

US Watch

May CPI inflation: Narrowly driven

Key takeaways

- The May CPI report was in line with expectations as headline rose by 0.1% m/m and core increased by 0.4% m/m.
- Core inflation remains high at 5.3% y/y but that is due to used cars and shelter. Elsewhere there has been improvement.
- The details of the report reaffirm our expectation for the Fed remain on hold at its June meeting, which started today.

Used cars and shelter drive core CPI increase

The May Consumer Price Index (CPI) report was in line with Consensus and our expectations. Headline CPI increased by 0.1% m/m (0.124% unrounded) resulting in the y/y rate falling by nine tenths to 4.0%, which is also down from 8.6% from a year ago. Additionally, the three-month annualized change fell from 3.2% to 2.2% as there continues to be significant progress made on inflation at the headline level.

The soft increase in headline CPI owed largely to a 3.6% m/m decline in energy prices as both energy goods and services fell on the month. We had expected the decline in energy goods given data on gasoline prices. Meanwhile energy services fell for a fourth consecutive month. In short, consumers enjoyed some relief at both the pump and on their utility bills.

Though energy did decline, food prices rose by 0.2% m/m after two consecutive flat readings. Food at home edged up by 5bps, its first increase in three months. The May increase was driven by price rises for fruit and vegetables, and nonalcoholic beverages, which offset price drops for meats, poultry, fish, & eggs, and dairy & related products. Food away from home rose by 0.5% m/m (NSA) as high labor costs continues to make dining out an increasingly expensive option for households.

Core inflation was also in line with expectations as it came in at 0.4% m/m (0.436% unrounded). The improvement in core inflation has been more gradual than headline. Indeed, the y/y rate ticked down just two tenths to 5.3%, and the three-month annualized change fell a tenth to 5.0%. While this is certainly improvement from the 5.8% rate seen last May, it's far less impressive than the realized disinflation for headline CPI.

In our view, however, the details were once again more encouraging than the topline core print. First, used cars were again a major driver of core CPI, increasing by 4.4% m/m and accounting for roughly 15bps of the increase in core CPI. As a result, used cars were also responsible for the 0.6% m/m increase in core goods. The good news on used cars is that the increases in April and May are likely to retrace over the course of the summer as wholesale used car prices, which lead consumer prices, fell sharply in both April and May. *(Continued on next page)*

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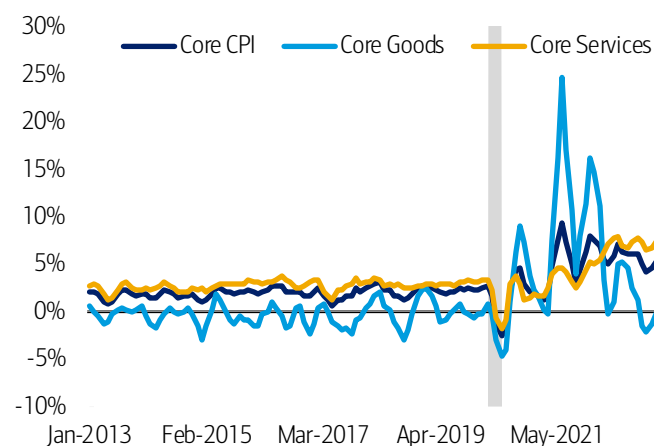
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Glossary

CPI = Consumer Price Index
NSA = Not Seasonally Adjusted
OER = Owners' Equivalent Rent
OIS- Overnight Indexed Swap
PCE = Personal Consumption Expenditures (Price Index)
PPI = Producer Price Index

Exhibit 1: Core CPI and its major components (3-month annualized % change)

Increases in used cars prices have driven a surge in core goods inflation

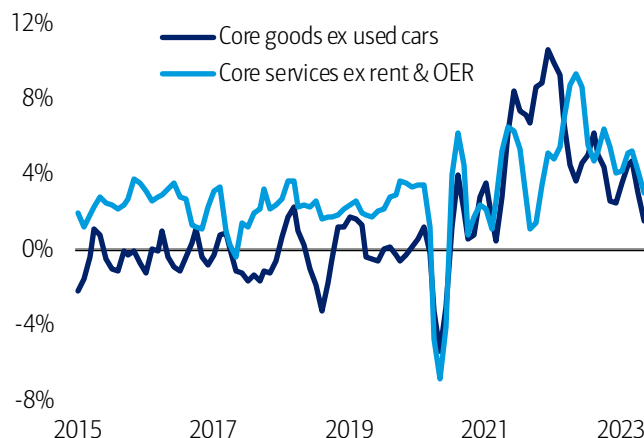


Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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Exhibit 2: Core goods ex used cars vs. Core services ex rent and OER (3-month annualized % change)

