Trend Macrolytics, LLC
Donald Luskin, Chief Investment Officer
Thomas Demas, Managing Director
Michael Warren, Energy Strategist

MACROCOSM

Celebrate Victory Over Inflation, Even if the Fed Doesn't

Tuesday, November 14, 2023
Donald Luskin

Curing the economic cancer of inflation is an end in itself. The Fed will catch on soon enough.

We had to confess that our prediction for a blow-off top this year in US equities didn't exactly come true, to put it mildly, with an almost 11% correction in the S&P 500 from the July highs (see "That Quarter, Those Yields, This Correction" October 27, 2023). At least we took that opportunity to call the bottom of it, and at the moment that appears to have been perfect to the very day, with the S&P 500 up almost 10% as of this writing.

- Our call for a run for the roses in US equities was based on our forecast that inflation would completely subside; that there would be no recession, not even a soft landing; *and that the Fed would take a prideful victory lap that would ignite triumphalism in markets*.
- Check. Check. And, uh, *very much not check on that all-important last point*.
- To be sure, we noted that the November FOMC statement contained small but critical language changes pointing definitively –

Generative AI token: "The consensus was expecting very little inflation. We got even less."

Source: DreamStudio running SDXL 1.0

Update to strategic view

US MACRO, FEDERAL RESERVE: This morning's beats in headline and core CPI are the first of what will be two great pieces of inflation news before the FOMC meets in December. Without OER, both headline and core are already below the Fed's targets. There will be no more rate hikes. Outright deflation will start to manifest in Q1-2024 in indices excluding OER, and in Q2-2024 in all of them. The Fed's aggressive hiking has little to do with the monetary roots of the rapid relief from this inflation cycle. Its very rapidity has supported growth despite the Fed. Now with inflation visibly conquered and deflation soon to emerge, the first rate cut should come in March. We continue to call for no recession.

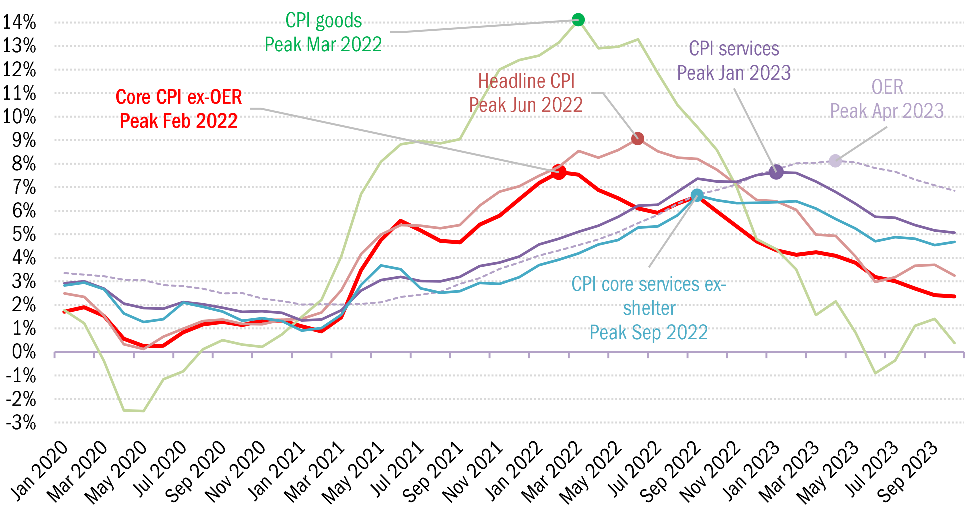
[Strategy dashboard]

at last! – to the end of this aggressive hiking cycle (see [“On the November FOMC”] November 1, 2023). And that has surely been a big part of the present rally.

- But there was no pridefulness in Chair Jerome Powell in [the post-meeting presser], as he aggressively avoided anything but a “higher rates for longer” narrative and fear-mongering that inflation remained a clear and present danger.

But now comes this morning’s October Consumer Price Index report – and whether or not it will trigger any pridefulness in Powell for markets to key off of, the double-beat in headline and core is something to be proud of (please see the chart below, and “Data Insights: CPI/PPI” November 14, 2023).

Consumer Price Index, year-over-year



Source: BLS, TrendMacro calculations

- *The consensus was expecting very little inflation in October. We got even less.*
- Headline CPI was reported flat for the month – up 0.54%, to be precise.
- There was a statistical bump in health care because of a new and even more arcane method for measuring the price of insurance. Without health care, headline CPI would have been up only 0.24%.
- Year-over-year, headline is now 3.2%, barely above the Fed’s target for CPI-based indices of 2.5%. Core is up 4.0% year-over-year.
- Owners’ equivalent rent – the largest and most absurdly laggy component of CPI – makes these numbers seem worse than they really are. Without OER, headline is up 1.71% year-over-year, and core is up 2.3%, both below the Fed’s target.
- This completely comports with our monetarist model based on year-over-year changes in the M2 money supply, which continues

