



May inflation recap: Don't forget the cloud for the silver lining

- Both headline CPI (unch. vs. +0.31% in April) and core (+0.16% vs. +0.29%) were softer than expected, largely a function of weaknesses in core services excluding housing, particularly in transportation services. Taken together, the year-over-year rate for headline ticked down a tenth to 3.3%, while that for core fell by two tenths to 3.4%. Shorter-term trends showed improvement, with the three- and six-month annualized rates falling by 80bps (to 3.3%) and 30bps (to 3.7%) respectively.
- The PPI featured strength in major categories that pass through into core PCE, namely hospital prices, which could be a tailwind for core PCE going forward. All in all, our read based on the May CPI and PPI data is that core PCE should increase +0.17% m/m, which would have the year-over-year rate fall by 12bps to 2.63%. One note of caution is that our estimate does not include the -10.2% plunge in the seasonally adjusted PPI for international scheduled passenger air transportation. Our estimate would be about 5bps lower if the BEA does not smooth through this drop.
- While the overall May CPI data was weaker than we expected, the details point to a largely unchanged forecast. Our initial read on the May core CPI data is that it should come in at +0.25% m/m (just rounding up to 0.3%), with the year-over-year rate ticking back up a tenth to 3.5%. While our 2024 core CPI forecast has fallen by two-tenths to 3.3% (Q4/Q4), this mostly due to incorporating the May data. We continue to expect core CPI falling to 2.5% in 2025 and 2.4% in 2026 (both unch.). The aforementioned May core PCE print is close to what we had penciled in prior to this week's data; as such, our core PCE forecasts are largely unchanged: 2.7%, 2.2%, and 2.0% for 2024-2026 respectively. The analogous numbers for headline CPI are 2.8%, 2.6%, and 2.3% for 2024-2026 and 2.2%, 2.3%, and 1.9% for headline PCE.
- In terms of the Fed, our baseline remains only one cut this year in December (see "[US outlook update: Trying to reason with election season](#)"). However, the May inflation data do keep the door open to a September rate cut. That outcome requires the next few months to show similarly tame inflation readings and possibly some softening in the growth and labor market data. Indeed, Powell emphasized in his press conference that rate decisions are not just a function of inflation readings, but that they are based on the "totality of the data."

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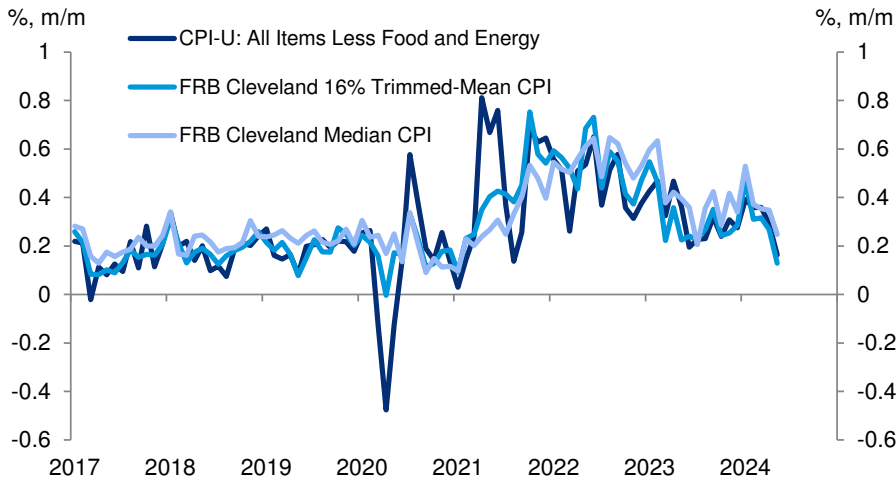
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May CPI and PPI

Both headline CPI (unch. vs. +0.31% in April) and core (+0.16% vs. +0.29%) were softer than expected, largely a function of weaknesses in core services excluding housing, particularly in transportation services. Taken together, the year-over-year rate for headline ticked down a tenth to 3.3%, while that for core fell by two tenths to 3.4%. Shorter-term trends showed improvement, with the three- and six-month annualized rates falling by 80bps (to 3.3%) and 30bps (to 3.7%) respectively.

Figure 1: Measures of trend inflation decelerating from Q1



Source : BLS, FRB Cleveland, Haver Analytics, Deutsche Bank

The skew of the outliers within core CPI was tilted to the upside, with the five largest outliers contributing about 20bps to the core print, mostly a function of the roughly 15bps contribution from owners' equivalent rent (OER). On the other side, the five largest downside outliers subtracted about 7bps, over half of which came from airfares. Both trimmed mean and median CPI showed similar decelerations, to +0.13% and +0.25%, respectively. The year-over-year rate for both fell, the former by a tenth to 3.4% and the latter by two to 4.3%.

