

Contributors

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Chart 1

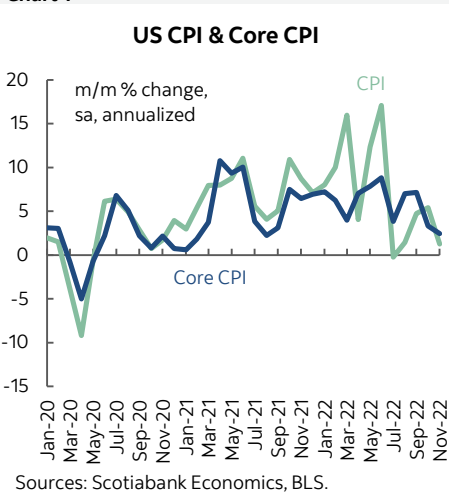
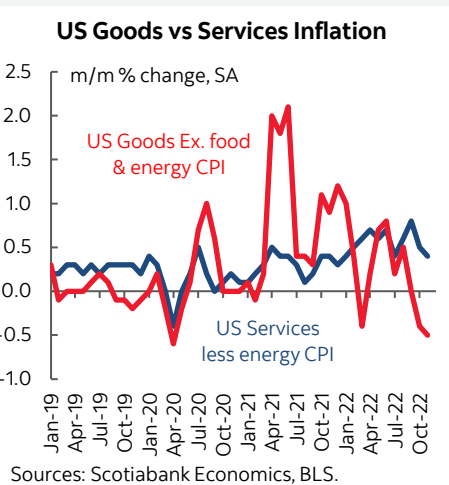


Chart 2



Markets Party Like Inflation's Over—But Is It?

- Core inflation surprised lower for a second month
- Financial markets rejoiced as the dollar sank, yields fell, equities rallied and oil surged
- Another soft patch or the end of the great surge?

US CPI, m/m % SA // y/y %, November:

Actual: 0.1 / 7.1
 Scotia: 0.4 / 7.4
 Consensus: 0.3 / 7.3
 Prior: 0.4 / 7.7

US core CPI, m/m % SA // y/y %, November:

Actual: 0.2 / 6.0
 Scotia: 0.4 / 6.2
 Consensus: 0.3 / 6.1
 Prior: 0.3 / 6.3

Are we in just another soft patch or is the great inflation surge over and done with? Whatever the answer may be, the BLS may have made it back onto Santa's nice list.

Time and patience will tell the answer to this question and markets rarely have both. For now, we have the two softest back-to-back months for US core CPI increases since September of last year before it began to take off again as omicron hit, fuller effects of damaged supply chains took root, pent-up services demand would later be released and the war in Ukraine struck. See chart 1. I retain my doubts given that the US economy remains in excess demand with a very hot labour market into an uncertain period for many prices over Winter and beyond. The details also showcase mixed readings including pockets of still elevated price increases that shouldn't be ignored. The implications of change in China and the future developments around Ukraine are both big question marks. Coming basket weight changes in January CPI (due out in February) from 2019–20 biennial weights to 2021 spending weights also pose mild risk that may have added a couple of tenths or so to today's year-over-year rate if applied now. It's also probable that we remain at a highly nascent stage of developments in terms of revamping global supply chains in a process that will take years.

But spending too much time counselling caution on the back of figures like these is like standing in the middle of the track at the Indy 500 and wagging a finger at the cars to slow down. Markets didn't hesitate to interpret 0.2% m/m core CPI as a dovish signal into tomorrow's FOMC announcements as the USD sank, the two-year US Treasury yield rallied by 23bps at first and is retaining a drop of 16bps now in a 2s10s steepener move as the 10 year yield is down about 13bps on the day. Fed funds futures are pricing a terminal rate of around 4 ¾% and are pricing nearly 100bps of rate cuts by early 2024 if the policy rate does indeed peak at 5% into early 2023. That's still a significantly restrictive policy rate path for quite a while yet so let's not lose our heads here. US S&P500 equity futures instantly took off toward a nearly 3% gain but the cash market is now giving back almost all of that with a 0.8% gain so far on the day. Oil prices have moved nearly 4% higher. Some of this may be a violent unwinding of a positioning effect that was biased toward a higher number.

Nevertheless, this is the second consecutive downside surprise and a back-to-back big over-estimation by the Cleveland Fed's 0.5% m/m nowcast whose allure is now significantly dented. I again over-estimated core CPI against a prior decent track record so own the accountability. There is considerable company within consensus since the only two to get it right out of 67 forecasters are ones I've personally never heard of, though perhaps that's my deficiency.

DETAILS

So what caused it? Chart 2 shows that core goods prices did, while core service prices continue to climb fairly rapidly. Goods prices are more volatile and some big ticket items like autos drove much of this. So a first caution involves speculation toward whether service price inflation will remain hot as some goods prices temporarily benefit from easing supply chain pressures.

