Datanote: US CPI, May

In one line: Disinflation is back on track; expect two easings in today's 2024 dot plot.

- The May CPI was unchanged, below the consensus, 0.1%.
- The core increased by 0.16%, well below the consensus, 0.3%.

May's tiny increase in the core CPI—the smallest since August 2021—

should be good enough for the median FOMC participant to envisage today two 25bp reductions in rates in 2024, taking out only one of the three easings projected back in March. Prices for core services ex-rent were unchanged, following increases averaging 0.6% in the first four months of the year. Admittedly, this slowdown was partly driven by a 3.6% plunge in airline fares, which are erratic, and a surprise 0.1% decline in auto insurance prices, a far cry from YTD average monthly increases of 1.7%. The airline fares and motor vehicle insurance components of the core PCE deflator—the Fed's preferred inflation gauge—are derived from PPI, not CPI data, and they often diverge substantially month-to-month. Nevertheless, our core-core services index, which removes the airline fare, auto repair and insurance, health insurance, hospital services, and accommodation services components from core services ex-rents, rose by just 0.04%, well below the 0.38% average increase between January and April. In short, then, the slowdown in inflation was pleasingly broad based, though we'd be surprised if the trend in auto insurance price increases has suddenly dropped to zero.

Less encouragingly, on the face of it, primary rent increased by 0.39%, in line with the year-to-date average, while owners' equivalent rent, rose by 0.43%. But the 0.04pp gap between the increases in OER and primary rents likely primarily reflects the January increase in the weight in the sample of single-family detached homes—SFD—

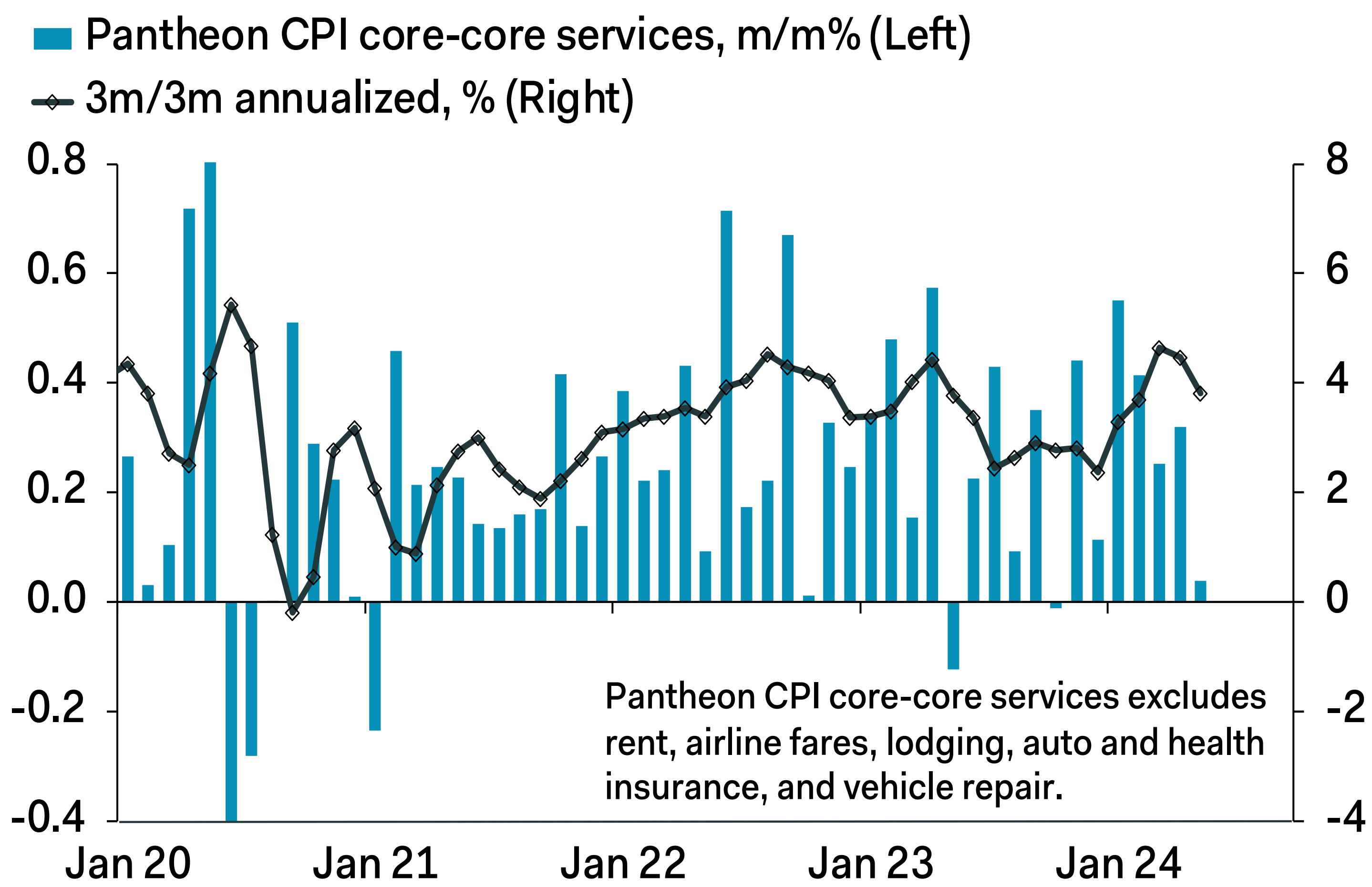
which attract higher rents than multi-family units. Remember, the reported month-to-month change in both OER and primary rents is the sixth root of the change in rents in the same panel across the past six months, so January's annual weight change will boost the month-to-month change in OER for the last time in June. In addition, the renewed slowdown in Zillow's measure of new rent increases in April and May suggests that primary rent inflation also will moderate further over the next year.

