MACRO THOUGHTS

INVESTMENT RESEARCH / MARKET COMMENTARY / CONSULTANCY

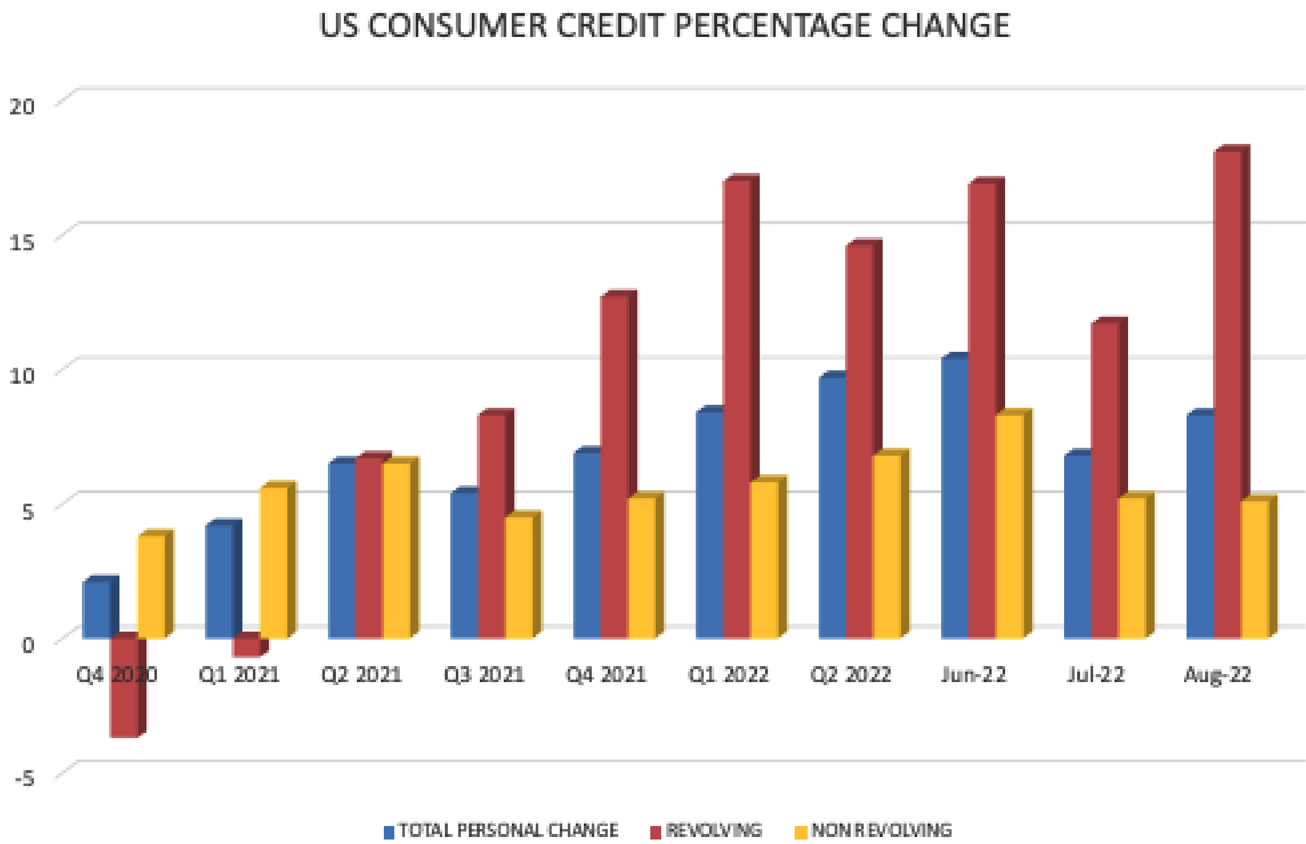
US CPI Comment

The market reaction to disappointing US CPI data, which was worse than the previous release and worse than expected, may be an overreaction, but given the Fed's aggression, it's understandable. ***However, the components of the data moved as should have been expected; the data is in line with our expectation for a deterioration in household budgets and we expect an even more significant slowdown in consumer activity, which could be as soon as the new year.***

