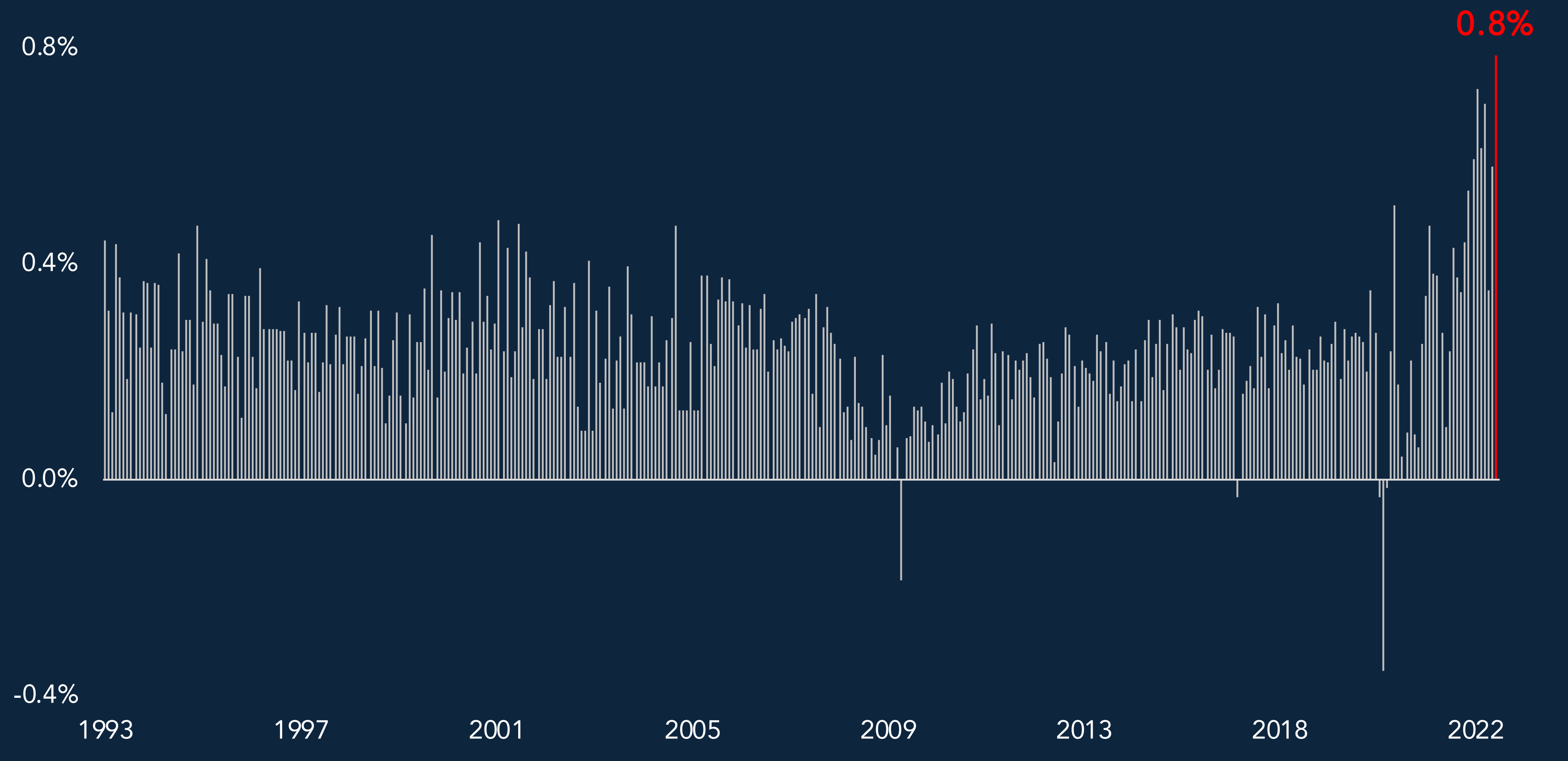
# Policy Note

With services representing approximately 80% of US GDP, the persistent rise in US core services CPI has become the most concerning area of persistent US inflation. The 0.8% m/m rise in core services CPI in September was the highest monthly increase since August 1990.

***US CPI core services, m/m***




## Summary Conclusions on Elevated Inflation

Throughout 2022, markets (and the Fed) have consistently underestimated the magnitude of inflation, and the pace of policy tightening.

**1. Elevated Inflation a Problem Globally**

Inflation rising across nearly every major economy globally in synchronized fashion, with most countries well above "target," and many not yet at "peak inflation"

**2. Inflation has been Broad-based and Entrenched**

Elevated US inflation is broad-based and entrenched across many segments of the economy (food, energy, shelter, medical, transportation, etc.).

**3. US Core CPI Exceeded Expectations**

With energy prices actually declining in September, the +0.6% m/m increase in core CPI to 6.6% y/y was both larger and more broad-based than anticipated.

**4. Services Inflation Remains a Primary Area of Concern**

With services representing 80% of US GDP, the sharp 0.8% m/m rise in core services CPI, the highest monthly gain since August 1990, is perhaps the greatest area of concern.

**5. Core Goods Inflation Should Moderate from Here**

For the first time in 5 months, core goods prices were flat m/m. Lower energy prices and moderating supply chain stress (port backlogs, transportation time and cost) should drive continued improvement in months ahead.

**6. Energy Prices Especially High for Non-US Countries**

While US energy prices declined 2.1% m/m in September, they remain elevated at +20% on a y/y basis, and even higher at +30-40% y/y for countries importing USD-denominated commodities (i.e., Europe, Japan).

**7. Real Wage Growth Remains Deeply Negative**

With broader CPI rising more rapidly than wage inflation, US real wage growth remains deeply negative, a significant concern for a US economy where the consumer is 70% of GDP.

**8. Market Focus to Shift from "Peak" Inflation to "Sticky" Inflation in 2023**

As inflation pressures moderate in 2023 (base effects, lower goods inflation, etc.), the market will likely shift its focus from the timing of "peak" inflation to the strength of "sticky" inflation across numerous sub-segments of the economy (labor, services).

**9. UST Yields Tend to Peak Toward the End of the Cycle**

Monetary policy operates with a lag. Central banks often start too late, and do too much. Casualties of Fed tightening are common. UST yields tend to peak near the end of a tightening cycle.

**10. The More Inflation, the More Hard Landing Risk**

Europe & the UK are likely entering a reasonably deep recession right now (Q4), while the US and global economy are likely entering comparatively milder recessions in the 1H 2023. Going back to 1950, the US has nearly always entered recession when y/y headline inflation rises above 5%.

*Source: (1) Bloomberg. Data as of October 19, 2022.*

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