

US Watch

April CPI inflation: Supportive of a pause

Key takeaways

- The April Consumer Price Index report was broadly in line with expectations. Headline and core CPI rose by 0.4% m/m.
- While the topline numbers are discouraging, the details were encouraging. Core services ex OER and rent rose by 0.1% m/m.
- We maintain our forecast for the Fed to pause in June, but we still have one more jobs and one more CPI report.

More signs of disinflation

The April Consumer Price Index (CPI) report was broadly in line with expectations. Headline CPI rose by 0.4% m/m (0.37% unrounded), which was roughly in line with our and consensus expectations. As a result, the y/y rate ticked down a tenth to 4.9%, and the 3-month annualized change fell from 3.8% in March to 3.2%, its lowest reading since December 2021.

There was some good news within the noncore components. Specifically, food prices were unchanged for a second consecutive month as food at home prices fell for a second consecutive month suggesting grocery bills are beginning to decline. Meanwhile, energy prices rose by 0.6% m/m, which was below our expectations, as energy services fell (-1.7% m/m) more than we expected.

Meanwhile, core inflation rose by 0.4% m/m (0.41% unrounded), in line with consensus and a little stronger than our expectations (0.34%). Core inflation continues to move sideways. While the y/y rate did tick down a tenth to 5.5%, it's printed at 5.5% in three of the last four months. Additionally, on a three-month annualized basis core CPI rose by 5.1%, unchanged from March. In short, at the top-line level, core inflation remains stubbornly high.

That said, we think the details of the report are encouraging. First, the 0.4% m/m print was driven by a 4.5% surge in used car prices, its first increase since last June. This accounted for 14bp of the core increase. We think the Fed can look through some of this increase as wholesale prices fell sharply in April after four consecutive advancing for four consecutive months.

Indeed, used car prices were also the main driver of core goods inflation (+0.6% m/m). Core goods excluding used cars rose by just 4bps, its lowest reading since February 2021. This reflected deflation in household furnishings, new cars, other recreational goods, and education and communication goods. While this is just one month of data, it could be the start of broader goods price deflation given the improvement in supply chains and softening demand.

(Continued on next page)

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Glossary

CPI = Consumer Price Index

PPI = Producer Price Index

PCE = Personal Consumption Expenditures (Price Index)

OER = Owners' Equivalent Rent

NSA = Not Seasonally Adjusted

OIS- Overnight Indexed Swap

Core services inflation, meanwhile, rose by 0.4% m/m, roughly in line with our expectations. Rent and owners' equivalent rent (OER) both rose by 0.5% m/m, suggesting that the moderation seen in March has some staying power. While inflation of 0.5% for rent and OER is still well above pre-pandemic levels, asking rent data continue to suggest further moderation over the course of the year.

Core services excluding rent and OER, meanwhile, slowed from 0.4% m/m in March to 0.1% m/m in April, which is positive news for the Fed. As we had flagged in our preview, lodging away from home and airfares both declined sharply on the month. Education and communication services inflation also moderated from 0.3% m/m to 0.1%. However, motor vehicle insurance remained sticky-high, increasing by 1.4% m/m and recreation services prices rose by 0.7% reflecting a 2.7% increase in pet services prices. On a three-month annualized basis core services ex rent and OER rose by 4.2%, down from 5.2% in March. While this is still too high, the April data are certainly a step in the right direction.

Fed: We maintain our policy outlook

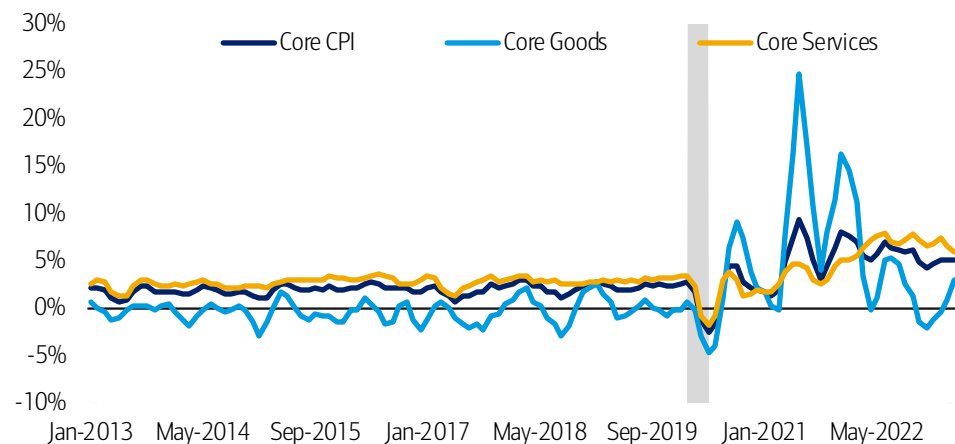
In our view, this is an encouraging print for the Fed. Broad-based deceleration, and concerns about used cars offset by the fact that wholesale prices are falling again. This report should keep the Fed comfortable with a hold in June. However, note that we have one more jobs report and one more inflation print before the June meeting