Chart 3 shows a breakdown of the month-over-month price changes in seasonally adjusted terms and chart 4 weights their contributions. Charts 5 and 6 do likewise for year-over-year changes.

There was softness in vehicle prices that dragged 0.1 percentage points off of headline inflation in weighted terms. This was driven by a 4.1% weight on 0% m/m change in new vehicle prices and a 3.7% weight on a 2.9% decline in used vehicle prices plus a 1.9% m/m drop in leased vehicles. It's tempting to think this reflects rising financing costs and I'm sure it is to some extent, but the hit has been focused upon used vehicle prices and not new vehicles which is a bit curious from a relative affordability standpoint. Another possibility is that new vehicle backlogs are gradually easing and this is first showing up in continued declines in used vehicle prices that have for some time now lost their allure as an outlet for buying vehicles amid new vehicle shortages that have improved.

There was also a greater than seasonally normal amount of caution around holiday era travel that required discounting. That may reflect ongoing pandemic effects into the official start of the US holiday shopping and travel season. Airfare prices fell by 3% m/m. Vehicle rental prices were down 2.4%. Lodging rates slipped by 0.7%. Intercity bus fare fell by 1.6% m/m. People were still travelling, but needed enticements and deals in order to get the bookings up.

Medical care services fell by 0.7% m/m due to a 4.3% drop in health insurance for a second straight large drop and third one in the past four reports, and a drop in prices for eyeglasses and eye care clearly because some people out there don't stare at their screens for most of their days.

Medical care commodities were up 0.2% m/m but prescription drug prices fell again by 0.2% m/m.

Energy prices fell by 1.6% m/m and knocked about 0.1 ppts off of headline CPI in month-over-month weighted contribution terms. That reflected a 2% m/m drop in seasonally adjusted gasoline prices but also lower natural gas prices and a slight drop in electricity prices. By definition this category didn't explain core CPI.

There wasn't much evidence of discounting around holiday shopping items or at least not enough to have much of a weighted effect which is the part of it all that I had expected versus greater than expected weakness in some other components. Apparel prices were up 0.2% m/m which went against the popular narrative that massive discounting due to bloated inventories was going on in that category, but the 2.5% weight makes this a trivial effect. Toy prices were down 1.4% m/m but only carry a 0.3% weight. Furniture prices fell 0.8% m/m with a weight of just under 1%. Video and audio product prices fell 1.2% m/m with just a 0.3% weight and captures TVs and audio equipment.

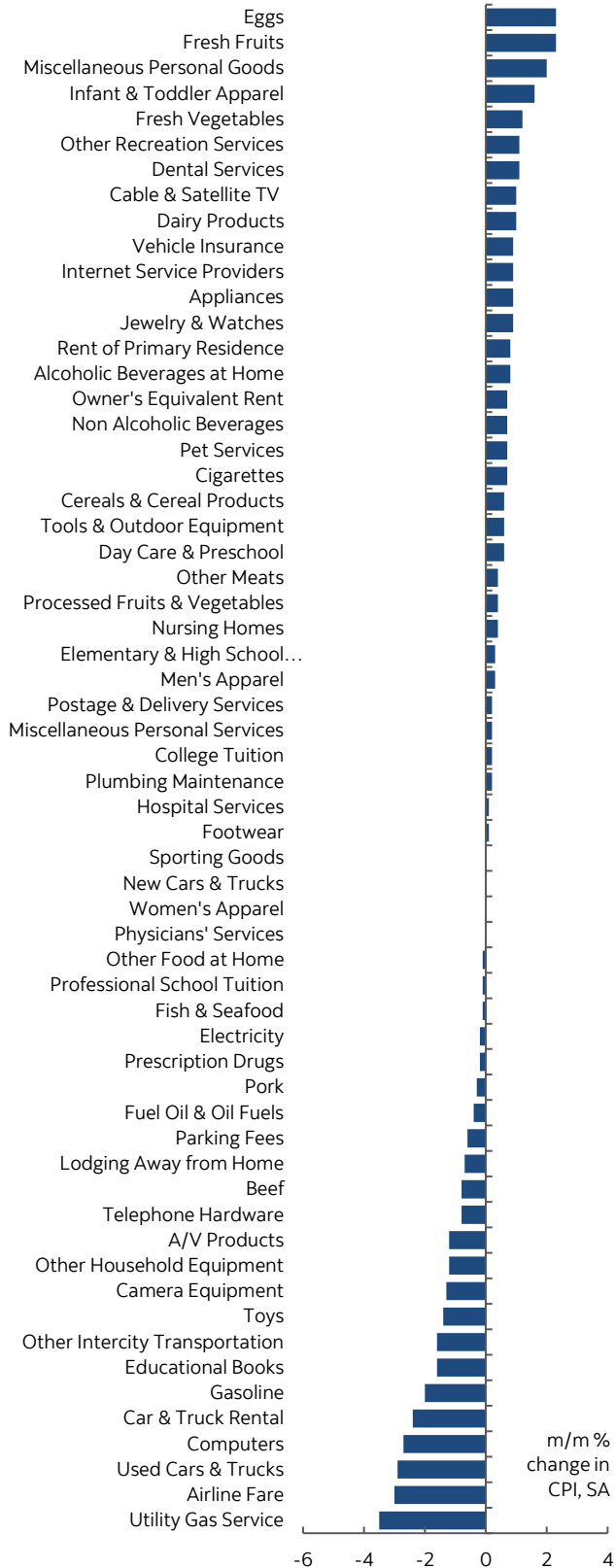
Beyond that, the rest of the components were pretty hot and so breadth was at best mixed. Owners' equivalent rent was hot again at 0.7% m/m and may face lagging downward pressures into 2023 with the caveat on that argument being that market-based measures may be easing but are still much higher than previously and so folks transitioning toward new living arrangements through 2023 may still incur higher housing costs in terms of how CPI captures the effects for the average consumer.