Outside of OER, rent and used cars there has been significant improvement in inflation



Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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Second, core goods ex used cars prices were flat on the month after posting a modest 6bp increase in April. We believe the recent improvement in core goods ex used cars reflects the unclogging of supply chains as well slightly softer demand for goods. Indeed, household furnishings and supplies, which are import intensive, fell for a second consecutive month, and education and communication commodities, which includes computers, smartphones, and tablets, declined for an 11th straight month.

Third, rent and owner's equivalent rent (OER) inflation continues to progress broadly as expected. Both increased by 0.5% m/m in May and have averaged an increase of 0.5% over the last three months. Indeed, the three-month annualized rate of change for rent and OER inflation fell by 1.1% and 0.7% to 6.3% and 6.4% respectively. While this is still well above levels seen prior to the pandemic, we expect further disinflation in rent and OER over the course of the year given rising vacancy rates, moderation in asking rent inflation, and further growth in multifamily supply.

Last core services excluding rent and OER rose by 0.2% m/m in May after a 0.1% m/m increase in April. As a result, the three-month annualized change fell from 4.2% to 3.0%, its lowest reading since October 2021. This segment of CPI has been a focus for members of the Fed given its relationship to the labor market and wage growth. Therefore, the recent improvement is welcomed news. Additionally, wage inflation has moderated of late, which should continue to limit upside pressure on this segment of inflation.

The upshot is that the May CPI report, like April, suggests core inflation is being narrowly driven by used cars and shelter. Outside of those two components, the trend has become very encouraging. Moreover, we see reasons to expect that the current two tailwinds of core CPI will ease over the course of the year and into next. Therefore, we should continue to see improvement in core CPI, though it's likely to be more gradual than the disinflation of headline CPI.

Fed: Affirming the June hold

Today's reading on May CPI reaffirms our view that the Fed will likely remain on hold at the June FOMC meeting as it assess the lagged effects of prior rate hikes and ongoing stresses in small and regional banks (see the report [Bank Balance sheets: deposit inflows continue](#)). In our view, the Fed is likely to retain upside bias to its policy rate path by maintaining language in the statement about the potential for additional policy rate firming. In addition, we expect the median FOMC member to raise the terminal target

range to 5.25-5.50% amid upward revisions to growth and inflation - and downward revisions to the unemployment rate path - in the updated Summary of Economic Projections.

GDP tracking: unchanged

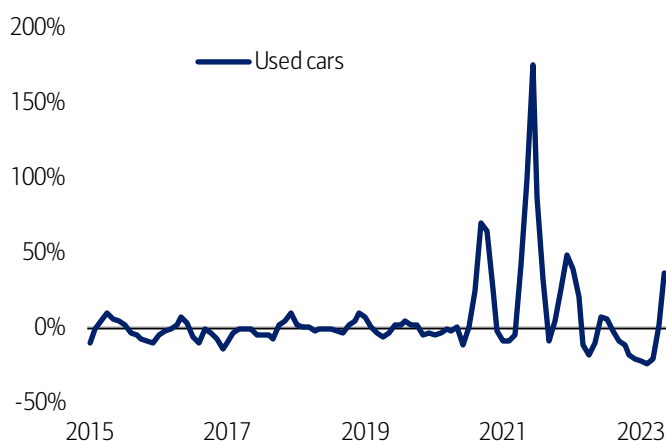
The May CPI print was broadly in line with consensus expectations and ours. We use the CPI data as deflators in our personal consumption expenditure tracking estimate. Today's print left our 2Q and 1Q US GDP tracking estimate unchanged at 1.2% q/q saar and 1.9% q/q saar, respectively.

Rates strategy view

Both the nominal and breakeven curve bull steepened following the print. Front-end breakevens declined modestly, consistent with a print that was largely in line with consensus and continuing to reflect a picture of cooling cyclical components and broadening goods disinflation. The market is still pricing 19bps of hikes by the July FOMC, from 23bps ahead of the print. The market still believes that June will be a skip rather than a pause. However, the inflation market is currently pricing a sharp trajectory of disinflation that pushes back on rhetoric from the hawks of the committee who are concerned about inflation persistence underpinning the need for additional hikes.

