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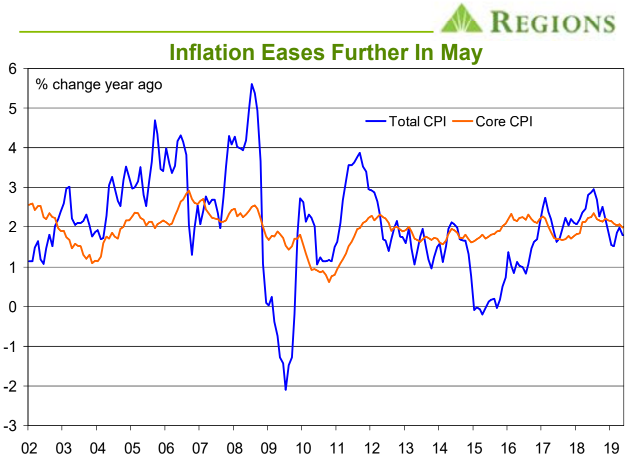
May Consumer Price Index: Inflation Eases Further

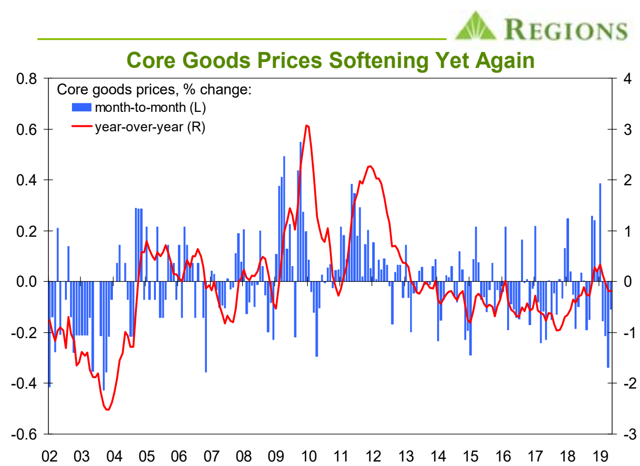
- The total CPI rose by 0.1 percent (0.077 percent unrounded) in May; the core CPI rose by 0.1 percent (0.113 percent unrounded)
- On a year-over-year basis, the total CPI was up 1.8 percent and the core CPI was up 2.0 percent in May

The total CPI rose by 0.1 percent in May, as we and the consensus expected, with the core CPI also up by 0.1 percent, below the 0.2 percent increase we and the consensus expected. On an over-the-year basis, the total CPI is up 1.8 percent and the core CPI is up 2.0 percent. Energy was a drag on the headline CPI in May, while a smaller increase in primary rents and another curiously large decline in prices for used motor vehicles held down the core CPI. The bigger story is that core CPI inflation is running at its slowest pace since February 2018, with few signs pointing to a meaningful and sustained acceleration any time soon, at least to the extent that would worry the FOMC. Instead, muted inflation pressures will give the FOMC room to cut the Fed funds rate should the economic data point to a more pronounced and broad based slowdown in growth.

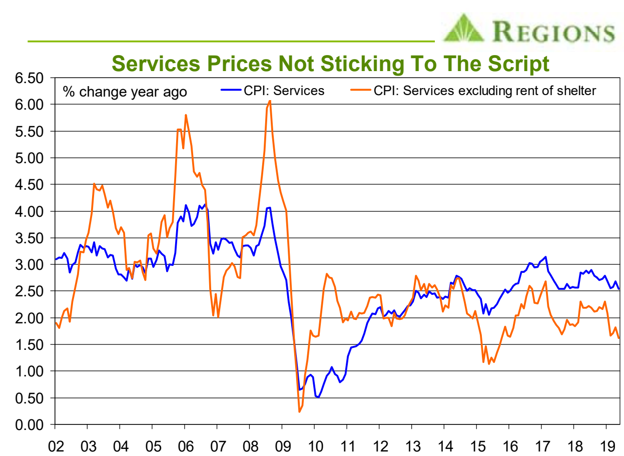


The overall energy index fell by 0.6 percent in May, leaving it down 0.5 percent year-on-year. Retail gasoline prices actually rose by 2.4 percent on a not seasonally adjusted basis in May, but as this is a smaller increase than is typical for the month of May, it turned into a modest decline (down 0.5 percent) in the seasonally adjusted data. The drag from gasoline prices will be much more genuine in the June CPI data, given that retail pump prices began declining in the last week of May and that decline has picked up pace thus far in June. Prices for electricity and residential gas service also declined sharply in June, and both are down on an over-the-year basis.

Food prices were up 0.3 percent in May, led by a 0.3 percent in prices for food consumed at home (think grocery store effects). This extends the odd behavior exhibited by this category over recent months – sizable increases in February and March teamed up to yield the largest two-month increase since early-2014, followed by a 0.5 percent decline in April, and now May's increase. While prices for food consumed at home are up just 1.2 percent year-on-year, the monthly data leave it unclear where prices head from here. Prices for food consumed away from home (think restaurants) were up by a below-trend 0.2 percent in May, leaving them up 2.9 percent year-on-year.



After back-to-back 0.4 percent increases in primary rents in March and April, we expected some payback in May, but a gain of just 0.2 percent was more payback than our forecast anticipated. Owners' equivalent rents posted a trend-like 0.3 percent increase in May. Thus far in 2019, rents have proved more resilient than our forecast had anticipated, though we question how much longer this can last given the immense backlog of rental apartment units under construction. After two large monthly declines, largely triggered by a change in methodology, apparel prices were flat in May, but it will take more time to become comfortable with this category, in terms of sizable monthly swings being a thing of the past, given the change in methodology. Prices for new motor vehicles were up 0.1 percent in May, but this modest increase was swamped by a 1.4 percent decline in prices for used motor vehicles, this after a 1.3 percent decline in April. This is another category in which a methodological change has resulted in significantly greater volatility. More substantively, core goods prices fell by 0.1 percent in May, a fourth consecutive monthly decline after it had appeared that core goods prices were gaining traction. A stronger U.S. dollar is helping put downward pressure on core goods prices, while the tariffs now in place have been more oriented towards capital, rather than consumer, goods. As of May, core goods prices are down 0.2 percent year-on-year and have now been falling on this basis for the better part of six years. At the same time, services prices are also softening, which is somewhat surprising as service providers seemingly have greater latitude to pass along higher input costs, particularly labor costs, in the form of higher output prices than do goods producers. Yet, prices for services excluding rents posted their smallest over-the-year increase (1.6 percent) since January 2016 in May. We'll note that the recent softening in this category coincides with markedly weaker nonfarm proprietors' income, a proxy for small business profits, suggesting service providers may have less pricing power than is commonly assumed.



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