Rates strategy view

Following the print, the market priced a slimmer probability of a hike in June and sharper cuts into the second half of 2023. FOMC OIS reflects about 3bps of a hike in June and implies about 70bps of cuts through December. Lower likelihood for a June hike is largely consistent with the cooling in the cyclical components, particularly core services ex shelter, which Powell has guided the market to focus on. While the degree of cuts priced into the second half of the year stands out to us as extreme, we are hesitant to fade ahead of anticipated market volatility in coming weeks around the debt limit. The breakeven curve steepened, with the front end moving even lower on the back of the print which was below Bloomberg consensus and the April CPI fixing. Both the 1y and 1y1y inflation swaps are at if not below the Fed's target accounting for the historical wedge between CPI and PCE. We continue to believe that end of cycle long duration trades are better placed in TIPS given the very limited inflation risk premium currently priced.

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

Core services inflation remains sticky-high leading to high core CPI inflation



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

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Exhibit 2: CPI Forecast vs. Actual (SA % m/m unless specified otherwise)

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

	April Forecast		
	Actual	Forecast	Error
NSA Index (level)	303.363	303.455	-0.092
Headline CPI (All Items)	0.37%	0.39%	-0.02%
Food	0.0%	0.3%	-0.2%
Energy	0.6%	1.2%	-0.7%
Core CPI	0.41%	0.34%	0.06%
Core goods	0.57%	0.23%	0.34%
Household furnishings and supplies	-0.4%	0.3%	-0.7%
Apparel	0.3%	0.2%	0.1%
Transportation commodities less motor fuel	1.5%	0.2%	1.2%
Of which:			
New vehicles	-0.2%	0.2%	-0.4%
Used cars and trucks	4.4%	0.3%	4.2%
Medical care commodities	0.5%	0.6%	-0.1%
Recreation commodities	0.3%	0.0%	0.3%
Other recreational goods	0.0%	0.4%	-0.4%
Education and communication commodities	-0.2%	-0.4%	0.3%
Alcoholic beverages	0.5%	0.2%	0.3%
Other goods	0.2%	0.5%	-0.3%
Core Services	0.36%	0.39%	-0.03%
Shelter	0.4%	0.5%	-0.1%
Of which:			
Rent	0.5%	0.5%	-0.1%
Lodging away from home	-3.0%	-0.5%	-2.5%
OER	0.5%	0.5%	0.0%
Water and sewer	0.3%	0.4%	-0.1%
Medical care services	-0.1%	-0.4%	0.3%
Of which:			
Health insurance	-3.8%	-3.9%	0.1%
Transportation services	-0.2%	0.7%	-0.9%
Of which:			
Airfares	-2.6%	-1.5%	-1.1%
Recreation services	0.7%	0.5%	0.3%
Education and communication	0.1%	0.3%	-0.2%
Other personal services	1.5%	0.5%	1.0%

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

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Exhibit 3: CPI heatmap (%m/m)

