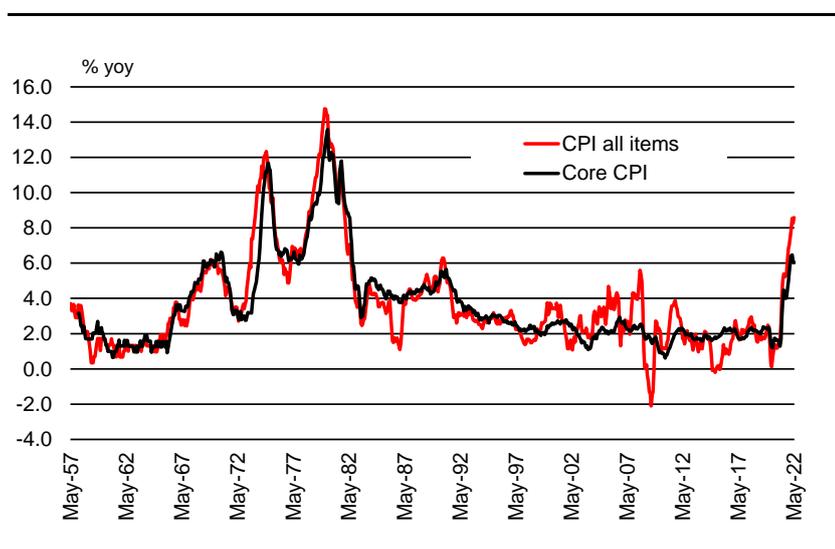


US CPI: Inflationary pressures are not easing, increasing odds of a 50bp Fed hike in September

- US CPI inflation accelerated to 8.6% yoy in May, up from 8.3% yoy in April. It is the highest year-on-year rate since December 1981. Core CPI (that is, excluding energy and food) inflation eased slightly in year-on-year terms, to 6.0% from 6.2% in the prior month. Since base effects influence year-on-year rates, a clearer picture of underlying inflation dynamics can be seen by looking at the monthly seasonally-adjusted inflation rates. On a monthly basis, headline CPI rose a rapid 1.0% mom in May, up from 0.3% mom in April, while core CPI rose a strong 0.6% mom, the same rate as in April and three times the rate consistent with the Fed's inflation target. Price rises were broad-based, with the largest upward contributions to monthly inflation coming from shelter, energy and food.
- The rise in energy and food prices was widely expected, although the magnitude of the rise was a bit larger than we had expected, notably for utility gas prices. Energy prices rose 3.9% mom, with gasoline prices up 4.1% mom and utility gas prices up a huge 8.0% mom, reflecting recent movements in crude oil and natural gas prices, respectively. Food price inflation accelerated to 1.2% mom in May, with the food at home index rising 1.4% mom. This largely reflects the increase in food commodity prices, with the UN FAO Food and Agricultural World Food Price Index up almost 20% since the end of last year.
- The big news in the May CPI report is the stickiness of monthly core inflation. It was hoped that, as expenditure-switching away from goods and towards services continued, rising core services price inflation would be offset by a decline in core goods inflation. But in fact, only the first part of this was true in May. Core services inflation (0.6% mom) remained strong, reflecting an acceleration in rents (0.6% mom) as well as rapid price rises for travel-related items. The strength in rents reflect the high demand for housing, tight labor market and strong wage growth. Rents tend to be sticky as rental agreements are set periodically. As the direct effects of the pandemic fade and pent-up demand for services is unleashed, the price of travel-related services surged (airfares up 12.6% mom after 18.6% mom in April). The surprise, however, was that core goods inflation accelerated to 0.7% mom in May, reversing the trend of the previous three months of deceleration. We suspect this is due to supply bottlenecks, particularly in China during the past couple of months as well as from the Russia-Ukraine conflict, and still strong demand for goods, as evident in the US retail sales figures. Notably, used and new car prices rose strongly.
- For the Fed, the May CPI report is precisely the kind of report that could cause it to lean towards a 50bp rate hike in September, in addition to the likely 50bp hikes on 15 June and on 27 July. Indeed, as Fed Vice Chair Lael Brainard recently said, "if we don't see the kind of deceleration in monthly inflation prints" then it may be appropriate to hike by 50bp in September too.