As interest rates have forced mortgage applications to collapse, rents were a significant driver of prices, as were food and new car prices. We have been highlighting these trends over the past months, therefore, each increase can be accounted for, as can the fall in gasoline prices. Core CPI was 6.6% in September, the highest since 1982, up from 6.3% in the previous month and above market forecasts of 6.5%. For such a small difference, which may get revised lower, the market reaction was severe, with 2023 rate cuts being priced out. Excluding energy and food prices, the month on month rise was 0.6%, the same as in the previous month, and above market expectations for a 0.5% rise.

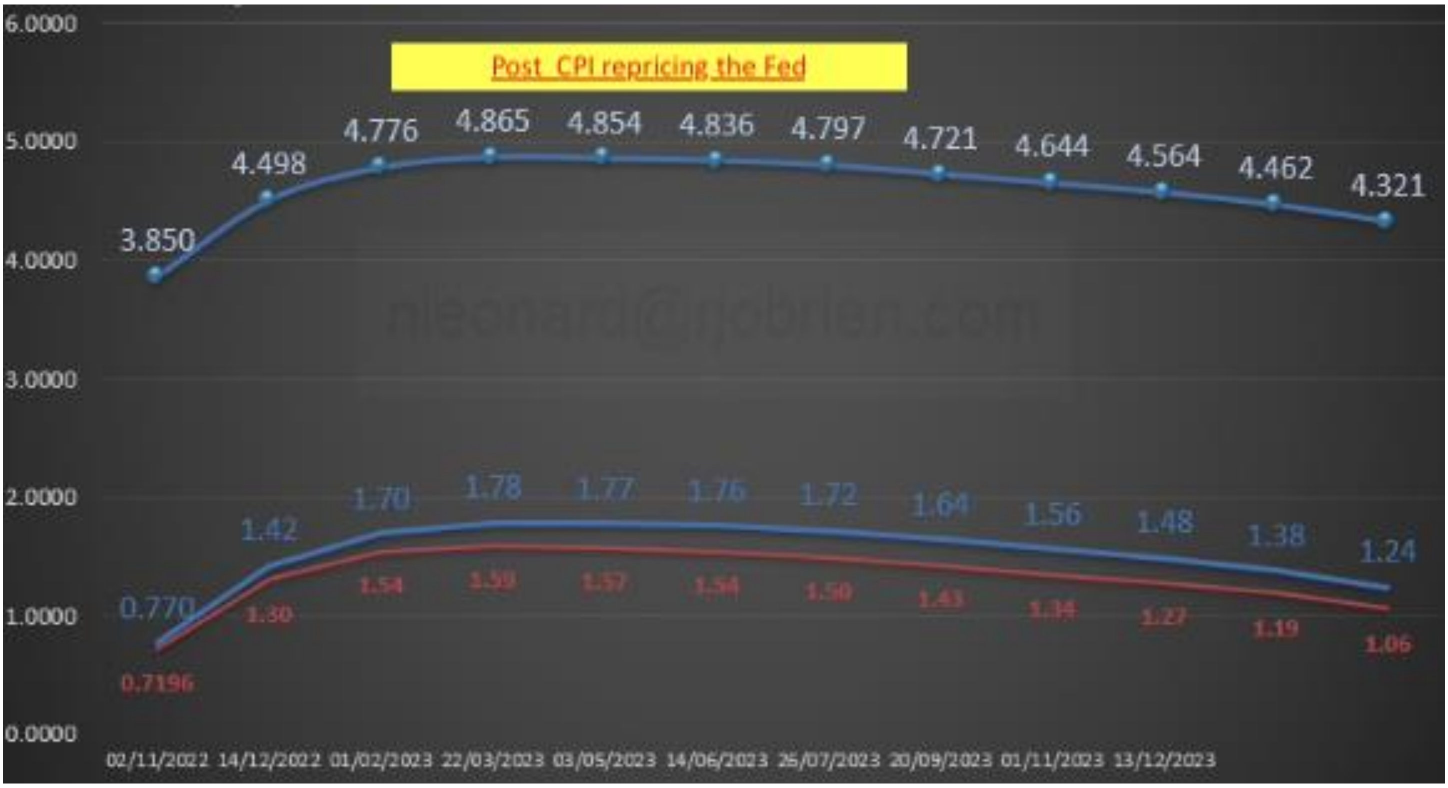
CPI Movers	Month on Month
Gasoline	-4.90%
Food at Home Rents	0.70%
Rents	0.80%
Used Cars	-0.01%
Apparel	-0.30%

