

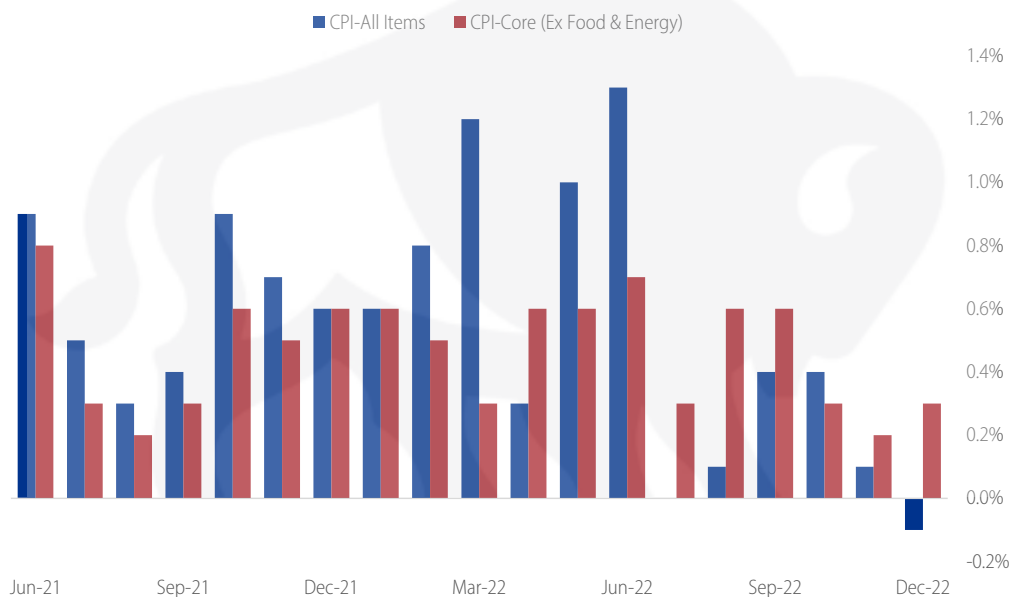
Markets Signal Smaller Rate Hike in Feb on Negative CPI Reading

The overall consumer price index (CPI) fell by -0.1% in December, *the first negative reading in 32 months*, while the year-over-year pace of consumer inflation decreased from +7.1% to +6.5%. Both the monthly and annual rates exactly matched forecasts. *On a three-month annualized basis, headline CPI is now advancing at a +1.8% rate.*

Overall energy prices were down -4.5% last month with gasoline prices -9.4% lower. The food index showed significant moderation, up just +0.3% after averaging +0.8% over the previous six months. New vehicle prices were negative (-0.1%) as available supply increased, but more significant was the -2.5% drop in used car prices. The fourth straight decline in the price of used vehicles has dragged the annual pace into negative territory (-8.8%). Just 10 months ago, the year-over-year advance in the price of used vehicles was a jaw-dropping +41%.

Core CPI, which excludes food and energy, rose +0.3% in December. Although this reading also matched the median forecast, it was slightly higher than the +0.2% increase logged in November. On an annual basis, the core rate fell from +6.0% to +5.7%, again matching expectations.

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



Source: Bureau of Labor Statistics

Shelter costs, the largest component of the index, climbed +0.8% in December following a +0.6% rise the previous month. Shelter costs are notoriously sticky, although more recent data indicates lower costs on the horizon.

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Bonds took a minute to digest the data before embarking on another rally. The futures market is now indicating just a 25 basis point hike at the next FOMC meeting in three weeks. Most Fed officials continue to signal multiple hikes in the first quarter, but *the market isn't so sure this will be necessary*. This morning, Philadelphia Fed President Patrick Harker jumped off-script with his opinion that quarter-point increases are now appropriate going forward.

The inflation trend is clearly lower, and most expect the annual headline increase to decline significantly over the next several months. However, China's emergence from a broad lockdown promises to increase global energy demand which will likely nudge pump prices higher in the first quarter. The core rate is likely to be a bit more stubborn. In addition to those sticky shelter costs, wage pressures continue to rise.

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Market Indications as of 9:17 A.M. Central Time

DOW	Up 136 to 34,109 (HIGH: 36,800)
NASDAQ	Up 18 to 10,950 (HIGH: 16,057)
S&P 500	Down 12 to 3,958 (HIGH: 4,797)
1-Yr T-bill	current yield 4.69%; opening yield 4.71%
2-Yr T-note	current yield 4.15%; opening yield 4.22%
3-Yr T-note	current yield 3.84%; opening yield 3.92%
5-Yr T-note	current yield 3.60%; opening yield 3.66%
10-Yr T-note	current yield 3.52%; opening yield 3.55%
30-Yr T-bond	current yield 3.67%; opening yield 3.68%

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