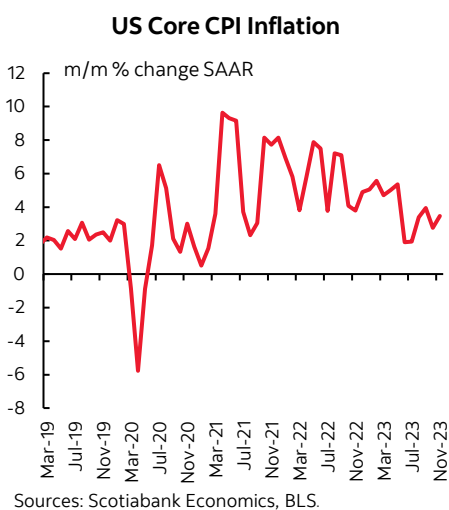


Contributors

Derek Holt

VP & Head of Capital Markets Economics
 Scotiabank Economics
 416.863.7707
derek.holt@scotiabank.com

Chart 1



US CPI Throws a Wrench Into Rate Cuts

- Core inflation has convincingly emerged from the summertime soft patch
- Core services inflation is offsetting core goods disinflation
- Markets slightly shaved rate cut pricing...
- ...but are cautiously awaiting the Fed...
- ...that is unlikely to validate what markets are pricing for rate cuts

US CPI m/m % change headline / core, November, SA:

Actual: 0.1 / 0.3
 Scotia: -0.1 / 0.1
 Consensus: 0.0 / 0.3
 Prior: 0.0 / 0.2

US core CPI inflation picked up from the prior month's reading and was on consensus (chart 1). The table above shows the m/m numbers. CPI was up by 3.1% y/y (3.2% prior) with core up by an unchanged 4% y/y. The core acceleration alongside evidence that core service price inflation picked up again drove markets to ease off rate cut pricing a touch.

MARKET REACTION

By the time the dust all settled the 2-year Treasury yield was up by about 3–4bps post-data. The USD is only slightly firmer on a DXY basis. The S&P500 initially fell at the open, and then shook it off to move on to a new all time record high; equities are probably betting the Fed will still ease eventually but that it's good news company pricing power hasn't evaporated. Pricing for a rate cut continues to cling to March.

THE FED

Inflation's soft patch back in June and July has decidedly faded since then (chart 2). It hasn't done so by the same extent as prior soft patches, but the soft readings we saw in June and July have clearly pivoted back toward m/m SAAR readings for core inflation that are materially higher.

Next up will be how the FOMC reads the tea leaves tomorrow. I think it's highly unlikely that they will validate market pricing for 100–125bps of cuts by the end of next year into early 2025. If I'm right, and if bond markets listen to the dot plot as much as they surprisingly did in September given the poor track record of the dots, then I think bonds and equities are vulnerable to some cheapening.

Chart 2

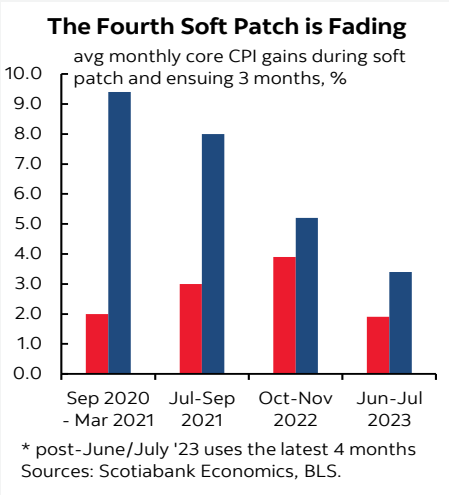


Chart 3

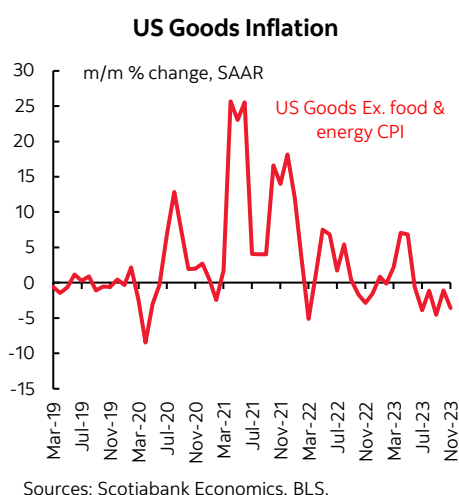
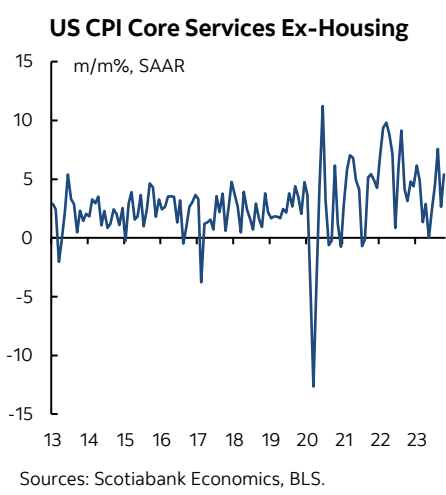


Chart 4



December 12, 2023

Chair Powell is probably feeling a little relieved with data and markets snapping at his heels a little less given recent momentum in the data. Friday's 200k nonfarm print was in line with expectations, but the half million gain in the household survey that drove the unemployment rate two-tenths lower and the pick-up in wages to 0.4% m/m SA signal a resilient job market. This inflation update leans in favour of how the next leg lower for underlying inflationary pressures is going to be tough to achieve. Combined, the two reports provide him with fresh reason to lean against markets by saying it's much too soon to be thinking about cutting.