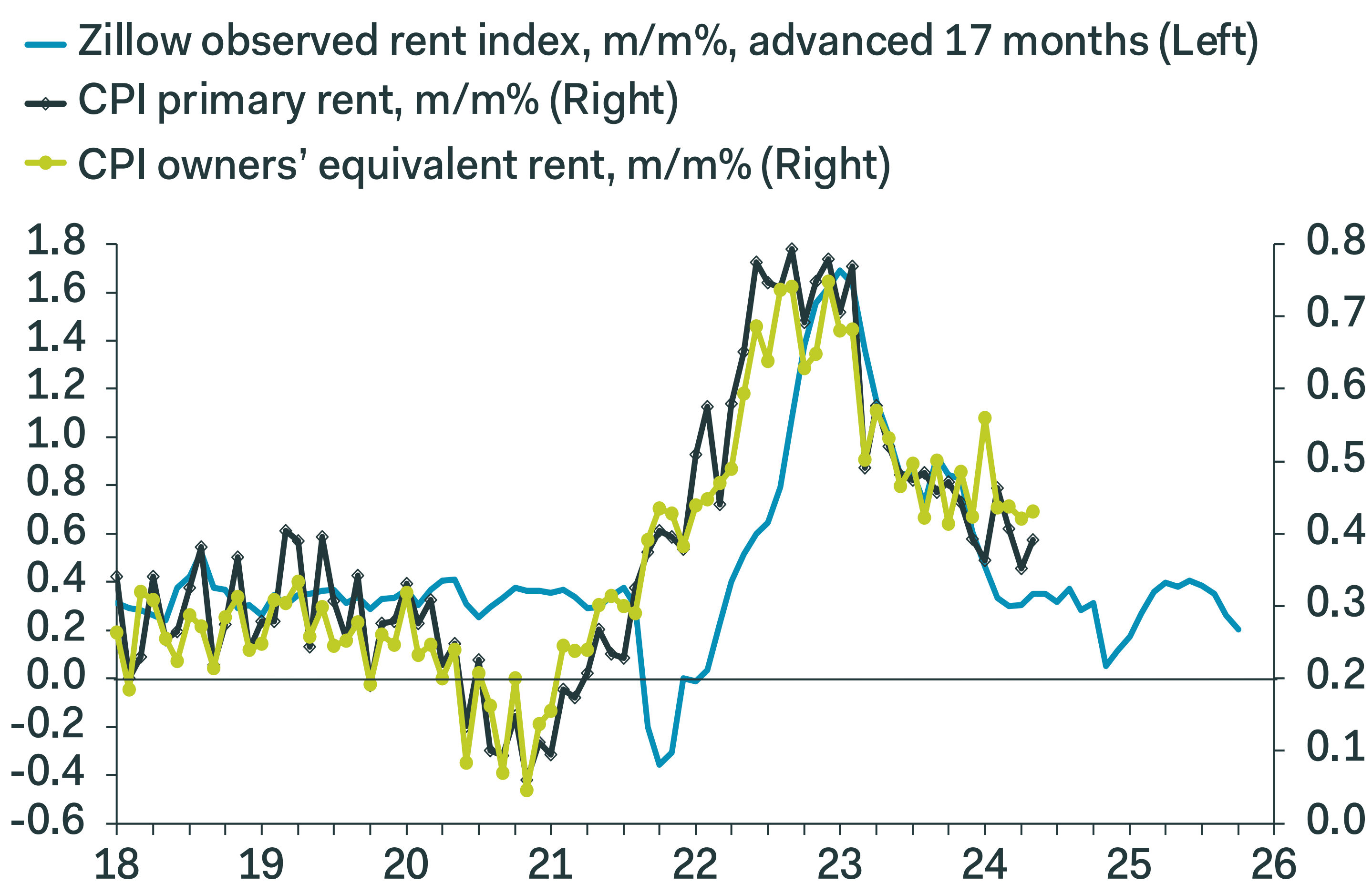
Meanwhile, core goods prices were unchanged, with new car prices falling by 0.5%—the fourth consecutive drop—and used car prices rising by 0.6%, a smaller increase than we expected and reversing less than half of April's 1.4% decline. The trends in both new and used car prices are falling. Core goods ex-auto prices were flat, leaving April's 0.2% increase looking like noise, rather than the start of a renewed upward trend.