Food prices were hot again (+0.5% m/m) with food-at-home (e.g. groceries) up 0.5% and food away-from-home (e.g. take-out, restaurants etc) also up 0.5% m/m.

Please also see the accompanying charts showing m/m price pressures for several key categories. Also see the accompanying detailed table with various measures including z-score deviations from norms and micro charts.

Chart 3

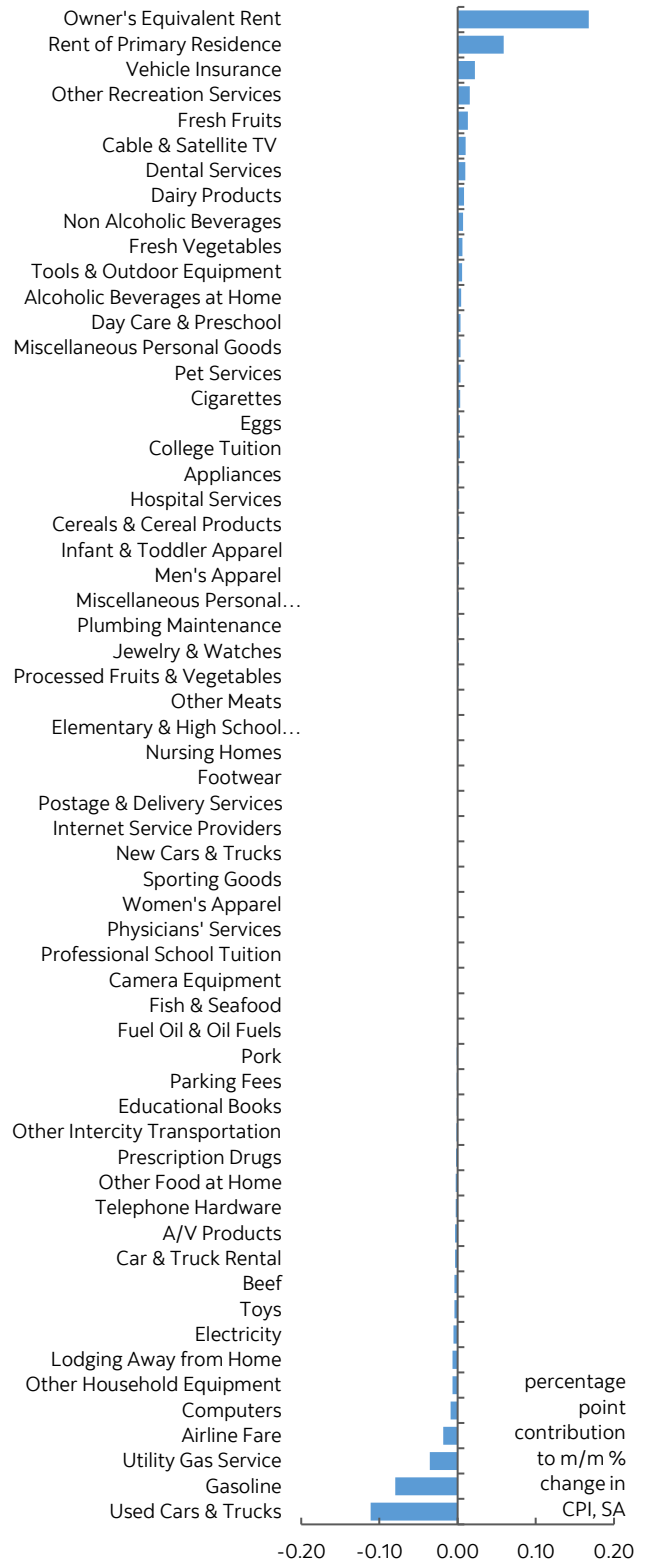
November Changes in US Headline CPI Categories



Sources: Scotiabank Economics, US BLS.

Chart 4

November Weighted Contributions to Monthly Change in US Headline CPI



Sources: Scotiabank Economics, US BLS.

