US Daily: October CPI Preview: Residual Seasonality and Health Insurance Turn Around (Abecasis/Hill)

- We expect a 0.32% increase in October core CPI (vs. 0.3% consensus), corresponding to a year-over-year rate of 4.13% (vs. 4.1% consensus). We expect a 0.09% increase in October headline CPI (vs. 0.1% consensus), which corresponds to a year-over-year rate of 3.29% (vs. 3.3% consensus). Our forecast is consistent with a 0.28% increase in core services excluding rent and owners' equivalent rent in October.
- We highlight three key component-level trends we expect to see in this month's report. First, we expect residual seasonality to boost core CPI inflation by around 7bp this month, as the CPI seasonal factors likely overfit the deceleration in inflation in the fall of 2020. Second, health insurance inflation should swing from -4% per month to +1% per month as the BLS incorporates new source data on insurer profitability and a couple of methodological changes with this month's report. We expect the swing in health insurance inflation to boost core CPI inflation by 4bp in October. Third, we expect shelter inflation to slow somewhat (we forecast rent to increase by 0.45% and OER to increase by 0.44%), as the gap between rents for new and continuing leases continues to close and the rent-OER gap normalizes after last month's jump. The core PCE price index measures health insurance using a different methodology and different source data, and we expect less of a boost from residual seasonality to core PCE in October. As a result, our tentative forecast for October core PCE inflation currently stands at 0.21% month-over-month.
- Going forward, we expect monthly core CPI inflation to remain around 0.3% in the next few months. We see further disinflation in the pipeline in 2024 from rebalancing in the auto, housing rental, and labor markets, though we expect a small offset from a delayed acceleration in healthcare. We forecast year-over-year core CPI inflation of 4.0% in December 2023 and 2.7% in December 2024.

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October CPI Preview: Residual Seasonality and Health Insurance Turn Around

We expect a 0.32% increase in October core CPI (vs. 0.3% consensus), corresponding to a year-over-year rate of 4.13% (vs. 4.1% consensus). We expect a 0.09% increase in October headline CPI (vs. 0.1% consensus), reflecting higher food (+0.3%) and lower energy (-3.0%) prices. This corresponds to a year-over-year rate of 3.29% (vs. 3.3% consensus). Our forecast is consistent with a 0.28% increase in core services excluding rent and owners' equivalent rent in October. Exhibit 1 provides a component-level summary of our forecast.

Exhibit 1: We Expect a 0.32% Increase in Core CPI in October

	Core CPI			
	Weight	3-Month Trend	September, MoM SA	October, MoM SA, GS Forecast
Core	100%	0.25%	0.32%	0.32%
Apparel	3%	-0.2%	-0.8%	1.0%
New cars	5%	0.2%	0.3%	0.2%
Used cars	3%	-1.7%	-2.5%	-1.3%
Motor vehicle parts	1%	-0.5%	-1.5%	0.0%
Medical care commodities	2%	0.3%	-0.3%	-0.1%
Tobacco	1%	0.5%	0.2%	0.3%
Rent of primary residence	10%	0.47%	0.49%	0.45%
Lodging away from home	1%	0.1%	3.7%	1.5%
Medical care services	8%	-0.01%	0.32%	0.48%
Public transportation	1%	-0.7%	0.5%	-2.1%
Transportation services ex-public	7%	1.0%	0.7%	0.5%
Pets	1%	-0.1%	0.3%	0.4%
Recreation ex-pets	6%	0.1%	0.4%	0.1%
Education	3%	0.2%	0.3%	0.3%
Communication	4%	-0.1%	0.0%	-0.2%
Household furnishings and ops.	5%	0.1%	0.2%	0.4%
Personal care	3%	0.4%	0.6%	0.3%
Alcoholic beverages	1%	0.3%	0.8%	0.2%
Owners' equivalent rent	32%	0.48%	0.56%	0.44%
Residual (implicit)	3%			0.4%
Core Goods	26%	-0.27%	-0.39%	0.15%
Core Services	74%	0.44%	0.57%	0.37%
Core Services Ex-Rent and OER	32%	0.39%	0.61%	0.28%
Implied NSA Headline Index Level	--	--	--	307.813

Source: Department of Labor, Goldman Sachs Global Investment Research

We highlight three key component-level trends for the October report:

1. Residual seasonality. We expect residual seasonality to boost core CPI inflation by around 7bp this month. The CPI seasonal factors likely overfitted the rebound in prices in the summer months of 2020 as the economy recovered from the initial pandemic shock, and we estimate that this contributed to lower inflation readings in June and July of this year. Now, we expect residual seasonality to instead boost core CPI inflation, as the seasonal factors look for inflation to decelerate like it did in October 2020 (Exhibit 2). We expect this pattern to play out across the apparel, lodging, pets, and household furnishings and operations categories.