Exhibit 3: Used cars (3-month annualized % change)

Used car prices surged again in May but we expect that to retrace over the coming months

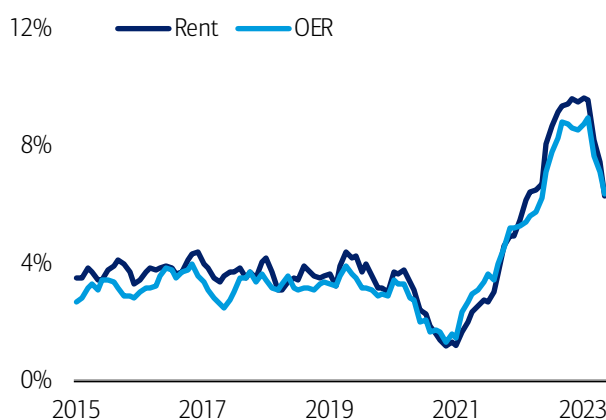


Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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Exhibit 4: Rent and OER (3-month annualized % change)

Rent and OER inflation is turning lower which should continue over the course of the year



Source: BofA Global Research, Bureau of Labor Statistics, Haver Analytics

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Exhibit 5: CPI Forecast vs. Actual (SA % m/m unless specified otherwise)

Below is a table that compares our bottoms-up CPI forecasts to actuals

	May Forecast		
	Actual	Forecast	Error
NSA Index (level)	304.127	304.061	0.066
Headline CPI (All Items)	0.12%	0.11%	0.01%
Food	0.2%	0.1%	0.1%
Energy	-3.6%	-3.0%	-0.6%
Core CPI	0.44%	0.38%	0.06%
Core goods	0.55%	0.40%	0.15%
Household furnishings and supplies	-0.4%	0.1%	-0.5%
Apparel	0.3%	0.3%	0.0%
Transportation commodities less motor fuel	1.5%	1.0%	0.5%
<i>Of which:</i>			
New vehicles	-0.1%	-0.1%	0.0%
Used cars and trucks	4.4%	2.7%	1.7%
Medical care commodities	0.6%	0.4%	0.2%
Recreation commodities	0.0%	-0.2%	0.2%
Other recreational goods	0.2%	0.2%	0.1%
Education and communication commodities	-0.2%	-0.5%	0.3%
Alcoholic beverages	0.5%	0.1%	0.4%
Other goods	0.6%	0.5%	0.1%
Core Services	0.40%	0.37%	0.02%
Shelter	0.6%	0.4%	0.1%
<i>Of which:</i>			
Rent	0.5%	0.5%	0.0%
Lodging away from home	1.8%	-0.5%	2.3%
OER	0.5%	0.5%	0.1%
Water and sewer	0.6%	0.5%	0.1%
Medical care services	-0.1%	-0.3%	0.3%
<i>Of which:</i>			
Health insurance	-3.7%	-3.9%	0.2%
Transportation services	0.8%	0.6%	0.2%
<i>Of which:</i>			
Airfares	-3.0%	-0.5%	-2.5%
Recreation services	-0.1%	0.7%	-0.8%
Education and communication	-0.2%	0.4%	-0.5%
Other personal services	0.5%	0.7%	-0.2%

Source: BofA Global Research, Bureau of Labor Statistics, Bloomberg

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Exhibit 6: CPI heatmap (%m/m)