Chart 5

November 12-Month Changes in US Headline CPI Categories

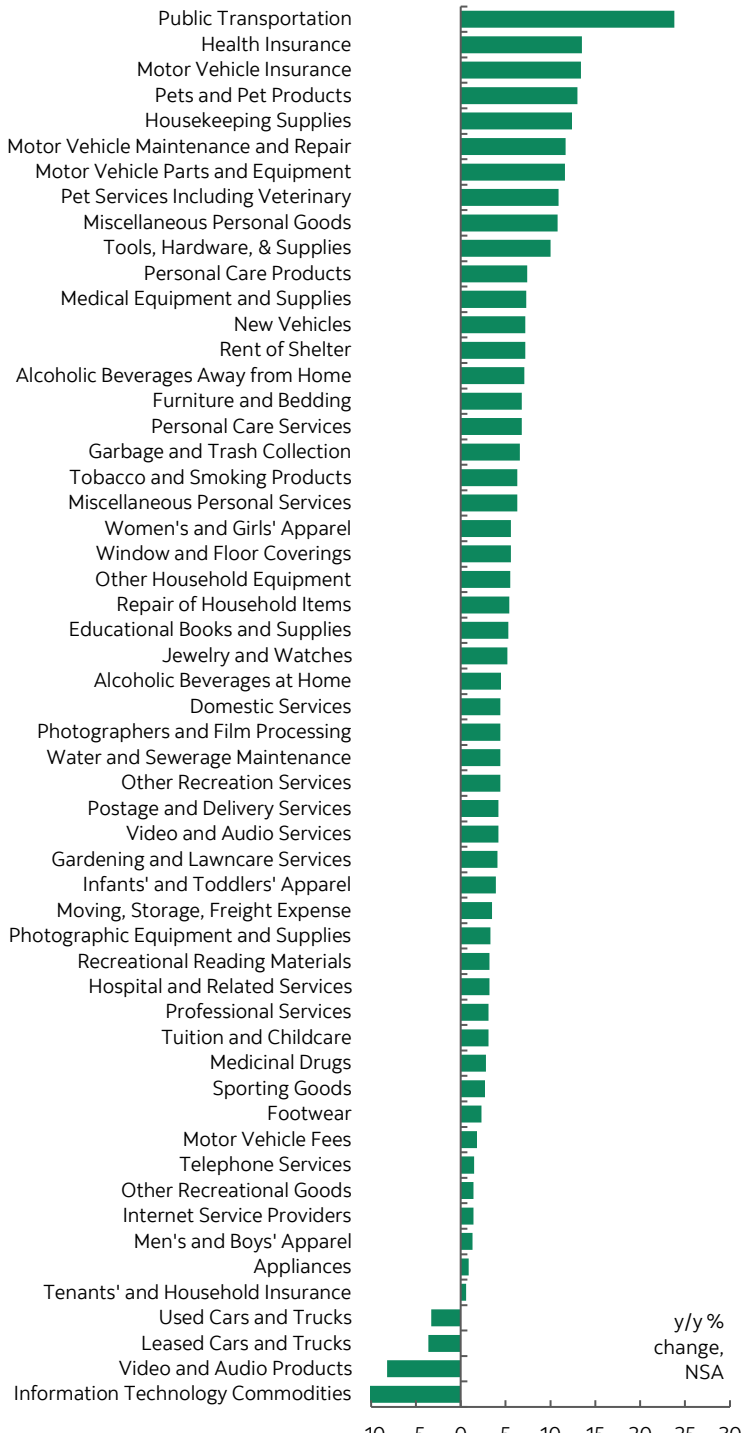


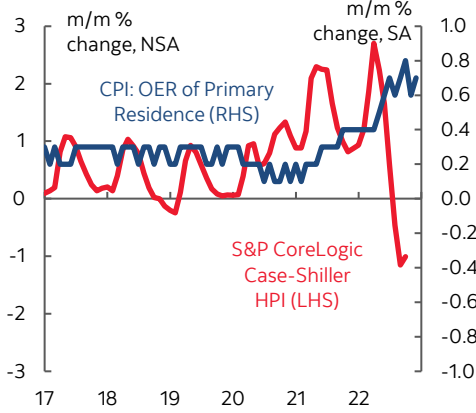
Chart 6

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



Chart 7

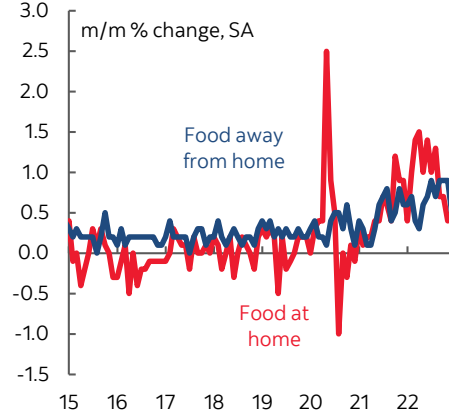
US Home Prices & Rent



Sources: Scotiabank Economics, BLS, S&P.

