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US CPI: A good one, but the Fed will need to see more

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Consumer Price Index (monthly change, %)	Apr 2024	Mar 2024	Feb 2024	Jan 2024	Dec 2023	Nov 2023	Apr NSA YoY%
All items	0.3	0.4	0.4	0.3	0.2	0.2	3.4
Ex-food/energy	0.3	0.4	0.4	0.4	0.3	0.3	3.6
• Ex-food	0.4	0.4	0.5	0.3	0.2	0.2	3.5
• Ex-energy	0.3	0.3	0.3	0.4	0.3	0.3	3.4
Energy	1.1	1.1	2.3	-0.9	-0.2	-1.6	2.6
Services	0.4	0.5	0.5	0.7	0.4	0.5	5.3
Housing	0.2	0.4	0.4	0.6	0.3	0.4	4.5
Fuels & util.	-0.3	0.5	0.7	1.2	0.2	0.8	3.8
Food/beverages	0	0.1	0	0.4	0.2	0.2	2.2
• Food	0	0.1	0	0.4	0.2	0.2	2.2
Apparel	1.2	0.7	0.6	-0.7	0.0	-0.6	1.3
Transportation	0.7	0.8	1.4	-0.6	0.1	-0.2	3.5
Medical care	0.4	0.5	0	0.5	0.4	0.5	2.6
Recreation	0.2	-0.1	0.2	0.5	0.4	-0.2	1.5
Education, comm.	0.2	0	0.4	0.4	0.1	-0.3	0.4
Other good, serv.	0.4	0.4	-0.3	0.5	0.0	0.4	4.3
Commodities	0.2	0.1	0.4	-0.3	0.0	-0.4	0.3

Source: Haver Analytics.

- Jay Powell will breathe a sigh of relief after today's consensus matching inflation report showed price pressures subside a bit. Core CPI prices rose 0.3% m/m in April, down one notch from the month prior and in line with forecasters predictions. Headline inflation also came in at 0.3%, one tick below expectations. Services prices edged down one notch to 0.4% in the month, reflecting some cooling in non-housing services, and particularly in transportation services which has been ultra-hot in recent months. Core goods prices declined by 0.1% in the month. After three bad inflation reports in a row, the Fed will need to see more prints like this to regain its confidence. They will remain in data-dependent mode watching for lower market-based rents to feed into CPI, price stickiness in non-housing services to unwind a bit more and demand in the economy to continue cooling. We estimate that today's core CPI reading, and yesterday's PPI report, implies core PCE at about 0.2% m/m.
- As of writing, the market is pricing in 50 basis points of easing in 2024, with September and December being the key dates. That aligns with our view. We expect that while there will be more bumps along the way, there are enough encouraging signs to suggest that inflation progress will continue, albeit at slower pace than what we saw last year.

- One of those encouraging signs is inflation in rents. While headline shelter inflation stayed at 0.4% as owner's equivalent rent did not really budge probably due to high single family home prices, rental inflation is clearly on its way down again with the 6-month annualized reading coming in a shade below 5% compared to 5.2% last month. FOMC members have been very confident about shelter inflation easing and next month we are likely to see a rental inflation number sub-0.4% in m/m terms and gradually, that too should push down OER as multi-family rental units start to impact the broader shelter picture. There is a risk that this pace could also pick up given how much market-based rental prices of apartments have come down.
- Another supportive sign is the trend in goods inflation. We always believed that core goods prices had more room to remain in disinflationary territory, in large part because used car market still seems incredibly imbalanced. Auto production is rebounding and with Americans working more from home, vehicle miles travelled are well below their pre-pandemic trend. Higher interest rates on top of those forces should continue to exert downward pressure on used car prices which are still 30% above their pre-pandemic levels as recorded in the CPI. Other core goods prices too should remain soft, in part because of monetary policy but also because the global supply of goods remains so rich. The New York Fed Supply Chain Pressures Index has edged down again, and the strength of the dollar is also helping here.
- These supportive forces will buy the Fed some time, even if non-housing services inflation remains bumpy. Today's reading definitely will generate cheers at the FOMC data briefing this week, as non-housing service inflation came in at 0.2%, down from 0.6%. Household operations, transportation services and medical services contributed to that slowdown in price pressures. But the trend in this category has not encouraging and the Fed will either want to see more signs of cooling in this category, or to be convinced that most of this is not demand-driven.
- Medical services and transportation, which are half of this segment and about the same size, are the real culprits here. Our view is that ,in large part, price pressures in these categories are not mostly demand-driven with rising insurance costs in these segments looking more like a catch-up or adjustment to post-pandemic realities. For example, car insurance premiums continue to be hot because of the past jump in car prices and higher road accidents, weakening insurer profitability. There is likely some room for these categories to keep rising at an above average pace and it will be interesting to see how the Fed views the outsized role of transportation services in particular going forward. That category alone was adding about 0.1 percentage points on average to monthly core CPI readings over the prior three month period.
- Taking a step back, and taking off one's data-dependent hat, the forward-looking picture of economy and inflation still seems constructive for monetary policy easing to guide a soft landing. Wage pressures are softening as the supply of workers remains strong, consumer spending is shifting in a slightly lower gear it seems, interest-sensitive sectors remain weak and a range of different underlying metrics of inflation suggest most of higher inflation is either due to categories where prices are "sticky" (adjusted infrequently) or have a weaker associated with slack. Recency bias is preventing the FOMC from trusting their macro instincts and fully looking-through somewhat higher inflation, but in an economy that is not very interest-rate sensitive, they still have time on their sides.

Implications & actions

Re: Economic forecast — Today's report is a good one for the Fed but the will need to see more reports like this. We continue to expect the Fed will ease twice this year -- in September and December.

Re: Markets — Both bond yields and the greenback fell as core inflation eased after three straight hot readings to start the year.

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