

# US Macroeconomics

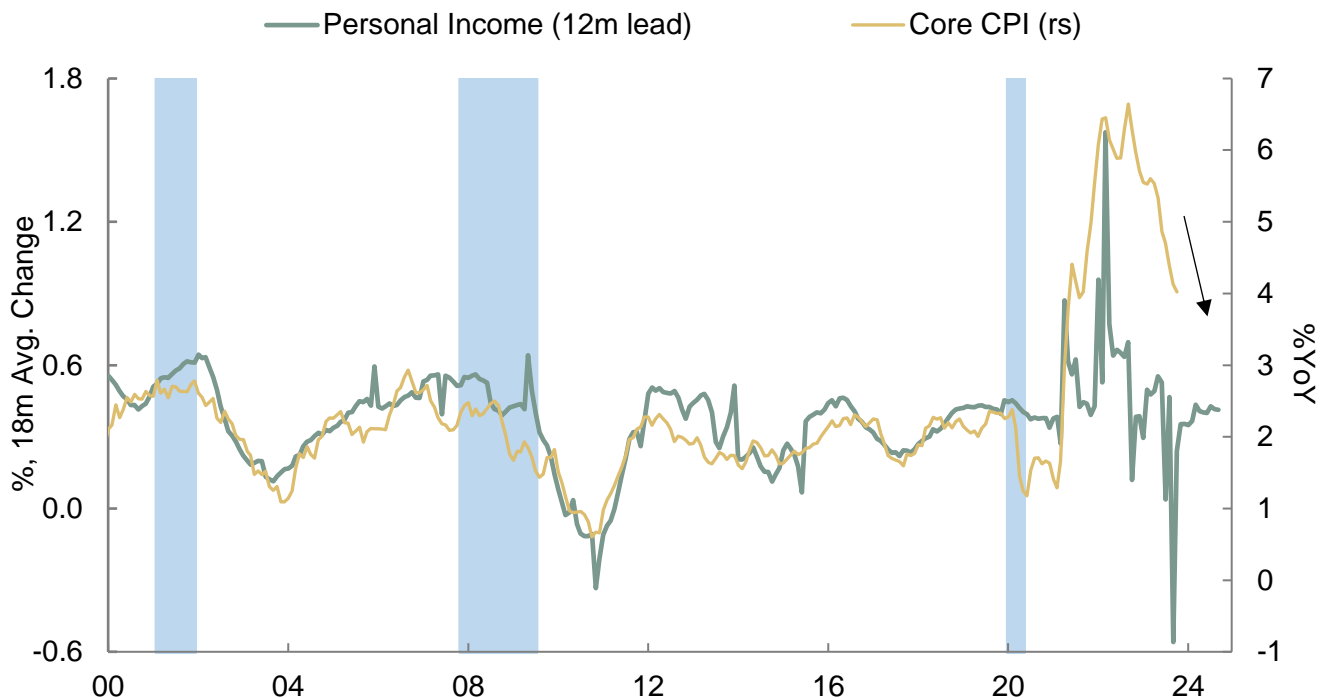
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## More Disinflation is Still in the Pipeline

Amidst a slew of other hawkish remarks last week, Chair Powell said that the Fed would not hesitate to tighten policy further if appropriate, and that the FOMC is “not confident” that enough had been done to return inflation to target. These comments followed a few reports showing inflation-progress stalling. Today’s CPI data however, showed an encouraging *softening* in inflation where shelter costs decelerated to 0.3% MoM (back in line with its ten-month downtrend after inexplicably jumping last month), while super-core (the Fed’s preferred measure) decelerated to 0.2%. Both series printed their softest figures since the summer. But that is not all. We remain optimistic that inflation will *continue* to relent in the coming year. One reason for this (among many) is because of the relationship between income, spending and inflation.

**Where incomes go, core prices go one year later** (see chart below). The logic is fairly simple: **if incomes are down, consumers spend less, and when they spend less, firms’ price-setting abilities are reduced, and inflation relents.** This process takes approximately one year empirically. When accounting for the one-year lead time, this relationship has worked remarkably well, moving in near lockstep with core prices historically. The biggest dislocation came in the pandemic, due to a set of highly unusual circumstances. Nevertheless, core prices are continuing to fall right back in line, just as the relationship with incomes (from 12-months ago) would suggest. Even ignoring other disinflationary/deflationary drivers (potential recession, energy prices, et al.) this relationship alone implies core CPI should decelerate from 4% YoY at present to 2.4% by Q3 2024.



Sources: BEA, BLS, NBER, Haver, SMBC Nikko

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