Chart 8

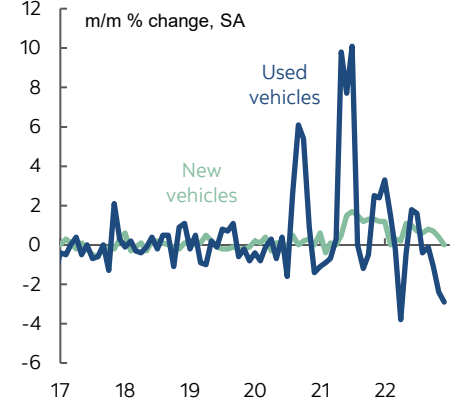
US Food Prices



Sources: Scotiabank Economics, BLS.

Chart 9

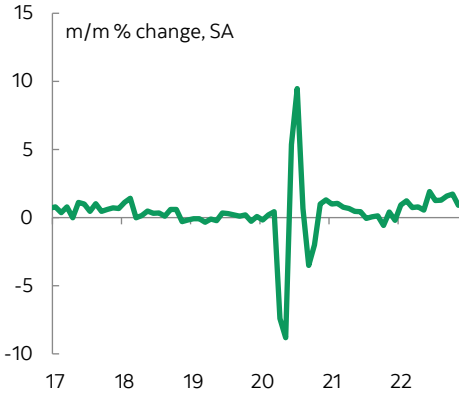
New vs Used Vehicle Inflation



Sources: Scotiabank Economics, BLS.

Chart 10

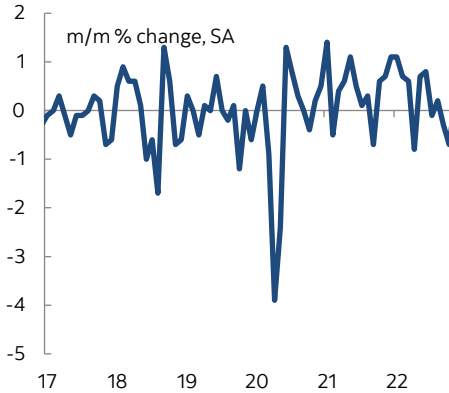
US Motor Vehicle Insurance



Sources: Scotiabank Economics, BLS.

Chart 11

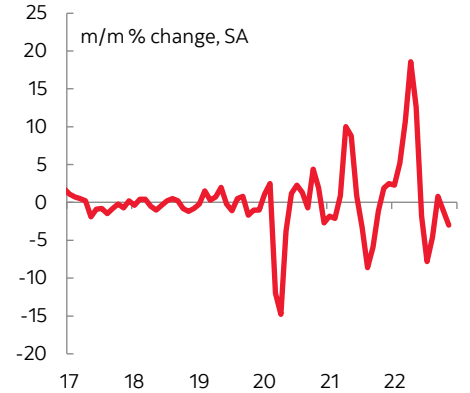
US Apparel



Sources: Scotiabank Economics, BLS.

Chart 12

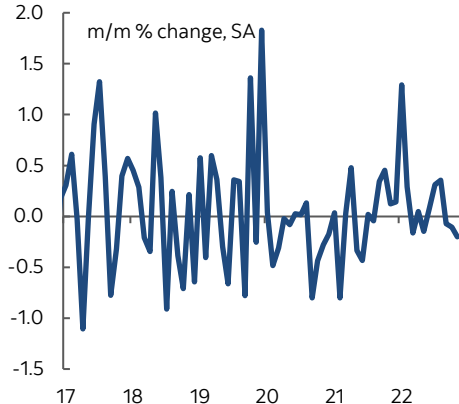
US Airfare



Sources: Scotiabank Economics, BLS.

Chart 13

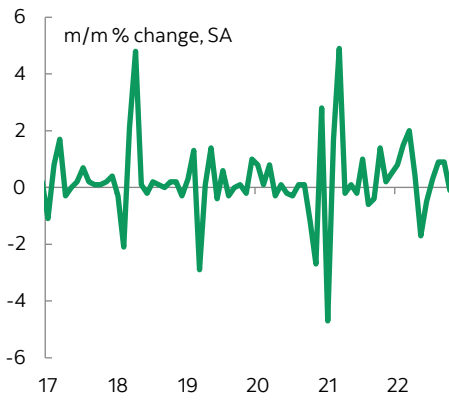
Prescription Drug Prices



Sources: Scotiabank Economics, BLS.

Chart 14

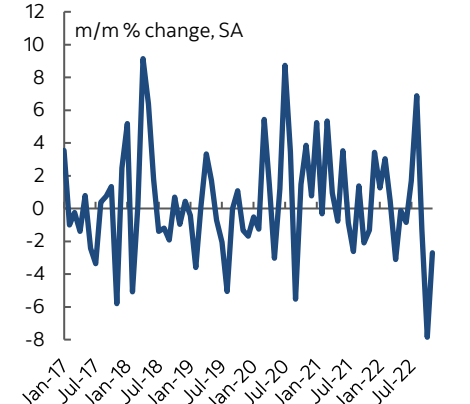
US Financial Services



Sources: Scotiabank Economics, BLS.