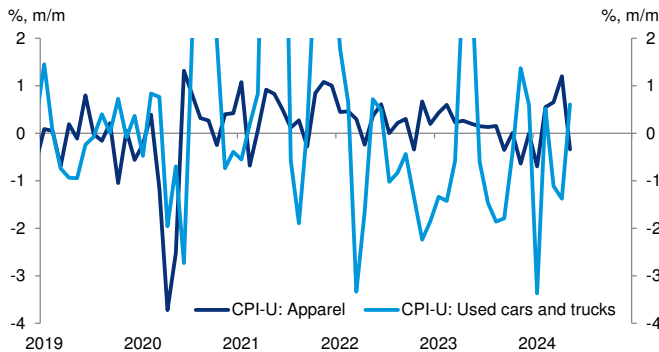
In terms of the breakdown within the expenditure basket, core goods were mostly unchanged (-0.04%) as expected. Apparel (-0.3%) and used cars and trucks (+0.6%) showed some payback from their outsized moves in April (+1.2% for apparel and -1.4% for used cars and trucks in April). Prices for new vehicles (-0.5%) continued to slide, the fifth monthly decline in a row, while those for medical care commodities spiked by 1.3%, the largest monthly gain since August 2016. While prices for household furnishings and supplies were mostly unchanged (+0.03%), twelve of the last fourteen prints have been negative averaging -27bps. This could be one area to watch for near term price pressures stemming from higher shipping costs and import prices, the latter of which was specifically flagged by Chair Powell in his June press conference (see ["June FOMC recap: Inflation keeps lifting dots higher...and higher"](#)). While our baseline forecast has core goods prices essentially going sideways over the next twelve months, there is some upside risk to that.

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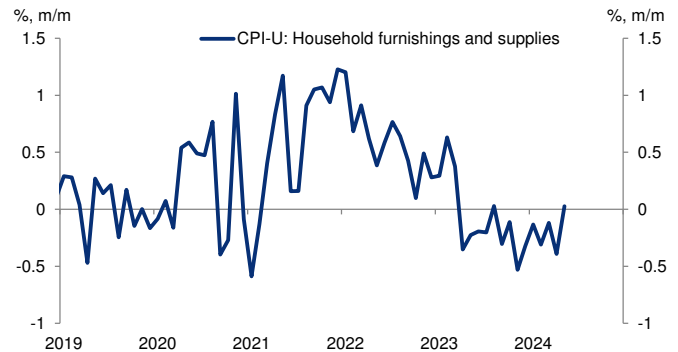


Figure 2: Offsetting payback in apparel and used cars



Source : BLS, Haver Analytics, Deutsche Bank

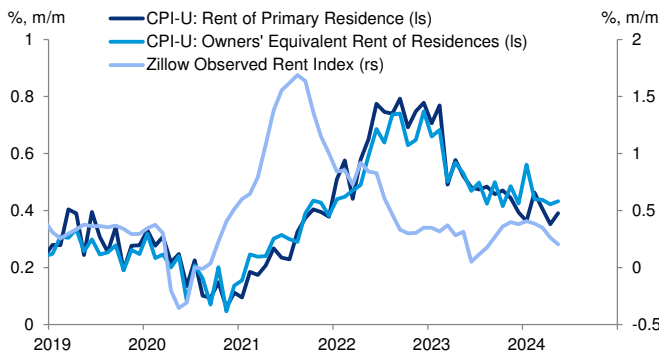
Figure 3: Household furnishings worth watching for any supply chain pressures



Source : BLS, Haver Analytics, Deutsche Bank

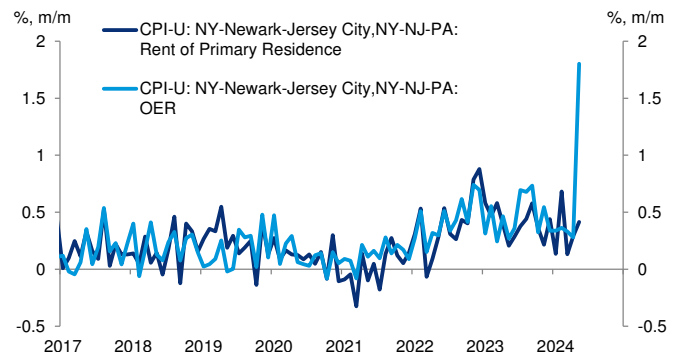
Core services inflation fell to 0.22%, actually a couple of basis points below its average print from 2015 to 2019. That being said, the slight acceleration in both primary rents (0.39% vs. 0.35% in April) and OER (+0.43% vs. +0.42%) takes some of the shine off this good news. While the stalled disinflation in rents is concerning, there are some anomalies in the regional rent data, e.g. a very large 1.8% spike in OER compared with only an 0.4% increase in primary rents for the New York metro area, that suggest the moves in the May rental data were potentially somewhat of a fluke. Given that asking rents remain well behaved, we continue to expect rental disinflation to proceed, though we have, yet again, pushed back the timeline over which that should occur. In June, we expect primary rents to reverse back to their April print (+0.35%) before slowing to 32bps on average in Q3 and 26bps in Q4. OER should follow a similar path.

