

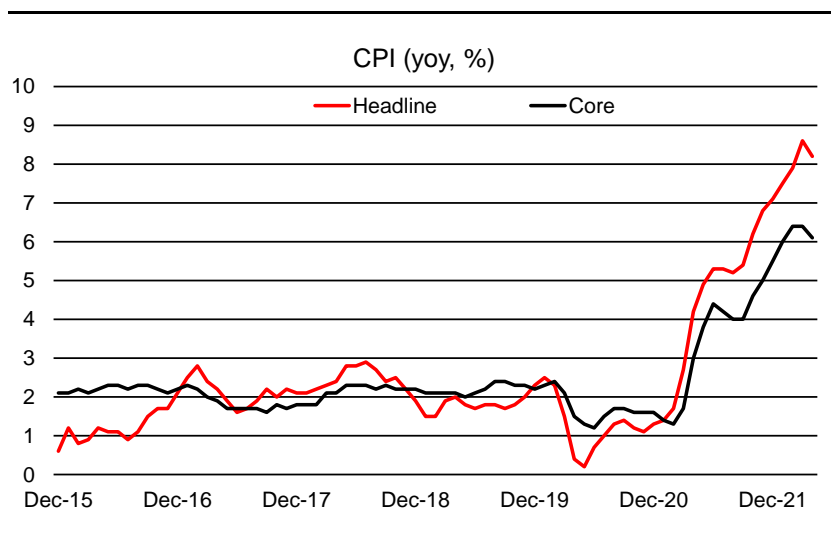
US CPI: core services inflation picks up

- All-item CPI inflation decelerated to 8.3% yoy in April, down from 8.5% yoy in March, whereas core inflation eased to 6.2% yoy from 6.5% yoy. Looking at monthly changes, instead, the picture is more blurred. Headline inflation eased to 0.3% mom in April from 1.2% in March, thanks primarily to a decline in energy prices, whereas core inflation accelerated to 0.6% mom from 0.3% mom in the prior month.
- Shelter, food, airfares, and new vehicles were the largest contributors to the monthly increase in CPI. Airfares, in particular, increased by a whopping 18.6% mom after a rise of 10.6% in the prior month. There are likely two reasons for the jump in airfares in April. First, ongoing expenditure-switching away from goods and towards services as the direct effects of the pandemic fade has pushed up prices for travel-related items. This is likely to last at least a few more months as pent-up demand for travel is absorbed. Second, the later timing of Easter this year compared to last year probably temporarily inflated airfares in April. When it comes to shelter, rents surged 0.6% mom and Owners' Equivalent Rent (OER) was up 0.5% mom, a very strong pace. Considering that rents and OER tend to be sticky, and together they account for 31% of the CPI basket and 40% of the core CPI one, it will likely continue to remain a key driver of inflation going forward.
- Core goods prices are showing some signs of easing (apparel -0.8% mom, used cars -0.4% mom, appliances -0.5% mom), but new vehicle prices (1.1% mom) were up strongly as supply bottlenecks continue and might intensify in the coming months as a result of negative spillovers from the Russia-Ukraine conflict and anti-COVID restrictions adopted in China.
- All in all, today's inflation report provides two key messages. First, energy-related inflation is losing steam as oil prices are stabilizing, albeit at high levels. Second, the lifting of restrictions and the reopening of the economy are being accompanied by a normalization in spending patterns, away from goods towards services. Consequently, core goods inflation is now moderating, while core services inflation is accelerating. The challenge facing the Fed in bringing inflation down towards the target is highlighted by the following. Rents and OER alone are currently contributing 0.2pp to monthly core inflation, and this is likely to continue for some time. It means that for monthly core inflation to moderate towards target-consistent levels, core goods inflation would likely have to turn negative (not only moderate, as it is now) in order to offset rising core services inflation driven by expenditure-switching and a very tight labor market. Therefore, today's CPI report will give the Fed more reason to continue with its tightening plans.