Of note is the rise in food prices at employee sites and schools, which rose 44.9% in September, reflecting the expiration of some free school lunch programmes. This will have an acute impact on families and markets should have been prepared for higher food prices following poor harvests, both in the US and globally. September matched August for food at home prices, which increased 0.7% mom, and away from home, at 0.9% mom. Fruits and vegetables rose 1.6%, while the index for cereals and bakery products rose 0.9%.



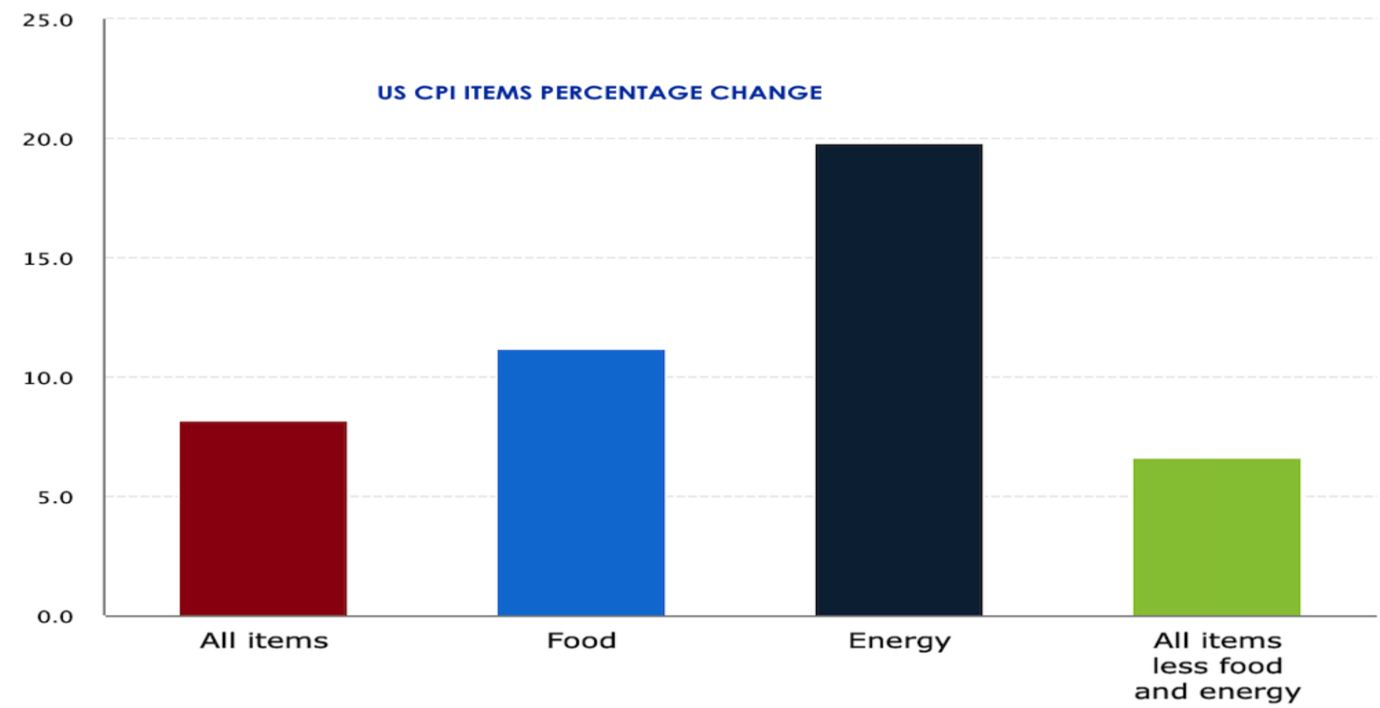
Not seasonally adjusted CPI measures:

