January CPI

FEBRUARY 14, 2024

The January Consumer Price Index (CPI) report was certainly a disappointment, with core CPI rising 39 basis points on the month, its largest increase since last April. The print breaks a generally favorable run of inflation prints going back to last June. As for policy implications, absent a material slowing in the labor market, the CPI print will likely push the first Fed rate cut out to June at the earliest. It will take a few months of better inflation readings for the Fed to shore up its confidence that inflation remains on a glide path to two percent.

There was little to cheer in the details of the report. Goods prices fell further, but this bit of good news was largely due to a sharp decline in two categories: used vehicles and apparel prices. Within services, the so-called "supercore" measure that excludes housing inflation rose by 85 basis points, far above what the Fed would consider acceptable. Recall, policymakers have focused on core services excluding housing as they believe that this component of overall inflation is very sensitive to strength in the labor market.

The housing inflation measures were somewhat disappointing as well. Rent of primary residences continues to moderate month-over-month, though at a glacial pace, while owners' equivalent rent picked up on the month. The stickiness of housing inflation has been puzzling given the meaningful moderation in market rents since the second half of 2022. One explanation is existing tenant leases are still playing catch-up to new tenant leases. That is, last year as new rental supply came to market, landlords may have prioritized retaining existing tenants by not marking up rent renewals aggressively. If this is the case, it would suggest that cooling in new rents may be offset by the continued catch-up of rents on renewing leases. The net result could be some continued stickiness in housing inflation as measured by the BLS.

We will have a better sense of feed-through to core Personal Consumption Expenditures (PCE) after the release of the Producer Price Index (PPI) at the end of the week, as some components of PCE inflation (most importantly, health care services) are drawn from that release. Core PCE should come in lower than core CPI, given that health care services inflation in the PPI is very likely to be far below the 70 basis points seen in the CPI report, as the PPI measure includes the cost of health care services provided through government programs. Still, even with this bit of encouraging news, core PCE should still be quite a bit stronger than the 17 basis point increase that would, strictly speaking, be consistent with the Fed's two percent inflation objective. Penciling in a 30 basis point month over month increase, core PCE would rise back above 2 percent on a 6 month Annualized Rate basis, even as the year over year figure continues to moderate.

Despite this disappointing inflation print, it is premature to hit the panic button on the disinflation narrative. I continue to expect inflation to moderate, even if today's data may indicate a bumpier path for prices. Supply and demand in the labor market continues to come into better balance, real wage growth is far from excessive, and importantly, inflation expectations remain well-anchored. Finally, recent productivity gains suggest that businesses may have better scope to absorb any increases in input costs without crimping margins. If sustained, strong productivity growth would lower the pressure on firms to attempt to push higher costs on to consumers.

IMPORTANT DISCLOSURE

Availability of this document and products and services provided by MacKay Shields LLC may be limited by applicable laws and regulations in certain jurisdictions and this document is provided only for persons to whom this document and the products and services of MacKay Shields LLC may otherwise lawfully be issued or made available. None of the products and services provided by MacKay Shields LLC are offered to any person in any jurisdiction where such offering would be contrary to local law or regulation. This document is provided for information purposes only. It does not constitute investment or tax advice and should not be construed as an offer to buy securities. The contents of this document have not been reviewed by any regulatory authority in any jurisdiction.

This material contains the opinions of certain professionals at MacKay Shields but not necessarily those of MacKay Shields LLC. The opinions expressed herein are subject to change without notice. This material is distributed for informational purposes only. Forecasts, estimates, and opinions contained herein should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. Any forward-looking statements speak only as of the date they are made and MacKay Shields assumes no duty and does not undertake to update forward-looking statements. No part of this document may be reproduced in any form, or referred to in any other publication, without express written permission of MacKay Shields LLC. ©2024, MacKay Shields LLC. All Rights Reserved.

Information included herein should not be considered predicative of future transactions or commitments made by MacKay Shields LLC nor as an indication of current or future profitability. There is no assurance investment objectives will be met.

Past performance is not indicative of future results.

NOTE TO UK AND EUROPEAN AUDIENCE

This document is intended only for the use of professional investors as defined in the Alternative Investment Fund Manager's Directive and/or the UK Financial Conduct Authority's Conduct of Business Sourcebook. To the extent this document has been issued in the United Kingdom, it has been issued by MacKay Shields UK LLP, 80 Coleman Street, London, UK EC2R 5BJ, which is authorised and regulated by the UK Financial Conduct Authority. To the extent this document has been issued in the EEA, it has been issued by MacKay Shields Europe Investment Management Limited, Hamilton House, 28 Fitzwilliam Place, Dublin 2 Ireland, which is authorised and regulated by the Central Bank of Ireland.

NOTE TO CANADIAN AUDIENCE

The information in these materials is not an offer to sell securities or a solicitation of an offer to buy securities in any jurisdiction of Canada. In Canada, any offer or sale of securities or the provision of any advisory or investment fund manager services will be made only in accordance with applicable Canadian securities laws. More specifically, any offer or sale of securities will be made in accordance with applicable exemptions to dealer and investment fund manager registration requirements, as well as under an exemption from the requirement to file a prospectus, and any advice given on securities will be made in reliance on applicable exemptions to adviser registration requirements.

MacKay Shields LLC is a wholly owned subsidiary of New York Life Investment Management Holdings LLC, which is wholly owned by New York Life Insurance Company. "New York Life Investments" is both a service mark, and the common trade name of certain investment advisers affiliated with New York Life Insurance Company. Investments are not guaranteed by New York Life Insurance Company or New York Life Investments.

Information included herein should not be considered predicative of future transactions or commitments made by MacKay Shields LLC nor as an indication of current or future profitability. There is no assurance investment objectives will be met.