CIBC CAPITAL MARKETS

Economics

ECONOMIC FLASH!

economics.cibccm.com

June 13, 2023

US CPI cooling supports Fed inaction tomorrow

by **Katherine Judge** katherine.judge@cibc.com

Consumer Price Index (monthly change, %)	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023	Dec 2022	May NSA YoY%
All items	0.1	0.4	0.1	0.4	0.5	0.1	4.0
Ex-food/energy	0.4	0.4	0.4	0.5	0.4	0.4	5.3
• Ex-food	0.1	0.4	0.1	0.4	0.5	0.1	3.6
• Ex-energy	0.4	0.4	0.3	0.4	0.4	0.4	5.5
Energy	-3.6	0.6	-3.5	-0.6	2	-3.1	-11.7
Services	0.3	0.2	0.3	0.5	0.6	0.7	6.3
Housing	0.2	0.2	0.3	0.5	0.8	0.7	6.8
Fuels & util.	-1.1	-1.1	-1.7	-1.4	1.6	0.9	0.9
Food/beverages	0.2	0.1	0	0.3	0.5	0.5	6.6
• Food	0.2	0	0	0.4	0.5	0.4	6.7
Apparel	0.3	0.3	0.3	0.8	0.8	0.2	3.5
Transportation	-0.2	1.2	-0.5	0.2	0.4	-1.6	-2.0
Medical care	0.1	0	-0.3	-0.5	-0.4	0.3	0.7
Recreation	-0.1	0.5	0.1	0.9	0.5	0.2	4.5
Education, comm.	-0.2	0	0.2	0.1	0.4	0.1	1.5
Other good, serv.	0.5	0.9	0.5	0.9	0.6	-0.1	6.7
Commodities	-0.2	0.6	-0.3	0.2	0.4	-0.7	0.6

Source: Haver Analytics.

- Price pressures decelerated in the US in May, as a drop in gasoline prices limited the headline CPI advance to 0.1% m/m, in line with expectations. Excluding food and energy, core CPI rose by 0.4%, also in line with expectations, and that reflected an acceleration in shelter prices and a jump in used car prices. But all eyes were on the Fed's preferred measure of prices tied to underlying demand, core services excluding rent of shelter, which showed a 0.2% increase in May, leaving the three-month annualized pace at 3.0%, down from 4.2% in the prior month. That's consistent with leaving policymakers on the sidelines at tomorrow's interest rate announcement, but officials could set the stage for further hikes in Q3 given the resilience in the labor market.
- Within the Fed's preferred measure of core services ex. rent of primary residences and ex. owners' equivalent rent, transportation services increased, while most other groups retreated, including recreation services, medical services, and education and communication services. The easing in some discretionary service categories will give the Fed some comfort that demand is being thwarted by past rate hikes.
- Core goods prices jumped by 0.6% for the second month in a row, with a climb in used car prices being the main culprit again. Apart from medical goods, which saw lower prices, most other core goods categories posted more

modest price increases. Inventories at car dealers are still lean, but for retailers outside of auto dealers, the inventory-to-sales ratio is at its pre-pandemic level, which should keep a lid on core goods prices outside of autos ahead. Demand for autos will likely fade as interest rate hikes work their way through the economy, and continued supply chain improvements will also work to contain prices.

- The shelter sub-index accelerated to 0.6%, reversing the downward trend that started earlier in the year. That included a 2.1% surge in hotel prices, following a sharp drop in April. Rent increases of primary residences slowed by a tick to 0.5%, and owners' equivalent rent remained at a 0.5% pace. We continue to expect last year's softness in rent to feed through to the aforementioned indices ahead, which will be key in getting the core CPI index back to 2.0% in 2024.
- Looking at the total CPI, gasoline prices were down by 5.6%, adding to downwards pressure on electricity and natural gas prices. Grocery store prices rose by a modest 0.1%, masking a 13.8% drop in egg prices, the second largest monthly drop on record for eggs, as the avian flu situation has improved. That would have left more money for spending elsewhere, with restaurant prices increasing by a strong 0.5%.
- The annual pace of inflation was down sharply for the total CPI, to 4.0% from 4.9%, which was helped by base effects, and is the slowest pace seen since May 2021, while core annual inflation subsided by two ticks to 5.3%.

Implications & actions

Re: Economic forecast — Today's inflation data showed tame advances in enough key categories to justify a pause from the Fed tomorrow. Although the annual core inflation pace will continue to cool in the summer months, helped by base effects, the ongoing strength in the labor market suggests that 2.0% inflation won't be attainable on a sustained basis, and we could see two final 25bp rate hikes in Q3 from the Fed as a result.

Re: Markets — Bond yields fell and the greenback depreciated ahead of the release, with both remaining around those levels following the data release, as this report wasn't seen as strong enough to bring a Fed hike as early as tomorrow.

CIBC Capital Markets – PO Box 500, 161 Bay Street, Brookfield Place, Toronto, Canada M5J 2S8 – Bloomberg @ CIBC