

US Watch

March CPI inflation: A soft report but keeps the Fed on track for a hike in May

Key takeaways

- The March CPI report was softer than expected as headline rose by 0.1% m/m and core increased by 0.4% m/m.
- Services inflation remained sticky but rent and OER moderated in March and details more broadly point to disinflation.
- The moderation in cyclical inflation components led more cuts to get priced, allowing the nominal curve to bull steepen.

Details point to disinflationary pressures

The March Consumer Price Index (CPI) report was softer than expected, in our view. Headline inflation CPI rose by 0.1% m/m (0.053% m/m unrounded), below expectations for a 0.2% m/m increase. As a result, the y/y rate tumbled from 6.0% to 5.0%. On a 3-month annualized basis, headline inflation increased by 3.8% m/m in March, compared to 4.2% m/m in Feb but up from 3.4% in December.

The soft headline print was driven by a 3.5% m/m drop in energy prices as energy goods and services fell 4.6% m/m and 2.3% m/m respectively. Additionally, food price inflation was flat on the month as food at home fell by 0.3% m/m offsetting a continued 0.6% m/m (NSA) increase in food away from home. The decline in food at home was somewhat surprising, but we have seen transportation costs and commodity prices fall of late which should support disinflation in the category. Food away from home, meanwhile, will likely remain sticky until we see more moderation in wages.

Meanwhile, core inflation rose by 0.4% m/m (0.385% unrounded), in line with consensus and our expectations. This resulted in the y/y rate ticking up to 5.6% from 5.5%. That said, the 3-month annualized change did tick down 5.2% m/m to 5.1%.

The increase in core inflation was driven again by shelter inflation (+0.6% m/m), which contributed 24.2bp to the 38.5bp increase. That said, rent and owners' equivalent rent (OER) inflation both cooled to 0.5% m/m. We suspect this is the start of the long-awaited moderation in rent and OER given the disinflation seen in asking rents, which lead CPI rent. We continue to expect the shelter inflation to cool more quickly in 2H.

Core services inflation, overall, was 0.4% m/m compared to a 0.6% m/m increase in February. On a 3-month annualized basis core services rose by 6.6% down from 7.3% in February. The measure has been choppy of late but does point to moderate disinflation in core services. Additionally, core services excluding rent and OER cooled from 0.5% m/m to 0.4% m/m resulting in the y/y rate falling to 5.8% from 6.1%. *(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

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Importantly the details this month suggest broader disinflation in the categories that make up this measure than in prior months. Indeed, medical care services prices fell again (-0.5% m/m) and the decline was driven by more than just the ongoing drop in health insurance (-4.2% m/m NSA). Indeed, professional services inflation was little changed on the month and hospital services prices fell by 0.2% m/m. Aside from medical care services, recreation services moderated significantly (+0.0% m/m in March vs. 1.2% m/m in February) as did other personal services, and water & sewer & trash collection services. Transportation services inflation, meanwhile, remained sticky at 1.4% m/m owing to a 4.0% m/m increase in airfares and a 1.3% m/m rise in motor vehicle insurance. Overall, the services data suggest some disinflation, but inflation remains above where the Fed would like to see it.

Last, core goods rose by 0.2% m/m, up slightly from 0.0% in the prior month as the declines in used car prices were more modest this month. Excluding used cars, we did see a slight moderation in core goods from 0.4% to 0.3% m/m. Therefore, we are seeing disinflation but not yet broad-based deflation in the goods categories. That said, ongoing improvement in supply chains and weakening demand as evidenced by our card data, should support further goods disinflation.

Fed: We maintain our policy outlook

We think the March CPI print keeps the Fed on track to hike by 25bp at its May meeting. Despite the improvement in March, inflation is still likely much too high from the Fed's perspective. On a three-month annualized basis, core CPI inflation is still running at 5.1%, which is about double the rate the Fed would deem consistent with its 2% PCE inflation target. As long as banking sector stress remains subdued, we think the Fed will be inclined to deliver on its dot-plot forecast by raising rates to 5.0-5.25%. GDP implications: 1Q tracking unchanged

