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US CPI: a cooler start to the summer

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Consumer Price Index (monthly change, %)	June 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	Jan 2023	June NSA YoY%
All items	0.2	0.1	0.4	0.1	0.4	0.5	3.0
Ex-food/energy	0.2	0.4	0.4	0.4	0.5	0.4	4.8
• Ex-food	0.2	0.1	0.4	0.1	0.4	0.5	2.5
• Ex-energy	0.1	0.4	0.4	0.3	0.4	0.4	5.0
Energy	0.6	-3.6	0.6	-3.5	-0.6	2	-16.7
Services	0.3	0.3	0.2	0.3	0.5	0.6	5.7
Housing	0.3	0.2	0.2	0.3	0.5	0.8	6.3
Fuels & util.	0.3	-1.1	-1.1	-1.7	-1.4	1.6	-1.0
Food/beverages	0.1	0.2	0.1	0	0.3	0.5	5.7
• Food	0.1	0.2	0	0	0.4	0.5	5.7
Apparel	0.3	0.3	0.3	0.3	0.8	0.8	3.1
Transportation	0.2	-0.2	1.2	-0.5	0.2	0.4	-5.1
Medical care	0	0.1	0	-0.3	-0.5	-0.4	0.1
Recreation	0.1	-0.1	0.5	0.1	0.9	0.5	4.3
Education, comm.	-0.2	-0.2	0	0.2	0.1	0.4	1.1
Other good, serv.	0.2	0.5	0.9	0.5	0.9	0.6	6.3
Commodities	0.1	-0.2	0.6	-0.3	0.2	0.4	-1.2

Source: Haver Analytics.

- Americans finally saw some relief from higher prices in key categories in June, as total CPI inflation decelerated sharply to 3.0% y/y. While that was helped by base effects as a large price increase from a year-ago dropped out of the calculation, it also reflected a deceleration in core prices to 0.2% m/m (vs. 0.3% expected), and more encouragingly, the Fed's preferred prices measure, core services ex. rent of shelter was flat on the month, showing that past rate hikes are starting to work to dampen inflation in categories that are tied more closely to underlying demand. While the tightness in the labor market still leans the FOMC towards two 25 bp hikes ahead, this latest news should increase market confidence that we're nearing the end of the road for Fed action.
- Within the core services ex. shelter group, there was a sizeable 8.1% drop in airline fares that shaved 0.2%-points off of the monthly increase. That is a volatile category that could have partly reflected a drop in demand in June for discretionary travel services, in line with the sharp drop in hotel prices. Even when adding the 0.2%-points back onto the headline, the three-month annualized pace would have fallen to 2.2%. Other core service sub-categories showed mixed readings, with recreation prices rebounding from a drop in May, while medical services prices were flat, and education and communications prices dropped off. A continued easing in some discretionary service categories will give the Fed comfort that demand is being thwarted by past rate hikes.

- Core goods prices eased by 0.1%, after showing strong increases in the past two months. Used car prices continued to be the swing factor for that group, as prices decreased following two months of strong increases. Inventories at car dealers are on an upward trajectory but are still lean. 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. Moreover, 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. Overall, the annual pace of inflation in core goods is at 1.3%, and this doesn't pose a risk to the Fed's inflation target.
- The shelter sub-index decelerated to 0.4%, resuming a downward trend that started earlier in the year but had reversed temporarily. That included a deceleration in owners' equivalent rent to the slowest pace seen since late 2021, as last year's softness in on-the-ground rent measures is feeding through to that index with a lag. While that is key for returning inflation to 2% given the high weight of shelter in the index, the Fed typically excludes this component when judging underlying price pressures tied to demand as it lags developments on the ground by several months.
- Looking at the total CPI, grocery store prices were flat, while restaurant prices decelerated to 0.2% m/m, the slowest monthly pace seen since early 2021. With food commodity price indices still falling, we continue to expect food prices to remain contained. Energy prices rebounded partially following a sizeable drop in May, as gasoline and electricity prices increased, while natural gas prices eased.

Implications & actions

Re: Economic forecast — The pace of annual headline inflation could accelerate temporarily in the next couple of months as base effects become unfavorable, but the more important core group should continue to see inflation melt away. Although the Fed will clearly view the progress in the core services ex. rent of shelter group favorably, the ongoing strength in the labor market likely has them doubting the sustainability of that deceleration, so we continue to expect two further quarter point hikes ahead.

Re: Markets — Bond yields fell and the greenback depreciated on the downside surprises in the data, as they reduce the odds that the Fed will have to press ahead with additional rate hikes further into 2023.