Headline CPI rose by 0.1% m/m in May

Apr-23 weight	Component	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22
100.0	Headline CPI	0.12%	0.37%	0.05%	0.37%	0.52%	0.13%	0.21%	0.49%	0.41%	0.23%	-0.03%	1.19%
13.4	Food	0.20%	0.02%	0.01%	0.39%	0.51%	0.45%	0.55%	0.68%	0.78%	0.83%	1.08%	1.00%
7.0	Energy	-3.59%	0.56%	-3.52%	-0.56%	1.97%	-3.06%	-1.41%	1.68%	-1.74%	-3.89%	-4.70%	6.89%
79.6	Core CPI	0.44%	0.41%	0.38%	0.45%	0.41%	0.40%	0.31%	0.33%	0.57%	0.58%	0.31%	0.60%
4.4	Household Furnishings and Supplies	-0.41%	-0.40%	0.37%	0.76%	0.51%	0.25%	0.36%	0.04%	0.48%	0.88%	0.62%	0.55%
2.6	Apparel	0.29%	0.27%	0.26%	0.81%	0.83%	0.21%	0.10%	-0.25%	0.04%	0.28%	-0.12%	0.70%
7.7	Motor Vehicles & parts	1.49%	1.45%	-0.04%	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%	-0.16%	0.37%	-0.14%	0.53%
4.3	New Vehicles	-0.12%	-0.22%	0.38%	0.18%	0.23%	0.58%	0.47%	0.56%	0.67%	0.84%	0.47%	0.52%
2.7	Used Cars and Trucks	4.42%	4.45%	-0.88%	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%	-1.10%	-0.18%	-0.82%	0.52%
1.5	Medical Care Commodities	0.65%	0.46%	0.59%	0.15%	1.06%	0.11%	0.19%	-0.02%	-0.09%	0.24%	0.59%	0.39%
2.3	Recreation Commodities	-0.05%	0.29%	0.24%	0.44%	0.12%	0.09%	-0.34%	0.78%	-0.05%	0.64%	0.15%	0.39%
0.9	Education and Communication Commodities	-0.20%	-0.18%	-0.50%	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%	-0.53%	-0.40%	-0.46%	0.18%
0.8	Alcoholic Beverages	0.51%	0.47%	0.14%	-0.28%	0.41%	0.65%	0.64%	0.69%	0.31%	0.36%	0.43%	0.35%
1.2	Other Goods	0.59%	0.24%	0.53%	0.74%	0.77%	-0.07%	0.62%	0.58%	0.39%	1.15%	0.34%	0.50%
34.6	Shelter	0.56%	0.42%	0.56%	0.76%	0.74%	0.79%	0.64%	0.72%	0.74%	0.67%	0.57%	0.58%
25.4	Owners' Equivalent Rent of Residences	0.52%	0.54%	0.48%	0.70%	0.67%	0.79%	0.65%	0.62%	0.79%	0.69%	0.63%	0.67%
7.5	Rent of Primary Residence	0.49%	0.56%	0.49%	0.76%	0.74%	0.79%	0.77%	0.72%	0.81%	0.74%	0.70%	0.76%
1.2	Lodging Away From Home	1.80%	-2.96%	2.70%	2.26%	1.20%	1.10%	-0.52%	3.49%	-0.51%	-0.09%	-1.74%	-3.09%
1.1	Water & Sewer & Trash Collection Services	0.58%	0.33%	0.27%	0.79%	0.85%	0.25%	0.31%	0.17%	0.79%	0.49%	0.35%	0.40%
0.9	Household Operations	-1.19%	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	0.14%
6.4	Medical Care Services	-0.05%	-0.14%	-0.50%	-0.70%	-0.68%	0.30%	-0.49%	-0.38%	0.83%	0.68%	0.39%	0.65%
5.9	Transportation Services	0.84%	-0.18%	1.38%	1.14%	0.85%	0.63%	0.33%	0.60%	1.91%	0.99%	-0.40%	1.80%
0.6	Airline Fares	-2.95%	-2.55%	3.96%	6.38%	-2.15%	-2.05%	-1.63%	-1.16%	0.44%	-1.53%	-8.39%	-1.98%
3.1	Recreation Services	-0.09%	0.74%	0.01%	1.19%	0.73%	0.29%	0.94%	0.78%	0.19%	0.03%	0.50%	0.32%
4.8	Education and Communication Services	-0.15%	0.07%	0.29%	0.21%	0.45%	0.26%	0.98%	0.17%	0.17%	0.21%	-0.04%	0.12%
1.5	Other Personal Services	0.47%	1.52%	0.47%	1.06%	0.54%	-0.15%	0.82%	0.36%	0.27%	0.30%	0.40%	0.43%

Source: BofA Global Research, Bureau of Labor Statistics

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Exhibit 7: CPI heatmap (%y/y)