Figure 4: Rents still moving sideways, but asking rents remain well behaved



Source : BLS, Zillow, Haver Analytics, Deutsche Bank

Figure 5: Some anomalies in the regional rental data



Source : BLS, Haver Analytics, Deutsche Bank

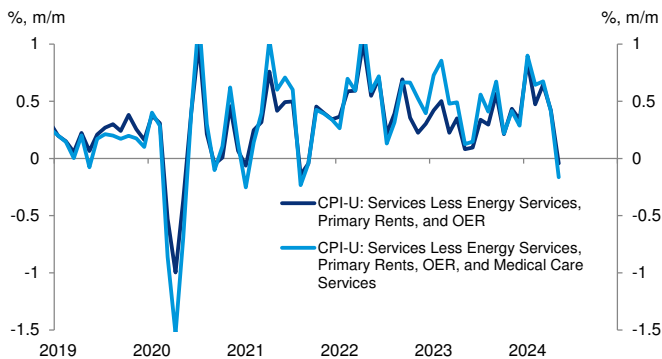
Overall medical services inflation (+0.3%) came off a tenth from the previous month. Prices for professional medical services rose by 0.3%, a slight acceleration from April, while the print for hospital and related services (+0.3) slowed slightly from the prior month's gain (+0.3% vs. +0.6%). Health insurance gains picked up slightly (+0.5% vs. +0.3%), but are expected to increase by roughly this monthly pace through at least the September data.

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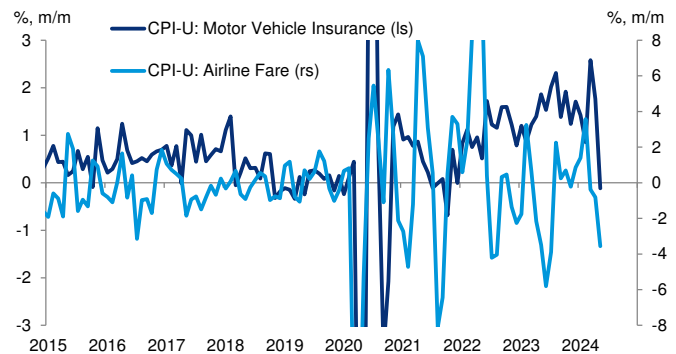


Figure 6: First negative supercore CPI print since late 2021



Source : BLS, Haver Analytics, Deutsche Bank

Figure 7: Mostly because of transportation services



Source : BLS, Haver Analytics, Deutsche Bank

The bulk of the weakness in the data was in core services other than rent, OER, and medical services. This category fell by 0.16% (vs. +0.41% in April), the first outright price decline since September 2021. Much of this decline was led by weakness transportation services, namely airline fares (-3.6%), car and truck rentals (-1.2%), and motor vehicle insurance (-0.1%). The latter is particularly noteworthy given that May was the first negative print after growing almost 47% in the 28 months since the last price decline in December 2021. Indeed, about half of the decline in the core CPI print from April to May (-13bps) can be attributed to the change in the contribution from motor vehicle insurance alone (-7bps). Should this print stick, it would be a meaningful development for the inflation outlook.

There was significant weakness in some other supercore categories as well, though these declines are more likely to be fleeting. Recreation services fell by three-tenths, the first decline since November 2021; however, this was driven by a 1.5% plunge in video and audio services, e.g. cable, satellite, and live streaming television services, as well as the purchase, subscription, and rental of video. Similarly, the three-tenths decline in other personal services was mostly a function of funeral service prices falling by 0.5%.

