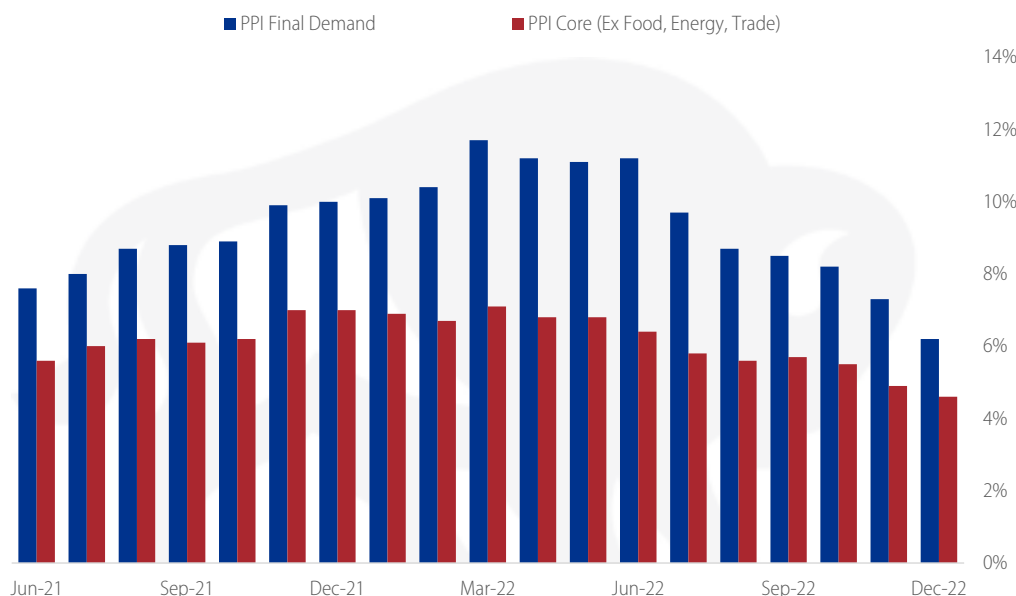


## Yields Slide as Producer Prices Retreat

This morning, the December producer price index (PPI), like CPI last week, indicated further deceleration of price pressures. This suggests that Fed tightening is having the desired effect, and that fewer rate hikes may be required going forward.

Headline final demand PPI dropped -0.5%, last month, well below the -0.1% median forecast and matching the tamest producer price reading in 2½ years. Year-over-year producer inflation was rising at a +6.2% pace in December, down from a revised +7.2% in November. Just six months earlier, headline PPI was increasing at a troubling +11.3% pace.

### Producer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

Within the headline, food prices fell -1.2%, *the biggest drop in two years*, while energy prices plunged -7.9%. Goods prices (which include food and energy) fell -1.6%, while prices for services rose by just +0.1%.

Core PPI (which excludes the volatile food and energy components) rose +0.1% in December and +5.5% year-over-year, down from +6.2% in November.

Also released this morning was the December retail sales report. The advance measure (which is not inflation-adjusted and focuses almost entirely on goods) dropped by a larger-than-expected -1.1%, while November sales were revised downward from a previously reported -0.6% to a more substantial -1.0%. The softening was widespread with declines in 10 of 13 major categories. This weakening in consumption should drag Q4 GDP lower.