1 Q GDP tracking unchanged at 1.5%

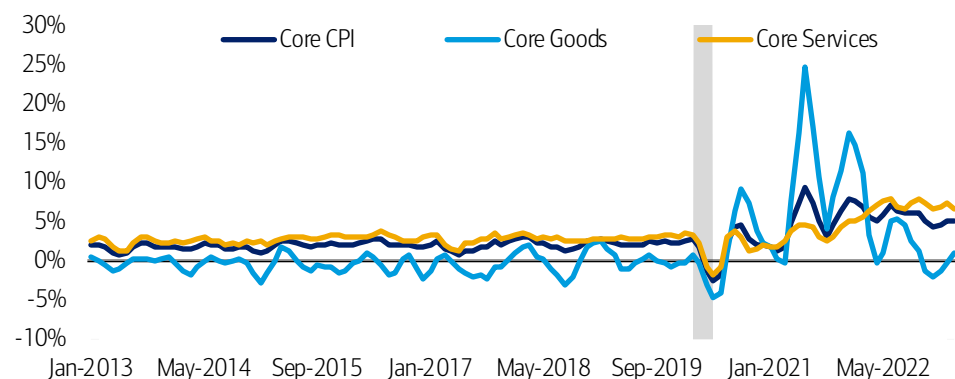
We use the CPI data as deflators in our PCE estimate. Today's print left our 1Q US GDP tracking estimate unchanged at 1.5% q/q saar.

Rates strategy view

With the print coming in below both market pricing and Bloomberg consensus, the inflation curve bull steepened. 2y and 5y spot breakevens declined about 18bps and 8bps, respectively. The market is likely responding to the moderation in shelter inflation with MoM OER printing at the lowest level since April '22. The repricing in breakevens in part likely reflect expectations for a sooner turn in shelter inflation. May FOMC OIS is 2bps lower following the print, now about 18bps of a hike or 72% probability of a 25bps hike. The sharpest declines in OIS were in 2024 expiries, with the market now pricing over 200bps of cuts through December 2024. The moderation in more cyclical components of

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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the inflation basket encourages more cuts to get priced, allowing the nominal curve to
bull steepen.



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

	March Forecast		
	Actual	Forecast	Error
NSA Index (level)	301.836	302.668	-0.832
Headline CPI (All Items)	0.05%	0.35%	-0.30%
Food	0.0%	0.4%	-0.3%
Energy	-3.5%	-0.5%	-3.0%
Core CPI	0.38%	0.43%	-0.04%
Core goods	0.18%	0.08%	0.10%
Household furnishings and supplies	0.4%	0.2%	0.2%
Apparel	0.3%	0.3%	0.0%
Transportation commodities less motor fuel	0.0%	-0.1%	0.1%
<i>Of which:</i>			
New vehicles	0.4%	0.2%	0.2%
Used cars and trucks	-0.9%	-0.7%	-0.2%
Medical care commodities	0.6%	0.4%	0.2%
Recreation commodities	0.2%	0.0%	0.2%
Other recreational goods	0.9%	0.5%	0.5%
Education and communication commodities	-0.5%	-0.6%	0.1%
Alcoholic beverages	0.1%	0.3%	-0.1%
Other goods	0.5%	0.5%	0.1%
Core Services	0.45%	0.55%	-0.10%
Shelter	0.6%	0.7%	-0.2%
<i>Of which:</i>			
Rent	0.6%	0.8%	-0.2%
Lodging away from home	2.7%	0.5%	2.2%
OER	0.5%	0.7%	-0.2%
Water and sewer	0.3%	0.6%	-0.4%
Medical care services	-0.5%	-0.3%	-0.2%
<i>Of which:</i>			
Health insurance	-4.2%	-4.1%	-0.1%
Transportation services	1.4%	0.6%	0.7%
<i>Of which:</i>			
Airfares	4.0%	-0.5%	4.5%
Recreation services	0.0%	0.8%	-0.8%
Education and communication	0.3%	0.4%	-0.1%
Other personal services	0.5%	0.5%	0.0%

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

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Exhibit 3: CPI heatmap (%m/m)