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

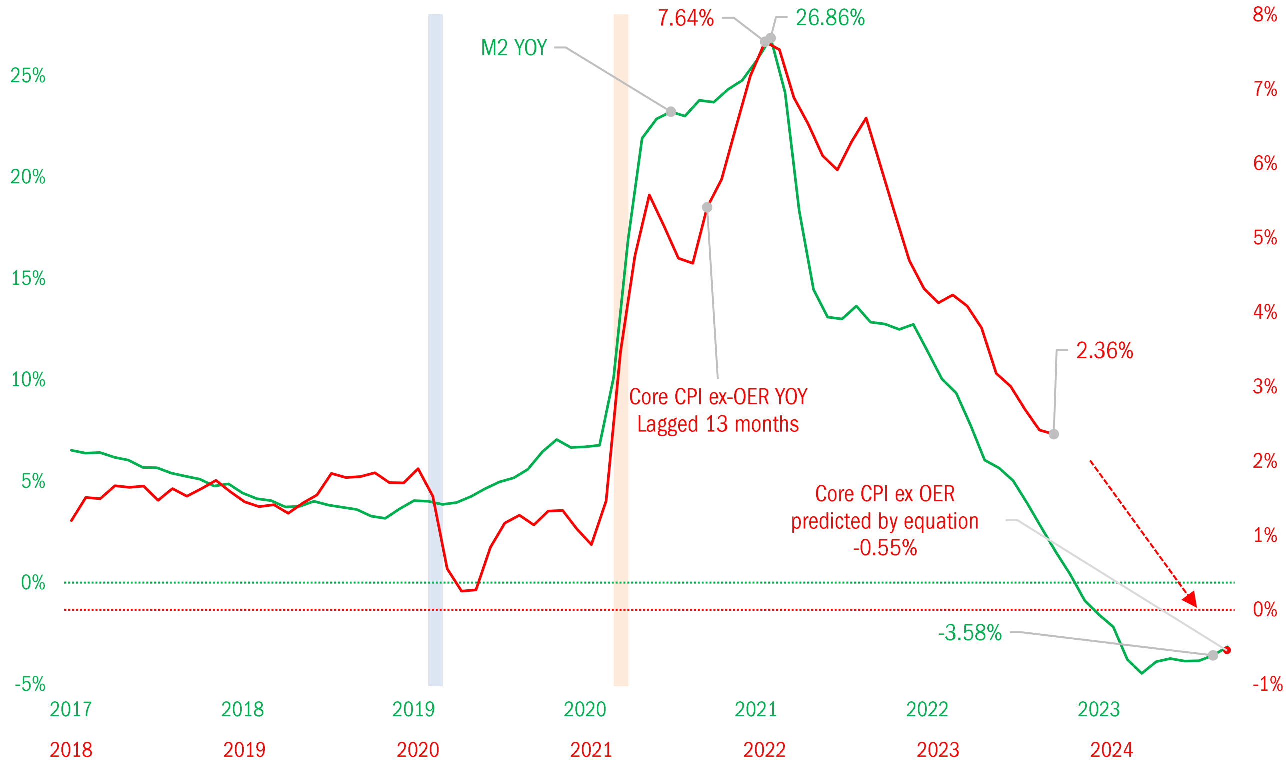
Donald Luskin
Dallas TX
214 550 2020
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

[About us]

Monetarist inflation model



Source: BLS, FRB, NBER, TrendMacro calculations

to point to outright deflation emerging the first half of 2024 (please see the chart above).

- *We can't emphasize enough how important it is to recognize that, Fed or no Fed, conquering inflation – and then a little deflation to act as "reparations" for the burst of inflation over the last three years – is a gigantic positive for the growth outlook. Inflation is economic cancer. We are cured. Celebrate – even if Powell doesn't.*
- Our monetarist model doesn't give the Powell Fed much credit for the cure. All it took was a cessation of pandemic stimulus spending. But the credit isn't important. What's important is that the rapid relief from the post-pandemic inflation outbreak has supported growth sufficiently to overcome Powell's best efforts to cause a recession.
- *Of course if would be better if Powell celebrated – even if he takes credit for something he didn't do. It is not helpful to have a too-tight Fed potentially causing a recession just when we should be having a disinflationary boom.*
- *We think this morning's CPI, and what we expect to be another excellent inflation report in mid-December before the FOMC meets, has absolutely utterly closed the door on any future rate hikes, and has brought closer the day of the first cut*. We are delighted after so many months alone in the wilderness on this that some Wall Street economics shops have started to come around over the last week,

including UBS and Morgan Stanley. When even Goldman Sachs admits it, our work here will be done.

- *Our monetarist model predicts that outright deflation will start showing up in the first quarter of 2024, if owners' equivalent rent is removed. Even including OER, it will start showing up in the second quarter. We continue to think this will drive the first Fed rate cut to the March FOMC. If that is so, then we continue to think the Fed's tightening thus far will not be enough to cause a recession.*

Bottom line

This morning's beats in headline and core CPI are the first of what will be two great pieces of inflation news before the FOMC meets in December. Without OER, both headline and core are already below the Fed's targets. There will be no more rate hikes. Outright deflation will start to manifest in Q1-2024 in indices excluding OER, and in Q2-2024 in all of them. The Fed's aggressive hiking has little to do with the monetary roots of the rapid relief from this inflation cycle. Its very rapidity has supported growth despite the Fed. Now with inflation visibly conquered and deflation soon to emerge, the first rate cut should come in March. We continue to call for no recession.