- For all Urban Consumers (CPI-U) increased 8.2% yoy and just 0.2% mom
- Consumer Price Index for Urban Wage Earners increased 8.5% yoy and 0.1% to the prior seasonal adjustment
- Chained Consumer Price Index (adjusting Dollar amounts for inflation) increased 8% yoy & 0.3% mom



While the Fed may feel that they can solve the inflation issue by raising rates and tightening financial conditions, they are ignoring the clear signs that households are coming under intense pressure.

The Fed can now be expected to raise rates to 4½%. We had believed long end rates had peaked, and maybe that will prove to be so, but for now there is little to reason to believe the Fed will change their course. Tax receipts have increased and are higher than had been expected, so there are pay increases, however pay rises are not keeping up with the rising cost of living. **With the all items CPI at 8.2%, and average hourly earnings running at around 5%, clearly, the divergence between incomes and non-discretionary spending has continued.**

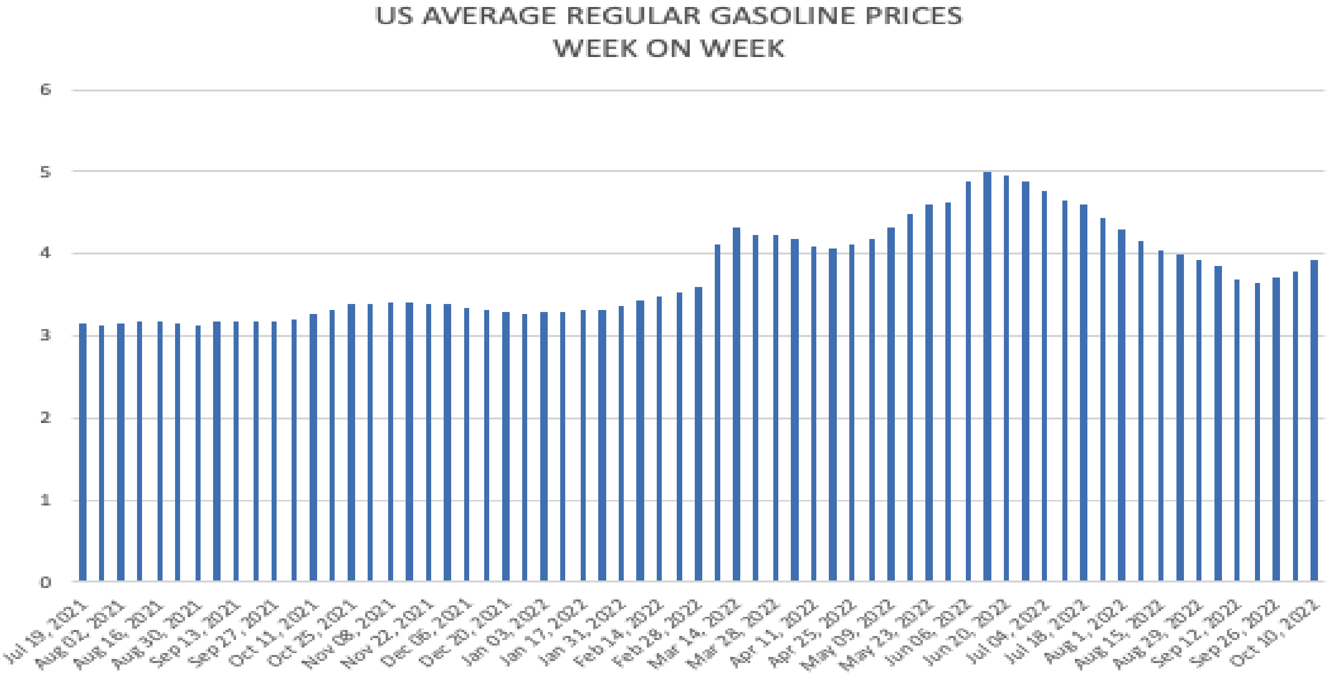


There are serious indications to expect as deep a recession as any previous downturn, particularly since property markets may already be in recession and as PMI and ISM surveys are showing no improvements in inventory levels (if anything, they continue to rise), while new orders are falling.

Fed data highlighted the explosion in Consumer Credit, which has followed the collapse in the personal savings rate. **In other words, households had been using up their savings to adjust to the rising cost of living and are now being forced to borrow, even at higher interest rates.**

Consumer credit in August increased at a seasonally adjusted annual rate of 8.3%, **Revolving credit (including credit cards) spiking to a rate of 18.1%,** while non-revolving credit increased at an annual rate of 5.1%. Total outstanding consumer credit at the end of August was $4.68tn ($1.15tn in Revolving credit and $3.5tn in Non-revolving credit), with new car loan rates at commercial banks above 5.50% for 60days.

In August, Personal saving was $652.8bn and ***the Personal Saving rate (personal saving as a percentage of disposable personal income) remained at 3.5%, having dropped to an all-time low of 3% in June.***



The indexes for shelter, medical care, motor vehicle insurance, new vehicles, household furnishings and operations, and education pushed the inflation index higher, discretionary goods, such as used cars and trucks, apparel, and communication declined. There, to some degree, the data is in line with an expectation for a deterioration in household budgets and a slowdown in consumer activity.

