Markets Signal Smaller Rate Hike in Feb on Negative CPI Reading

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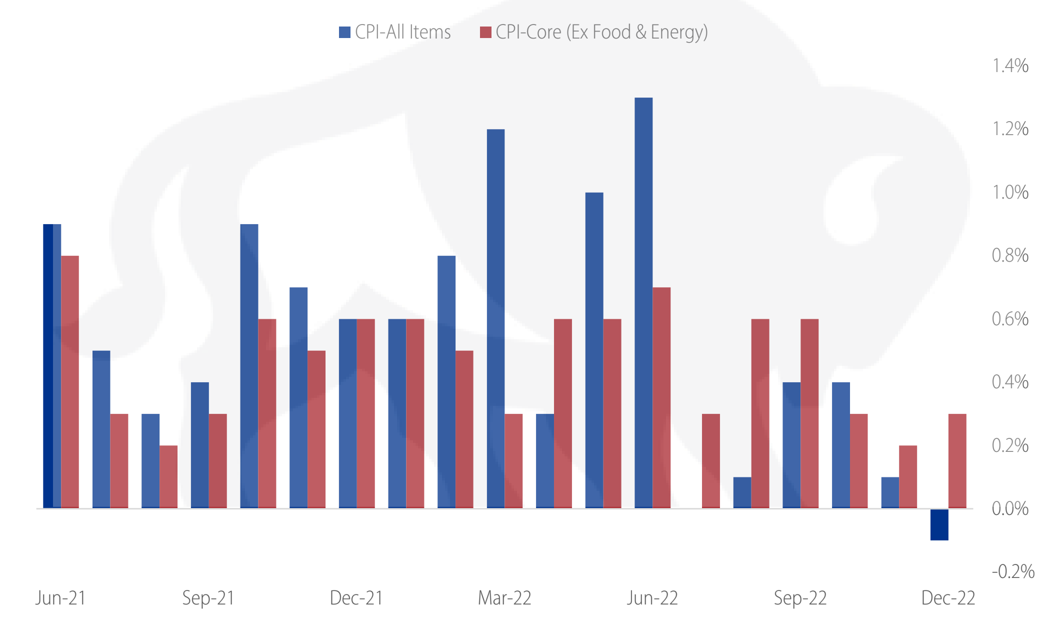
The overall consumer price index (CPI) fell by -0.1% in December, *the first negative reading in 32 months*, while the year-over-year pace of consumer inflation decreased from +7.1% to +6.5%. Both the monthly and annual rates exactly matched forecasts. *On a three-month annualized basis, headline CPI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

On a three-month annualized basis, headline CPI is now advancing at a +1.8% rate.

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



Source: Bureau of Labor Statistics

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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.

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.

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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.

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%