Headline CPI rose by 0.4% m/m in April

Mar-23 weight	Component	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22
100.0	Headline CPI	0.37%	0.05%	0.37%	0.52%	0.13%	0.21%	0.49%	0.41%	0.23%	-0.03%	1.19%	0.92%
13.5	Food	0.02%	0.01%	0.39%	0.51%	0.45%	0.55%	0.68%	0.78%	0.83%	1.08%	1.00%	1.10%
6.9	Energy	0.56%	-3.52%	-0.56%	1.97%	-3.06%	-1.41%	1.68%	-1.74%	-3.89%	-4.70%	6.89%	3.36%
79.6	Core CPI	0.41%	0.38%	0.45%	0.41%	0.40%	0.31%	0.33%	0.57%	0.58%	0.31%	0.60%	0.63%
4.4	Household Furnishings and Supplies	-0.40%	0.37%	0.76%	0.51%	0.25%	0.36%	0.04%	0.48%	0.88%	0.62%	0.55%	0.24%
2.6	Apparel	0.27%	0.26%	0.81%	0.83%	0.21%	0.10%	-0.25%	0.04%	0.28%	-0.12%	0.70%	0.45%
7.6	Motor Vehicles & parts	1.45%	-0.04%	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%	-0.16%	0.37%	-0.14%	0.53%	1.24%
4.3	New Vehicles	-0.22%	0.38%	0.18%	0.23%	0.58%	0.47%	0.56%	0.67%	0.84%	0.47%	0.52%	0.60%
2.6	Used Cars and Trucks	4.45%	-0.88%	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%	-1.10%	-0.18%	-0.82%	0.52%	1.86%
1.5	Medical Care Commodities	0.46%	0.59%	0.15%	1.06%	0.11%	0.19%	-0.02%	-0.09%	0.24%	0.59%	0.39%	0.25%
2.3	Recreation Commodities	0.29%	0.24%	0.44%	0.12%	0.09%	-0.34%	0.78%	-0.05%	0.64%	0.15%	0.39%	0.11%
0.9	Education and Communication Commodities	-0.18%	-0.50%	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%	-0.53%	-0.40%	-0.46%	0.18%	-1.71%
0.8	Alcoholic Beverages	0.47%	0.14%	-0.28%	0.41%	0.65%	0.64%	0.69%	0.31%	0.36%	0.43%	0.35%	0.38%
1.2	Other Goods	0.24%	0.53%	0.74%	0.77%	-0.07%	0.62%	0.58%	0.39%	1.15%	0.34%	0.50%	0.80%
34.6	Shelter	0.42%	0.56%	0.76%	0.74%	0.79%	0.64%	0.72%	0.74%	0.67%	0.57%	0.58%	0.62%
25.4	Owners' Equivalent Rent of Residences	0.54%	0.48%	0.70%	0.67%	0.79%	0.65%	0.62%	0.79%	0.69%	0.63%	0.67%	0.59%
7.5	Rent of Primary Residence	0.56%	0.49%	0.76%	0.74%	0.79%	0.77%	0.72%	0.81%	0.74%	0.70%	0.76%	0.62%
1.2	Lodging Away From Home	-2.96%	2.70%	2.26%	1.20%	1.10%	-0.52%	3.49%	-0.51%	-0.09%	-1.74%	-3.09%	1.70%
1.1	Water & Sewer & Trash Collection Services	0.33%	0.27%	0.79%	0.85%	0.25%	0.31%	0.17%	0.79%	0.49%	0.35%	0.40%	0.29%
0.9	Household Operations	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	0.14%	2.08%
6.5	Medical Care Services	-0.14%	-0.50%	-0.70%	-0.68%	0.30%	-0.49%	-0.38%	0.83%	0.68%	0.39%	0.65%	0.44%
5.9	Transportation Services	-0.18%	1.38%	1.14%	0.85%	0.63%	0.33%	0.60%	1.91%	0.99%	-0.40%	1.80%	1.55%
0.6	Airline Fares	-2.55%	3.96%	6.38%	-2.15%	-2.05%	-1.63%	-1.16%	0.44%	-1.53%	-8.39%	-1.98%	11.14%
3.1	Recreation Services	0.74%	0.01%	1.19%	0.73%	0.29%	0.94%	0.78%	0.19%	0.03%	0.50%	0.32%	0.50%
4.9	Education and Communication Services	0.07%	0.29%	0.21%	0.45%	0.26%	0.98%	0.17%	0.17%	0.21%	-0.04%	0.12%	0.18%
1.4	Other Personal Services	1.52%	0.47%	1.06%	0.54%	-0.15%	0.82%	0.36%	0.27%	0.30%	0.40%	0.43%	0.12%

Source: BofA Global Research, Bureau of Labor Statistics

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Exhibit 4: CPI heatmap (%y/y)