DETAILS—MORE SERVICES INFLATION OFFSETS GOODS DISINFLATION

Please see the charts on the next page, plus the following two pages that show a break down of y/y and m/m rates of inflation by component in raw and weighted contribution terms. Also please see the table at the back of the publication that provides a full breakdown.

Core CPI landed on consensus at 0.3% m/m SA and was firmer than my estimate which I'll come back to in a moment. Headline CPI was slightly firmer than most expected at 0.1% m/m SA.

Core inflation picked up to 3.5% m/m SAAR (seasonally adjusted at an annualized rate) compared to 2.8% the prior month. The three-month moving average of 3.4% was unchanged.

That remains too hot for the Fed and it won't validate market pricing for cuts when the FOMC weighs in tomorrow. The evidence of a soft-patch rebound from the 1.9% m/m SAAR core CPI increases in June and July toward a steady string of hotter readings over each of the past four months provides plenty of ammunition to argue that this summertime was just a fourth soft-patch head fake.

What drove it all? There was softness in core goods prices that I had anticipated, but core service prices rebounded faster than expected.

Core goods prices fell by -0.3% m/m (ie: commodities less food and energy commodities) and that extends the string of monthly declines to six in a row now (chart 3).

Core services prices (ie: services ex-energy services and ex-housing) accelerated to 0.44% m/m SA which was double the prior month's rate that had driven that month's deceleration (chart 4). That's significant because recall that the prior month was about how core service price inflation was ebbing and perhaps concern about wage connections was weakening. Reverse that logic this month as wages were up 0.4% m/m last Friday and core services CPI bounced back with it.

It's therefore pretty clear that core goods inflation may be behind us, unless we get further supply chain shocks (looking at you Trump...) and with everything still at a nascent stage of revamping global supply chains. However, core services inflation has taken over. Folks are spending their money on other things than when we were all on a first name basis with the Amazon delivery guy.

What drove the softness in core goods prices? For starters, the holiday discounting theme shone through in the data. Look at clothing prices that fell by 1.3% m/m. Price discounting data was also showing greater weakness in other price categories as previously observed and that's confirmed in several CPI categories. Furniture prices fell by 1.1% m/m SA. Appliances fell by -1% m/m SA. Recreation commodity prices were down by 0.6% m/m with widespread weakness across electronics (TVs down 1.6% m/m for example).

One mild upside was vehicle prices as used vehicle prices were up by 1.6% while new vehicles were flat (-0.1% m/m).

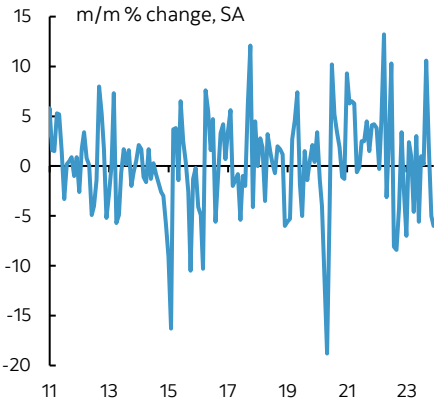
What weighed on headline CPI was that gasoline prices fell by -6% m/m SA following the -5% m/m prior reading which knocked 0.2 ppts off of headline CPI in m/m SA terms.

Food prices were unspectacular at 0.2% m/m with food at home (ie: mostly groceries) flat at 0.1. Food away from home (eating out, etc) was up 0.4% for the fourth month in a row

What drove services prices higher? rent of primary residence was up 0.5% m/m SA and the same as the prior month. Owners' equivalent rent was up 0.5% (0.4% prior). Medical care services jumped 0.6% m/m. Auto insurance still spiking, up another 1% m/m. But again, it was the breadth behind services prices ex-housing and energy services that was the upside surprise.

Chart 5

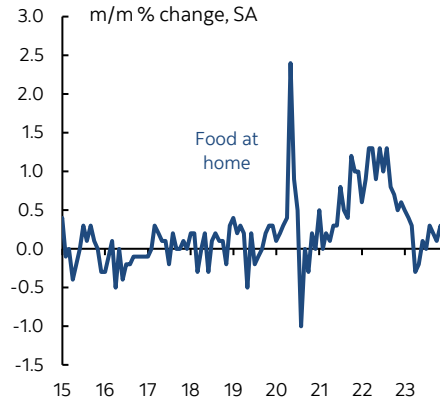
US Gasoline



Sources: Scotiabank Economics, BLS.

