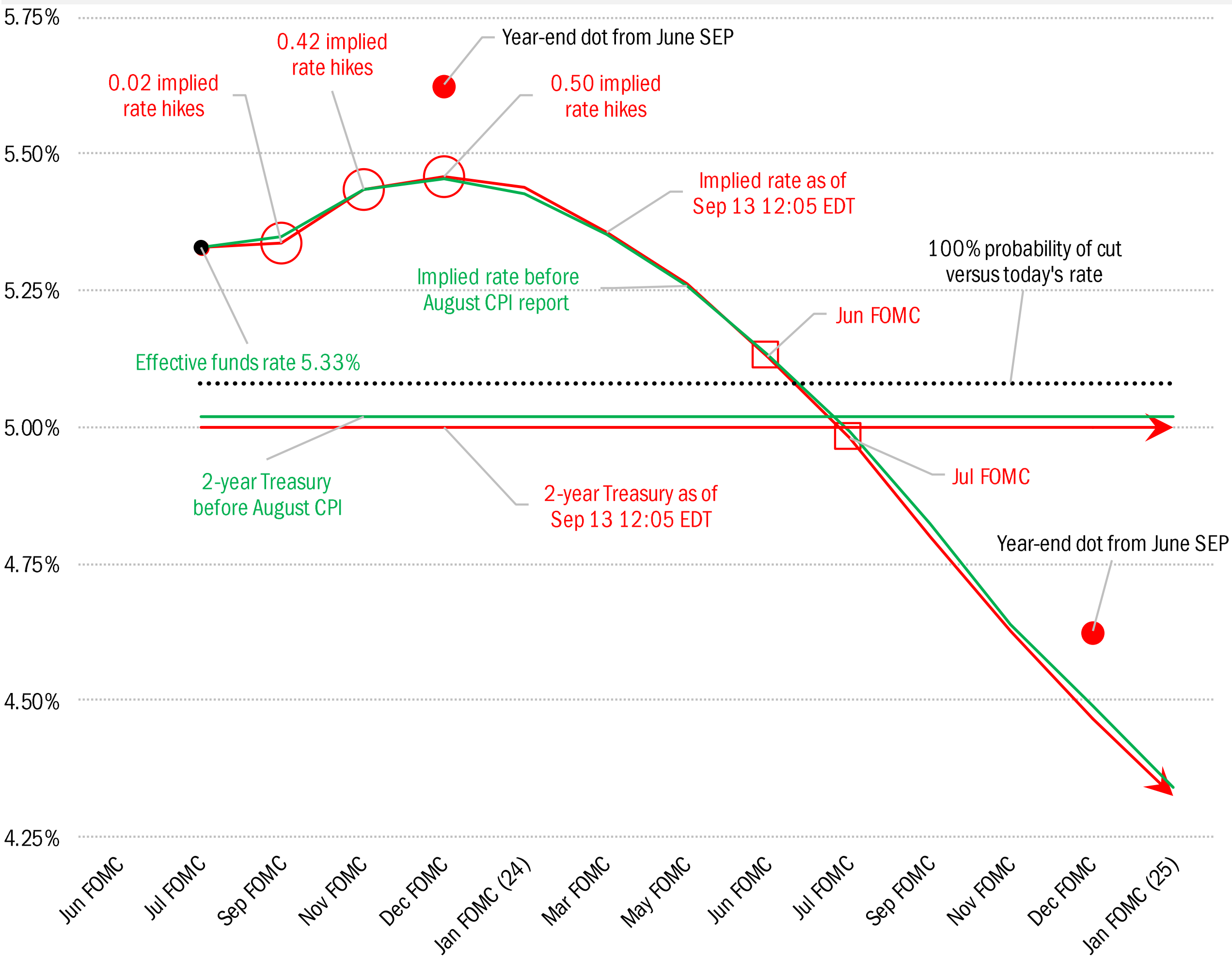
**Futures-implied fed funds rate path, by FOMC meeting**




Source: Bloomberg, TrendMacro calculations *deflation* (see, originally, "Surprises of 2023 Volume 1: From Inflation to Deflation" January 3, 2023).

