

# U.S. Inflation Insight: May 2022

## MNI View: Stronger Than Just Airfares Taking Off

By Chris Harrison

**Yesterday's April CPI report saw both headline and core inflation exceed expectations, with most of the surprise coming from an even larger rise in airfares plus another ramp higher in rent inflation.** Headline CPI slowed to +0.33% M/M with the surprise mainly in core inflation at +0.57% M/M as volatile items were within the ballpark of analyst expectations. Energy prices slid -2.7% M/M after the March surge and food prices continued to rise strongly at +0.9% M/M, a pace averaged over the past eight months now due to a variety of factors including drought in parts of the country, labour shortages in transportation and more recently impacts from the war in Ukraine.

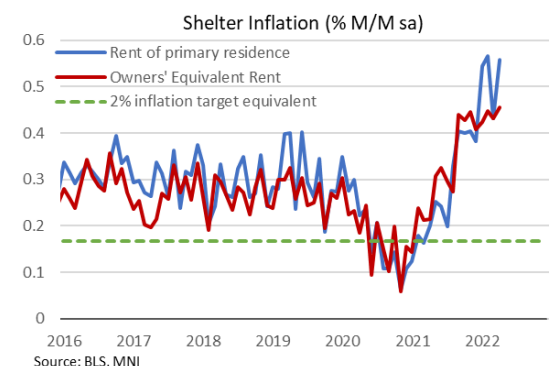
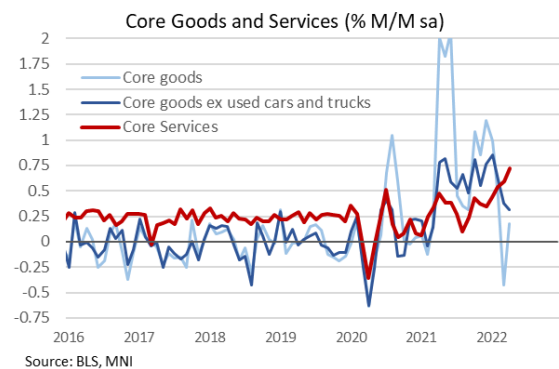
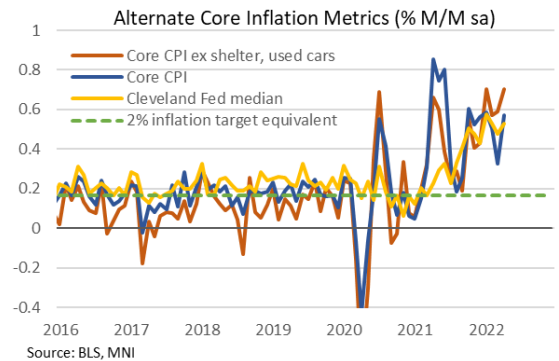
**Base effects meant that annual rates pulled back from what was likely the peak of the cycle in March at multi-decade highs,** easing from 8.5% to 8.3% Y/Y for headline and 6.5% to 6.2% Y/Y for core. However, this likely carries little weight with the FOMC, which is more focused on sequential developments.

**The rotation from core goods to core services continued in earnest,** with core services on fire at +0.72% M/M, a fresh post-1990 high, and core goods only up +0.18% M/M despite an additional boost from a change in methodology that likely added to new car price inflation. That core goods print was broadly as expected, helped by used cars unwinding the -0.2pp drag from overall core inflation from March but with further weakness from that measure expected ahead.

**The main surprise of the report came from core services and in particular booming airfares and shelter.** Airfares jumped from 10.7% to 18.6% M/M, with the change accounting for ~0.06pps of the 0.25pps increase in core inflation but perhaps closer to 0.1pp of the 0.17pp beat on consensus. This was heavily discounted by the fact it's expected to be unwound, especially with the price level now meaningfully above pre-pandemic level (and partly supported by a much smaller rise in the admittedly more volatile PPI data). What shouldn't be discounted though was the surprise rebound in tenants' rents, firming 13bps to 0.56% M/M, whilst OER was also marginally stronger than expected at 0.46% M/M for fractionally above the recent strong run rate to technically the highest since Jun-2006.

**The inherent stickiness behind the rent measures should be the most concerning for the FOMC, along with a re-broadening of price pressures evidence by the Cleveland Fed median CPI rising again to +0.53% M/M.** CPI inflation may have peaked but with gasoline prices since touching new highs, continued disruptions from China lockdowns and a tight labour market, the deceleration in inflation is likely to be slow.

**Analysts reviewed below saw relatively little change in already front-loaded rate paths, which invariably foresee at least one more 50bp hike in June.** BofA thought it could leave room for discussion of a 75bp hike at the margin but that the probability remained low. The initial hawkish reaction from the release has since been offset by growth concerns, but nevertheless continues to broadly price in 2x50bp hikes ahead (98.5bps for July) with almost 200bps to come over the six meetings to Feb 1, 2023.