Chart 6

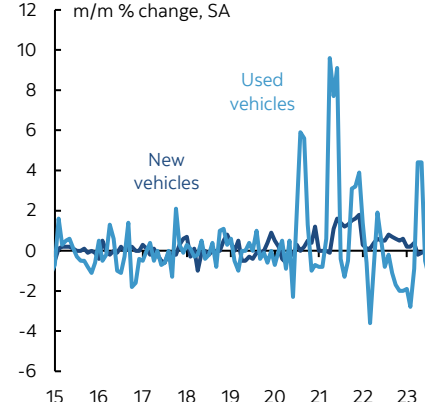
US Food Prices



Sources: Scotiabank Economics, BLS.

Chart 7

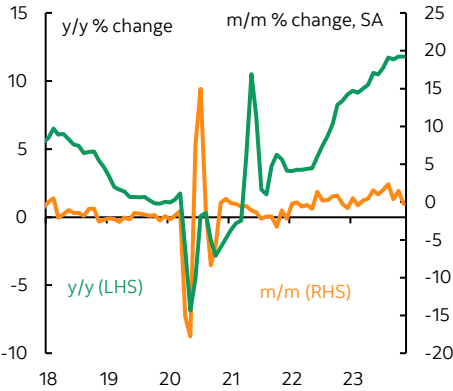
New vs Used Vehicle Inflation



Sources: Scotiabank Economics, BLS.

Chart 8

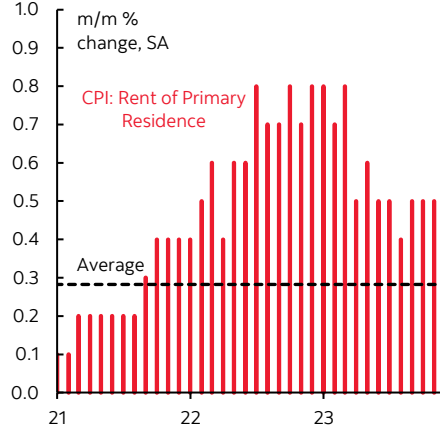
US Motor Vehicle Insurance



Sources: Scotiabank Economics, BLS.

Chart 9

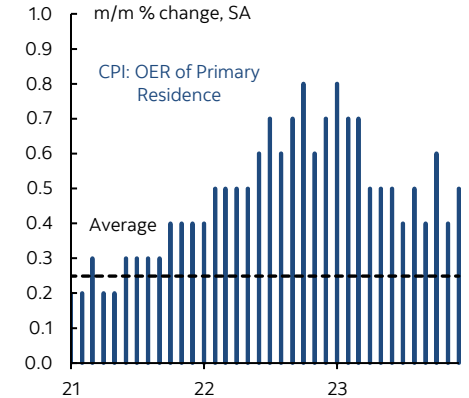
Sticky Rent Inflation



Sources: Scotiabank Economics, BLS.

Chart 10

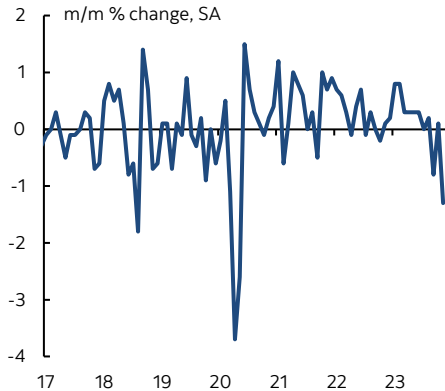
US Owners' Equivalent Rent Remains Sticky



Sources: Scotiabank Economics, BLS.

Chart 11

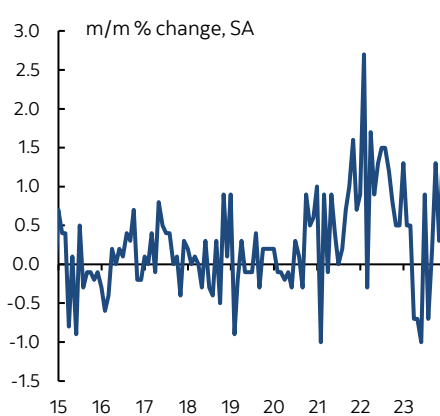
US Apparel



Sources: Scotiabank Economics, BLS.

Chart 12

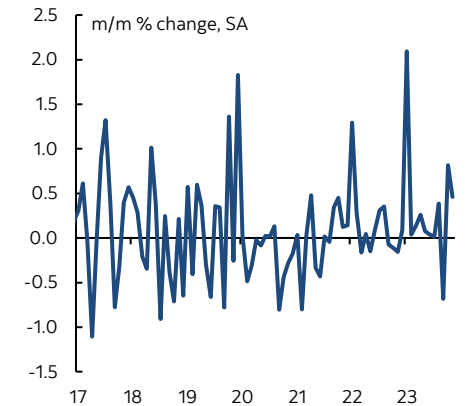
US Electricity



Sources: Scotiabank Economics, BLS.

Chart 13

Prescription Drug Prices



Sources: Scotiabank Economics, BLS.