Headline CPI rose by 0.1% m/m in March

Feb-23 weight	Component	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22
100.0	Headline CPI	0.05%	0.37%	0.52%	0.13%	0.21%	0.49%	0.41%	0.23%	-0.03%	1.19%	0.92%	0.40%
13.5	Food	0.01%	0.39%	0.51%	0.45%	0.55%	0.68%	0.78%	0.83%	1.08%	1.00%	1.10%	0.81%
7.0	Energy	-3.52%	-0.56%	1.97%	-3.06%	-1.41%	1.68%	-1.74%	-3.89%	-4.70%	6.89%	3.36%	-0.97%
79.5	Core CPI	0.38%	0.45%	0.41%	0.40%	0.31%	0.33%	0.57%	0.58%	0.31%	0.60%	0.63%	0.47%
4.4	Household Furnishings and Supplies	0.37%	0.76%	0.51%	0.25%	0.36%	0.04%	0.48%	0.88%	0.62%	0.55%	0.24%	0.57%
2.6	Apparel	0.26%	0.81%	0.83%	0.21%	0.10%	-0.25%	0.04%	0.28%	-0.12%	0.70%	0.45%	-0.14%
7.6	Motor Vehicles & parts	-0.04%	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%	-0.16%	0.37%	-0.14%	0.53%	1.24%	-0.04%
4.3	New Vehicles	0.38%	0.18%	0.23%	0.58%	0.47%	0.56%	0.67%	0.84%	0.47%	0.52%	0.60%	0.45%
2.6	Used Cars and Trucks	-0.88%	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%	-1.10%	-0.18%	-0.82%	0.52%	1.86%	-0.68%
1.5	Medical Care Commodities	0.59%	0.15%	1.06%	0.11%	0.19%	-0.02%	-0.09%	0.24%	0.59%	0.39%	0.25%	0.06%
2.3	Recreation Commodities	0.24%	0.44%	0.12%	0.09%	-0.34%	0.78%	-0.05%	0.64%	0.15%	0.39%	0.11%	0.53%
0.9	Education and Communication Commodities	-0.50%	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%	-0.53%	-0.40%	-0.46%	0.18%	-1.71%	-2.23%
0.8	Alcoholic Beverages	0.14%	-0.28%	0.41%	0.65%	0.64%	0.69%	0.31%	0.36%	0.43%	0.35%	0.38%	0.36%
1.2	Other Goods	0.53%	0.74%	0.77%	-0.07%	0.62%	0.58%	0.39%	1.15%	0.34%	0.50%	0.80%	0.34%
34.5	Shelter	0.56%	0.76%	0.74%	0.79%	0.64%	0.72%	0.74%	0.67%	0.57%	0.58%	0.62%	0.50%
25.4	Owners' Equivalent Rent of Residences	0.48%	0.70%	0.67%	0.79%	0.65%	0.62%	0.79%	0.69%	0.63%	0.67%	0.59%	0.47%
7.5	Rent of Primary Residence	0.49%	0.76%	0.74%	0.79%	0.77%	0.72%	0.81%	0.74%	0.70%	0.76%	0.62%	0.57%
1.2	Lodging Away From Home	2.70%	2.26%	1.20%	1.10%	-0.52%	3.49%	-0.51%	-0.09%	-1.74%	-3.09%	1.70%	0.72%
1.1	Water & Sewer & Trash Collection Services	0.27%	0.79%	0.85%	0.25%	0.31%	0.17%	0.79%	0.49%	0.35%	0.40%	0.29%	0.32%
0.9	Household Operations	0.00%	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	0.14%	2.08%	#N/A
6.5	Medical Care Services	-0.50%	-0.70%	-0.68%	0.30%	-0.49%	-0.38%	0.83%	0.68%	0.39%	0.65%	0.44%	0.49%
5.8	Transportation Services	1.38%	1.14%	0.85%	0.63%	0.33%	0.60%	1.91%	0.99%	-0.40%	1.80%	1.55%	2.25%
0.6	Airline Fares	3.96%	6.38%	-2.15%	-2.05%	-1.63%	-1.16%	0.44%	-1.53%	-8.39%	-1.98%	11.14%	15.70%
3.1	Recreation Services	0.01%	1.19%	0.73%	0.29%	0.94%	0.78%	0.19%	0.03%	0.50%	0.32%	0.50%	0.33%
4.9	Education and Communication Services	0.29%	0.21%	0.45%	0.26%	0.98%	0.17%	0.17%	0.21%	-0.04%	0.12%	0.18%	0.19%
1.4	Other Personal Services	0.47%	1.06%	0.54%	-0.15%	0.82%	0.36%	0.27%	0.30%	0.40%	0.43%	0.12%	0.51%

Source: BofA Global Research, Bureau of Labor Statistics

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Exhibit 4: CPI heatmap (%y/y)

