ECONOMIC UPDATE
REGIONS
June 13, 2023

May Consumer Price Index: Favorable Base Effects Still Leave Inflation Too High

- The total CPI rose 0.1 percent in May (up 0.124 percent unrounded); the core CPI rose 0.4 percent (up 0.436 percent unrounded)
- On a year-over-year basis, the total CPI is up 4.0 percent and the core CPI is up 5.3 percent as of May

The total CPI rose by 0.1 percent in May with the core CPI up by 0.4 percent, each matching the consensus forecast but each one-tenth more than our forecast anticipated. Our forecast miss mainly reflects another implausibly large increase in prices for used motor vehicles as reported in the CPI – a second straight monthly increase of 4.4 percent which added 0.14 points to the monthly change in the core CPI. As anticipated, a sharp decline in gasoline prices on a seasonally adjusted basis acted as a significant drag on the headline CPI, offset only slightly by food prices perking up a bit in May. It is worth noting that the sharp deceleration in the year-over-year percentage increase in the total CPI reflects favorable base effects. Recall that last May the monthly increase in the total CPI was 0.9 percent, which was followed by a 1.2 percent increase last June, with these jumps similarly impacting the over-the-year changes. As such, this May was set up to be the beneficiary of favorable base effects, as evidenced by the over-the-year change in the total CPI going from 4.9 percent in April to 4.0 percent in May, and there will be a similarly large drop in the over-the-year change reported in the June data. That these base effects are nowhere near as pronounced in the core CPI is a function of continued upward pressure on core services prices, with the over the-year increases in rents still running at eight percent, though outside of rents there are signs that inflation pressures in the services sector are abating. That said, while the May CPI data may support those FOMC members opposed to a Fed funds rate hike at this week's meeting, that inflation remains well ahead of the FOMC's target rate supports those members who think it too soon to rule out further funds rate hikes at subsequent meetings.

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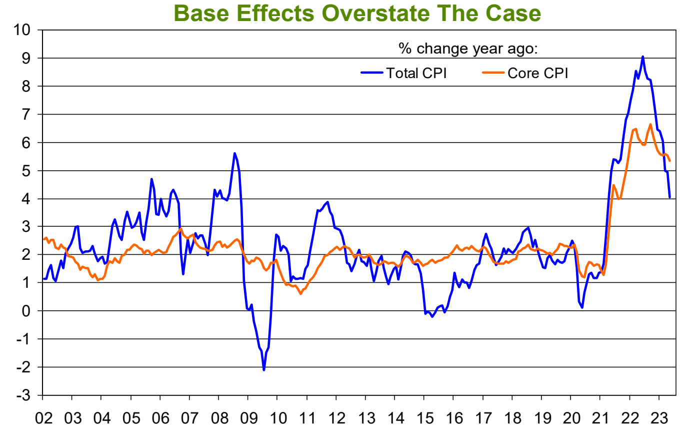
Base Effects Overstate The Case



The broad energy index fell by 3.6 percent in May. On a not seasonally adjusted basis, retail gasoline prices fell in May, which is at odds with typical seasonal patterns, hence the 5.6 percent decline in gasoline prices on a seasonally adjusted basis reported in the May CPI data. Prices for electricity and residential gas service also fell in May. After having been flat in the prior two months, the overall index of food prices rose by 0.2 percent in May, as prices for food consumed at home ticked higher after two straight monthly declines. Prices for food consumed away from home rose by 0.5 percent, with ongoing increases in prices at full and limited service restaurants in part reflecting continued rapid growth in labor costs.

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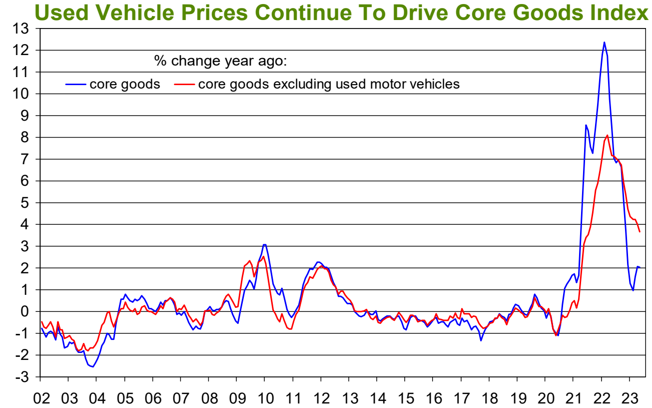
Used Vehicle Prices Continue To Drive Core Goods Index



The index of core goods prices rose by 0.6 percent in May. To our earlier point, however, that reflects little more than the second straight 4.4 percent monthly increase in prices for used motor vehicles, as the BLS's measure of core goods prices excluding used vehicles was unchanged for the second month in a row. Despite the jumps in the past two months, the CPI measure of used vehicle prices is still down 4.2 percent year-on-year, which is acting to hold down the over-the-year increase in core goods prices. Outsized monthly swings in used vehicle prices have been common since the pandemic, but that large changes in a component that has such a low weight can have such a pronounced impact on the aggregate, in this case core goods prices, is one of the inherent flaws in using a fixed-weight basket as a measure of price changes. Prices for new motor vehicles, home furnishings, electronics, and appliances fell in May, posing downside risk to May retail sales as retail sales are reported on a nominal (i.e., not adjusted for price changes) basis.

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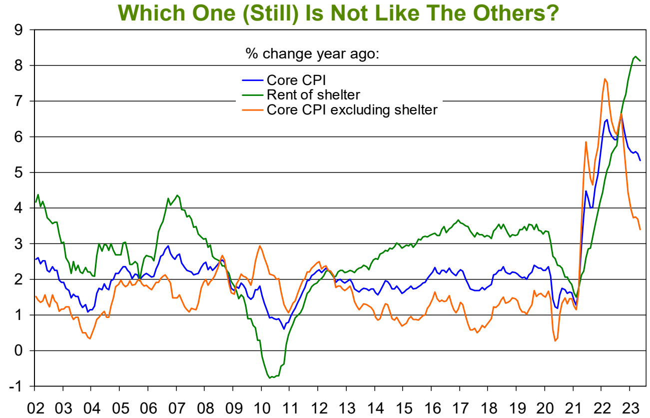
Which One (Still) Is Not Like The Others?



Primary and owners' equivalent rents rose 0.5 percent in May, and while the monthly changes are moderating a bit the over-the-year changes are running at eight percent. With rents carrying a weight of over forth percent, they continue to prop up core CPI inflation. As our bottom chart shows, however, aside from rents inflation pressures in the services sector are abating, though to be fair the CPI measure of medical care services continues to be skewed to the downside by reported declines in prices for health insurance.

The CPI data come with so many caveats – lags here, methodological changes there, seasonal adjustment noise everywhere – that it may be tempting to simply dismiss them. In one sense, however, they are consistent with the PCE Deflator, the FOMC's preferred gauge of inflation, in showing inflation remains much too high for the FOMC's comfort.

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