Chart 14

November 12-Month Changes in US Headline CPI Categories

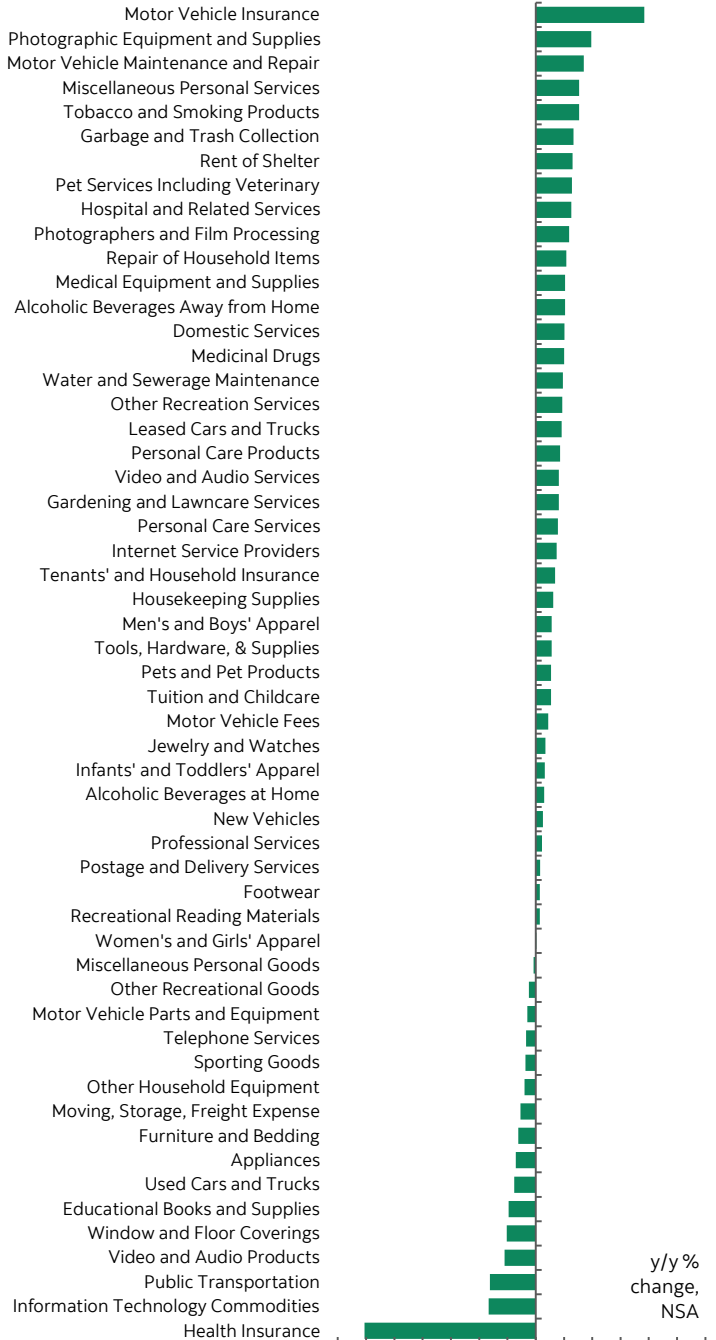
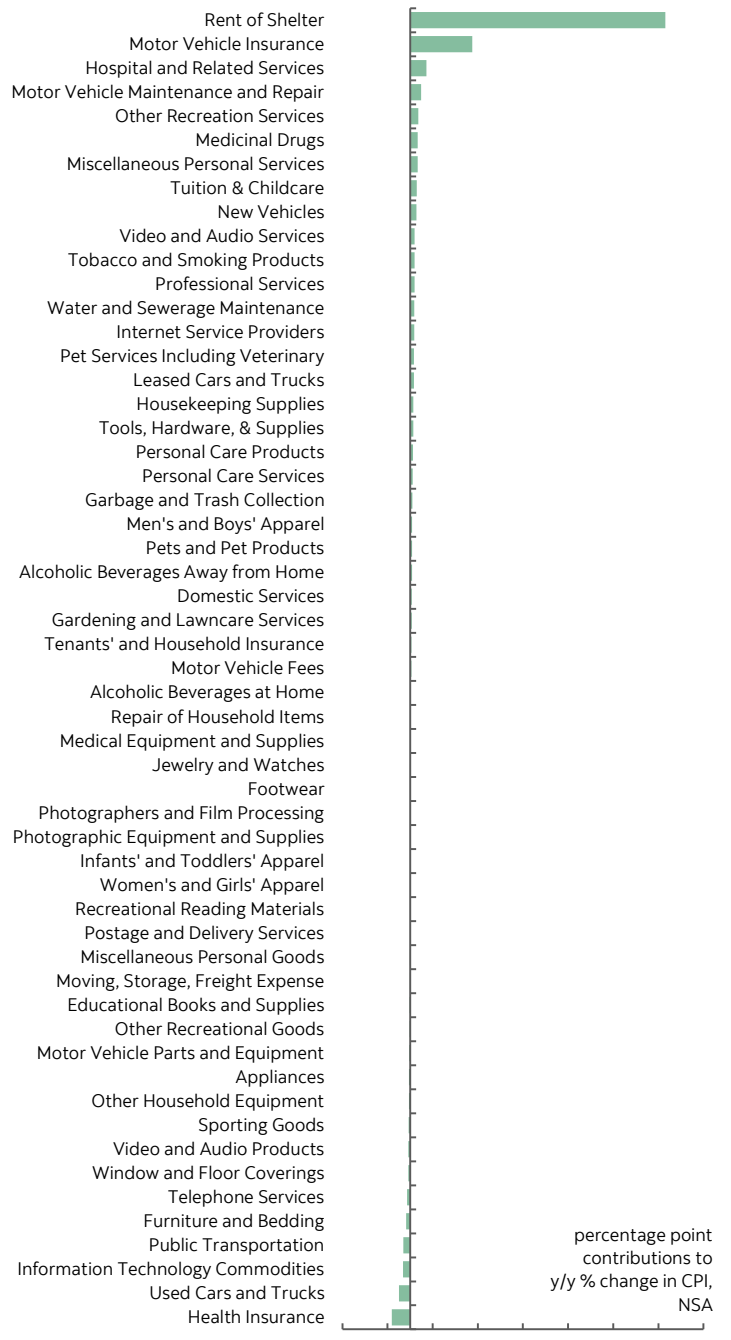