Chart 1 shows that, in year-on-year terms, CPI inflation is at a 40-year high, at 8.6%, while core CPI inflation is at 6.0%.

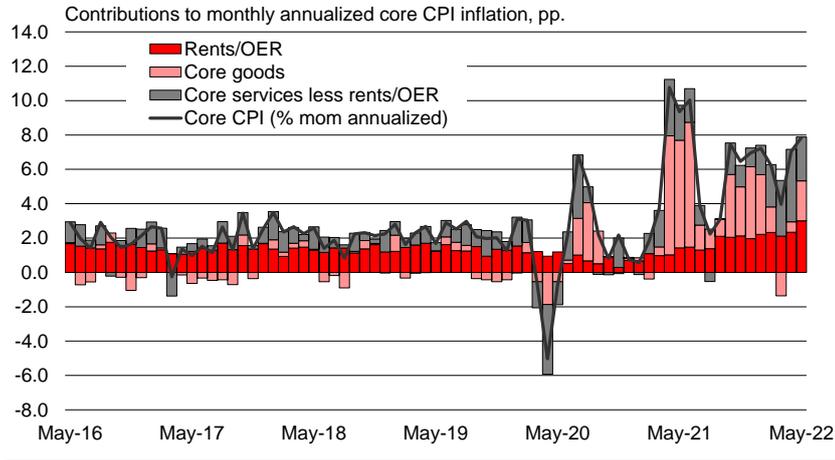
CHART 1: CPI INFLATION AT A 40-YEAR HIGH



Source: BLS, UniCredit Research

Chart 2 displays the contributions to monthly core CPI inflation. The contribution from rents and Owner Equivalent Rent (OER) is rising, as it is for other core services. After three months when core goods inflation had shown signs of easing, it rebounded strongly in May.

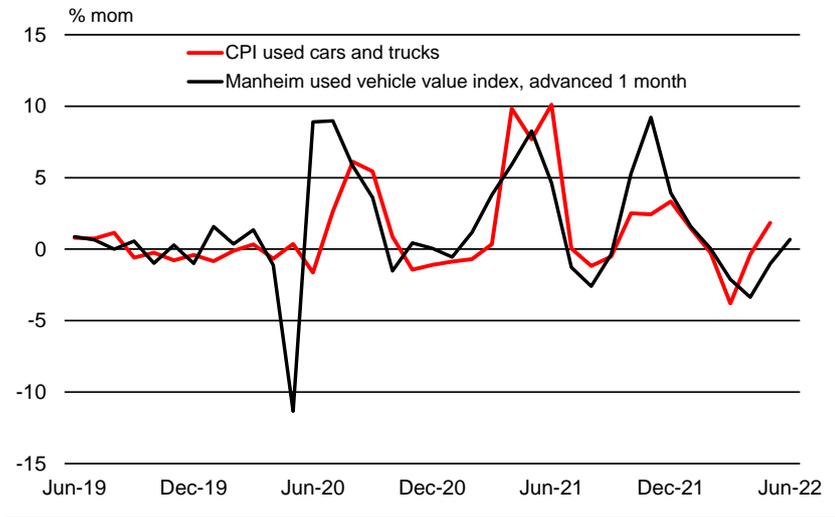
CHART 2: RENTS, OTHER CORE SERVICES AND CORE GOODS INFLATION WAS STRONG



Source: BLS, UniCredit Research

Chart 3 shows that used car prices are rising again, up 1.8% mom in May after declining in the prior three months.

CHART 3: USED CAR PRICES ARE RISING AGAIN



Source: BLS, Manheim, UniCredit Research

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