Consumer Price Index May 2024

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Disinflation resumes (wink, wink)

- Headline Consumer Price Index (CPI) was unchanged in May, lower than expected, with energy prices down 2.0% and food prices up a tick. Core CPI rose a modest 0.2% month over month (m/m) — its lowest advance in eight months and lower than the average 0.4% m/m gain in Q1 — pointing to ongoing disinflation. As a result, headline CPI inflation eased 0.1 percentage points (ppt) to 3.3% year over year (y/y) while core CPI inflation eased 0.2ppt to 3.4% y/y — its lowest since April 2021.
- Core goods prices were flat on the month — they have risen only once in the past 12 months — while core services prices only rose 0.2% — the weakest gain since September 2021. While shelter costs advanced a moderate 0.4%, lower hotel and airfare prices along with the first decline in auto insurance prices since October 2021 drove the cooler headline gain. The Fed's favored (but perhaps misleading) "supercore" CPI measure — core services excluding shelter costs — fell 0.04%, the first decline since late 2021 and much lower than the average 0.5% gain over the prior three months.
- Short-term inflation dynamics softened smartly: on a three-month annualized basis, headline CPI inflation eased 1.8ppt to 2.8% while core CPI inflation fell 0.8ppt to 3.3%. On a six-month annualized basis, headline and core CPI inflation eased 0.3ppt to 3.4% and 3.7%, respectively.
- Given unfavorable year-on-year comparisons, CPI inflation is likely to hover around an "uncomfortable plateau" over the summer with headline inflation around 3.3% and core inflation around 3.4%. While softer consumer spending growth due to increased pricing sensitivity, moderating wage growth, declining rent inflation, reduced markups and stronger productivity growth will continue to provide a healthy disinflationary impulse, it's not until September that inflation readings will fall below that uncomfortable plateau.
- While it's not unusual for Fed policymakers to be extra-cautious when approaching the onset of a new monetary policy cycle, the focus and debate around the timing of the first Fed rate cut have become excessive and backward-looking. We continue to believe a July onset of the easing cycle would have been optimal given easing inflation and softening labor market conditions, but a September onset is now likely. We foresee two 25 basis points (bps) rate cuts before year-end, in September and December.

Looking into the details

Energy prices fell for the first time in five months, down 2.0% m/m in May, on broad-based softness. The decline was led by a 3.6% drop in gasoline prices and a 0.8% decline in utility gas prices.

Food prices rose a tick in May but have been essentially flat for the last four months on lower grocery store prices. Restaurant prices picked up modestly and rose 0.4% on a non-seasonally adjusted basis — in line with pre-pandemic trends. As a result, grocery store price inflation has moderated markedly from a peak of 13.5% y/y in August 2022 to just 1.0% y/y in May while restaurant price inflation has cooled from 8.8% y/y in early 2023 to 4.0% y/y in May — a three-year low.

Core goods prices were flat in May. New car prices plunged 0.5%, the fourth consecutive monthly decline and the largest since April 2020, while used car prices rebounded 0.6%. Apparel prices cooled 0.3% after three hot months and are now slightly higher than they were a year ago. Used car prices are now 9.3% lower than last year and have been declining on a year-over-year basis for 19 months while new car prices are 0.8% lower than last year.

Core services prices rose 0.2% m/m — the smallest gain since September 2021. The Fed's favored (but perhaps misleading) supercore CPI measure — core services excluding shelter costs — fell 0.04%, the first decline since late 2021 and much lower than the average 0.5% gain over the prior three months.

On an annual basis, supercore CPI inflation eased 0.2ppt to 4.7% y/y. This is certainly too hot for comfort for the Fed, but we have increasing doubts as to whether this is a reliable indicator of so-called underlying price pressures given the distortions from auto insurance prices. Without auto insurance cost inflation, which arguably the Fed can't do much about, supercore inflation is running around 2.5% y/y.

Looking into the services details, **transportation costs** fell 0.5% m/m, the first decline since September 2021, as motor vehicle insurance prices fell 0.1% — the first decline since October 2021. Auto insurance prices had risen for 30 consecutive months until May, but the monthly decline led to a moderation in the pace of inflation from 22.6% y/y in April to 20.3% y/y in May. Airfares, meanwhile, plunged 3.6% m/m and are now 5.9% below last year.

Medical care services rose 0.3% m/m in May, driven by a 0.5% increase in hospital services. Health insurance prices rose 0.5% m/m on a non-seasonally adjusted basis — pushing deflation from 11.6% y/y to 7.7% y/y in May.

Shelter costs maintained a 0.4% pace in May, as rent prices and owners' equivalent rent (OER) posted a 0.4% advance. Hotel prices fell 0.2% last month indicating softer travel demand and increased pricing sensitivity. Overall, shelter inflation fell 0.1ppt to 5.4 % in May, a rate well below its 8.2% peak of April 2023. Rent inflation cooled to 5.3% while OER inflation cooled to 5.7%.

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