



December CPI Eases in Line with Expectations

December CPI Falls 0.1%, Core Rises 0.3%

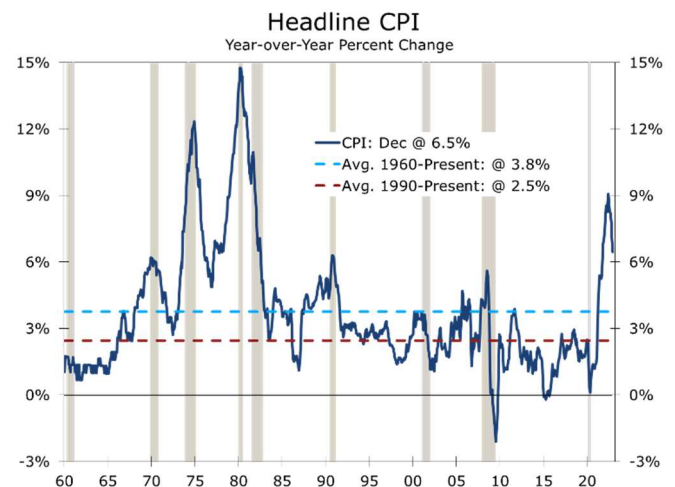
- ▲ The Consumer Price Index fell 0.1% in December, thanks largely to lower gasoline prices. Food prices rose 0.3% but have also eased somewhat.
- ▲ After excluding food and energy, the core CPI rose 0.3%. Both numbers were roughly in line with expectations.
- ▲ The pace of inflation appears to have peaked around mid-2022. The CPI rose 1.3% in June and the 3-month rate of growth topped at a 10.6% pace.
- ▲ Much of the improvement in inflation results mostly from a turnaround in items temporary driven higher by the pandemic. These include energy, used cars and other assorted consumer goods.
- ▲ The pivot in consumer spending toward services continues to fuel price gains elsewhere. Rent and owners' equivalent rent remain the largest drivers. Both rose 0.8% in December.

The Consumer Price Index came in almost precisely in line with expectations in December, with the headline CPI declining 0.1% and the core rising 0.3%. The CPI topped out around the middle of last year, with much of the improvement resulting from a turnaround in items that were temporary driven higher by the abrupt shifts in consumer preferences during the pandemic.

Falling energy prices were responsible for much of the drop in the headline CPI. Overall energy prices fell 4.5% in December, with fuel oil prices tumbling 16.6% and gasoline prices falling 9.4%. While the drops are welcome, a big part of the decline in fuel oil costs is due to unseasonably mild weather in Europe and the

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Northeast U.S. Many consumers already purchased fuel oil at higher prices for the winter and do not stand to benefit from December's drop unless the weather turns colder, which would boost energy use and likely pull those prices back up again. Energy has gone from contributing 3.7 points to the year-to-year change in the CPI in June to just 0.6 points in December.



Source: Bureau of Labor Statistics

Food prices rose 0.3% in December, with prices at restaurants rising 0.4% and prices at grocery stores rising a more modest 0.2%. The moderation in grocery store prices, which remain up 11.8% year-to-year, partly results from lower energy prices. Prices for fresh fruit and vegetables fell 0.6% and are bound to reverse following the extreme weather currently impacting California. Prices for meat, poultry, fish and eggs rose 1.0% in December and are up a staggering 16.1% from last December. Eggs are up 59.9%!