Chart 15

November Weighted Contributions to the 12-Month Change in US Headline CPI



Sources: Scotiabank Economics, BLS.

Source: Scotiabank Economics, BLS.

Chart 16

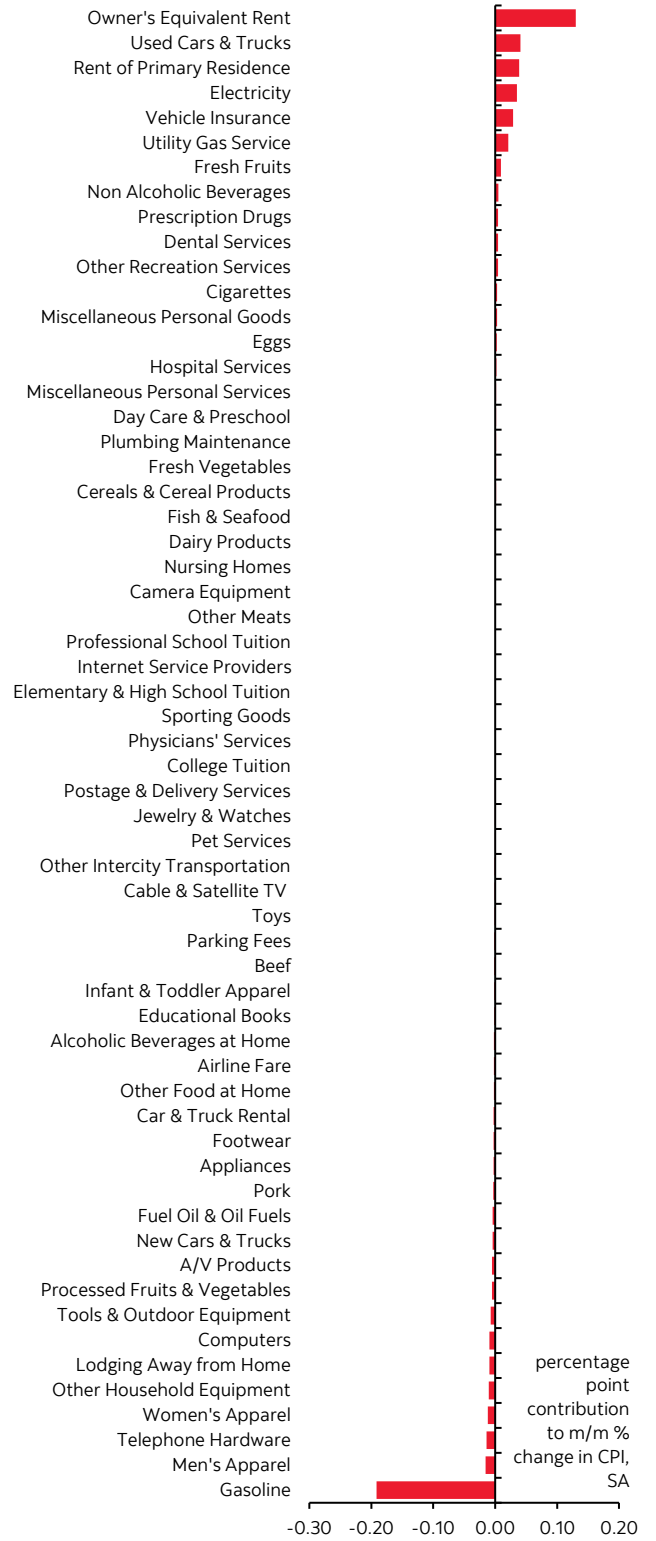
November Changes in US Headline CPI Categories



Sources: Scotiabank Economics, US BLS.

Chart 17

November Weighted Contributions to Monthly Change in US Headline CPI



Sources: Scotiabank Economics, US BLS.