New car prices remained at elevated levels, despite the slowdown in July and August sales, and this was helped by models being made available following supply chains problems over the past year. As we have recently highlighted, the Houston floods of 2017 destroyed 1 million vehicles, involving insurance claims and an increase in used car prices, and the floods in Florida are said to have impacted on 300k cars, which will similarly impact on used car prices in the short term.

At best, new car sales in September and Q3 can be described as a 'mishmash', as sales continued to hold up, though there were demand headwinds and some automakers continue to struggle with production. Actual sales rose 2.8% mom, 13.5mio units, and above September 2021 sales. Overall though, sales fell 0.9% in Q3, despite the improvement in September. The improvement at the end of the quarter was largely due to filling orders of some months ago, as shortages of computer chips and other parts started to ease and auto factories were able to produce more.

As the prices of new vehicles rise and the cost of financing car purchases increases with each interest rate hike, being able to buy a new car will become beyond the means of more and more consumers; having ordered a new car months ago and waited for delivery, down payments will have increased and finance repayments may have risen to the point of no longer being affordable.

	Two Bedroom Appartment Medium Rents			
	Per Month	Per Year	MoM	YoY
New York	$4,410	$52,920	0.20%	40%
San Francisco	$4,170	$50,040	-0.70%	6.90%
Boston	$3,360	$40,320	6%	20%
San Diego	$3,420	$41,040	4.90%	26.20%
Miami	$3,400	$40,800	-0.30%	30.80%%
Los Angeles	$2,470	$29,640	1.20%	14.80%
Washington	$2,360	$28,320	-1.20%	8.50%

We have been highlighting the impact of rate increases on mortgage demand and rising rents, where the average two bedroom apartment in New York is up 40% yoy. ***Rent added 6.7% yoy and 0.8% mom to CPI.***

We have also been highlighting the fall in gasoline prices since June and notably the 4.9% decline in gasoline impacted the energy index, which decreased by -2.1%; however, over recent weeks, prices have started to rise and as OPEC reduces its production by 2 million barrels a day, wholesale prices have risen back to circa $90, having been below $80, and so the improvement in gasoline prices is likely to reverse in the months ahead.

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