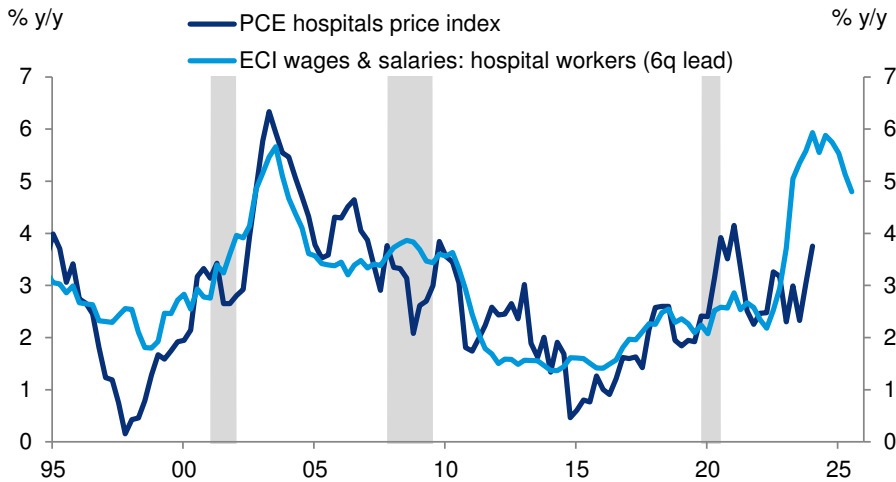
It is important to note, however, that the weakness in the core CPI services does not have a direct pass-through into core PCE, which is the Fed's preferred inflation measure. Along with yesterday's CPI data, today's PPI data helped to round out our expectations for May core PCE. Broadly speaking, components in the PPI were a little stronger. Selected healthcare services in the PPI had a very strong showing (+0.7% seasonally adjusted), posting the second largest monthly increase in this series's history going back to 2007. This was largely due to a 1.1% spike in seasonally adjusted hospital prices. As a reminder, we have previously noted upside risks from hospital worker wage growth (specifically from the ECI) as that is one of the factors that the Center for Medicare and Medicaid Services uses to determine the annual adjustment to Medicare reimbursements for health care service providers.

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Figure 8: Hospital inflation could pick up further going forward



Source : BEA, BLS, Haver Analytics, Deutsche Bank

In terms of the other categories that come from the PPI, domestic airfares fell by 1.2% while portfolio management and investment advice prices fell by 2.1% and auto insurance rose by 1.1%. As a reminder, the decline in portfolio management prices is tied to the April equity selloff and will thus reverse in the June data (and likely July as well) from the subsequent rally, becoming a near term tailwind for core PCE.

All in all, our read based on the May CPI and PPI data is that core PCE should increase by 0.17% m/m, which would have the year-over-year rate fall by 12bps to 2.63%. One note of caution is that our estimate does not include the -10.2% drop in the seasonally adjusted PPI for international scheduled passenger air transportation. While the BEA does take this series into account when determining the price of passenger fares for foreign travel, sometimes it seems to smooth through particularly large moves (see Figure 10). Given that it is about half a percent of core PCE, if the BEA used the monthly change in foreign airfares as above, our estimate for May core PCE would be about 5bps lower.

Figure 9: International airfares are a key uncertainty in our May core view



Source : BEA, BLS, Haver Analytics, Deutsche Bank

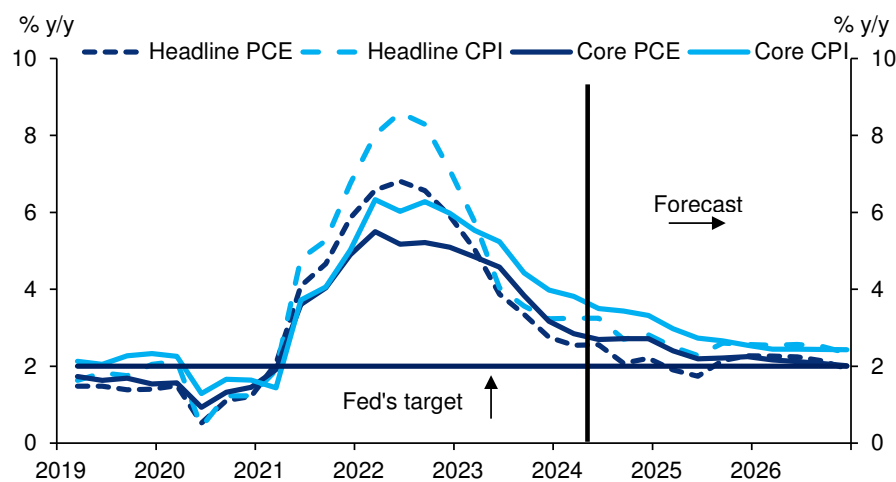
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Figure 10: DB inflation forecasts



Source : BEA, BLS, Haver Analytics, Deutsche Bank

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Appendix 1

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