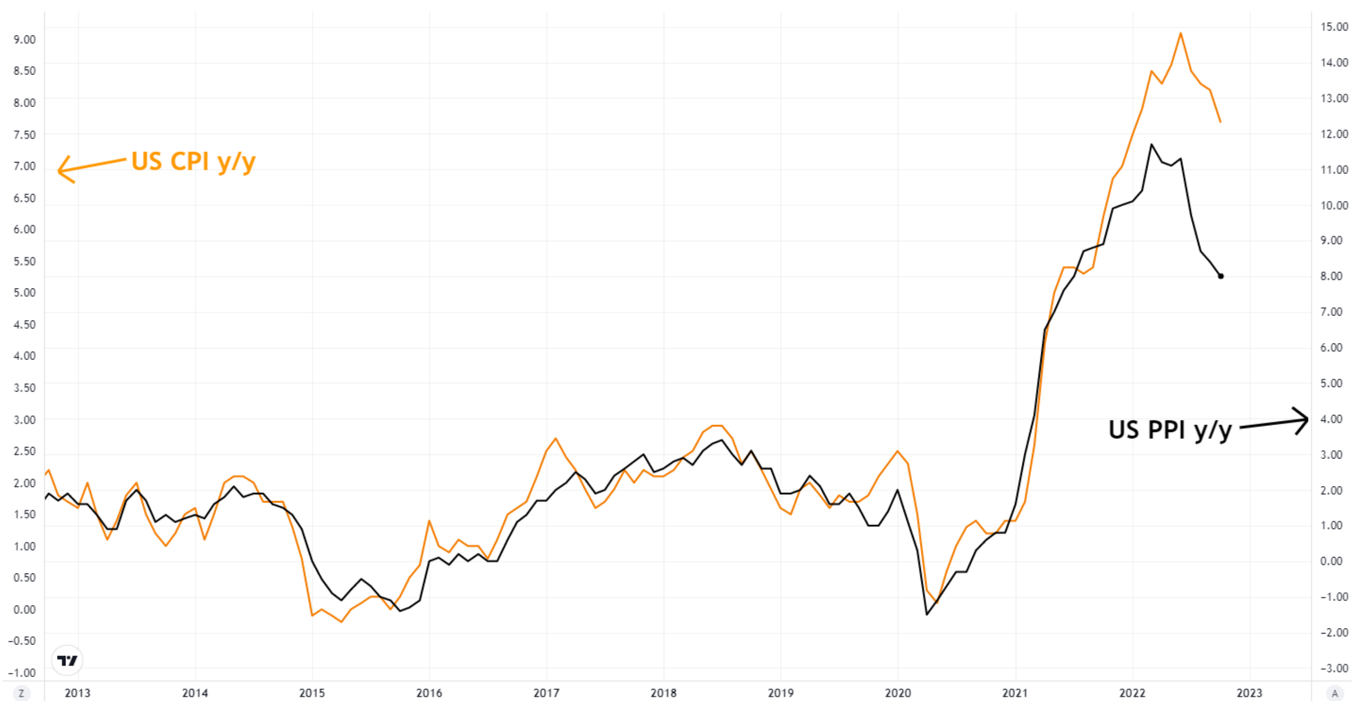
[Has Inflation Peaked in Q4 2022?]

Leading Indicators of Inflation suggest price pressures will ease in 2023

Last week we saw the US PPI (Producer Price Index) come in at 8.0% y/y for October, below analysts' estimates for 8.3% and representing the fourth consecutive month of descending US PPI. Core PPI also came in lower, at 6.7% vs expectations for 7.2%.

On the chart below, you will see the US PPI y/y rate in black (scale on right-hand side) and US CPI y/y in orange (left). As can be seen over the past 10 years, producer price changes have generally been highly correlated with consumer price changes. However, we have seen a divergence over the course of this year, especially as US PPI has fallen faster in recent months than CPI.

