Economic Analysis

Headline CPI Up in May, but Core Prices Subdued

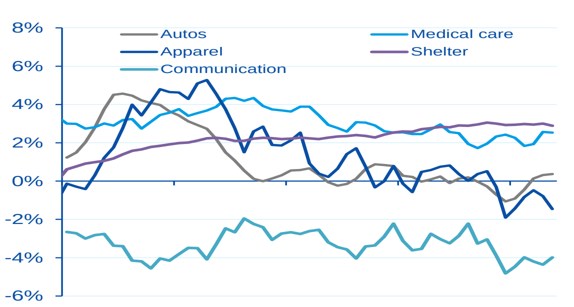
Kim Chase

- **Headline CPI rose 0.4% in May, the fastest monthly pace since February 2013**
- **Core CPI rose a modest 0.15% but decelerated slightly to 1.7% YoY**
- **May's CPI report holds in line with our expectations for a September rate hike**

Inflation pressures are slowly moving upward in line with the Fed's expectations. In May, headline CPI increased 0.4%, the strongest monthly pace since February 2013. This was primarily due to a 4.3% jump in the energy index, with crude oil and natural gas prices up nearly 8.0% and 10.0%, respectively, for the month. However, the energy services index declined for the fifth consecutive month, though this should gradually pick back up again as services adjust to rising input prices. In other headline CPI news, food inflation remained flat for the second straight month. Headline inflation was flat on a YoY basis but finally crossed out of negative growth territory for the first time since December.

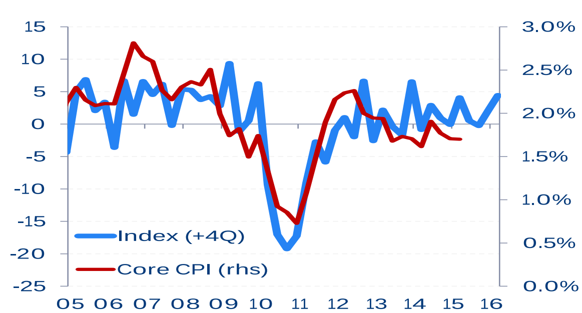
Core inflation, a key component of the Fed's data-dependent monetary policy strategy, increased 0.15% in May following a 0.3% gain in April. The core commodities index actually declined a modest 0.1% for the month, dragged down mostly by apparel and used cars and trucks. Shelter and medical care services continue to be consistent drivers of core inflation, each up 0.2% in May. Compared to 12 months ago, core CPI decelerated slightly from 1.8% to 1.7%. While this is not a significant decline in magnitude, the implications for the Fed could be more meaningful. Recent FOMC statements, minutes, and speeches have made it very clear that the Fed is waiting for economic data to evolve in a way that leaves them "reasonably confident" that inflation will move towards their 2.0% target (~2.5% for core CPI) in the mid-term. Many of the FOMC comments hinted at the possibility of a lagged impact on core inflation that had yet to be realized, so just one month should not make much of a difference in their minds. However, if this downward trend in core inflation continues for a few more months, the Fed may choose to delay the first federal funds rate hike until core inflation ticks back up again. At this point, with May's CPI data and the June FOMC meeting officially behind us (see our latest FedWatch), we maintain our expectations for liftoff in September.

Chart 1
CPI: Selected Indexes (YoY % change)



Source: BLS & BBVA Research

Chart 2
BBVA Research USA Inflation Risk Index (Higher risk<0, Lower risk>0)



Source: BLS & BBVA Research

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