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US CPI (May): Good news on inflation, but this won't last

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Consumer Price Index (monthly change, %)	May 2025	Apr 2025	Mar 2025	Feb 2025	Jan 2025	Dec 2024	May NSA YoY%
All items	0.1	0.2	-0.1	0.2	0.5	0.4	2.4
Ex-food/energy	0.1	0.2	0.1	0.2	0.4	0.2	2.8
• Ex-food	0	0.3	-0.1	0.2	0.5	0.4	2.3
• Ex-energy	0.2	0.2	0.1	0.2	0.4	0.2	2.8
Energy	-1	0.7	-2.4	0.2	1.1	2.4	-3.5
Services	0.2	0.4	0.2	0.3	0.5	0.3	3.7
Housing	0.3	0.5	0.3	0.4	0.3	0.3	4.0
Fuels & util.	0.4	1.1	1.1	1.2	0.5	0.6	6.0
Food/beverages	0.3	-0.1	0.4	0.2	0.4	0.3	2.8
• Food	0.3	-0.1	0.4	0.2	0.4	0.3	2.9
Apparel	-0.4	-0.2	0.4	0.6	-1.4	0.1	-0.9
Transportation	-0.7	0	-1.8	-0.4	1.2	1.2	-1.3
Medical care	0.3	0.5	0.2	0.3	0.2	0.1	2.5
Recreation	0.1	0	-0.1	0.3	1.0	0.0	1.8
Education, comm.	0.1	-0.1	0.3	0.2	0.3	0.0	0.3
Other good, serv.	0.5	0.1	1	0.6	-0.3	0.0	3.8
Commodities	-0.1	0	-0.4	0.1	0.4	0.5	-0.1

Source: Haver Analytics.

- Despite elevated tariffs, there were no major signs of sticker prices rising with inflation coming in soft in May. Core CPI rose by 0.13% m/m in the month, below expectations of a 0.3% gain, and the three-month annualized core CPI fell four ticks to 1.7%. Headline inflation also increased by 0.1%, also tick below forecasters' predictions. In year-over-year terms, headline and core came in at 2.4% and 2.8% respectively. Core goods prices were subdued in the month showing little sign of significant tariff impact. Used cars dropped again but even stripping out used cars prices, core goods were soft in the month. Service price growth was also modest in the month across all major sub-categories.
- Today's data could indicate that US businesses and their counterparts could have been trying to manage the early stages of the trade war by eating the tariffs in the hope that cooler heads would prevail. Some of it could also be that most of those goods sold were coming from pre-tariff inventories, and businesses could be offering extra discounting to clear out inventories given worries of weaker future sales. But with the US-China framework agreement and the federal appeals decision mean that the current tariff will last at least through most of the summer. If that ends up being the permanent state of affairs for US trade policy, softer inflation reports like today won't be norm and in that scenario, we would expect core prices to rise by 1% over time and the level of GDP to be permanently dented by 0.5% from tariffs and uncertainty. Those forces will keep the Fed on the sidelines until December.

- Apparel (-0.4%) and cars/parts (-0.3%) were soft in the month, pushing down core goods prices and that's were discounting of past inventories or margin compression could be showing up to blunt the tariff impact. But other categories showed some signs of increase including household furnishings (+0.3%) and recreational commodities (+0.4%). But even there, price gains were within a standard deviation of a normal price change, and there was some weakness in prior months.
- Services inflation was also subdued across the board. Shelter costs dipped on weaker rent prices (+0.2%) and OER (+0.3%), and three-month annualized shelter costs have steadily downshifted since Q3 of last year and now sit at 3.3%, not far from their pre-pandemic pace. Actual rents have been stable a rates slightly below their pre-pandemic pace over the past year and that still services as a reasonable guide for CPI shelter costs.
- But no small part of the softness in today's report came from non-housing services, which came in at 0.1% and has dropped significantly since the January "price resetting", with the three-month annualized pace also registering 0.1% in May. Transportation services dropped in May again and have been weak for the past few months given softer energy prices continue to weigh on airfares, and car insurers profits look restored so premiums are not rising as quickly anymore. Medical services costs also slowed after a very rising for the past three months.
- Overall, today's report was a bit of a surprise. Our expectation is that it won't last and core goods prices will have to start to rise. The economy will slow and that will make opportunistic pricing less pronounced than we have seen during the prior tariff episode or the pandemic, and also contain service inflation. The softer pace of May inflation is good news for the Fed but it doesn't change the calculus. They still need to wait and see how the economy and the job market respond, where tariffs settle and what fiscal policy looks like.

Implications & actions

Re: Economic forecast — Good news on inflation, but it likely won't last. Goods prices should gradually start to rise as firms run out of pre-tariff inventories and pass-on costs to consumers.

Re: Markets — Bond yields and the broad dollar fell on the downside surprise.