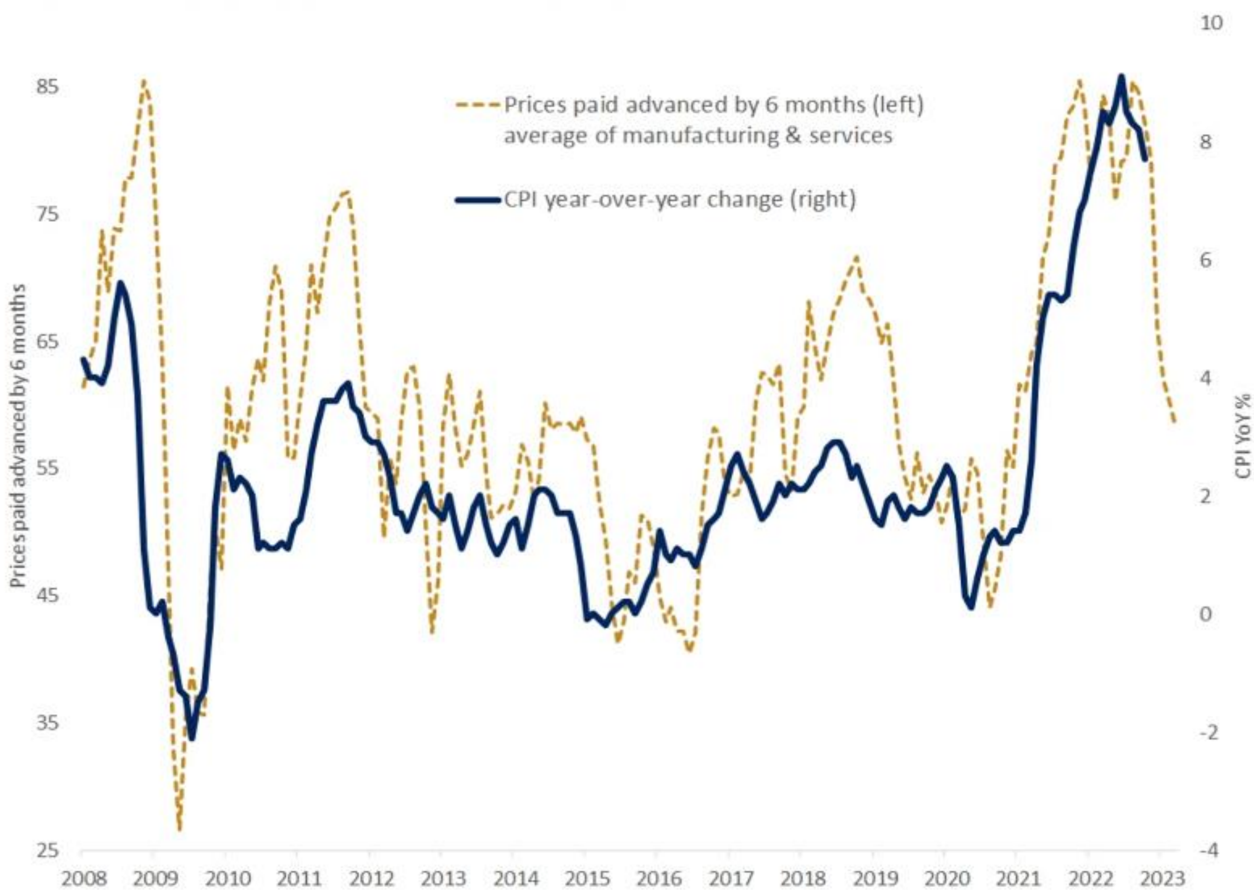
The PPI rate often serves as a leading indicator for CPI, i.e., when producers face input inflation (or disinflation), the increases (or decreases) in their costs are usually passed on to consumers. We believe over the course of 2023 and likely into 2024 we will see US CPI follow PPI sharply lower, which will allow the Federal Reserve to pause and eventually cut the Fed Funds rate. This should send both stocks and bonds significantly higher.



Source: Seaspray, November 2022

While it may not be in a perfectly straight line, it is our base case at Seaspray for the US to see a sustained moderation in inflation throughout next year. Prices paid for inputs by manufacturing and services firms have historically been good leading indicators of inflation. An average of both measures (seen as the dotted line below) is consistent with inflation falling below 4% sometime next year.

Leading indicators of inflation suggest price pressures will increase in 2023



Source: FactSet, Edward Jones