Headline CPI rose by 5.0% y/y in March, down from 6.0% previously

Feb-23 weight	Component	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22	Aug-22	Jul-22	Jun-22	May-22	Apr-22
100.0	Headline CPI	4.98%	6.04%	6.41%	6.45%	7.11%	7.75%	8.20%	8.26%	8.52%	9.06%	8.58%	8.26%
13.5	Food	8.50%	9.49%	10.13%	10.41%	10.63%	10.95%	11.24%	11.37%	10.93%	10.44%	10.15%	9.38%
7.0	Energy	-6.42%	5.19%	8.70%	7.31%	13.07%	17.63%	19.79%	23.81%	32.93%	41.62%	34.60%	30.27%
79.5	Core CPI	5.59%	5.54%	5.58%	5.71%	5.96%	6.28%	6.63%	6.32%	5.91%	5.92%	6.02%	6.16%
4.4	Household Furnishings and Supplies	5.79%	6.33%	6.37%	7.28%	8.28%	8.81%	9.90%	10.60%	10.78%	10.17%	9.71%	10.63%
2.6	Apparel	3.25%	3.26%	3.06%	2.91%	3.55%	4.09%	5.46%	5.06%	5.13%	5.23%	4.98%	5.36%
7.6	Motor Vehicles & Parts	-1.82%	-3.18%	-2.26%	-0.95%	2.37%	5.48%	8.40%	9.10%	8.80%	9.55%	14.14%	17.21%
4.3	New Vehicles	6.12%	5.83%	5.78%	5.89%	7.20%	8.39%	9.40%	10.05%	10.44%	11.43%	12.62%	13.21%
2.6	Used Cars and Trucks	-11.15%	-13.58%	-11.62%	-8.83%	-3.34%	2.03%	7.18%	7.78%	6.61%	7.10%	16.06%	22.73%
1.5	Medical Care Commodities	3.59%	3.19%	3.39%	3.21%	3.13%	3.06%	3.67%	4.09%	3.65%	3.22%	2.41%	2.13%
2.3	Recreation Commodities	3.16%	2.85%	3.27%	4.11%	3.63%	4.31%	4.05%	3.84%	4.12%	4.47%	3.77%	4.03%
0.9	Education and Communication Commodities	-10.17%	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%	-8.32%	-7.33%	-6.99%	-5.71%	-6.03%	-4.01%
0.8	Alcoholic Beverages	4.53%	4.92%	5.82%	5.78%	5.54%	5.01%	4.09%	4.28%	4.22%	4.04%	4.04%	3.87%
1.2	Other Goods	6.91%	6.96%	7.15%	7.17%	7.51%	7.21%	7.90%	7.57%	6.73%	6.57%	6.16%	5.17%
34.5	Shelter	8.18%	8.10%	7.88%	7.51%	7.12%	6.92%	6.59%	6.24%	5.69%	5.61%	5.45%	5.14%
25.4	Owners' Equivalent Rent of Residences	8.04%	8.01%	7.76%	7.53%	7.13%	6.89%	6.68%	6.29%	5.83%	5.48%	5.09%	4.79%
7.5	Rent of Primary Residence	8.81%	8.76%	8.56%	8.35%	7.91%	7.52%	7.21%	6.74%	6.31%	5.78%	5.22%	4.82%
1.2	Lodging Away From Home	7.26%	6.73%	7.69%	3.18%	3.24%	5.86%	2.91%	4.03%	1.04%	10.00%	19.27%	19.66%
1.1	Water & Sewer & Trash Collection Services	5.39%	5.25%	4.97%	4.94%	5.01%	4.77%	4.93%	4.63%	4.35%	4.43%	4.35%	4.18%
0.9	Household Operations	0.00%	#N/A	#N/A	#N/A	#N/A	6.57%	#N/A	6.61%	#N/A	6.49%	5.34%	6.43%
6.5	Medical Care Services	1.03%	2.15%	2.99%	4.12%	4.38%	5.45%	6.51%	5.65%	5.09%	4.82%	4.02%	3.47%
5.8	Transportation Services	13.88%	14.64%	14.63%	14.58%	14.19%	15.19%	14.60%	11.32%	9.15%	8.83%	7.93%	8.46%
0.6	Airline Fares	17.70%	26.54%	25.56%	29.14%	35.90%	43.02%	42.64%	33.70%	26.60%	33.56%	37.59%	33.48%
3.1	Recreation Services	5.94%	6.34%	5.75%	5.71%	5.38%	3.94%	4.06%	4.24%	4.53%	4.72%	4.86%	4.42%
4.9	Education and Communication Services	3.25%	2.86%	2.77%	2.41%	2.24%	1.32%	1.36%	1.53%	1.52%	1.69%	1.68%	1.67%
1.4	Other Personal Services	5.25%	5.21%	5.34%	5.55%	6.49%	5.76%	5.93%	5.77%	5.91%	6.73%	6.46%	6.19%

Source: BofA Global Research, Bureau of Labor Statistics

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