December 12, 2023

Nov 2023				Weighted Contributions (ppts)*			5-Year Pre-Pandemic			10-Year Pre-Pandemic			
US INFLATION COMPONENT BREAKDOWN	y/y % change	10-year trend	Pandemic trend (Jan 2019–Present)	m/m % change	Weights (%)	y/y	m/m	2015–2019 avg. y/y	Std. Dev.	Z-Score	2011–2019 avg. y/y	Std. Dev.	Z-Score
Food	2.9			0.2	13.42	0.39	0.03	1.3	0.8	2.2	1.7	1.1	1.0
Food, home	1.7			0.1	8.58	0.15	0.01	0.2	1.1	1.3	1.2	1.9	0.3
Cereals & bakery products	3.4			0.5	1.16	0.04	0.01	0.4	0.9	3.4	0.9	1.7	1.5
Meats, poultry, fish & eggs	0.1			-0.2	1.79	0.00	0.00	-0.2	3.2	0.1	2.1	3.9	-0.5
Dairy & related products	-1.4			0.1	0.78	-0.01	0.00	-0.6	1.6	-0.5	1.1	3.1	-0.8
Fruits & vegetables	0.4			0.3	1.47	0.01	0.00	0.4	1.7	0.0	1.0	2.0	-0.3
Non-alcoholic beverages	2.9			0.5	1.03	0.03	0.01	0.6	1.0	2.2	0.5	1.6	1.5
Other food at home	3.3			-0.1	2.34	0.08	0.00	0.5	0.6	4.4	1.0	1.6	1.5
Food, away	5.3			0.4	4.84	0.26	0.02	2.7	0.3	8.8	2.5	0.5	5.4
Full services meals & snacks	4.3			0.5	2.31	0.10	0.01	2.6	0.4	4.7	2.4	0.5	3.8
Limited services meals and snacks	6.0			0.4	2.26	0.14	0.01	2.8	0.3	9.9	2.5	0.7	5.0
Food at employee sites and school	4.0			0.4	0.08	0.00	0.00	2.8	2.4	0.5	2.8	1.9	0.6
Food from vending machines & mobile vendors	14.6			0.3	0.03	0.00	0.00	3.1	1.0	11.6	2.5	1.3	9.3
Other food away from home	7.6			0.3	0.17	0.01	0.00	2.5	1.3	3.8	2.3	1.0	5.3
Energy	-5.4			-2.3	6.96	-0.38	-0.16	-1.9	10.0	-0.4	1.6	9.6	-0.7
Energy comm.	-9.8			-5.8	3.72	-0.36	-0.22	-2.8	17.0	-0.4	3.0	17.1	-0.7
Fuel oils & other fuels	-19.3			-2.2	0.19	-0.04	0.00	-2.3	15.8	-1.1	2.7	14.4	-1.5
Motor fuel	-9.2			-6.0	3.53	-0.32	-0.21	-2.8	17.1	-0.4	3.0	17.3	-0.7
<u>Gasoline</u>	<u>-8.9</u>			<u>-6</u>	<u>3.44</u>	<u>-0.31</u>	<u>-0.21</u>	<u>-2.8</u>	<u>17.1</u>	<u>-0.4</u>	<u>3.0</u>	<u>17.4</u>	<u>-0.7</u>
<u>Other</u>	<u>-17.4</u>			<u>-4.2</u>	<u>0.09</u>	<u>-0.02</u>	<u>0.00</u>	<u>-2.3</u>	<u>19.5</u>	<u>-0.8</u>	<u>3.6</u>	<u>17.9</u>	<u>-1.2</u>
Energy serv.	-0.1			1.7	3.24	0.00	0.06	0.0	2.4	-0.1	0.5	2.7	-0.2
Electricity	3.4			1.4	2.52	0.09	0.04	0.5	1.5	2.0	1.0	1.7	1.4
Utility (piped gas service)	-10.4			2.8	0.72	-0.07	0.02	-1.4	7.5	-1.2	-0.9	7.3	-1.3
All items less food and energy	4.0			0.3	79.62	3.18	0.24	2.0	0.2	8.8	1.8	0.4	5.3
Commodities less food and energy	0.0			-0.3	20.91	0.00	-0.06	-0.3	0.4	0.8	0.2	0.9	-0.2
Household furnishings	-0.3			-0.7	3.77	-0.01	-0.03	-0.8	1.2	0.4	-0.9	1.2	0.5
Window & floor coverings	-5.1			-3.3	0.30	-0.02	-0.01	-2.3	1.7	-1.6	-2.8	1.8	-1.3
Furniture & bedding	-3.1			-1.1	1.12	-0.03	-0.01	-0.3	1.7	-1.6	-0.9	2.1	-1.1
Appliances	-3.5			-1.0	0.27	-0.01	0.00	-1.2	3.1	-0.7	-1.6	3.0	-0.6
Other household equipment	-2.0			-2.4	0.56	-0.01	-0.01	-3.5	1.8	0.8	-3.7	1.5	1.1
Tools & hardware	2.8			-0.7	1.05	0.03	-0.01	-0.1	1.0	2.8	-0.3	1.2	2.6
Housekeeping supplies	3.1			-0.5	0.96	0.03	0.00	0.3	1.2	2.4	0.4	1.3	2.1