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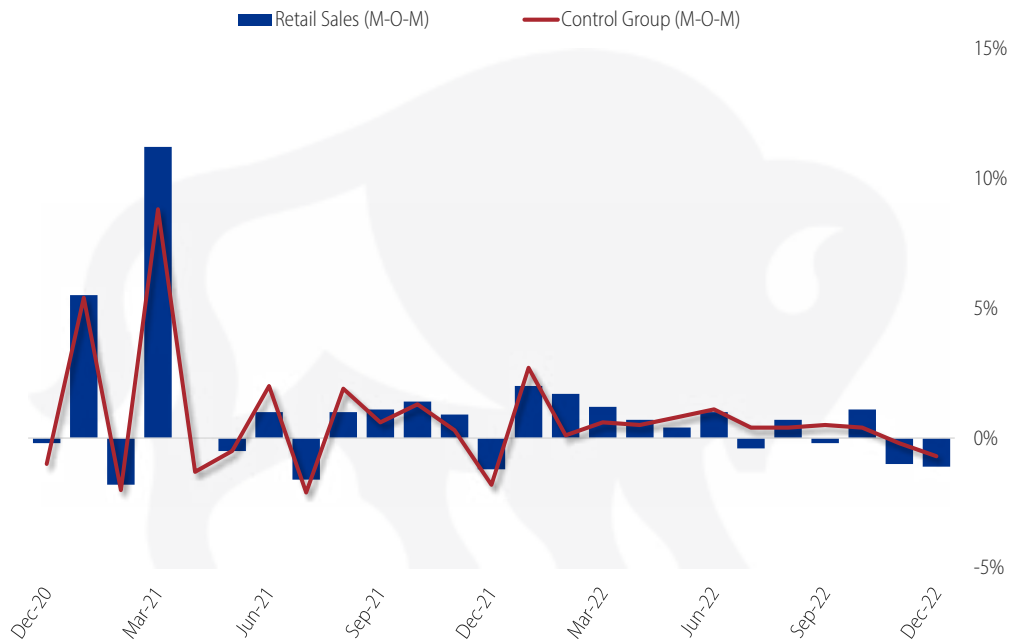
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*Headline final demand PPI dropped -0.5%, last month, well below the -0.1% median forecast and matching the tamest producer price reading in 2½ years.*

*Although Bullard believes policy "has to stay on the tighter side during 2023," his online Wall Street Journal interview seemed to carry a less urgent tone.*

## Retail Sales (Month-over-Month Percent Change)



*The softness in consumer spending is real. The U.S. economy is expected to weaken further in 2023 which will starve demand, allowing supply to catch up.*

Source: US Census Bureau

Gasoline station sales were down -4.6% last month, following a -1.6% drop in November. Because sales are not adjusted for inflation, this primarily reflects lower pump prices. Food and beverage sales were *unchanged* in December, while sales at eating and drinking establishments were down -0.9%. Other major categories logging declines last month included vehicles and parts (-1.2%), clothing (-0.3%), general merchandise (-0.8%) and non-store retailers (-1.1%).

Several dovish Fed officials have recently indicated the tightening cycle is nearing completion. This morning, a notorious hawk weighed-in. St. Louis Fed President James Bullard admitted monetary policy was almost restrictive, although "not quite there yet." Although Bullard believes policy "has to stay on the tighter side during 2023," his online Wall Street Journal interview seemed to carry a less urgent tone.

The softness in consumer spending is real. The U.S. economy is expected to weaken further in 2023 which will starve demand, allowing supply to catch up. However, the recent drop in overall inflation has much to do with lower energy prices, which can be attributed to reduced demand in China during much of the third and fourth quarters. The reopening of the Chinese economy promises to boost energy demand and cap oversized declines at the pump.

*Right or wrong, rate cuts are now priced in for November, December and next January. This is where the bond market parts company with the FOMC.*

Bond yields have plunged in early trading while stocks are mixed. The futures market is still indicating 25 bp rate hikes for early February and late March. However, right or wrong, rate cuts are now priced in for November, December and next January. This is where the bond market parts company with the FOMC. At this point, no committee member has signaled a policy reversal this year.

## Market Indications as of 9:54 A.M. Central Time

DOW	Down -151 to 33,760 (HIGH: 36,800)
NASDAQ	Up 2 to 11,097 (HIGH: 16,057)
S&P 500	Up 4 to 3,995 (HIGH: 4,797)
1-Yr T-bill	current yield 4.65%; opening yield 4.65%
2-Yr T-note	current yield 4.10%; opening yield 4.20%
3-Yr T-note	current yield 3.76%; opening yield 3.87%
5-Yr T-note	current yield 3.47%; opening yield 3.61%
10-Yr T-note	current yield 3.41%; opening yield 3.54%
30-Yr T-bond	current yield 3.57%; opening yield 3.65%

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