Chart 15

Laundry Equipment Prices



Sources: Scotiabank Economics, BLS.

December 13, 2022

Nov 2022				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	10.6			0.5	13.71	1.45	0.07	1.3	0.8	12.2	1.7	1.1	7.8
Food, home	12.0			0.5	8.51	1.02	0.04	0.2	1.1	10.4	1.2	1.9	5.8
Cereals & bakery products	16.4			1.1	1.11	0.18	0.01	0.4	0.9	18.2	0.9	1.7	9.2
Meats, poultry, fish & eggs	6.8			-0.2	1.90	0.13	0.00	-0.2	3.2	2.2	2.1	3.9	1.2
Dairy & related products	16.4			1.0	0.81	0.13	0.01	-0.6	1.6	10.6	1.1	3.1	4.9
Fruits & vegetables	9.7			1.4	1.43	0.14	0.02	0.4	1.7	5.4	1.0	2.0	4.3
Non-alcoholic beverages	13.2			0.7	0.98	0.13	0.01	0.6	1.0	12.1	0.5	1.6	8.0
Other food at home	13.9			0.1	2.28	0.32	0.00	0.5	0.6	20.8	1.0	1.6	8.2
Food, away	8.5			0.5	5.20	0.44	0.03	2.7	0.3	19.5	2.5	0.5	11.5
Full services meals & snacks	9.0			0.4	2.41	0.22	0.01	2.6	0.4	17.4	2.4	0.5	13.2
Limited services meals and snacks	6.7			0.6	2.51	0.17	0.02	2.8	0.3	12.1	2.5	0.7	5.9
Food at employee sites and school	110.1			1.7	0.07	0.08	0.00	2.8	2.4	43.8	2.8	1.9	55.9
Food from vending machines & mobile vendors	11.5			0.5	0.04	0.00	0.00	3.1	1.0	8.5	2.5	1.3	6.9
Other food away from home	5.5			0.0	0.17	0.01	0.00	2.5	1.3	2.3	2.3	1.0	3.2
Energy	13.1			-1.6	8.01	1.05	-0.13	-1.9	10.0	1.5	1.6	9.6	1.2
Energy comm.	12.2			-2.0	4.31	0.53	-0.09	-2.8	17.0	0.9	3.0	17.1	0.5
Fuel oils & other fuels	41.7			-0.4	0.22	0.09	0.00	-2.3	15.8	2.8	2.7	14.4	2.7
Motor fuel	10.8			-2.1	4.09	0.44	-0.09	-2.8	17.1	0.8	3.0	17.3	0.5
<u>Gasoline</u>	<u>10.1</u>			<u>-2</u>	<u>3.99</u>	<u>0.40</u>	<u>-0.08</u>	<u>-2.8</u>	<u>17.1</u>	<u>0.8</u>	<u>3.0</u>	<u>17.4</u>	<u>0.4</u>
<u>Other</u>	<u>43.3</u>			<u>2.3</u>	<u>0.10</u>	<u>0.04</u>	<u>0.00</u>	<u>-2.3</u>	<u>19.5</u>	<u>2.3</u>	<u>3.6</u>	<u>17.9</u>	<u>2.2</u>
Energy serv.	14.2			-1.1	3.70	0.53	-0.04	0.0	2.4	5.8	0.5	2.7	5.1
Electricity	13.7			-0.2	2.69	0.37	-0.01	0.5	1.5	9.0	1.0	1.7	7.6
Utility (piped gas service)	15.5			-3.5	1.02	0.16	-0.04	-1.4	7.5	2.2	-0.9	7.3	2.2
All items less food and energy	6.0			0.2	78.29	4.70	0.16	2.0	0.2	17.8	1.8	0.4	10.2
Commodities less food and energy	3.7			-0.5	21.18	0.78	-0.11	-0.3	0.4	10.3	0.2	0.9	4.0
Household furnishings	8.3			0.4	3.79	0.31	0.02	-0.8	1.2	7.6	-0.9	1.2	7.7
Window & floor coverings	5.6			-1.8	0.30	0.02	-0.01	-2.3	1.7	4.6	-2.8	1.8	4.7
Furniture & bedding	6.8			-0.8	0.98	0.07	-0.01	-0.3	1.7	4.1	-0.9	2.1	3.7
Appliances	1.7			0.9	0.25	0.00	0.00	-1.2	3.1	0.9	-1.6	3.0	1.1
Other household equipment	5.5			-1.2	0.56	0.03	-0.01	-3.5	1.8	4.9	-3.7	1.5	6.2
Tools & hardware	10.0			0.6	0.94	0.09	0.01	-0.1	1.0	9.7	-0.3	1.2	8.4
Housekeeping supplies	12.4			0.6	0.95	0.12	0.01	0.3	1.2	10.2	0.4	1.3	9.1

