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# Macro Alert

## Inflation Release Adds to Good News for the Fed...and Bonds

By the Macroeconomic and Investment Research Group

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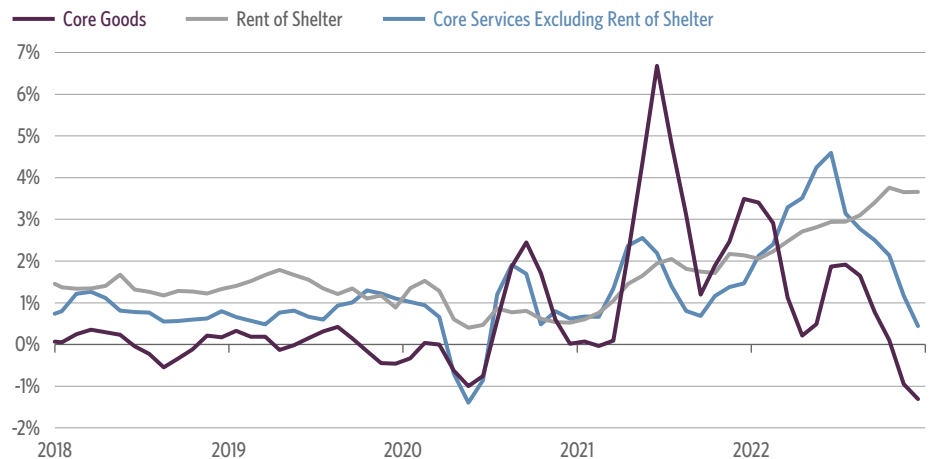
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The December Consumer Price Index (CPI) numbers are the latest in a string of encouraging data that show a meaningful cooldown in price pressures in the economy. These developments support our view that the Federal Reserve (Fed) will be able to step down the size of rate increases to 25 basis points at the Feb. 1 FOMC meeting and wind down its hiking cycle by the second quarter. This better inflation and Fed environment suggests that the most worrisome scenarios for credit markets are dissipating and gives a positive sign for those looking to invest in fixed income, particularly high-grade credit.

Falling energy prices drove headline CPI deflation on a month-over-month basis but, more importantly for the medium-term outlook, core CPI has now slowed to an annualized pace of 3.1 percent over the last three months, down from 7.9 percent in the three months through June.

### Goods Are Now in Deflation and Services Are Cooling Off

Contribution to 3-Month Annualized Change in Core CPI



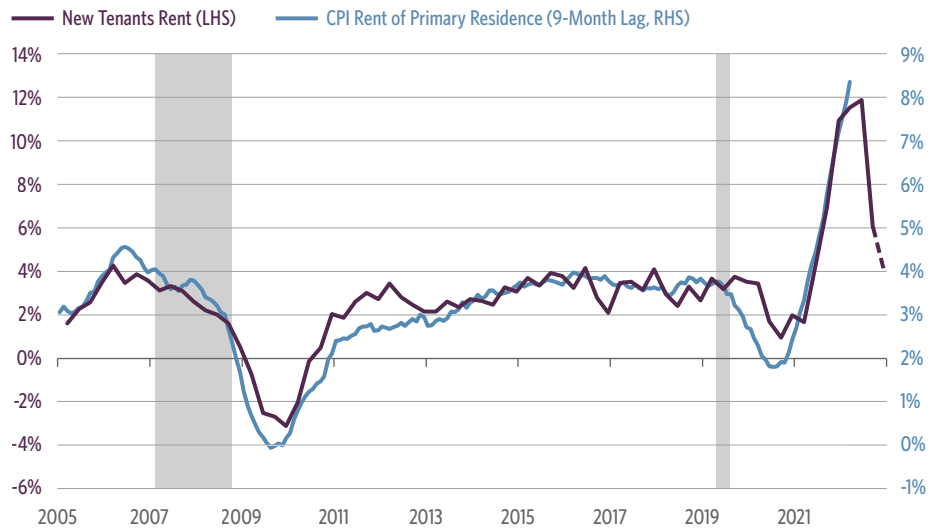
Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2022.

