PANTHEON MACROECONOMICS

Datanote: US CPI, March

In one line: Ouch. June is now a much longer shot

- The March CPI rose 0.4%, a tenth above the consensus, 0.3%.
- The core also rose 0.4%, also a tenth above the consensus, 0.3%.

This is disappointing; the core to 2dp rose 0.36%; we looked for 0.23%. The biggest contributions to the overshoot relative to our forecast came from rents, hospitals and auto insurance/repair. Both primary rents and OER rose a tenth more than we expected, up 0.41% and 0.43%, overshooting relative to the Zillow numbers for the second straight month for primary, and the third for OER. They likely will revert to the Zillow-implied pace over time but caution dictates that we raise our forecasts for the next three months, by which time the current uptick will have worked through all six subsets of the CPI rental property sample. Hospital prices jumped 1.2%, the second big increase in the past three months, lifting the y/y rate to 7.7%, the highest since April 2008. This likely is the lagged effect of surging wage growth in the sector in 2022-to-23. Our chart suggests that inflation in the sector could easily rise further, though wage growth is now slowing sharply.

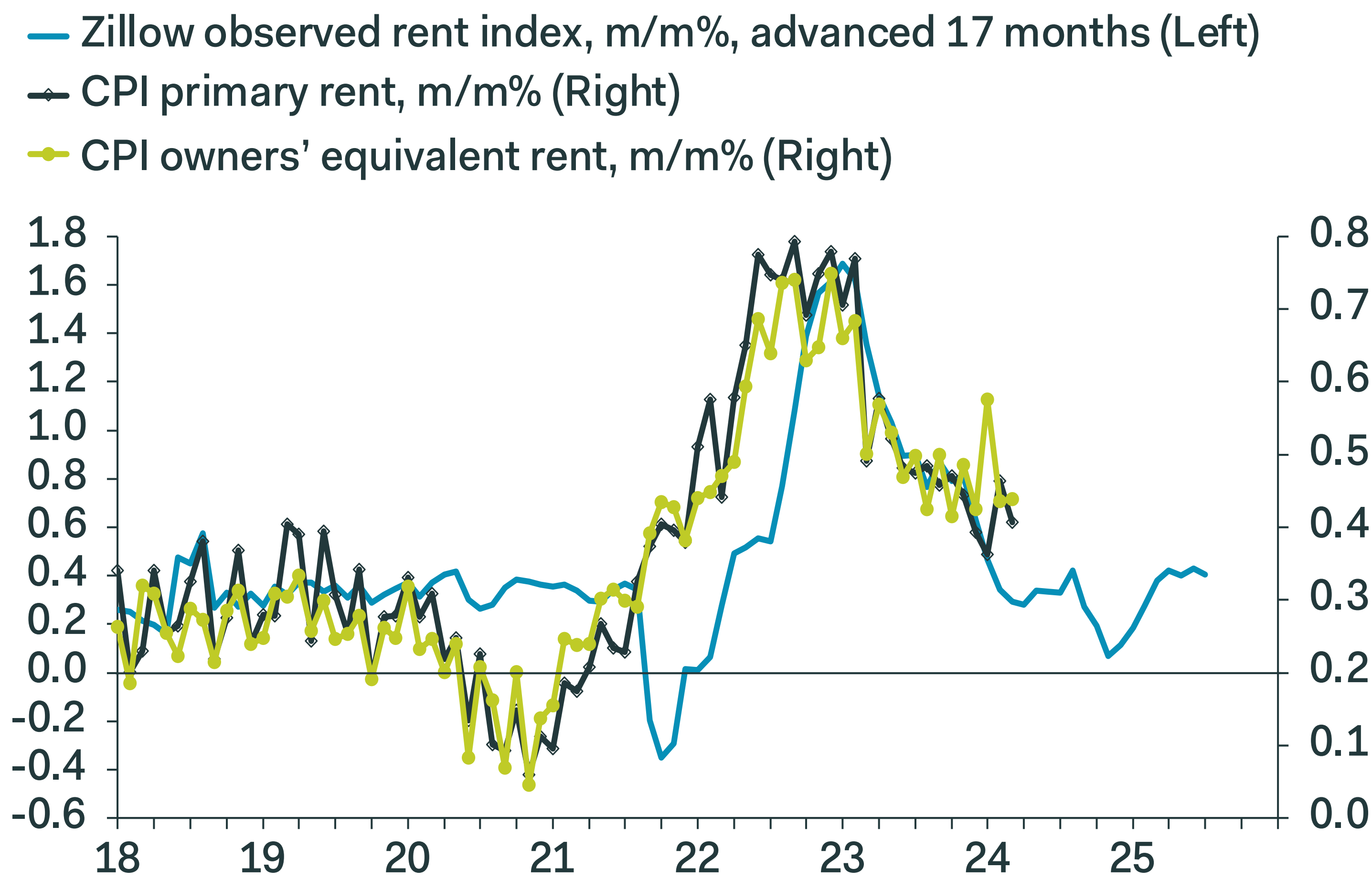
The 2.6% leap in auto insurance was twice the average gain for the past three months and came out of the blue; the trend has been slowing, lagging the ongoing downshift in new car price inflation. At this point we have no way of knowing whether it marks the start of a renewed acceleration; a surprise in one month proves nothing. The same applies to repair costs, which jumped 1.7%, after average gains of just 0.3% in the previous three months. The March numbers look like noise, but we can't be sure.