December 13, 2022

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Apparel	3.6			0.2	2.48	0.09	0.00	-0.5	1.0	4.2	0.3	1.7	1.9
Men's & boys apparel	1.3			0.3	0.62	0.01	0.00	-0.3	1.5	1.1	0.5	2.3	0.4
Women's & girls apparel	5.6			0.0	0.99	0.06	0.00	-1.3	1.9	3.7	-0.1	2.5	2.3
Footwear	2.3			0.1	0.60	0.01	0.00	0.2	1.3	1.6	0.8	1.7	0.9
Infant & toddler's apparel	3.9			1.6	0.12	0.00	0.00	0.4	3.8	0.9	0.5	3.6	1.0
Jewelry & watches	5.2			0.9	0.16	0.01	0.00	1.0	3.4	1.2	1.5	3.8	1.0
Trans. less fuel	2.4			-1.3	8.41	0.20	-0.11	-0.3	0.9	3.1	0.4	1.5	1.3
New vehicles	7.2			0.0	4.06	0.29	0.00	0.1	0.7	10.8	0.8	1.2	5.2
Used cars & trucks	-3.3			-2.9	3.83	-0.13	-0.11	-1.3	2.1	-1.0	1.1	4.8	-0.9
Motor vehicle parts & equipment	11.6			0.6	0.43	0.05	0.00	0.2	1.1	10.8	0.9	2.2	5.0
Medical comm.	3.1			0.2	1.47	0.05	0.00	2.1	1.7	0.6	2.3	1.5	0.6
Medicinal Drugs	2.8			0.1	1.37	0.04	0.00	2.2	1.8	0.3	2.3	1.6	0.4
Medical equipment & supplies	7.3			1.7	0.10	0.01	0.00	0.4	1.2	5.6	0.3	1.2	5.9
Recreation comm.	3.6			-0.4	1.88	0.07	-0.01	-2.6	1.1	5.8	-2.3	0.9	6.5
Video & audio products	-8.2			-1.2	0.28	-0.02	0.00	-10.1	2.4	0.8	-9.2	2.2	0.5
Pets & pet products	13.0			0.5	0.57	0.07	0.00	0.4	1.5	8.6	0.5	1.5	8.6
Sporting goods	15.7			0.8	0.54	0.09	0.00	-0.7	1.5	10.7	-0.6	1.2	13.4
Photographic Equipment & supplies	2.7			0.0	0.02	0.00	0.00	-1.7	4.6	1.0	-3.0	4.0	1.4
Recreational reading materials	3.3			-1.3	0.10	0.00	0.00	1.6	1.9	0.9	1.5	1.8	1.0
Other recreational goods	3.2			-0.8	0.38	0.01	0.00	-6.5	1.3	7.3	-5.2	1.7	4.8
Educ. & communication comm.	1.4			-1.4	0.75	0.01	-0.01	-3.7	1.0	5.0	-3.5	0.9	5.4
Educational books & supplies	-9.7			-1.6	0.09	-0.01	0.00	2.2	3.0	-4.0	3.6	2.7	-4.9
IT commodities	5.3			0.1	0.67	0.04	0.00	-6.1	1.9	6.0	-6.8	1.8	6.7
Alcohol	-11.5			-1.8	0.87	-0.10	-0.02	1.3	0.3	-36.9	1.4	0.4	-35.0
Alcoholic beverages at home	5.5			0.7	0.58	0.03	0.00	0.8	0.6	7.8	0.8	0.5	8.9
Alcoholic beverages away from home	4.5			0.8	0.29	0.01	0.00	1.9	0.5	5.6	2.2	0.7	3.5
Other goods	7.1			0.3	1.35	0.10	0.00	1.4	0.9	6.7	1.4	0.7	8.0
Tobacco & smoking products	7.5			0.6	0.52	0.04	0.00	4.3	1.5	2.1	4.4	3.8	0.8
Personal care products	6.3			0.7	0.65	0.04	0.00	-0.3	0.6	11.3	-0.1	0.8	7.8
Miscellaneous personal goods	7.4			0.2	0.18	0.01	0.00	-2.4	3.1	3.2	-1.7	2.4	3.8

