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May 10, 2023

US CPI (Apr): markets find reason to cheer, but a long road ahead

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Consumer Price Index (monthly change, %)	Apr 2023	Mar 2023	Feb 2023	Jan 2023	Dec 2022	Nov 2022	Apr NSA YoY%
All items	0.4	0.1	0.4	0.5	0.1	0.2	4.9
Ex-food/energy	0.4	0.4	0.5	0.4	0.4	0.3	5.5
• Ex-food	0.4	0.1	0.4	0.5	0.1	0.1	4.5
• Ex-energy	0.4	0.3	0.4	0.4	0.4	0.3	5.8
Energy	0.6	-3.5	-0.6	2	-3.1	-1.4	-5.1
Services	0.2	0.3	0.5	0.6	0.7	0.4	6.8
Housing	0.2	0.3	0.5	0.8	0.7	0.5	7.5
Fuels & util.	-1.1	-1.7	-1.4	1.6	0.9	-0.3	4.8
Food/beverages	0.1	0	0.3	0.5	0.5	0.6	7.5
• Food	0	0	0.4	0.5	0.4	0.6	7.7
Apparel	0.3	0.3	0.8	0.8	0.2	0.1	3.6
Transportation	1.2	-0.5	0.2	0.4	-1.6	-0.7	0.2
Medical care	0	-0.3	-0.5	-0.4	0.3	-0.4	1.1
Recreation	0.5	0.1	0.9	0.5	0.2	0.5	5.0
Education, comm.	0	0.2	0.1	0.4	0.1	0.7	1.6
Other good, serv.	0.9	0.5	0.9	0.6	-0.1	0.7	6.6
Commodities	0.6	-0.3	0.2	0.4	-0.7	-0.2	2.1

Source: Haver Analytics.

- Investors dug into the US inflation data and found reason to cheer, but taken as a whole, the latest figures still showed a long road to get to where the Fed wants to be. The headlines were hardly rosy. Higher prices at the pump meant that overall price pressures picked up momentum once again, despite a second consecutive month of flat food prices. Headline CPI posted a 0.4% monthly advance in April, three ticks above the March pace and in line with consensus expectations, with the 12-month rate sitting at 4.9%. Core inflation continued to advance at a steady but uncomfortably hot pace in April in the US, as shelter prices continue to rise. Core inflation maintained its 0.4% m/m pace in April, in line with consensus expectations, and now sits at 5.5% y/y. All told, these aren't the inflation readings of a central bank that would be thinking of cutting rates any time soon.
- The market's eyes were elsewhere however, as the Fed's preferred gauge of underlying price pressures tied to the output gap, core services excluding housing, decelerated meaningfully from 0.4% m/m in March to just 0.1% in April. That sparked a rally in bonds despite the on-consensus headline figures. But at 5.1% y/y, and roughly 4% annualized in the last three months, this "supercore" measure is still elevated. One month of seasonally adjusted do not a trend make.

- Shelter prices decelerated further in April, as hotel prices dropped after four months of growth. Meanwhile, both rent of primary residence (+0.6%) and owners' equivalent rent (+0.5%) paused their deceleration, with the first growing a tick higher than last month while the second maintained its March pace. Nevertheless, there will be softness in the cards for rent measures by mid-year, as new rental rates have eased in line with the cooling in the housing market, and the CPI index picks that impact up with a lag. In a reversal of previous months, the fall in hotel prices was accompanied by a decline in airline fares, as demand for travel dropped off after a strong spring break period.
- In addition to shelter, core inflation was supported by strong growth for prices of used cars and trucks (+4.4%), which rebounded after nine months of decline, as well as motor vehicle insurance (+1.4%). In contrast, prices for new vehicles fell on the month. Overall, core goods prices accelerated in April, as many categories, such as apparel and recreation commodities, continue to increase. Meanwhile, many other services categories remain uncomfortably hot, with areas such as pet services, financial services, and motor vehicle maintenance and repairs all continuing to post strong gains.
- Gasoline prices rose 3.0% on the month, as expected, more than offsetting declines in other energy prices such as natural gas and electricity. The reprieve for consumers at the grocery store also continued in April, with a second month of flat food prices. The food at home index fell for the second consecutive month, offsetting restaurant prices that continue to rise. Plummeting grocery store prices for staples such as milk (-2.0%) and eggs (-1.5%), partly offsetting big increases over the past year, will continue to help consumers.

Implications & actions

Re: Economic forecast — Today's inflation data came in as we expected and therefore has no implications for our forecast. While the deceleration in the Fed's preferred gauge of underlying pressures, core services excluding housing, is encouraging for policy makers, the level remains elevated, and many core services categories continue to post strong monthly gains. Therefore, we continue to expect the Fed to maintain the Fed funds rate at its current level for the rest of the year, as the still hot pace in core inflation reaffirms that rate cuts are not in the cards until 2024.

Re: Markets — The market reacted strongly to today's release despite the fact that it came in as expected. Bond yields fell significantly as the cooling in the "supercore" measure and deceleration in the shelter index were interpreted as supportive of rate cuts before year end. The USD also depreciated slightly.

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