Headline CPI rose by 4.9% y/y in April, down from 5.0% previously

Mar-23 weight	Component	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22
100.0	Headline CPI	4.93%	4.98%	6.04%	6.41%	6.45%	7.11%	7.75%	8.20%	8.26%	8.52%	9.06%	8.58%
13.5	Food	7.65%	8.50%	9.49%	10.13%	10.41%	10.63%	10.95%	11.24%	11.37%	10.93%	10.44%	10.15%
6.9	Energy	-5.06%	-6.42%	5.19%	8.70%	7.31%	13.07%	17.63%	19.79%	23.81%	32.93%	41.62%	34.60%
79.6	Core CPI	5.52%	5.59%	5.54%	5.58%	5.71%	5.96%	6.28%	6.63%	6.32%	5.91%	5.92%	6.02%
4.4	Household Furnishings and Supplies	4.77%	5.79%	6.33%	6.37%	7.28%	8.28%	8.81%	9.90%	10.60%	10.78%	10.17%	9.71%
2.6	Apparel	3.65%	3.25%	3.26%	3.06%	2.91%	3.55%	4.09%	5.46%	5.06%	5.13%	5.23%	4.98%
7.6	Motor Vehicles & Parts	-0.30%	-1.82%	-3.18%	-2.26%	-0.95%	2.37%	5.48%	8.40%	9.10%	8.80%	9.55%	14.14%
4.3	New Vehicles	5.42%	6.12%	5.83%	5.78%	5.89%	7.20%	8.39%	9.40%	10.05%	10.44%	11.43%	12.62%
2.6	Used Cars and Trucks	-6.56%	-11.15%	-13.58%	-11.62%	-8.83%	-3.34%	2.03%	7.18%	7.78%	6.61%	7.10%	16.06%
1.5	Medical Care Commodities	4.01%	3.59%	3.19%	3.39%	3.21%	3.13%	3.06%	3.67%	4.09%	3.65%	3.22%	2.41%
2.3	Recreation Commodities	2.90%	3.16%	2.85%	3.27%	4.11%	3.63%	4.31%	4.05%	3.84%	4.12%	4.47%	3.77%
0.9	Education and Communication Commodities	-8.29%	-10.17%	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%	-8.32%	-7.33%	-6.99%	-5.71%	-6.03%
0.8	Alcoholic Beverages	4.64%	4.53%	4.92%	5.82%	5.78%	5.54%	5.01%	4.09%	4.28%	4.22%	4.04%	4.04%
1.2	Other Goods	6.80%	6.91%	6.96%	7.15%	7.17%	7.51%	7.21%	7.90%	7.57%	6.73%	6.57%	6.16%
34.6	Shelter	8.11%	8.18%	8.10%	7.88%	7.51%	7.12%	6.92%	6.59%	6.24%	5.69%	5.61%	5.45%
25.4	Owners' Equivalent Rent of Residences	8.12%	8.04%	8.01%	7.76%	7.53%	7.13%	6.89%	6.68%	6.29%	5.83%	5.48%	5.09%
7.5	Rent of Primary Residence	8.80%	8.81%	8.76%	8.56%	8.35%	7.91%	7.52%	7.21%	6.74%	6.31%	5.78%	5.22%
1.2	Lodging Away From Home	3.31%	7.26%	6.73%	7.69%	3.18%	3.24%	5.86%	2.91%	4.03%	1.04%	10.00%	19.27%
1.1	Water & Sewer & Trash Collection Services	5.41%	5.39%	5.25%	4.97%	4.94%	5.01%	4.77%	4.93%	4.63%	4.35%	4.43%	4.35%
0.9	Household Operations	8.01%	#N/A	#N/A	#N/A	#N/A	#N/A	6.57%	#N/A	6.61%	#N/A	6.49%	5.34%
6.5	Medical Care Services	0.41%	1.03%	2.15%	2.99%	4.12%	4.38%	5.45%	6.51%	5.65%	5.09%	4.82%	4.02%
5.9	Transportation Services	11.03%	13.88%	14.64%	14.63%	14.58%	14.19%	15.19%	14.60%	11.32%	9.15%	8.83%	7.93%
0.6	Airline Fares	-0.87%	17.70%	26.54%	25.56%	29.14%	35.90%	43.02%	42.64%	33.70%	26.60%	33.56%	37.59%
3.1	Recreation Services	6.39%	5.94%	6.34%	5.75%	5.71%	5.38%	3.94%	4.06%	4.24%	4.53%	4.72%	4.86%
4.9	Education and Communication Services	3.13%	3.25%	2.86%	2.77%	2.41%	2.24%	1.32%	1.36%	1.53%	1.52%	1.69%	1.68%
1.4	Other Personal Services	6.30%	5.25%	5.21%	5.34%	5.55%	6.49%	5.76%	5.93%	5.77%	5.91%	6.73%	6.46%

Source: BofA Global Research, Bureau of Labor Statistics

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