14 December 2022
Japanese report: 14 December 2022

Daiwa's View

Validation of interest rate peaking

➢ CPI-PCE spread also narrowing

Fixed Income Research Section
FICC Research Dept.

Chief Strategist
Eiichiro Tani, CFA
(81) 3 5555-8780
eiichiro.tani@daiwa.co.jp

Daiwa Securities Co. Ltd.

CPI-PCE spread also narrowing

Fed Governor Christopher Waller (6 Oct 2022)
Such a step-down in non-housing core inflation, if sustained over several months, would be a big improvement in inflation, and I think it is quite possible to get there because of the considerable tightening of monetary policy that has occurred so far and additional anticipated tightening.

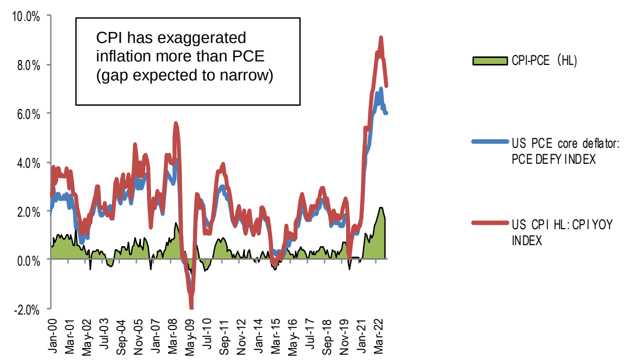
Validation of interest rate peaking

The US Consumer Price Index, released on 13 December, was again favorable. Core inflation excluding housing, which Fed Governor Christopher Waller and others have focused on, declined 0.1% m/m, falling for the second straight month. After the CPI release, market expectations that next February's rate hike will slow to 25bp intensified. The US Treasury yield curve overall fell sharply by more than 10bp. The Fed won't use "multi-month" data to justify halting its rate hiking phase as it wants to confirm that good data has lasted for "several months." That said, if the same trend continues for next month's data, there would be a three-month streak of good data and this criteria of "several months" would gradually come into view. While it is best not to be too hasty, the market, which tends to be one step ahead, will most likely react.

Also, we should probably remain aware of the spread between CPI and PCE (Personal Consumption Expenditures) from a market perspective. Since the start of this century, the difference between core CPI and core PCE has averaged 0.3%, but this spread has currently widened to 1.3%. This is due to the fact that the CPI data has been much higher than the PCE data during this inflation spike phase. The important point is that once inflation begins to subside, the CPI data will likely decline at a steeper pace than the PCE data.

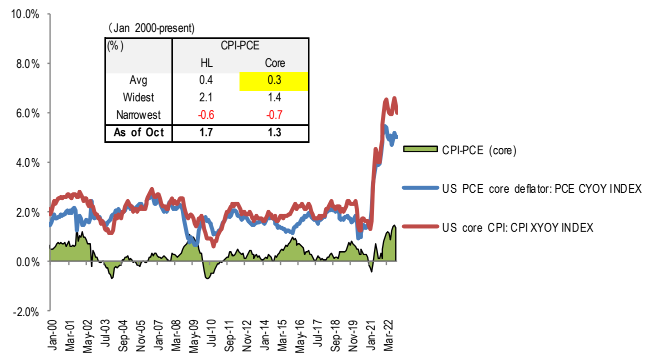
Of course, this is just an error that occurs when observing the same event with different measuring approaches, but it cannot be taken lightly when considering that this year's market has been both extremely cheered and saddened by the CPI data. The likely suspension of Fed rate hikes will almost certainly be the main market theme in the first half of 2023. The fact that the CPI, which provides the latest material for examining inflation trends, is likely to come out in a declining direction, could be a source of market turmoil (yield declines) next year. A sharp decline in the CPI would be seen as validation that interest rates are peaking.

US CPI, PCE (headline)



Source: Bloomberg; compiled by Daiwa Securities.

US CPI, PCE (core)



Source: Bloomberg; compiled by Daiwa Securities.

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