



The 2023 Inflation Outlook



December 2022

KEY INSIGHTS

- Inflationary pressures have been a headwind for financial markets, so recent reports showing a declining trend in prices have been encouraging to investors.
- Moderating inflation may slow—or even pause—Fed hikes in the near term, but we believe a rate cut is unlikely if inflation settles above the 2% Fed target.



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Elevated inflation has weighed down global financial markets and remains a key variable for investors. Recently, equity markets rallied strongly after inflation data for October 2022 showed that prices fell for the fourth consecutive month and services inflation, which had been steadily increasing, appeared to be peaking.

The cost of goods collectively—which includes food, energy, and other commodities—has declined consistently since the beginning of the year. The rapid improvement in supply chains since April has helped alleviate price pressures, and forward-looking indicators show that the downward trend is likely to continue (Figure 1).

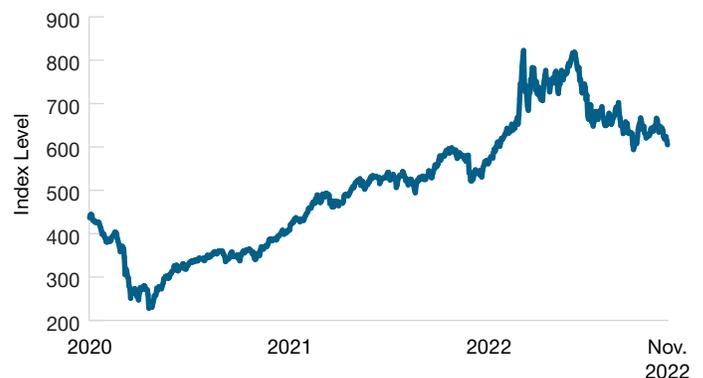
Goods Inflation Should Continue to Ease

(Fig. 1) Supply chains have improved significantly, while commodity prices remain below peak levels.

NY Fed Global Supply Chain Pressure Index
January 2012 to October 2022



S&P GSCI Index
January 1, 2020, to November 25, 2022



Past performance is not a reliable indicator of future performance.

Sources: New York Federal Reserve, Liberty Street Economics/Haver Analytics, and S&P Indices. See Additional Disclosures.

Meanwhile, commodity prices remain well below the inflated levels reached early this year and are expected to remain somewhat anchored amid fading demand due to weakening economic activity. Robust natural gas storage levels in Europe, supported by a mild winter thus far, and rising U.S. oil production have also eased energy supply concerns.

Rising costs within the services segment of inflation are a crucial area of focus for the Federal Reserve because services inflation is “stickier” and tends to persist for longer. On the positive side, shelter inflation—which is a large component of services

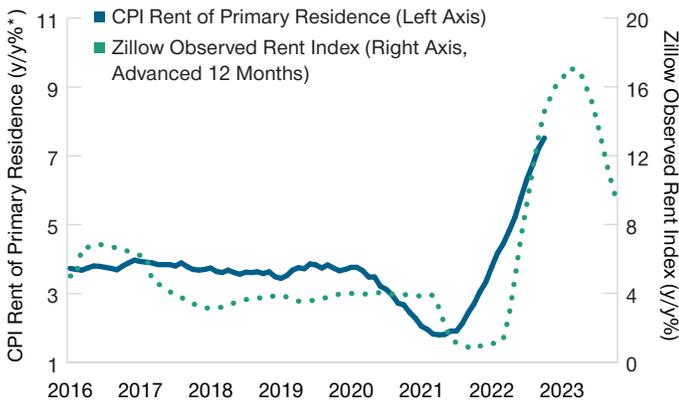
inflation—is expected to fall significantly over the next 12 months (Figure 2). Unfortunately, the outlook for other services components is less promising as wage inflation remains elevated, driven up by sustained labor shortages.

Overall, the costs of both goods and services are likely to decline considerably by the middle of next year, and it is, therefore, reasonable to expect the Fed to slow its pace of—or even pause—rate hikes. However, we believe that an interest rate cut is unlikely in 2023 if labor costs remain elevated and inflation settles well above the Fed’s 2% target.

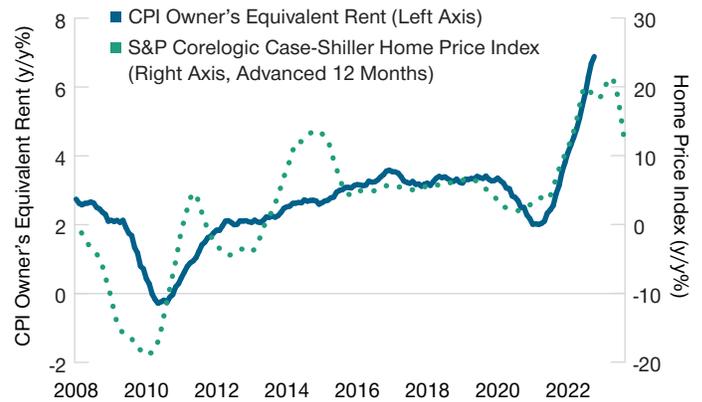
Shelter Inflation is Expected to Recede

(Fig. 2) Forward-looking indicators suggest a sharp pullback in housing costs within 12 months.

Rent Component of CPI†
January 2016 to October 2022



Home Price Component of CPI
January 2008 to October 2022



Sources: U.S. Bureau of Labor Statistics, S&P Indices, and Zillow/Haver Analytics. See Additional Disclosures.

*y/y = year over year

† Consumer Price Index (CPI) measures the monthly change in prices paid by consumers and is a widely used measure of inflation.

Actual future outcomes may differ materially from estimates.

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