Two-thirds of the components of the

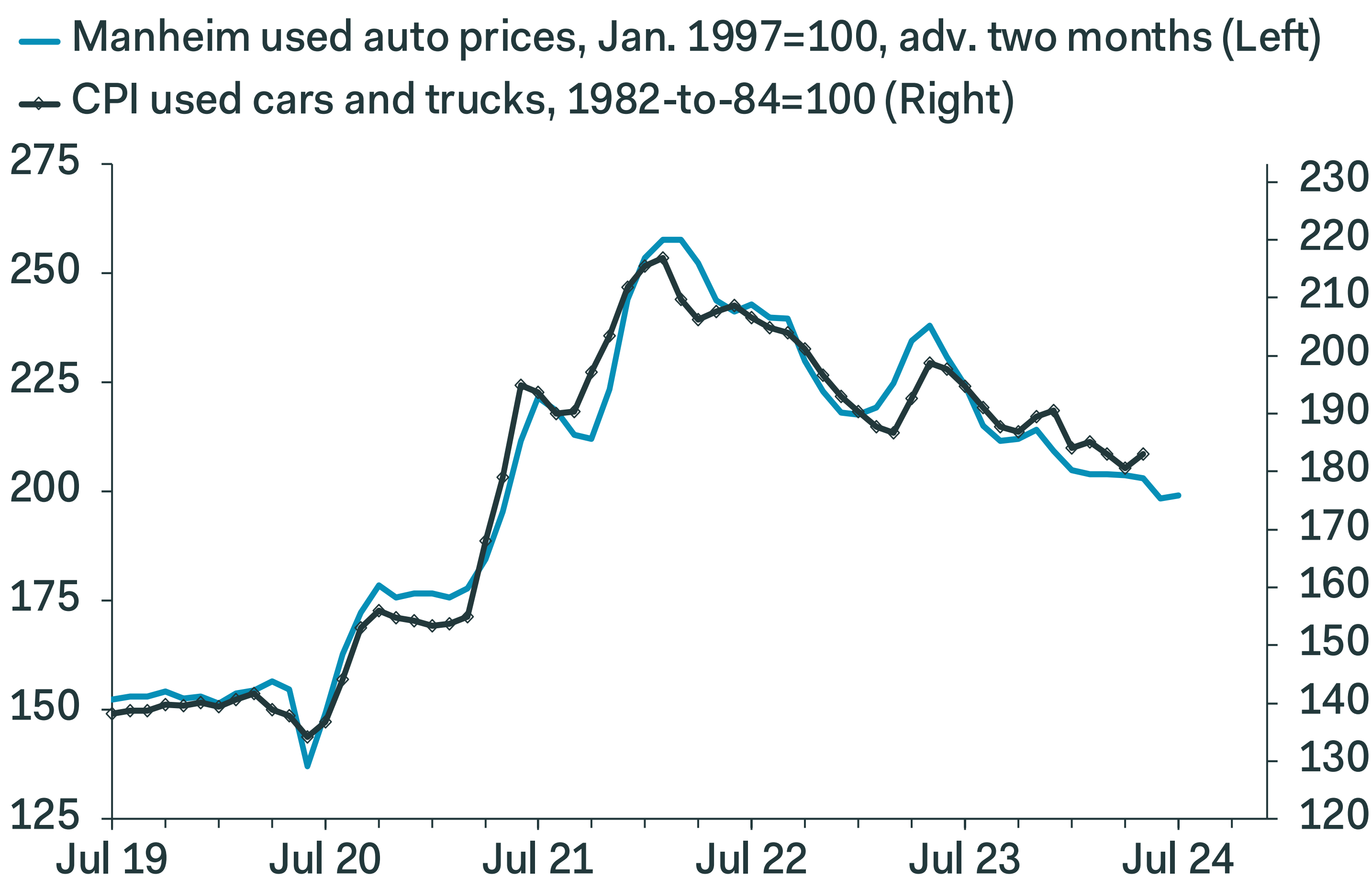
core PCE deflator are derived from CPI data, with the bulk of the remainder derived from the PPI numbers. After today's CPI data, we provisionally forecast that the core PCE deflator increased by 0.16% in May—well below the 0.34% average increase in the first four months of this year—but we will update our estimate after tomorrow's PPI data, which are more volatile than the CPI figures.