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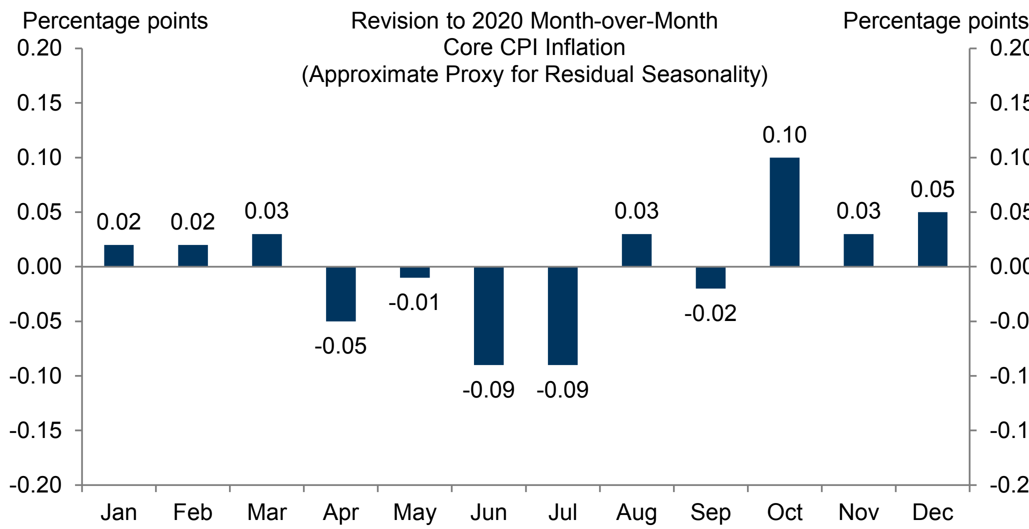
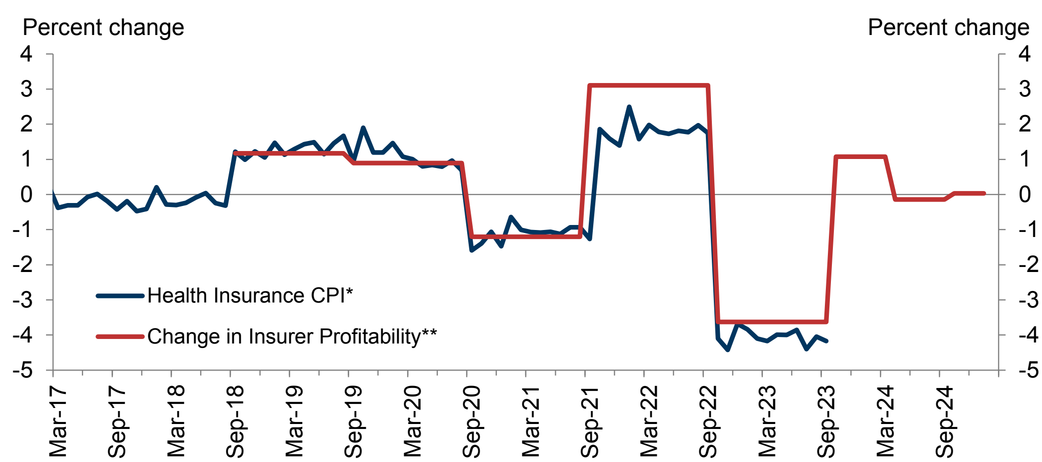
Exhibit 2: Residual Seasonality Is Likely to Boost Core CPI in October



Source: Department of Labor, Goldman Sachs Global Investment Research

2. Health insurance. We expect the health insurance component of the CPI to swing from declining 4% per month over the last year to increasing around 1% per month between October 2023 and March 2024, which should boost core CPI inflation by 4bp this month. The BLS will incorporate new data on health insurer profitability with this month's report, as usual, but it will also transition to incorporating the underlying source data on a two-year moving average basis (vs. one-year currently) and updating the source data semiannually (vs. annually currently). Starting in April 2024, we expect health insurance to be roughly flat for the subsequent six months.

Exhibit 3: We Expect Health Insurance Inflation to Swing From -4% Per Month to +1% In October Under the New CPI Methodology Before Slowing to 0% in April 2024