## Contents

- **Page 1:** MNI View
- **Page 2:** Sell-Side Analyst Summary
- **Page 3-6:** Sell-Side Analyst Comments
- **Page 7-9:** Inflation Chart Pack
- **Page 10-11:** MNI Policy Team Commentary

## Apr 2022 CPI Report: Analyst Reviews

Analyst	Summary
BofA	A noisy report where some of the strength should be faded due to airfares but underlying pressures remain elevated which keep the Fed on its front-loaded hiking path. They still view risks of a 75bp hike as low but the report clearly adds to the debate at the margin.
BMO	With heated price gains wide and far in April, apart from some further slippage in used car prices and a drop in clothing costs, the report may not spur a 75bp hike in June but it will lock in 50bps.
BNP	It confirmed that while peak inflation has passed, the deceleration "is likely to be sticky", with the service-driven upside surprise pointing "towards continued near-term strength and inflation prospects being increasingly susceptible to tight labor conditions".
CIBC	Reinforces the need for the front-loaded tightening cycle. Base effects will help annual inflation continue to decelerate in the near-term but it will be limited by the climb in gas prices, supply disruptions tied to lockdowns in China, the tightening in the labor market and upside from shelter.
DB	Don't read too much into the dip in Y/Y rates, the Fed will have to go fast and far to bring aggregate indices lower, as core services will be even more resistant to tighter policy.
GS	The spike in airfares contributed ~10bps to the surprise in core but the composition was generally firm as well.
ING	Consumer demand is firm and businesses have pricing power, meaning that they can pass higher costs onto their customers. They look for 3x50bp hikes before back to 25bp pace from Nov until peak 3.25% in early 2023.
JPM	Mixed changes across core CPI categories, but firmness overall, with persistent strength in the inflation data probably keeping pressure on the FOMC to hike 50bps at upcoming meetings.
Mizuho	Highly inertial inflation data, especially with regards to rents, make a hard-landing even more likely in 2022 as the Fed is unlikely to bend from its hawkish guidance in the near-term.
MS	Underlying trend for core inflation of 0.5% M/M when looking beyond airfares, broadly unchanged since Nov. Core PCE is likely notably softer than core CPI but watch PPI for airfares.
Pantheon	Still expect 50bp hike in June but the chance of a switch to 25bp in July probably now is less than we hoped unless May and June core much lower. Strip out cars, airfares and rents, and adjusted core inflation would have only increased +0.31% M/M for the smallest gain since September.
RBC	The tick lower in annual rates of inflation is not expected to change the Fed's view that higher interest rates are needed quickly. Looking for two 50bps hikes (Jun & Jul) followed by 25bps hikes to Jan with a terminal 2.75-3%.
StanChart	Less market-unfriendly than the headline surprise suggests but not nearly as market-friendly as investors had hoped for.
TD	Price gains within core appear to be spreading and not only contained within the shelter category. Continue to look for the Fed to maintain its aggressive tightening bias in the months ahead and see 50bp hikes in June and July, with a fourth 50bp increase in Sep also in play.
Wells Fargo	March's 6.5% Y/Y core CPI is "likely" the "high watermark for core inflation this year" so optimists can point to increasing likelihood that inflation has stopped getting worse. However, that's unlikely enough for the Fed to shift its tone, seeing further 50bp hikes in the pipeline.

**BofA: Fed Comfortable With Front-Loaded Hikes In Near-Term, 75bp Hike Risk Low**

BofA see a noisy report where some of the strength should be faded due to airfares but underlying pressures remain elevated which keep the Fed on its front-loaded hiking path. They still view risks of a 75bp hike as low but the report clearly adds to the debate at the margin.

- Headline CPI simmered down to a 0.3% M/M in April on the energy pullback which coupled with negative base effects saw year-ago inflation slow from a likely of 8.5% to 8.3% Y/Y.
- One of the main drivers of the upside to core was the record 18.6% M/M jump in airfares (adding 13bps).
- Even outside of the reopening-related categories, which we view as positive noise this month, there were notable broad-based gains across services amid tight labor markets and accelerating wages.
- Core goods was more mixed, explained by mixed signs of progress on supply chains in the US.
- The Russia/Ukraine conflict and China lockdowns remain risks to commodity prices and global supply chain conditions, which could lead to further choppiness. On net, we expect fairly strong core goods inflation through this year, around 5% by yearend.

**BMO: Locks In 50bp Hike For June**

BMO note that with heated price gains wide and far in April, apart from some further slippage in used car prices and a drop in clothing costs, the report may not spur a 75bp hike in June but it will lock in 50bps.