Headline CPI rose by 4.0% y/y in May, down from 4.9% previously

Apr-23 weight	Component	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22
100.0	Headline CPI	4.05%	4.93%	4.98%	6.04%	6.41%	6.45%	7.11%	7.75%	8.20%	8.26%	8.52%	9.06%
13.4	Food	6.69%	7.65%	8.50%	9.49%	10.13%	10.41%	10.63%	10.95%	11.24%	11.37%	10.93%	10.44%
7.0	Energy	-11.66%	-5.06%	-6.42%	5.19%	8.70%	7.31%	13.07%	17.63%	19.79%	23.81%	32.93%	41.62%
79.6	Core CPI	5.33%	5.52%	5.59%	5.54%	5.58%	5.71%	5.96%	6.28%	6.63%	6.32%	5.91%	5.92%
4.4	Household Furnishings and Supplies	4.08%	4.77%	5.79%	6.33%	6.37%	7.28%	8.28%	8.81%	9.90%	10.60%	10.78%	10.17%
2.6	Apparel	3.47%	3.65%	3.25%	3.26%	3.06%	2.91%	3.55%	4.09%	5.46%	5.06%	5.13%	5.23%
7.7	Motor Vehicles & Parts	0.12%	-0.30%	-1.82%	-3.18%	-2.26%	-0.95%	2.37%	5.48%	8.40%	9.10%	8.80%	9.55%
4.3	New Vehicles	4.66%	5.42%	6.12%	5.83%	5.78%	5.89%	7.20%	8.39%	9.40%	10.05%	10.44%	11.43%
2.7	Used Cars and Trucks	-4.22%	-6.56%	-11.15%	-13.58%	-11.62%	-8.83%	-3.34%	2.03%	7.18%	7.78%	6.61%	7.10%
1.5	Medical Care Commodities	4.42%	4.01%	3.59%	3.19%	3.39%	3.21%	3.13%	3.06%	3.67%	4.09%	3.65%	3.22%
2.3	Recreation Commodities	2.73%	2.90%	3.16%	2.85%	3.27%	4.11%	3.63%	4.31%	4.05%	3.84%	4.12%	4.47%
0.9	Education and Communication Commodities	-6.88%	-8.29%	-10.17%	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%	-8.32%	-7.33%	-6.99%	-5.71%
0.8	Alcoholic Beverages	4.77%	4.64%	4.53%	4.92%	5.82%	5.78%	5.54%	5.01%	4.09%	4.28%	4.22%	4.04%
1.2	Other Goods	6.58%	6.80%	6.91%	6.96%	7.15%	7.17%	7.51%	7.21%	7.90%	7.57%	6.73%	6.57%
34.6	Shelter	8.04%	8.11%	8.18%	8.10%	7.88%	7.51%	7.12%	6.92%	6.59%	6.24%	5.69%	5.61%
25.4	Owners' Equivalent Rent of Residences	8.05%	8.12%	8.04%	8.01%	7.76%	7.53%	7.13%	6.89%	6.68%	6.29%	5.83%	5.48%
7.5	Rent of Primary Residence	8.66%	8.80%	8.81%	8.76%	8.56%	8.35%	7.91%	7.52%	7.21%	6.74%	6.31%	5.78%
1.2	Lodging Away From Home	3.41%	3.31%	7.26%	6.73%	7.69%	3.18%	3.24%	5.86%	2.91%	4.03%	1.04%	10.00%
1.1	Water & Sewer & Trash Collection Services	5.71%	5.41%	5.39%	5.25%	4.97%	4.94%	5.01%	4.77%	4.93%	4.63%	4.35%	4.43%
0.9	Household Operations	4.55%	8.01%	#N/A	#N/A	#N/A	#N/A	#N/A	6.57%	#N/A	6.61%	#N/A	6.49%
6.4	Medical Care Services	-0.08%	0.41%	1.03%	2.15%	2.99%	4.12%	4.38%	5.45%	6.51%	5.65%	5.09%	4.82%
5.9	Transportation Services	10.18%	11.03%	13.88%	14.64%	14.63%	14.58%	14.19%	15.19%	14.60%	11.32%	9.15%	8.83%
0.6	Airline Fares	-13.44%	-0.87%	17.70%	26.54%	25.56%	29.14%	35.90%	43.02%	42.64%	33.70%	26.60%	33.56%
3.1	Recreation Services	5.76%	6.39%	5.94%	6.34%	5.75%	5.71%	5.38%	3.94%	4.06%	4.24%	4.53%	4.72%
4.8	Education and Communication Services	2.79%	3.13%	3.25%	2.86%	2.77%	2.41%	2.24%	1.32%	1.36%	1.53%	1.52%	1.69%
1.5	Other Personal Services	6.67%	6.30%	5.25%	5.21%	5.34%	5.55%	6.49%	5.76%	5.93%	5.77%	5.91%	6.73%

Source: BofA Global Research, Bureau of Labor Statistics

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