In greater detail,

Both headline and core CPI inflation likely peaked in March in year-on-year terms (chart 1) but, for the time being, the 2% inflation target remain elusive for the Fed with monthly core CPI inflation accelerating. Consequently, the descent from a 40-year high for year-on-year inflation is likely to be slow.

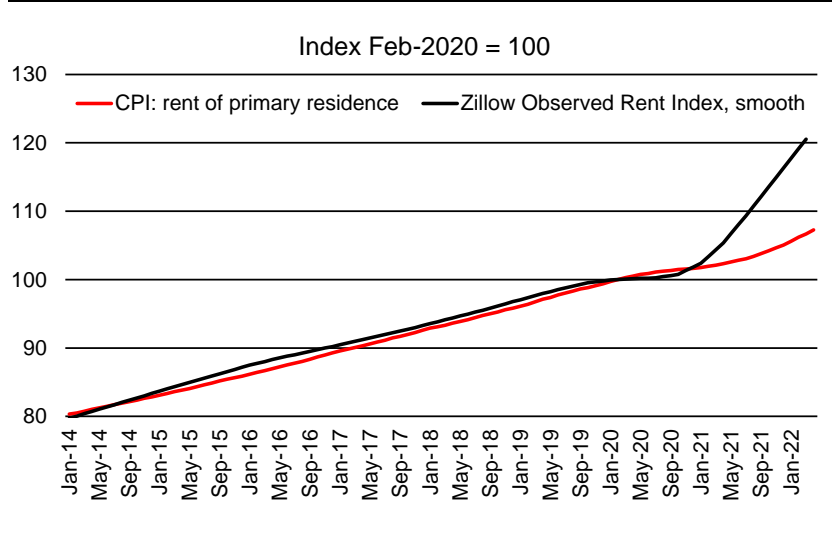
CHART 1. INFLATION HAS PEAKED IN ANNUAL TERMS



Source: BLS, UniCredit Research

Shelter will likely remain the main driver of core inflation in the coming months. Chart 2 shows that the Zillow Observed Rent Index keeps rising fast. These higher shelter-related costs for consumers will materialize in future CPI readings with a lag due to the way the CPI rents index is constructed.

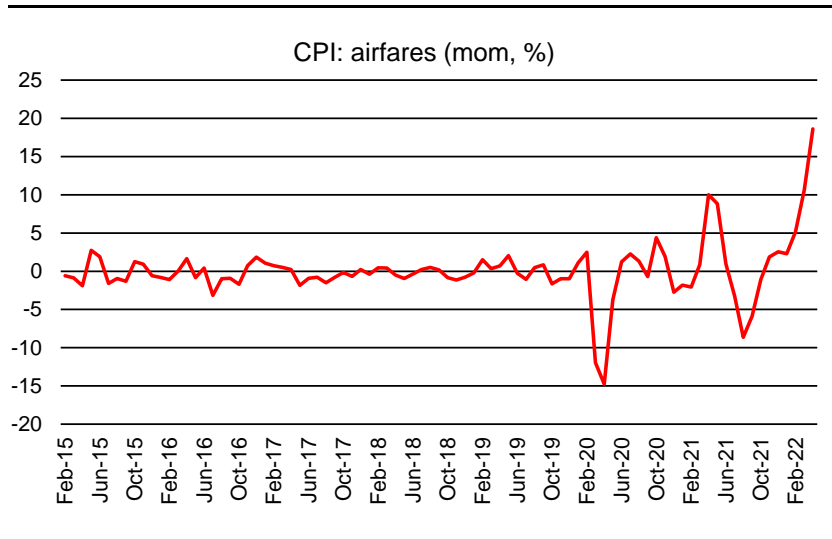
CHART 2. RENTS ARE SURGING



Source: BLS, UniCredit Research

Airfares jumped in April by 18.6% mom (chart 3), the largest one-month rise since records began in 1963. Separate figures concerning personal consumption expenditure show that travelling, especially abroad, is still below its pre-pandemic levels.

CHART 3. AIRFARES JUMPED IN APRIL



Source: BLS, UniCredit Research

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