- The big gainers included a record M/M for airfares (+18.6% M/M, adding a tenth to core) and hotel fares (another 1.7%). A resurgence in travel is adding pressure, but there's no doubt that surging fuel costs are a big driver too.
- Actual rent jumped 0.6%, while OER leaped 0.5%, matching a high set in the 2006 housing boom. There will be plenty of inertia in rents in the year ahead even as blazing hot house prices cool their jets.
- While a 6.1% (temporary) pullback in gasoline prices held the headline CPI to a 0.3% M/M, the bigger concern is that natural gas and electricity prices rose in the month and, most importantly, food costs jumped another 0.9%.
- Plenty of inertia in food costs ahead with fertilizer costs soaring and drought conditions persisting, whilst gasoline prices are up about 4% already in May.
- Inflation is getting hit on all sides: overheated labour markets and rising wages; sagging productivity as less-skilled workers are brought in to fill a record number of job vacancies; and soaring material costs and renewed supply-chain snarls stemming from the war in Ukraine and lockdowns in China.

**BNP: Inflation Deceleration Will Be Sticky**

BNP saw April's CPI report confirming that while peak inflation has passed, the deceleration "is likely to be sticky", with the service-driven upside surprise pointing "towards continued near-term strength and inflation prospects being increasingly susceptible to tight labor conditions".

- Of the rise in rents, BNP observes: "Ironically, as the Fed raises rates, more potential buyers will likely be diverted into the rental market, thereby exacerbating the shelter inflation trend. In our view, rent pressures may not abate until the unemployment rate starts to rise (presumably around the next recession)."
- That said, they also see the drop in apparel prices as an "early indication" of potential disinflationary impulses due to the recent appreciation of the dollar.
- They continue to see 50bp Fed hikes at the next 3 meetings, with a terminal 3.00-3.25% rate by Feb 2023.

**CIBC: Annual Inflation Decelerates But Remains Sky High**

The hotter than expected price pressures reinforce the need for the Fed's front-loaded tightening cycle, according to CIBC. Base effects will help annual inflation continue to decelerate in the near-term but it will be limited by the climb in gas prices, supply disruptions tied to lockdowns in China, the tightening in the labor market and upside from shelter.

- Continued strong food inflation of 0.9% M/M included the impact of the war in Ukraine on cereal products, the avian flu outbreak on meat prices, and droughts in some parts of the country. Labor supply shortage in transportation and extended wait times for commercial vehicles to cross the Southern border at some key crossings further add to costs.
- Core categories accounted for the bulk of the upside surprise, with the shelter of particular note due to its large weight and stickiness. Rents are playing catch-up to the lofty home price increases seen throughout the pandemic as activity returns to cities and leases reset to reflect those gains.
- Airfares were a major contributor, reflecting pent-up demand for travel services and the improvement in screenings during the month. Signs of some services activity levelling off lately as the Omicron subvariant spreads could weigh temporarily but higher fuel costs will also likely boost airfares in May.



**DB: Worrying Trend In Underlying Decomposition**

Deutsche warn against reading too much into the dip in Y/Y rates, noting the Fed will have to go fast and far to bring aggregate indices lower, as core services will be even more resistant to tighter policy.

- Some may note the slight deceleration in the Y/Y figures for headline (8.5 to 8.3%) and core (6.5% to 6.2%) from March's readings are a sign that the tightening in financial conditions may well have started to impact the real economy.
- However, along with monetary policy acting on long and variable lags, there's a worrying trend in the underlying decomposition as the contribution of core services to overall CPI readings has been marching steadily higher since ebbing out in the middle of the pandemic.

**GS: Generally Firm Composition**

GS note that the spike in airfares contributed ~10bps to the surprise in core but the composition was generally firm as well.

- Reopening categories were again strong and shelter categories rebounded after slowing in March.
- Core services prices overall rose at their fastest pace since 1990 and also of note was the re-acceleration in the labor-intensive food away from home category.
- Core goods prices were generally strong outside of apparel and used cars, consistent with renewed supply chain disruptions in Ukraine and China.

**ING: Inflation Has Peaked But It Will Be A Long Slow Descent**

Consumer demand is firm and businesses have pricing power, meaning that they can pass higher costs onto their customers. With little sign of significant supply side improvements and sticky housing inflation, they look for three more 50bp hikes before reverting to 25bp pace from Nov until peak 3.25% in early 2023.