Excluding food and energy items, the core CPI rose 0.3% in December, which was in line with expectations. Prices for many consumer goods have moderated considerably as demand has cooled and supply chain

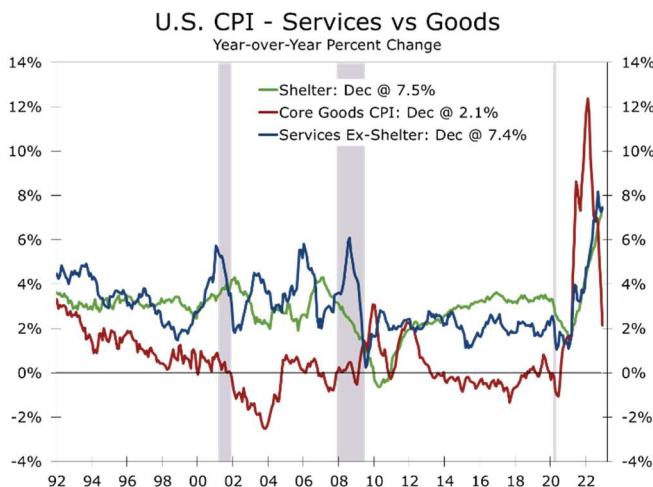


disruptions have subsided. Used car prices fell 2.5% in December and are now down 8.8% over the past year. New car prices were unchanged last month, however, and most cars are still selling at sticker price or more.

Inventories of many consumer goods are now abundant, and retailers are increasingly discounting. Price cuts are not yet apparent in the CPI. Prices for apparel were unchanged in December. Clothing and accessories account for just 2.4% of consumer expenditures, so even substantial declines will only have a modest impact on headline inflation in 2023.

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Inflation is most problematic in areas where labor accounts for a large share of selling prices. Prices at limited-service restaurants rose 0.5% in December and are up 6.6% year-to-year, while prices at full-service restaurants rose just 0.1% in December but are up 8.2% year-to-year. Prices for alcoholic beverages at bars rose 0.8% and are up 6.8% year-to-year, with wine up 7.8%, spirits up 7.4% and beer up 6.8%.



Source: Bureau of Labor Statistics

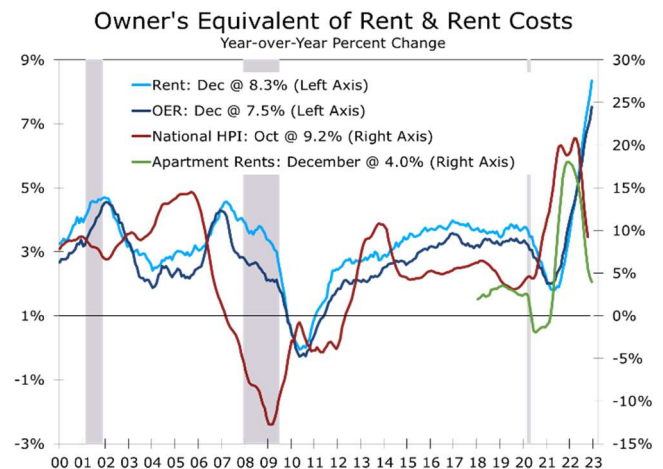
The biggest problem area for inflation, and most controversial, remains housing costs. Shelter accounts for 32.9% of the overall CPI and 42% of the core CPI. Housing costs have moderated only modestly, even

though home prices and apartment rents have been falling for the past few months.

The divergence between market rents and home prices and the CPI's measure of housing costs is receiving considerable attention. Many fear the Fed may be overreacting to today's high reported inflation. While we have some sympathy for this view, we feel housing costs are appropriately being accounted for in the CPI.

Rent of primary residence rose 0.8% in December and is up 8.3% year-to-year. Owners' equivalent rent also rose 0.8% and is up 7.5% year-to-year. Home prices and rents rose much more than owners' equivalent rent and residential rent, so two measures of housing costs are still being reconciled.

The CPI measures housing costs with a lag and over time so that it more accurately measures changes in housing costs for the typical household. People do not buy homes or rent apartments every month, but those that did in December did so at markedly higher prices.



Source: Bureau of Labor Statistics, SP/CoreLogic, & Apartment List

The moderation in the CPI is welcome and increases the odds the Fed will opt for a quarter-point hike at the February 1 FOMC meeting. We still believe a half-point hike is more likely, however, given the still high level of inflation and continued pressure on wages.

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