Markets Rally Big on Surprising Decline in Consumer Inflation

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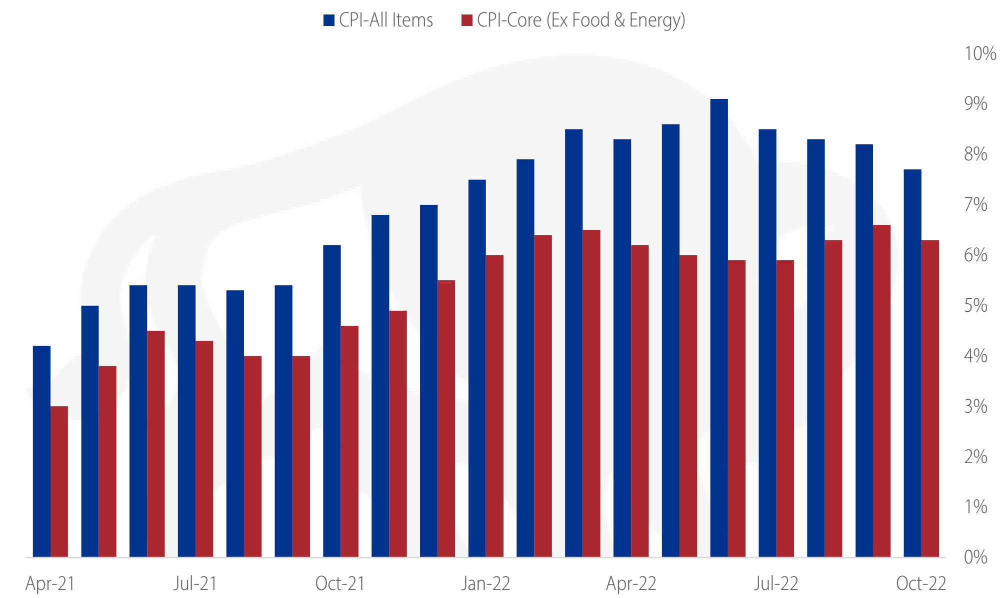
The headline consumer price index (CPI) rose by +0.4% in October, below the +0.6% median forecast, while core CPI increased by just +0.3%, cooler than the expected +0.5% gain. On an annual basis, headline CPI retreated from +8.2% to +7.7%, while the pace of core CPI slipped from +6.6% to +6.3%. Consumer Inflation is still much too high, but the optics of both the headline and core CPI moving significantly lower are feeding financial markets starved for good news.

The dollar is falling, while both stocks and bonds are rallying big in early trading. The somewhat cooler CPI report is providing unaccustomed relief as October marks only the third time in the last 20 months that headline consumer prices came in below forecast. Suddenly, a smaller 50 bp rate hike at the December FOMC meeting has become the more likely move.

Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

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Analysts expecting CPI to climb in October had expected energy costs would be the driver. As expected, the overall energy index rose +1.8% after three straight months of decline. Within the broad energy index, the price of gasoline rose +4.0% while the price of fuel oil increased +19.8%. However, falling prices in other categories unexpectedly outweighed energy. The cost for used cars and trucks plunged -2.4% last month, reflecting an increase in new car production as supply chain shortages eased and long-overdue microchip shipments arrived. Other notable price declines include health insurance (-4.0%), airfare (-1.1%), clothing (-0.7%) and medical services (-0.6%).

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Overall food costs were up *just* +0.6% in October, after averaging nearly +1.0% for much of the year. The category breakdown was also encouraging as the food-at-home index (groceries) rose at the slowest pace of the year. The cost of food away-from-home remained quite elevated, but eating out is a choice.

Unfortunately, shelter was a category that didn't turn lower, rising +0.8% last month. The largest monthly increase since 1990 contributed fully half of the headline advance. Lodging away-from-home rose +4.8%, reflecting continue wage pressures for hotels and motels. There has been very recent evidence of moderating rent prices throughout the nation, but declines have yet to filter through to the CPI Index. Bloomberg Economics pointed out that core CPI ex shelter was actually down -0.1% last month, the first outright decline since May 2020.

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Core goods prices continued a steady decline, falling another -0.4% last month, while prices of core services continued to rise, although at a lessor +0.5% pace.

There is some question as to whether this morning's softening inflation report warrants the massive market rally currently taking place. The inflation problem hasn't ended with a single upbeat report, but for Fed officials looking for an opportunity to moderate the pace of tightening, the October CPI surprise fits the bill.

Market Indications as of 9:33 A.M. Central Time

DOW	Up 838 to 33,352 (HIGH: 36,800)
NASDAQ	Up 560 to 10,913 (HIGH: 16,057)
S&P 500	Up 153 to 3,901 (HIGH: 4,797)
1-Yr T-bill	current yield 4.55%; opening yield 4.69%
2-Yr T-note	current yield 4.31%; opening yield 4.57%
3-Yr T-note	current yield 4.19%; opening yield 4.48%
5-Yr T-note	current yield 3.95%; opening yield 4.23%
10-Yr T-note	current yield 3.84%; opening yield 4.09%
30-Yr T-bond	current yield 4.11%; opening yield 4.26%