The spikes in hospital and auto insurance/repair meant that services prices ex-rents rose 0.65%, the second outsized jump in the past three months.

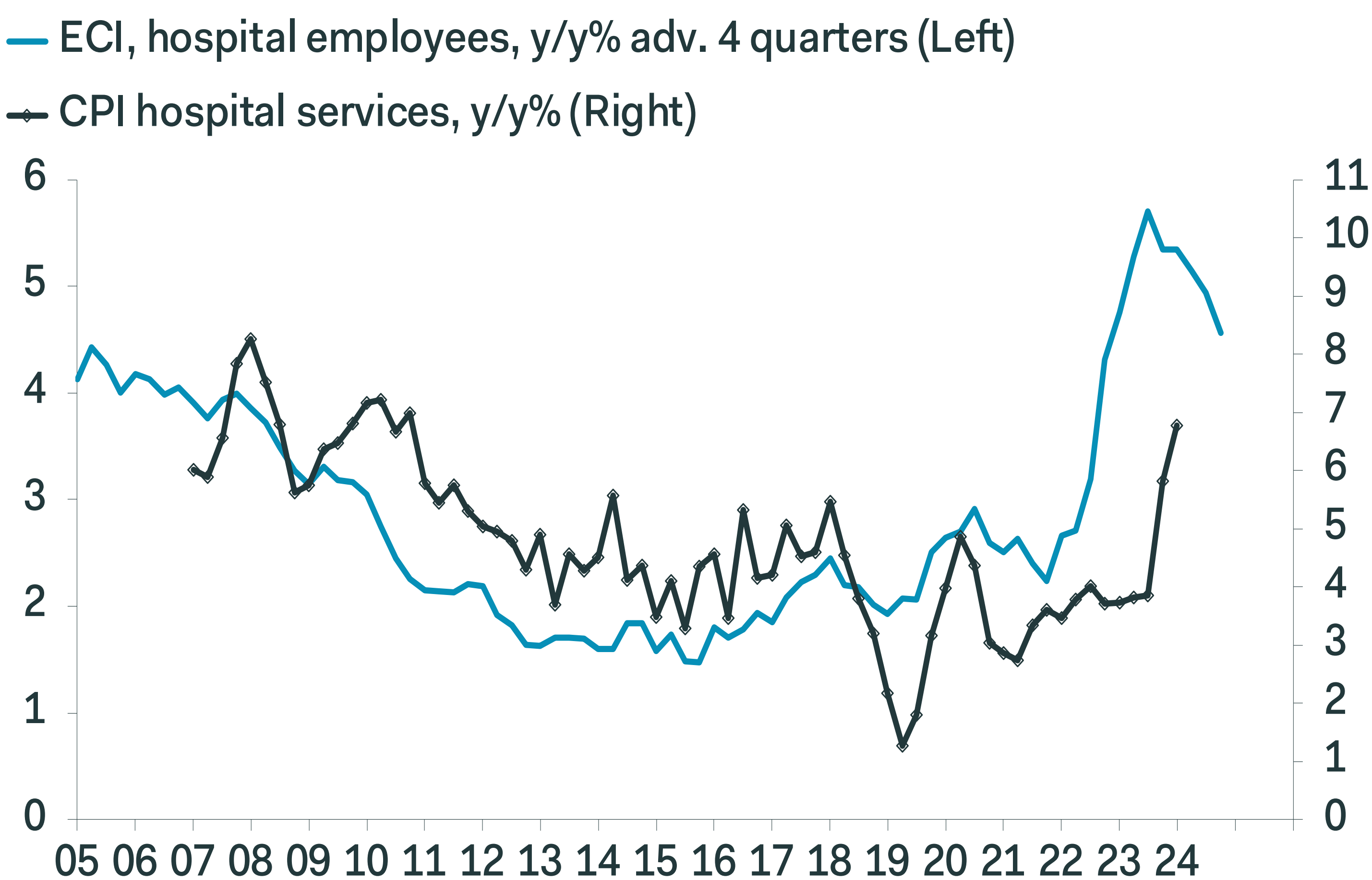
Core goods prices fell 0.2%, pushing the y/y rate down to a new cycle low of -0.7%, depressed by a 1.1% drop in used auto prices. Prices ex-used autos were unchanged, and the trend is flat. But that won’t matter to Fed policymakers, who have repeatedly emphasized the iportance of services inflation, and today's numbers clearly reduce the chance of a June easing still further. Remember though that the CPI provides only part of the data needed to forecast the PCE deflator, with the remainder coming in tomorrow's PPI report. Healthcare and insurance prices often behave very differently in the PCE, and rents have a much smaller weight. Still, the sell-off in Treasuries and equity futures is no surprise. Only a clear and unambiguous softening in payrolls and much better April inflation numbers would be enough now to trigger a June easing. We're sticking to that view, but this is now a low-conviction call.