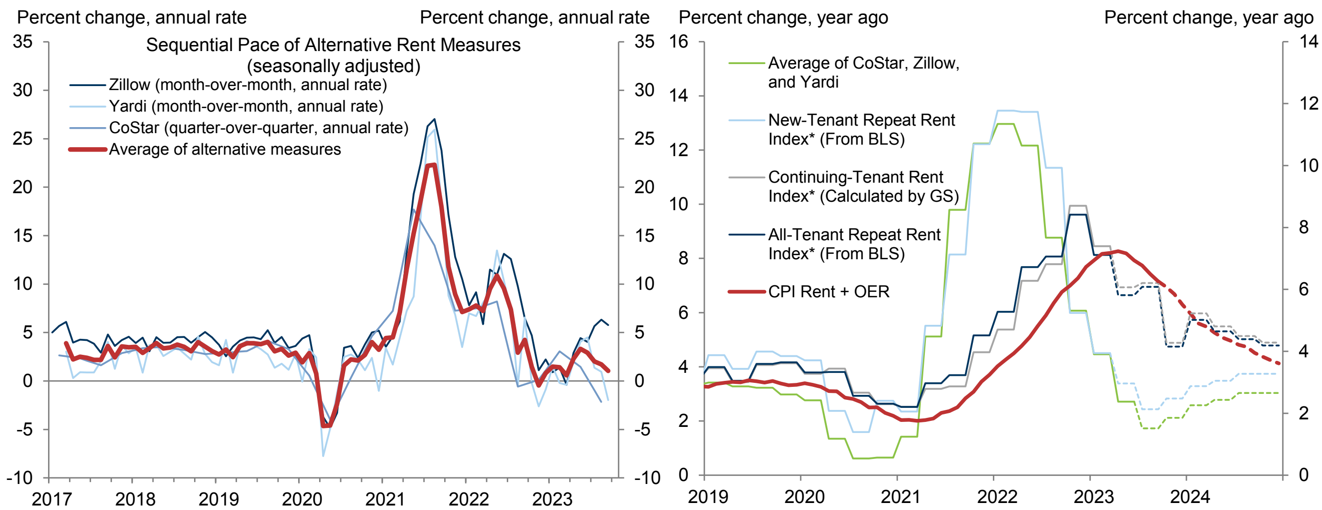


*Adjusted to exclude the trend in hospital services and physician services prices (average, 3CMA).
**Data on retention-benefit ratios transformed to CPI-equivalent basis. Forecasts average across United Health, Cigna, Humana, Centene, WellPoint, and Molina, and use company guidance for future quarters when available.

Source: Department of Labor, Company data, Goldman Sachs Global Investment Research

3. Shelter. We expect a somewhat slower pace of shelter inflation this month. We expect a narrowing gap between rents for new and existing tenants to lead to a modest deceleration in the pace of rent inflation, from 0.49% to 0.45%. We also expect the rent-OER gap to normalize after last month's jump, which would lead OER inflation to slow from 0.56% to 0.44%.

Exhibit 4: We Expect CPI Shelter Inflation to Slow Somewhat as the Gap Between Rent Growth for New- and Continuing-Tenant Leases Continues to Narrow



*Adjusted for the historical gap of the ATRR vs. CPI rent.

Source: Department of Labor, CoStar, Zillow, Yardi, Federal Reserve, Goldman Sachs Global Investment Research

Elsewhere in the report, we expect new car prices to increase 0.2%, reflecting a temporary production drag from the UAW strike and a related pullback in promotional dealer incentives, but used car prices to decline 1.3%, reflecting lower used car auction prices. We also expect weaker demand for travel to result in a 3% pullback in airfares in October. Finally, we expect car insurance inflation to decelerate to 0.8%, as premiums have nearly caught up to repair and replacement costs.

The core PCE price index measures health insurance using a different methodology and different source data, and we expect less of a boost from residual seasonality to core PCE in October. As a result, our tentative forecast for October core PCE inflation currently stands at 0.21% month-over-month.

Going forward, we expect monthly core CPI inflation to remain around 0.3% in the next few months. We see further disinflation in the pipeline in 2024 from rebalancing in the auto, housing rental, and labor markets, though we expect a small offset from a delayed acceleration in healthcare. We forecast year-over-year core CPI inflation of 4.0% in December 2023 and 2.7% in December 2024.

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Exhibit 5: We Forecast Year-on-Year Core CPI Inflation of 4.0% in December 2023 and 2.7% in December 2024

		Sep. 2023	GS Bottom-up CPI Forecast			
			Dec. 2023		Dec. 2024	
	Weight	YoY	YoY	Contribution to Change	YoY	Contribution to Change
Core CPI	***100.0***	**4.1**	**4.0**	-0.1	**2.7**	-1.4
Apparel	*3.1*	2.3	2.6	0.0	0.3	-0.1
New Cars	*5.4*	2.6	0.7	-0.1	-1.7	-0.2
Used Cars	*3.5*	-7.5	-6.8	0.0	-5.5	0.1
Medical Care Commodities	*1.8*	4.0	4.4	0.0	1.9	0.0
Health Insurance	*0.7*	-37.3	-27.1	0.1	2.5	0.3
Medical Services ex Insurance	*7.3*	1.9	2.1	0.0	4.1	0.2
Pets	*1.5*	5.8	5.0	0.0	1.3	-0.1
Household Furnishings + Ops.	*6.6*	1.5	1.8	0.0	1.7	0.0
Personal Care	*2.8*	5.5	5.0	0.0	2.6	-0.1
Rent + OER	*41.7*	7.2	6.3	-0.4	4.1	-1.3
Public Transportation	*0.9*	-12.5	-10.4	0.0	3.8	0.1
Private Transportation Services	*6.5*	12.0	12.7	0.0	4.3	-0.5
Miscellaneous goods and services	*18.2*	5.9	5.1	-0.1	3.6	-0.4
Headline CPI	***100.0***	**3.7**	**3.3**	-0.4	**2.5**	-1.2
Core CPI	*79.6*	4.1	4.0	-0.1	2.7	-1.1
Food	*13.4*	3.7	2.6	-0.2	2.8	-0.1
Energy	*7.0*	-0.5	-2.2	-0.1	-0.6	0.0

Source: Department of Labor, Goldman Sachs Global Investment Research

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