Positive Signs on The Inflation Front

As underlying economic slows, inflation pressures will, too. Last quarter, real private domestic demand grew just 0.5% at an annualized rate, the same pace as Q2 2022. **Over the last year, demand has grown only 1.4% after inflation.** Thus, the economy is not as strong as the 2.9% Q3 2022 increase suggests. In fact, the highly cyclical factory sector appears to be entering recession.

The collapse of the November Chicago purchasing managers’ index (37.2 vs. 45.2 previously) bodes ill for the more closely followed ISM manufacturing survey (released tomorrow). However, the Chicago figures are notoriously volatile and do not point to similar reading in the November ISM data. Nevertheless, we should expect to see a slowing in national manufacturing activity. As this unfolds, price pressures should moderate further. This is already apparent in the latest Chicago report.

**Prices paid, which capture industrial commodities, continue to moderate**—they fell nearly nine points in November to a 66.2 reading. Notably, this is down 30 points from its October 2021 cyclical high and is the lowest reading since October 2020 when the overall trend in inflation was quiescent. With aggregate demand trending downward, further moderation in prices, in particular industrial commodity prices, should be expected. These price trends tend to lead the behavior of the labor market, and they suggest we should see a meaningfully loosening in the jobs market in the months immediately ahead.

This is evident from the chart below which shows prices paid versus the ratio of the job openings rate to the unemployment rate. When openings fall and unemployment rises, the ratio declines. At present, **the sharp fall in prices paid suggests the ratio of job openings to unemployment will fall sharply going forward. As the labor market loosens so, too, should wage pressures. In turn, the inflation backdrop should noticeably improve.**

Source: Haver, MNI, Bureau of Labor Statistics, SMBC
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