December 12, 2023

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US INFLATION COMPONENT BREAKDOWN	y/y % change	10-year trend	Pandemic trend (Jan 2019–Present)	m/m % change	Weights (%)	y/y	m/m	2015–2019 avg. y/y	Std. Dev.	Z-Score	2011–2019 avg. y/y	Std. Dev.	Z-Score
Apparel	1.1			-1.3	2.55	0.03	-0.03	-0.5	1.0	1.7	0.3	1.7	0.4
Men's & boys apparel	2.8			-2.4	0.67	0.02	-0.02	-0.3	1.5	2.0	0.5	2.3	1.0
Women's & girls apparel	0.1			-1.2	1.05	0.00	-0.01	-1.3	1.9	0.8	-0.1	2.5	0.1
Footwear	0.7			-0.5	0.51	0.00	0.00	0.2	1.3	0.4	0.8	1.7	0.0
Infant & toddler's apparel	1.6			-1.4	0.10	0.00	0.00	0.4	3.8	0.3	0.5	3.6	0.3
Jewelry & watches	1.7			-0.2	0.22	0.00	0.00	1.0	3.4	0.2	1.5	3.8	0.1
Trans. less fuel	-0.9			0.5	7.46	-0.07	0.04	-0.3	0.9	-0.7	0.4	1.5	-0.9
New vehicles	1.3			-0.1	4.23	0.06	0.00	0.1	0.7	1.9	0.8	1.2	0.4
Used cars & trucks	-3.8			1.6	2.52	-0.10	0.04	-1.3	2.1	-1.2	1.1	4.8	-1.0
Motor vehicle parts & equipment	-1.5			0.1	0.47	-0.01	0.00	0.2	1.1	-1.6	0.9	2.2	-1.1
Medical comm.	5.0			0.5	1.47	0.07	0.01	2.1	1.7	1.7	2.3	1.5	1.9
Medicinal Drugs	5.0			0.5	1.35	0.07	0.01	2.2	1.8	1.6	2.3	1.6	1.8
Medical equipment & supplies	5.2			0.5	0.11	0.01	0.00	0.4	1.2	3.9	0.3	1.2	4.1
Recreation comm.	-0.6			-0.6	2.22	-0.01	-0.01	-2.6	1.1	1.9	-2.3	0.9	1.9
Video & audio products	-5.5			-1.9	0.27	-0.01	-0.01	-10.1	2.4	1.9	-9.2	2.2	1.7
Pets & pet products	2.7			-0.3	0.66	0.02	0.00	0.4	1.5	1.5	0.5	1.5	1.5
Sporting goods	-1.8			-0.6	0.73	-0.01	0.00	-0.7	1.5	-0.7	-0.6	1.2	-1.0
Photographic Equipment & supplies	9.8			1.3	0.02	0.00	0.00	-1.7	4.6	2.5	-3.0	4.0	3.2
Recreational reading materials	0.7			-0.3	0.11	0.00	0.00	1.6	1.9	-0.5	1.5	1.8	-0.5
Other recreational goods	-1.2			-0.5	0.42	-0.01	0.00	-6.5	1.3	4.0	-5.2	1.7	2.3
Educ. & communication comm.	-7.9			-2.6	0.86	-0.07	-0.02	-3.7	1.0	-4.1	-3.5	0.9	-4.9
Educational books & supplies	-4.8			-1.5	0.09	0.00	0.00	2.2	3.0	-2.4	3.6	2.7	-3.1
IT commodities	-8.3			-2.7	0.77	-0.06	-0.02	-6.1	1.9	-1.2	-6.8	1.8	-0.8
Alcohol	2.9			-0.1	0.84	0.02	0.00	1.3	0.3	4.8	1.4	0.4	4.2
Alcoholic beverages at home	1.5			-0.4	0.50	0.01	0.00	0.8	0.6	1.1	0.8	0.5	1.4
Alcoholic beverages away from home	5.2			0.1	0.33	0.02	0.00	1.9	0.5	7.1	2.2	0.7	4.5
Other goods	5.1			0.1	1.26	0.06	0.00	1.4	0.9	4.4	1.4	0.7	5.2
Tobacco & smoking products	7.7			1.1	0.51	0.04	0.01	4.3	1.5	2.2	4.4	3.8	0.9
Personal care products	4.3			-0.6	0.61	0.03	0.00	-0.3	0.6	7.9	-0.1	0.8	5.3
Miscellaneous personal goods	-0.4			-0.6	0.14	0.00	0.00	-2.4	3.1	0.7	-1.7	2.4	0.6