Our inflation base case, though,

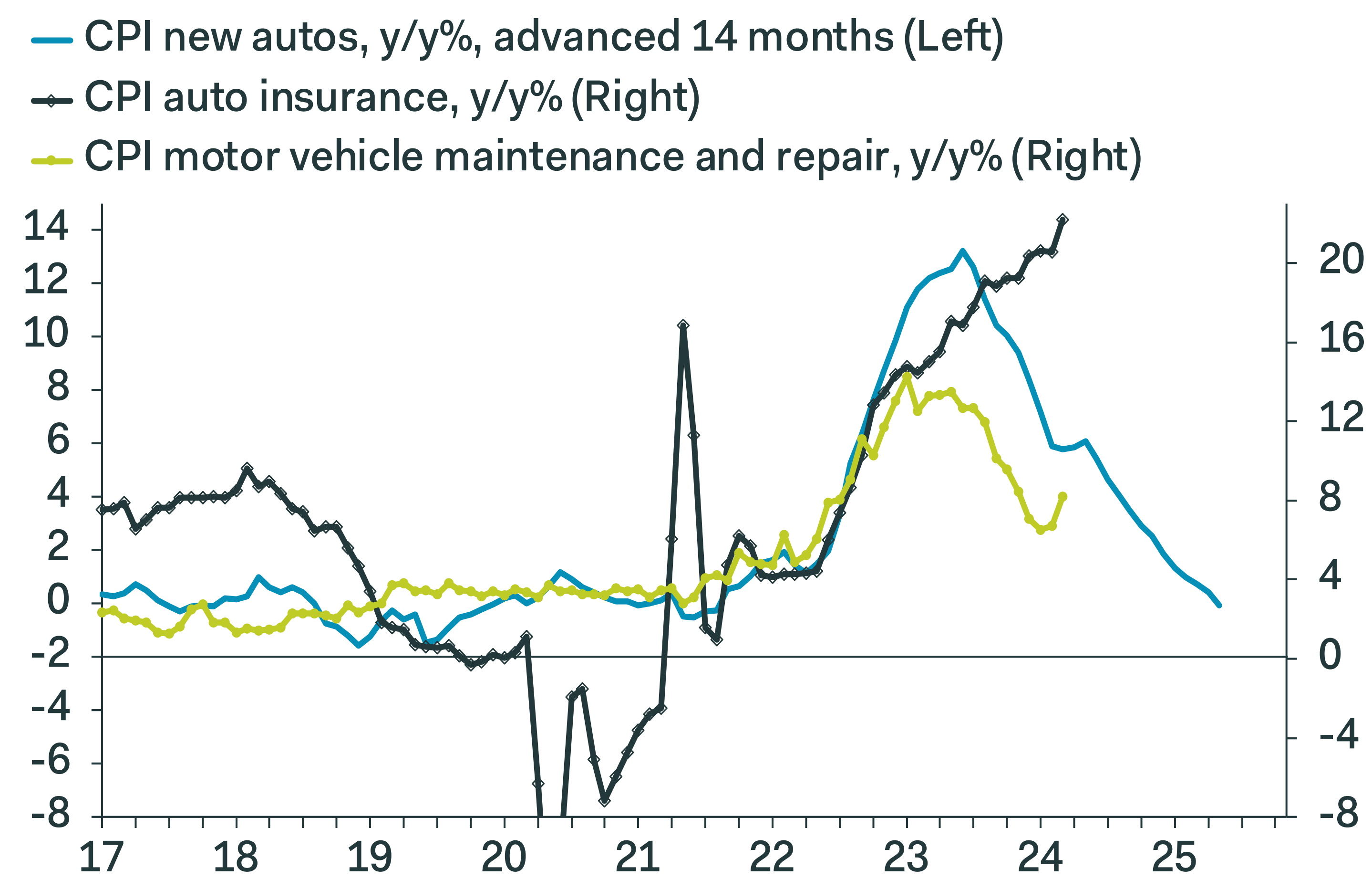
remains fundamentally optimistic. All the drivers of the post-Covid inflation boom are now heading in the right direction. Margin inflation has dropped from nearly 20% to near-zero; rent inflation for new tenants has returned to its pre-Covid pace; supply chains have normalized; wage growth is falling on the back of the plunge in quits; global food and energy inflation is no threat. These developments will feed through into the CPI, PPI and PCE inflation measures across this year and into 2025. The path will not be smooth, but short-term disappointment has to be seen in the context of the benign bigger picture. We see no reason to expect a sustained upturn, but this Fed is super-cautious and loud voices in the commentariat will be yelling at them not to ease after these numbers, as if inflation over the next few months can be influenced by current policy decisions. It can't, but this Fed is less willing than most to look at the leading fundamentals. Accordingly, the risk of a policy mistake and a recession is rising by the day.

