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May Consumer Price Index: Not Getting Worse Isn't The Same As Getting Better

- The total CPI was unchanged in May (up 0.006 percent unrounded); the core CPI rose by 0.2 percent (up 0.163 percent unrounded)
- On a year-over-year basis, the total CPI is up 3.3 percent and the core CPI is up 3.4 percent as of May

The total CPI was unchanged in May, contrary to the 0.1 percent increase we and the consensus expected, while the core CPI rose by 0.2 percent, matching our below-consensus forecast. On a year-on-year basis, the total CPI is up 3.3 percent as of May while the core CPI is up 3.4 percent, each a touch lighter than anticipated. Energy was a meaningful drag on the total CPI while falling prices (on a seasonally adjusted basis) for air fares, lodging rates, new motor vehicles, and apparel weighed on the core CPI. The report on the May CPI is, unsurprisingly, being warmly embraced by market participants, as any signs of slowing inflation will immediately be extrapolated into a higher probability of the FOMC beginning to cut the Fed funds rate. The FOMC will of course weigh in on that matter later today, but, while any progress against inflation is welcome, even the FOMC's preferred gauge of inflation, the PCE Deflator, shows inflation remains easily above the FOMC's 2.0 percent target rate. Moreover, despite the soft print on the core CPI, there nonetheless remain pockets of upward price pressures within the broad services sector, even tossing out implausibly firm readings on rents. So, if we had to summarize our take on the May CPI, we'd just note that not getting any worse isn't the same as getting better. We suspect at least a few FOMC members would agree with this take, even if they might word it a bit differently than we have here.

The overall energy index fell by 2.0 percent in May, and while a 3.6 percent decline in gasoline prices was the primary culprit, electricity prices were flat in May and have, over the past two months, become oddly quiescent after a series of robust increases, while prices for residential gas service logged a second straight monthly decline. The extent to which retail gasoline prices have fallen thus far in June all but assures that gasoline prices will also be a drag on the June CPI. Food prices behaved in line with our forecast, with prices for food consumed at home unchanged and prices for food consumed away from home rising by 0.4 percent, leaving the overall food price index up by 0.1 percent. To our point about not getting worse not being the same as getting better, prices for food consumed at home are up just 1.0 percent year-on-year, but that still leaves them up roughly twenty-five percent since the onset of the pandemic.

Core goods prices were flat in May, but a 0.6 percent increase in prices for used motor vehicles acted as a counter to a 0.1 percent decline in core goods prices excluding used motor vehicles. We think the latter to be more relevant than the former, as the CPI measure of used vehicle prices marches to its own beat and is at odds with continued declines in the wholesale level and with what of late have been declines in prices for new motor vehicles. New vehicle prices followed April's 0.4 percent decline by falling 0.5 percent in May and are now down 0.8 percent year-on-year. Increased inventories and demand being dinged by elevated interest rates are weighing on vehicle prices, with many dealers becoming more aggressive with incentives to help move vehicles off their lots. Prices for home furnishings and appliances fell further in May, and both categories are down significantly on an over-the-year basis. While continued declines in goods prices may seem at odds with rising input and shipping costs, don't discount the extent to which a strong U.S. dollar has been weighing on prices of imported consumer goods.

Core services prices rose by just 0.2 percent in May, the smallest monthly increase since September 2021 on an unrounded basis. Lodging rates and air fares declined in May on a seasonally adjusted basis, the result of smaller increases in unadjusted prices than are typical for the month of May, while rental car rates also fell. These declines could be further signs of the softening in discretionary services spending we've been pointing to over the past couple of months, but either way we think it worth keeping in mind the extent to which seasonal adjustment helped hold down the May increase in the core CPI. We noted in this week's *Economic Preview* that we expected the monthly change both primary and owners' equivalent rents to print at 0.4 percent but would be looking for signs of moderation in the unrounded changes. We were right on the former count, but wrong on the latter count, with rents still skewing the read on overall services prices in the CPI.