The Fed has discussed three distinct components of core inflation, and all three showed promising developments. Core goods prices fell outright for the third month in a row, helped by another big drop in used car prices. With an array of data and surveys suggesting supply chains have dramatically improved and demand for goods is cooling, we expect more deflation in this category in the coming months.

If there was any surprise in the CPI numbers it was the persistence of shelter inflation, with rent of shelter inflation showing some month-over-month reacceleration. This strength in shelter is set to fade over the course of 2023, however, as the rental market has softened quite a bit due to decreased household formation, slowing income growth, and looming supply increases. Recent work by the Cleveland Fed using Bureau of Labor Statistics data shows that rent growth for new tenants has fallen quickly in recent quarters, which will begin to show up in the official CPI numbers over the coming year.

### Leading Measures Show Rent Inflation Appears Poised to Come Down

YoY% Change

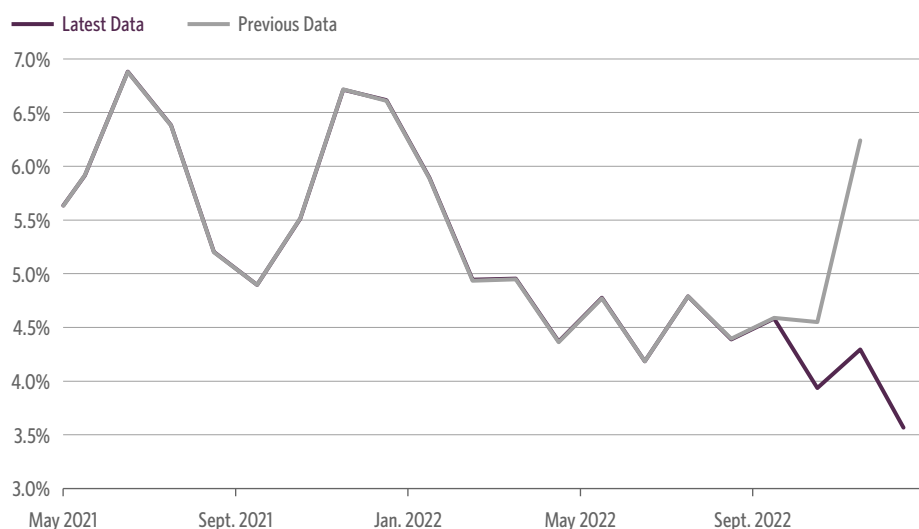


Source: Guggenheim Investents, Cleveland Fed, Bloomberg. Data as of 12.31.2022 for CPI, 9.30.2022 for New Tenants Rent with Guggenhei estimate for Q4. Shaded areas represent recession periods.

This coming disinflation in rents is well known to the Fed, which is why they've shifted their focus to "core services other than housing." As the first chart above shows, this category has also slowed, with three-month annualized gains of just 1.2 percent. Part of that is due to technical quirks related to health insurance measurements, which the Fed will probably look through as not indicative of underlying inflation. But there's good reason to be optimistic about services excluding housing, namely developments in wage growth, the major input cost for this component of consumer prices. Last Friday's employment report showed major downward revisions to recent wage growth figures, and the trajectory now looks much more benign.

## Better Wage Growth Picture Bodes Well for Service Sector Inflation

Composition Adjusted\* Average Hourly Earnings, 3-Month Annualized % Change



Source: Guggenheim Investments, Bloomberg. Data as of 12.31.2022. Note: Wages Adjusted for Composition Changes in Industry and Worker Type.

In conclusion, moderating inflation, along with last week's data that showed labor market pressures subsiding, should give the Fed more confidence the data are moving in their direction and that the need for substantial further tightening is reduced.

### IMPORTANT NOTICES AND DISCLOSURES

**Investing involves risk, including the possible loss of principal.** Investments in fixed-income instruments are subject to the possibility that interest rates could rise, causing their values to decline. High yield and unrated debt securities are at a greater risk of default than investment grade bonds and may be less liquid, which may increase volatility.

One **basis point** is equal to 0.01%.

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