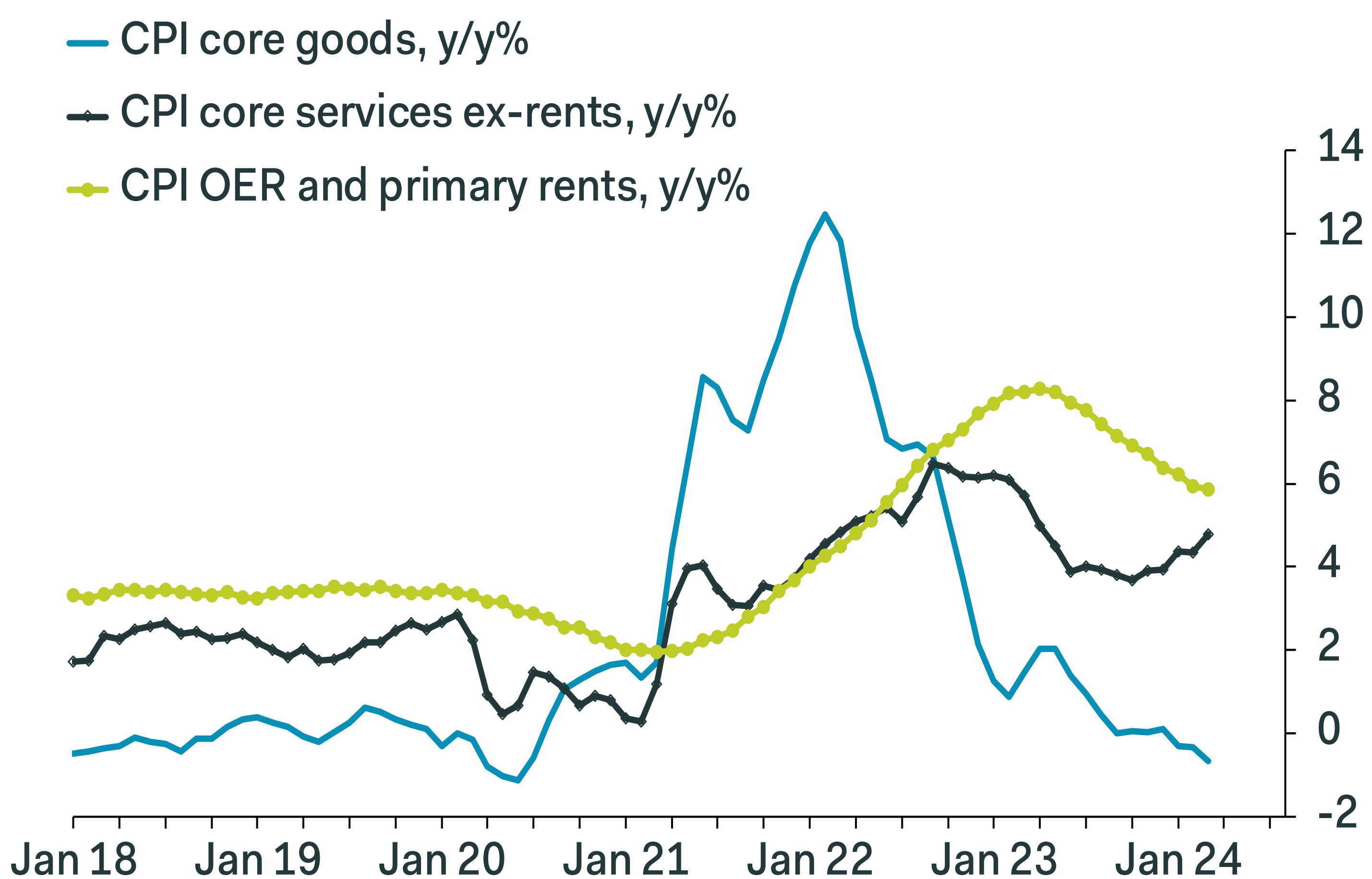


Zillow observed rent index, m/m%, advanced 17 months (Left)
CPI primary rent, m/m% (Right)
CPI owners' equivalent rent, m/m% (Right)
1.8
1.6
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
18
19
20
21
22
23
24
25



ECI, hospital employees, y/y% adv. 4 quarters (Left)
CPI hospital services, y/y% (Right)
6
5
4
3
2
1
0
11
10
9
8
7
6
5
4
3
2
1
0
05 06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24


CPI new autos, y/y%, advanced 14 months (Left)
CPI auto insurance, y/y% (Right)
CPI motor vehicle maintenance and repair, y/y% (Right)
14
12
10
8
6
4
2
0
-2
-4
-6
-8
20
16
12
8
4
0
-4
-8
17
18
19
20
21
22
23
24
25


CPI core goods, y/y%
CPI core services ex-rents, y/y%
CPI OER and primary rents, y/y%
14
12
10
8
6
4
2
0
-2
Jan 18
Jan 19
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24