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TRENDMACRO LIVE!

On November CPI: Good, Not Great

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Donald Luskin

Not the outright deflation we expected to set the stage for tomorrow's FOMC.

What's not to love? We've just had two back-to-back months with headline Consumer Price Index inflation below target at a seasonally adjusted annual rate – 1.11% for November, building on 0.54% for October. It's even better when you remember that the Fed's 2% target is expressed in terms of Personal Consumption Expenditures inflation, which has historically run 50 bp below CPI. So *the Fed's CPI target is 2.5%. We have just had two prints in a row at less than half that*.

- Our favorite inflation gauge, core CPI ex-owners' equivalent rent (representing about 55% of the basket weight, throwing out the most and least volatile parts) ratifies it – 1.50% for November, building on 0.94% for October (see "Data Insights: CPI/PPI" December 12, 2023).

Here's what's not to love. As good as November CPI was, it didn't meet expectations. The Wall Street consensus was for zero. The Cleveland Fed's Inflation Now real-time estimate was for outright deflation at a 1.2% annual rate. That's about what we were expecting, too. All year we've been calling for the onset of deflation to set in about now, and we've been seeing it begin to materialize (see, most recently, "On Wal-Mart's Deflation Call" November 16, 2023). But *this isn't the inescapable drop-dead proof we hoped the Fed would see before the FOMC meets tomorrow* and participants publish their "dot plots" indicating the course of the funds rate for 2024 (see "On the November Jobs Report" December 8, 2023).

- To be sure, *the goods sector of CPI – about half the weight of the basket – is in outright deflation* and has been for months. It declined at a rather amazing 7.58% at an annual rate in November, and this kind of thing has been going on so long it's even showing 0.10% deflation on a year-on-year basis. Again, that's almost half the basket.
- *But the real issue for the FOMC is the CPI version of Fed Chair Jerome Powell's proprietary "supercore" inflation index* – core services ex-rent of shelter. That came in at 5.81% at an annual rate for November, which is higher than its 4.89% year-on-year reading. If you are of a mind, you could say it's "accelerating" – but it's more true to say it's hanging at about the same too-high rate. Even though this is just 24% of the CPI basket (less than half the share of our preferred, more representative index), Powell acts as though

Update to strategic view

US MACRO, FEDERAL RESERVE: Headline CPI inflation for November came in far below the Fed's target for the second month in a row. But it slightly missed consensus expectations for flat, and our own expectations for outright deflation. It's not the drop-dead evidence of deflation we had expected and wanted before tomorrow's FOMC. The CPI version of Powell's "supercore" index showed no sign of slowing, and though it is less than a quarter of the basket weight, Powell seems to rely on it almost exclusively. We are not worried that it is "sticky" – it is merely laggy. Nothing about this changes our strong expectation (and the market's) for no rate hike tomorrow. The only question is the extent to which the 2024 "dot plot" gets lowered. It already indicates that, despite Powell's claims to the contrary, the committee is indeed thinking about cuts already. We think the moderation of Q3's torrid growth, and new inflation data however imperfect, will be enough to get that dot lowered, and start a more robust debate about when rate cuts can begin. We still think the first cut comes in March.

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it is the only part that counts. Changes in services inflation always lag changes in goods inflation – but Powell mistakes lagginess for stickiness (see “Video: What you're not hearing about the big lie of ‘sticky inflation’” July 31, 2023).

Slightly disappointing as all this is, we firmly assign a probability of zero to a rate hike at tomorrow’s FOMC. Yes, the rhetoric will likely be that the Fed stands ready to hike again if necessary, but that’s getting to be meaningless boilerplate. It hasn’t been necessary since July, despite red-hot GDP growth since then – that’s surely the end of this hiking cycle.

- The only question is whether Powell repeats his claim from the November FOMC that “the fact is the Committee is not thinking about rate cuts right now at all’ (see “On the November FOMC” November 1, 2023).
- That was an absurd claim from the get-go, considering that at the September FOMC the “dot plot” for the funds rate at year-end 2024 was raised to 5-1/8% from 4-5/8% (see “On the September FOMC” September 20, 2023). Yes, they raised the dot. But at 5-1/8%, the median participant is definitely “thinking about cuts right now” considering that the present funds rate is higher at 5-3/8%. Indeed 11 out of 17 participants put up a dot below 5-3/8% (see “Data Insights: Federal Reserve” November 1, 2023).
- The market has always made a mockery of that dot, and it continues to do so now with the futures-implied December 2024 funds rate at 4-1/8%, a full percentage point below the dot. With Q4-2023 growth slowing from Q3’s amazing pace (see “That Quarter, Those Yields, This Correction” October 27, 2023) – which the Fed will take as assurance that there is less risk of growth-driven resurgent inflation – taken with the improvements in inflation we’ve documented here, even if they are not ideal – we don’t see how that 2024 dot can fail to come down. Then it will be unmistakable that “the Committee *is* ~~not~~ thinking about rate cuts right now.”
- That will trigger a robust debate about when the first cuts will come. Markets still think May. We think March.
- But then again, the one way the Powell Fed never disappoints is that it always disappoints. The dot may not come down, and if it does, Powell may act like that doesn’t reflect anyone’s changed thinking. Look for our post-FOMC note tomorrow.

Bottom line

Headline CPI inflation for November came in far below the Fed’s target. But it slightly missed consensus expectations for flat, and our own expectations for outright deflation. It’s not the drop-dead evidence of deflation we had expected and wanted before tomorrow’s FOMC. The CPI version of Powell’s “supercore” index showed no sign of slowing, and though it is less than a quarter of the basket weight, Powell seems to rely on it almost exclusively. We are not worried that it is “sticky” – it is merely laggy. Nothing about this changes our strong expectation (and the

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