December 13, 2022

Nov 2022				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
Services less energy services	10.8			2.0	57.11	6.17	1.14	2.8	0.2	34.4	2.4	0.6	13.3
Shelter	6.8			0.4	32.62	2.22	0.13	3.3	0.2	20.9	2.5	1.2	3.7
Rent of shelter	7.1			0.6	32.26	2.29	0.19	3.3	0.2	20.6	2.5	1.2	3.9
<i>Rent of primary residence</i>	<i>7.2</i>			<i>0.6</i>	<i>7.35</i>	<i>0.53</i>	<i>0.04</i>	<i>3.7</i>	<i>0.1</i>	<i>26.3</i>	<i>2.9</i>	<i>1.1</i>	<i>3.9</i>
<i>Lodging away from home</i>	<i>7.9</i>			<i>0.8</i>	<i>0.93</i>	<i>0.07</i>	<i>0.01</i>	<i>2.3</i>	<i>2.0</i>	<i>2.8</i>	<i>2.2</i>	<i>2.2</i>	<i>2.6</i>
<i>OER of residences</i>	<i>3.2</i>			<i>-0.7</i>	<i>23.98</i>	<i>0.77</i>	<i>-0.17</i>	<i>3.2</i>	<i>0.2</i>	<i>-0.1</i>	<i>2.4</i>	<i>1.1</i>	<i>0.7</i>
Tenants' & household insurance	7.1			0.7	0.36	0.03	0.00	1.4	1.2	4.8	2.3	1.5	3.1
Water, sewer, trash collection	0.6			0.1	1.09	0.01	0.00	3.6	0.6	-5.3	4.3	1.0	-3.6
Water & sewage maintenance	5.0			0.3	0.78	0.04	0.00	4.0	0.8	1.3	4.8	1.4	0.1
Garbage & trash collection	6.6			0.5	0.31	0.02	0.00	2.5	1.5	2.8	2.5	1.1	3.8
Household ops.	6.6			0.1	0.83	0.05	0.00	3.8	1.3	2.2	2.6	1.6	2.5
Domestic services	4.4			-3.0	0.24	0.01	-0.01	2.0	1.1	2.3	1.6	1.0	2.7
Gardening & lawn care	4.1			0.2	0.30	0.01	0.00	4.3	2.7	-0.1	2.8	2.6	0.5
Moving, storage, freight	3.5			-1.2	0.10	0.00	0.00	5.6	3.9	-0.5	3.3	3.9	0.1
Repair of household items	5.4			0.1	0.11	0.01	0.00	4.8	2.1	0.3	4.2	2.0	0.6
Medical serv.	4.4			-0.7	6.89	0.30	-0.05	2.9	1.0	1.5	3.0	0.8	1.6
Professional Services	3.1			0.1	3.47	0.11	0.00	1.5	0.9	1.7	1.8	0.8	1.6
Hospital & related services	3.2			-0.3	2.51	0.08	-0.01	3.8	1.1	-0.6	4.5	1.3	-1.0
Health insurance	13.5			-4.3	0.92	0.12	-0.04	5.0	5.8	1.5	3.6	6.0	1.6
Transportation serv.	14.2			-0.1	5.95	0.84	-0.01	2.6	1.1	10.6	2.6	1.0	12.0
Leased cars & trucks	-3.6			-1.9	0.76	-0.03	-0.01	0.5	3.0	-1.4	-1.6	3.2	-0.6
Motor vehicle maintenance & repair	11.7			1.3	1.07	0.13	0.01	2.2	0.7	13.6	2.0	0.6	16.9
Motor vehicle insurance	13.4			0.9	2.46	0.33	0.02	5.5	2.6	3.0	4.8	2.0	4.2
Motor vehicle fees	1.8			-0.4	0.50	0.01	0.00	1.8	0.7	0.0	2.2	1.9	-0.2
Public transportation	23.8			-2.0	0.90	0.21	-0.02	-1.2	1.5	16.5	1.0	3.6	6.4
Recreation serv.	5.4			1.0	3.11	0.17	0.03	2.6	0.7	4.3	2.3	0.7	4.1
Video & audio services	4.2			0.9	1.13	0.05	0.01	2.7	1.4	1.0	2.6	1.3	1.2
Pet services	10.9			0.7	0.52	0.06	0.00	3.1	0.8	10.2	3.3	0.9	8.3
Photo services	4.4			0.5	0.03	0.00	0.00	-0.2	2.0	2.3	0.8	1.8	1.9
Other recreation services	4.4			1.1	1.43	0.06	0.02	2.4	0.6	3.4	1.7	1.1	2.5
Educ. & communication serv.	2.2			1.0	5.28	0.12	0.05	0.4	1.3	1.3	1.1	1.3	0.9
Tuition, school fees, child care	3.1			0.3	2.50	0.08	0.01	2.8	0.6	0.5	3.3	0.8	-0.3
Postage & delivery	4.2			0.2	0.08	0.00	0.00	2.3	2.0	1.0	3.3	2.0	0.5
Telephone services	1.5			2.1	1.78	0.03	0.04	-2.4	3.0	1.3	-1.3	2.4	1.2
Internet services	1.4			0.9	0.91	0.01	0.01	-0.2	1.5	1.1	0.1	1.3	1.0
Other personal serv.	6.5			0.8	1.35	0.09	0.01	2.7	0.7	5.6	2.4	0.6	6.5
Personal care services	6.8			1.4	0.54	0.04	0.01	2.3	0.7	6.5	1.8	0.8	6.1
Miscellaneous personal services	6.3			0.4	0.82	0.05	0.00	2.9	0.9	3.7	2.7	0.7	4.9

*Number may not add due to rounding

Sources: Scotiabank Economics, BLS.

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