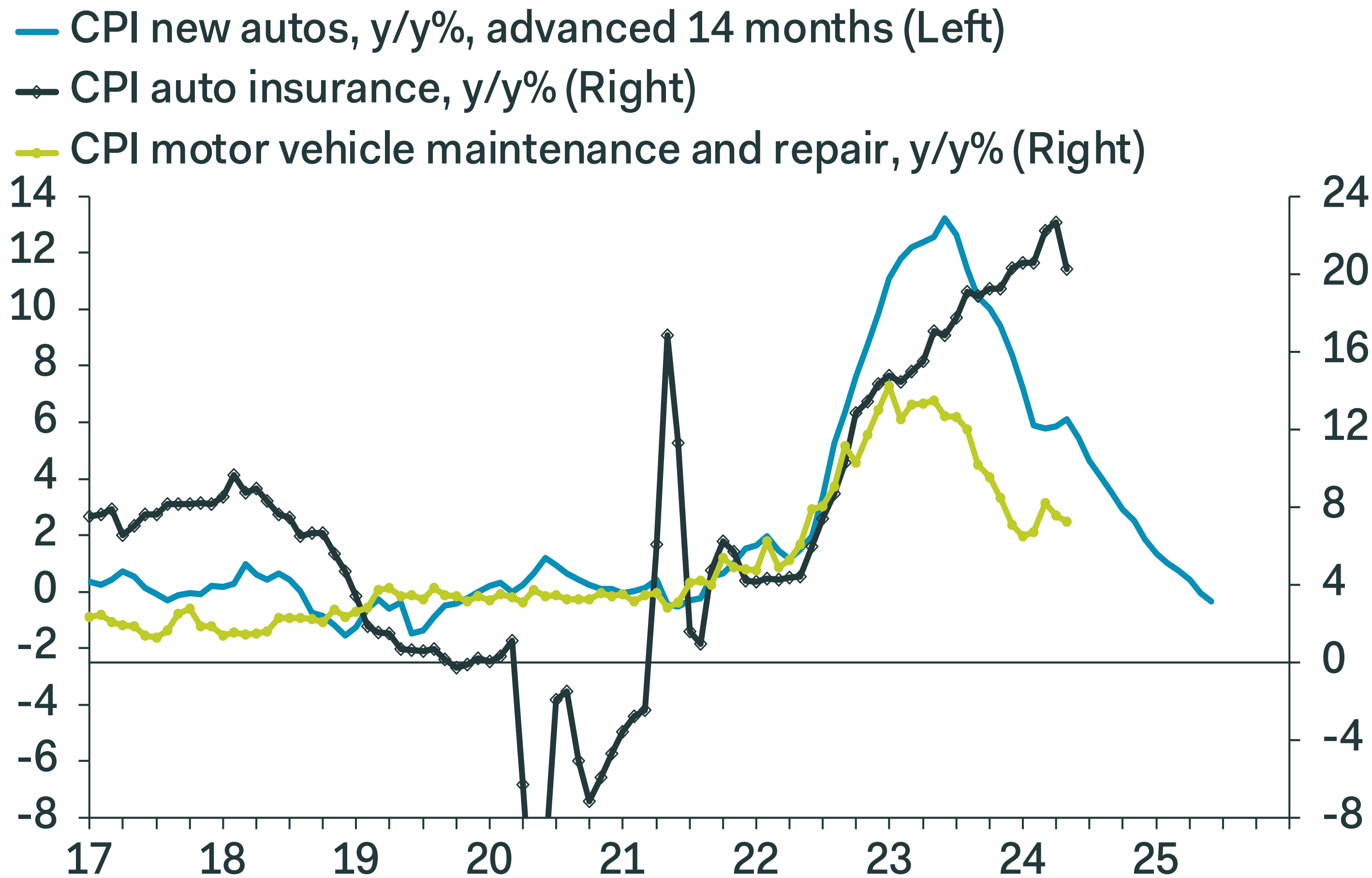
Looking ahead, the outlook for core CPI inflation looks benign. Wage growth is following the quits rate back to pre-Covid levels, pointing to a further slowdown in underlying services CPI inflation and rent inflation for new tenants. At the same time, slowing growth in consumer demand will squeeze profit margins, which still are far above pre-Covid levels. Meanwhile, supply chains are back to normal, global food and energy prices remain unthreatening, and capacity utilization in the manufacturing sector is below its 40-year average and still edging down. Furthermore, falling vehicle prices point to further sharp declines in the inflation rates for auto insurance and repair ahead. Accordingly, we continue to think that markets are greatly underestimating how soon and rapidly the Fed will cut rates this year and continue to look for 125bp of easing this year, with the first 25bp cut coming in September.


Pantheon CPI core-core services, m/m% (Left)
3m/3m annualized, % (Right)
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
8
6
4
2
0
-2
-4
Pantheon CPI core-core services excludes rent, airline fares, lodging, auto and health insurance, and vehicle repair.
Jan 20
Jan 21
Jan 22
Jan 23
Jan 24


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
26


ISM manufacturing, ave. of delivery times and order backlogs (Left)
CPI core goods ex-autos, y/y% (Right)
China-led boom in global commodity prices
Trade war
ISM advanced by 10 months
75
70
65
60
55
50
45
40
35
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
-6
06 07 08 09 10 11 12 13 14 15 16 17 18 19 20 21 22 23 24


Manheim used auto prices, Jan. 1997=100, adv. two months (Left)
CPI used cars and trucks, 1982-to-84=100 (Right)
275
250
225
200
175
150
125
230
220
210
200
190
180
170
160
150
140
130
120
Jul 19
Jul 20
Jul 21
Jul 22
Jul 23
Jul 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
24
20
16
12
8
4
0
-4
-8
17
18
19
20
21
22
23
24
25