- *But what matters is what Jay Powell thinks.* In his Jackson Hole speech two weeks ago, he said:

  *"Headline inflation is what households and businesses experience most directly… But food and energy prices are influenced by global factors that remain volatile, and can provide a misleading signal of where inflation is headed. In my remaining comments, I will focus on core…inflation, which omits the food and energy components."*

- Okay, then. Core CPI – the standard measure of core, which leaves in OER – reported this morning at 0.28% for the month, or 3.39% at an annual rate, just 0.89% above the Fed's target. It's now at 4.35% year-on-year, down from 4.65% in July (because the prior-year August rolling off was 0.44%).
- We can't read his mind (see "Video: TrendMacro conversation with Scott Adams" September 6, 2023), and he does not have a good record of intellectual consistency. But he did change the name of that speech, at the last minute, to "Inflation: Progress and the Path Ahead" (see "On Powell at Jackson Hole" August 25, 2023). And *this morning's data shows more "progress" in the dimension he said he favors, while the regress was in the dimension he calls "misleading."*
- And we note with special interest the remarks last week by Governor Chistopher Waller – who has been the most consistent among the governors for his relentlessly hawkish stance. He said in a CNBC interview:

  *"There is nothing that is saying we need to do anything imminent anytime soon…We can just sit there and wait for the data."*

- When he said that, the spike in gasoline prices in August was already in the bag. Waller knew about it and was choosing to ignore it. *That is a sea-change for the most hawkish influence in Powell's inner circle – it marks the first time he hasn't seized on any excuse to argue for tighter policy.*

Surely there will be no rate hike at next week's September FOMC. Markets are completely ruling it out. Markets give only a 50% implied cumulative probability for a hike any time through the December FOMC (again, please see the chart on the previous page). *So the critical thing for next week's FOMC is, first, where the Summary of Economic Projections puts the "dot plot" for December 2023 – is this hiking cycle already over, or one more to go?*

- *It's a tough call to set the December funds rate in September, which is what this amounts to, and still claim that you are "data dependent." We think the institutionally simplest course is to lower the dot to the current funds rate of 5-3/8% in harmony with the*

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… "imminent" action – even though, when he said it, he could see the August spike in gasoline prices. There will be no hike at next week's FOMC, and the year-end "dot plot" will be lowered to 5-3/8%, signaling this hiking cycle is over. The 2024 "dot plot" will be left unchanged at 4-5/8% to signal continued vigilance. But all that will be thrown out when outright deflation emerges early next year.

