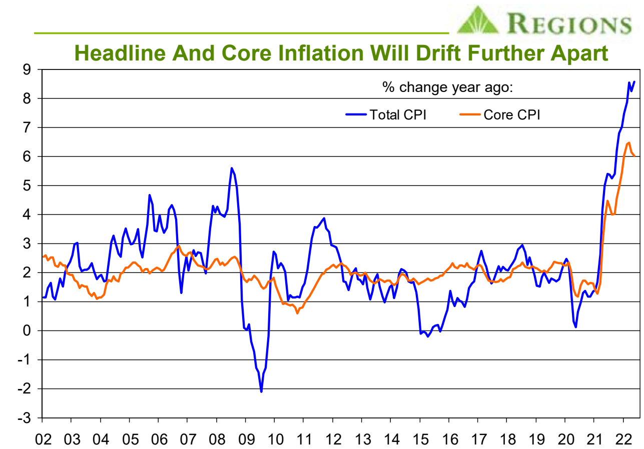
ECONOMIC UPDATE
REGIONS
June 10, 2022

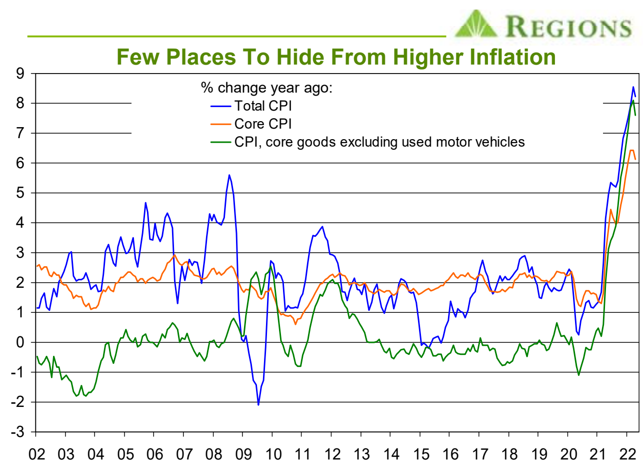
May Consumer Price Index: Headline And Core Inflation Will Drift Further Apart

- The total CPI rose by 1.0 percent in May (up 0.974 percent unrounded); the core CPI rose by 0.6 percent (up 0.631 percent unrounded)
- On a year-over-year basis, the total CPI is up 8.6 percent, and the core CPI is up 6.0 percent as of May

The total CPI rose by 1.0 percent in May, topping our above consensus forecast of a 0.8 percent increase, while the core CPI was up by 0.6 percent, more than the 0.5 percent increase we and the consensus expected. While food and energy prices accounted for much of the jump in the total CPI, the details of the May report show inflation pressures remain broad based, particularly within the services sector. On an over-the-year basis, the total CPI is up 8.6 percent as of May, with the core CPI up 6.0 percent. When the March data showed CPI inflation had hit 8.5 percent, we thought that would mark the peak rate of inflation for this cycle, but we also noted that, even if that proved to be the case, there was no cause for celebration as it would take considerable time for inflation to subside. We were obviously wrong on the "peak" part of that call but have seen nothing that makes us think the deceleration in inflation will be anything other than slow.

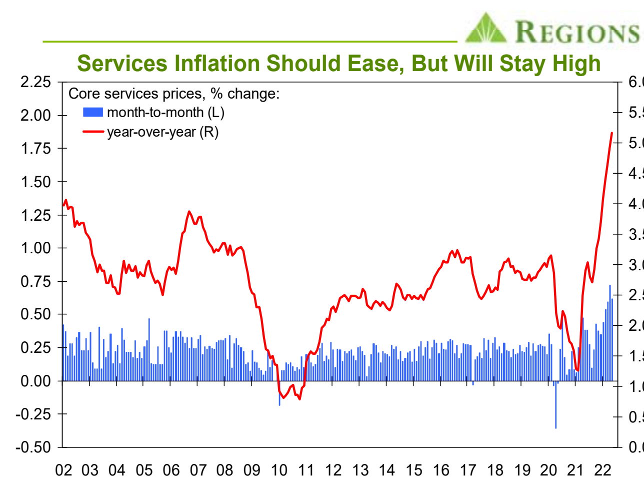


The broad energy index rose by 3.9 percent in May. On a not seasonally adjusted basis, retail gasoline prices were up by 7.8 percent, much more than the typical May increase, which left gasoline prices up 4.1 percent on a seasonally adjusted basis. It is also worth noting that diesel fuel prices are rising at a rapid pace; while this factors into the broad motor fuels index in the CPI data, higher diesel prices are indirectly feeding into core inflation to the extent they are driving up shipping costs for consumer goods, and we can make the same point about jet fuel costs and air fares. Higher electricity prices – up by 1.3 percent in May and up 12.0 percent year-on-year – are also contributing to the increase in the broad energy index. Food prices were up by 1.2 percent in May, with prices for food consumed at home up 1.4 percent and prices for food consumed away from home up 0.7 percent. On an over-the-year basis, prices for food consumed at home are up a staggering 11.9 percent, the largest increase since April 1979.



Despite an unexpectedly large increase in prices for used motor vehicles (up 1.8 percent after three straight monthly declines) and another hefty increase in prices for new motor vehicles, core goods inflation moderated a bit further in May. We've given up trying to make sense of the CPI's measure of used vehicle prices; higher prices for new vehicles reflect lingering supply constraints. Prices for household furnishings and supplies rose by just 0.1 percent, far less than over the prior several months, and within the broad category there were declines in furniture and bedding and appliances. To be sure, on a year-on-year basis prices are considerably higher, but the month-to-month deceleration is consistent with shifting patterns in consumer spending, with spending on discretionary goods coming under increased pressure from higher prices for necessities and waning demand.

Core services prices rose by 0.7 percent in May, leaving them up 5.2 percent year-on-year. Both primary rents and owners' equivalent rents rose by 0.6 percent in May; given that the CPI measures of rent growth lag other measures, don't be surprised to see further acceleration in rent growth in the CPI data over coming months. To the extent higher mortgage rates take some of the steam out of house price growth, that will feed into the CPI measure of owners' equivalent rents, but that will come only after a lengthy lag. Air fares rose by 12.6 percent in May, a third straight double-digit increase which leaves them up 37.8 percent year-on-year, while lodging costs were up 0.9 percent (up 19.3 percent year-on-year). While we are in the midst of very strong consumer spending on discretionary services, that more likely reflects the release of pent-up demand and, as such, current rates of growth in services spending will not be sustained. Also, should higher prices, not only for travel, dining out, and lodging but also grocery store and gasoline prices, weigh even heavier on household budgets, discretionary services spending will pull back even faster, taking some pressure off core services inflation.



The uncomfortable reality is that there are no signs of any relief from rising food and energy prices. As such, the divergence between headline and core inflation will become more pronounced. This will only further complicate the task for an FOMC already behind the curve on inflation.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com