

Economics Group

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CPI Preview: Onward and Upward

CPI likely rose a trend-like 0.2 percent in June amid steady gains in the core index. Consumers may have caught a little respite in travel costs last month, but solid demand and rising input costs point to inflation firming.

Carrying On

The upward climb in consumer price inflation that began in the middle of last year looks to have continued in June. We expect headline CPI to have risen 0.2 percent last month. By our estimates, that will likely be a “low” 0.2 percent (0.16 percent before rounding), leading to the risks being tilted to the downside. While our call for the monthly rise in headline CPI is in line with the consensus, our expectation for it to come in on the low side is driving our below-consensus call for a 2.8 percent year-over-year gain. Our model points to the non-seasonally adjusted index rising to 252.13.

Similar to the headline, we expect core inflation to come in at a soft 0.2 percent (0.17 percent before rounding). That rise should be just small enough to keep the year-ago rate unchanged at 2.2 percent.

What We'll Be Watching...

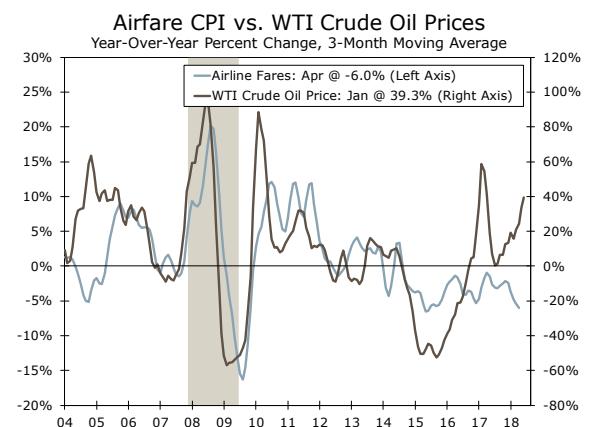
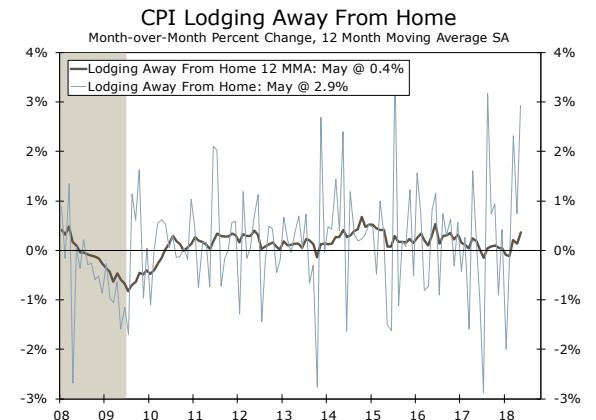
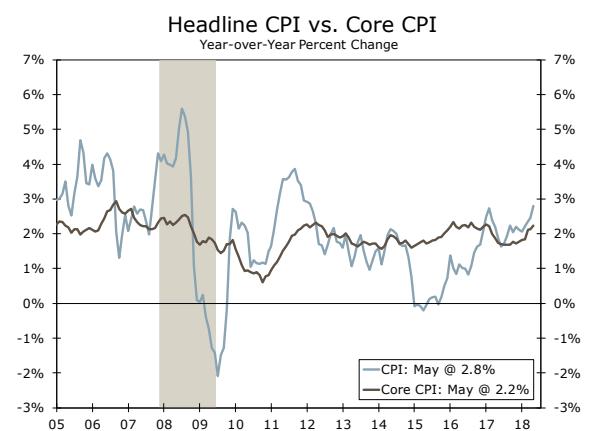
Gasoline: AAA gasoline prices trended lower in June, but the run-up in May, which peaked Memorial Day weekend, left the average monthly price little changed. Given that prices typically edge higher over the summer, gasoline will likely be a modest drag on the headline after seasonal adjustment.

Lodging Away from Home: It has not just been at the pump where consumers have been shelling out more for travel. Hotel/motel prices have increased at a 30 percent annualized rate over the past three months. That puts recent gains in lodging away from home well above the trend (middle chart). Despite stronger discretionary spending from consumers that remains supportive of demand, we see some scope for lodging away from home prices to fall in June.

Airfare: Airline fares posted another sizeable decline in May, falling 1.9 percent on the heels of a 2.7 percent drop in April. The rollout of “basic economy” among all three major domestic carriers in the past year has contributed to airfares falling 6.6 percent from a year ago. About half of the CPI’s airfare index consists of the lowest possible fare, but does not adjust for the value of picking seats or bringing a carry-on. The growing use of “basic economy” may be sufficient for another drop in airfare prices in June, but rising jet fuel prices and tougher base comparisons as the year goes on (United completed its rollout of domestic “basic economy” in May 2017) suggest airfare inflation will soon be flying high again.

Implications for the Fed

Inflation has become a much lower hurdle on the Fed’s path to normalize policy over the past year. Although we expect fairly moderate gains in headline and core CPI in June, the trend remains higher amid solid consumer spending and businesses facing higher input costs for materials and labor. Core CPI at 2.2 percent year-over-year in June and trending higher is consistent with the Fed’s more closely watched core PCE deflator running at 2 percent, which it finally hit in May.



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