December 12, 2023

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Services less energy services	5.5			0.5	58.70	3.23	0.29	2.8	0.2	11.5	2.4	0.6	4.9
Shelter	6.5			0.4	34.97	2.27	0.14	3.3	0.2	19.1	2.5	1.2	3.5
Rent of shelter	6.5			0.5	34.60	2.25	0.17	3.3	0.2	17.3	2.5	1.2	3.4
<i>Rent of primary residence</i>	<u>6.9</u>			<u>0.5</u>	<u>7.66</u>	<u>0.53</u>	<u>0.04</u>	<u>3.7</u>	<u>0.1</u>	<u>24.0</u>	<u>2.9</u>	<u>1.1</u>	<u>3.6</u>
<i>Lodging away from home</i>	<u>0.9</u>			<u>-0.9</u>	<u>1.11</u>	<u>0.01</u>	<u>-0.01</u>	<u>2.3</u>	<u>2.0</u>	<u>-0.7</u>	<u>2.2</u>	<u>2.2</u>	<u>-0.6</u>
<i>OER of residences</i>	<u>6.7</u>			<u>0.5</u>	<u>25.83</u>	<u>1.73</u>	<u>0.13</u>	<u>3.2</u>	<u>0.2</u>	<u>17.1</u>	<u>2.4</u>	<u>1.1</u>	<u>4.0</u>
Tenants' & household insurance	3.4			0.5	0.37	0.01	0.00	1.4	1.2	1.7	2.3	1.5	0.7
Water, sewer, trash collection	5.4			0.3	1.07	0.06	0.00	3.6	0.6	3.1	4.3	1.0	1.1
Water & sewage maintenance	4.8			0.2	0.76	0.04	0.00	4.0	0.8	1.0	4.8	1.4	0.0
Garbage & trash collection	6.7			0.7	0.31	0.02	0.00	2.5	1.5	2.9	2.5	1.1	3.9
Household ops.	6.7			-1.1	0.90	0.06	-0.01	3.8	1.3	2.3	2.6	1.6	2.5
Domestic services	5.1			-1.3	0.27	0.01	0.00	2.0	1.1	2.9	1.6	1.0	3.4
Gardening & lawn care	4.1			0.9	0.33	0.01	0.00	4.3	2.7	-0.1	2.8	2.6	0.5
Moving, storage, freight	-2.7			0.0	0.10	0.00	0.00	5.6	3.9	-2.1	3.3	3.9	-1.5
Repair of household items	5.4			1.7	0.12	0.01	0.00	4.8	2.1	0.3	4.2	2.0	0.6
Medical serv.	-0.9			0.6	6.34	-0.06	0.04	2.9	1.0	-3.9	3.0	0.8	-4.8
Professional Services	1.1			0.5	3.51	0.04	0.02	1.5	0.9	-0.4	1.8	0.8	-0.9
Hospital & related services	6.3			0.1	2.30	0.14	0.00	3.8	1.1	2.2	4.5	1.3	1.3
Health insurance	-30.3			1.1	0.53	-0.16	0.01	5.0	5.8	-6.1	3.6	6.0	-5.6
Transportation serv.	10.1			1.1	6.05	0.61	0.07	2.6	1.1	6.8	2.6	1.0	7.7
Leased cars & trucks	4.6			-0.2	0.74	0.03	0.00	0.5	3.0	1.3	-1.6	3.2	1.9
Motor vehicle maintenance & repair	8.5			0.3	1.14	0.10	0.00	2.2	0.7	9.0	2.0	0.6	11.3
Motor vehicle insurance	19.2			1.0	2.84	0.54	0.03	5.5	2.6	5.2	4.8	2.0	7.0
Motor vehicle fees	2.2			-1.1	0.49	0.01	-0.01	1.8	0.7	0.6	2.2	1.9	0.0
Public transportation	-8.1			1.0	0.73	-0.06	0.01	-1.2	1.5	-4.5	1.0	3.6	-2.5
Recreation serv.	4.8			0.1	3.12	0.15	0.00	2.6	0.7	3.4	2.3	0.7	3.3
Video & audio services	4.1			-0.2	0.99	0.04	0.00	2.7	1.4	1.0	2.6	1.3	1.1
Pet services	6.4			-0.1	0.55	0.04	0.00	3.1	0.8	4.3	3.3	0.9	3.4
Photo services	5.9			0.1	0.04	0.00	0.00	-0.2	2.0	3.0	0.8	1.8	2.8
Other recreation services	4.7			0.3	1.53	0.07	0.00	2.4	0.6	3.8	1.7	1.1	2.8
Educ. & communication serv.	1.4			0.1	4.80	0.07	0.00	0.4	1.3	0.7	1.1	1.3	0.3
Tuition, school fees, child care	2.7			0.1	2.16	0.06	0.00	2.8	0.6	-0.2	3.3	0.8	-0.8
Postage & delivery	0.8			-0.6	0.07	0.00	0.00	2.3	2.0	-0.7	3.3	2.0	-1.3
Telephone services	-1.7			0.0	1.60	-0.03	0.00	-2.4	3.0	0.2	-1.3	2.4	-0.2
Internet services	3.7			0.2	0.97	0.04	0.00	-0.2	1.5	2.6	0.1	1.3	2.7
Other personal serv.	6.1			0.3	1.47	0.09	0.00	2.7	0.7	5.0	2.4	0.6	5.9
Personal care services	3.9			0.3	0.61	0.02	0.00	2.3	0.7	2.3	1.8	0.8	2.6
Miscellaneous personal services	7.7			0.3	0.86	0.07	0.00	2.9	0.9	5.2	2.7	0.7	6.8

*Number may not add due to rounding

Sources: Scotiabank Economics, BLS.

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