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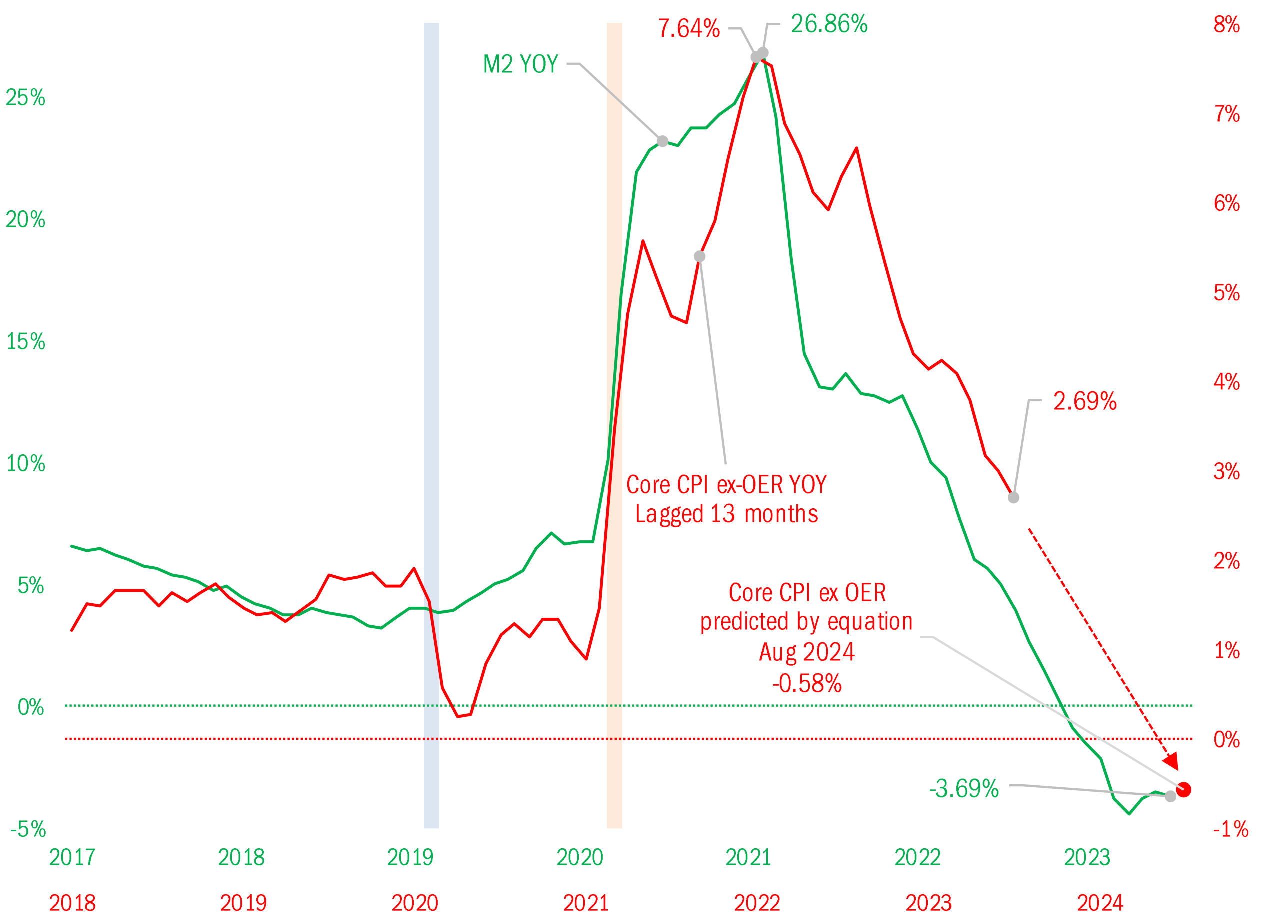
*recent remarks about "progress," and say that it can always be hiked one more time if necessary.*

- *But this Fed likes to keep markets on edge – almost as though it believes that cautious expectations will themselves somehow keep inflation in check. So we think it unlikely that the SEP will lower the December 2024 "dot plot" at all – leaving it at 4-5/8%. This will signal that rate cuts will come in 2024, but that's a signal already given at the last SEP in June* (see "On the June FOMC" June 14, 2023). *What will be new by leaving that "dot plot" unchanged will be the affirmation that while this tightening cycle is over slightly sooner than expected in terms of the peak level for the funds rate, nothing is changing the Fed's outlook for how long rates that it admits now are "restrictive" will be maintained.*
- Of course, with the money-supply in the first year-on-year contraction in the history of the data, we will be in outright deflation early next year (please see the chart below, and "Why Inflation Is on the Way Down" July 25, 2022) – and that unchanged "dot plot" will suddenly seem laughably conservative.

**Monetarist model relating M2 growth and inflation lagged 13 months**




Source: Bloomberg, TrendMacro calculations

## Bottom line

One item out of hundreds – gasoline – explains the whole August bump in headline CPI. Despite it, from peak in June 2022, it is now 82% of the way back to the Fed's target. Our preferred measure, core excluding OER, is virtually all the way back to target already – mission accomplished, and now comes deflation thanks to the lagged effects of all the Fed has done. At Jackson Hole Powell said headline can be "misleading," and that he will focus on core. Last week Waller said there is nothing driving "imminent" action – even though, when he said it, he could see the August spike in gasoline prices. There will be no hike at next week's FOMC, and the year-end "dot plot" will be lowered to 5-3/8%, signaling this hiking cycle is over. The 2024 "dot plot" will be left unchanged at 4-5/8% to signal continued vigilance. But all that will be thrown out when outright deflation emerges early next year.

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