- Energy prices fell 2.7% M/M on lower gasoline costs, but this will be fully reversed next month given gasoline is back at all-time highs.
- Countering that is Mannheim used car auction prices down 6.4% over the past three months so used vehicle prices should fall further (quite a heavy weight of 4.1% of the CPI basket).
- The shift in consumer demand from goods, whose availability has been significantly impacted by supply chain issues, towards services should also contribute to a gradual moderation in the rate of inflation.
- However, they remain nervous about the impact from gasoline and the growing price pressures within services whilst substantial declines are unlikely to materialise until significant improvements in geopol tensions, supply chain strains and labour market shortages.

**JPM: Persistent Strength Probably Keeps Pressure To Hike 50bp At Upcoming Meetings**

JPMorgan see mixed changes across core CPI categories, but firmness overall, with persistent strength in the inflation data probably keeping pressure on the FOMC to hike 50bps at upcoming meetings.

- Core services looked particularly strong, 0.7% M/M for the largest monthly gain since 1990. The 18.6% surge in airfares added about 0.2%pts to core services (0.1%pt to overall core) but the data looked firm even beyond this.
- Core goods prices were much softer on net, rising 0.2% M/M, and we are seeing signs that some of the factors that had pushed core goods prices up significantly earlier in the pandemic are starting to moderate or reverse.
- JPMs core PCE tracker looks for 0.25% M/M and 4.8% Y/Y in April, noting a key distinction between the two being the treatment of airfares, with PCE sourcing it from PPI data due Thursday.

**Mizuho: Fed Unlikely To Bend In The Near-Term From Its Hawkish Guidance**

Highly inertial inflation data, especially with regards to rents, make a hard-landing even more likely in 2022 as the Fed is unlikely to bend from its hawkish guidance in the near-term.

- Both core services and core goods inflation were stronger on the month and Mizuho's estimate of sticky core inflation remained high whilst their estimate of core flexible prices firmed.
- The underlying inflation impulse remains way too high, and the evidence of material moderation is minimal so far.
- The inflation data is also highly inertial, especially with regard to rents, so the inflation data will stay high even as activity more broadly begins to turn. This makes a hard-landing economic scenario even more likely in 2022.

**MS: In Line With Above Consensus Forecast Aside From Airfares**

Morgan Stanley note an underlying trend for core inflation of 0.5% M/M, broadly unchanged since November, when looking beyond airfares. Core PCE is likely notably softer than core CPI but watch PPI for airfares.

- Core CPI hit +0.57% M/M vs MSe 0.50. Beyond the jump in airfares, the rest of core services came in about right in line with our expectations, notably rents (0.56%, MSe 0.56), and OER (0.45%, MSe 0.46). Service inflation remained broadly based and fairly steady outside of those measures.
- Some silver lining from softer than expected core goods inflation (0.2%, MSe 0.4%), implying that supply-driven inflation may be cooling for now, especially in areas like apparel.
- Leaving aside airfares, the underlying trend appears broadly stable at 0.5% M/M where it's been running since Nov. Slower monthly increases in pandemic-sensitive categories like airfares, as well as further easing in goods price inflation are two key components that will be needed to get core inflation below that trend over coming months.
- Preliminary core PCE forecast of 0.33% M/M, which would slow the year-ago rate from 5.2% to 4.9% Y/Y but watch airfares within PPI.

**Pantheon: Disappointing Core But Details Are Better Than 0.6% Print**

Pantheon still expect a 50bp hike in June but the chance of a switch to 25bp in July probably now is less than we hoped unless May and June core prints are much lower. Strip out cars, airfares and rents, and adjusted core inflation would have only increased +0.31% M/M for the smallest gain since September.

- Used vehicle prices fell only -0.4% M/M, much less than implied by the lagged drop in auction prices. The CPI measure has fallen faster than the auction numbers suggested recently, indicating that dealer margins are compressing in a process that has much further to run. It was surprising to see a brief reversal of this in April but it could be partly a seasonal effect.
- The change in BLS methodology for new vehicle prices likely boosted M/M inflation but it could start to undershoot the old method at some point over the next few months.
- The current M/M trend in rents is in line with the 5% y/y rate implied by our long-term model, which points to a slowing in rent increases next year given the downshift in housing demand and the apparent moderation in wage growth.
- Further increases in airfares are likely though at a much slower pace than April's 18.7% M/M.

**RBC: Slowdown in Y/Y Won't Change Fed's View**

The tick lower in annual rates of inflation is not expected to change the Fed's view that higher interest rates are needed quickly. We look for two 50bps hikes (June, July) followed by 25bps hikes to Jan with a terminal 2.75-3%.

- Despite the decline in CPI Y/Y, price pressures remain exceptionally firm – and broadly-based with 80% of the CPI basket (excluding shelter) seeing an above-target rate (2%) of price growth in April versus pre-pandemic levels.
- Stronger consumer demand, global supply chain disruptions, and higher business input costs all continue to underpin inflation. Meantime labour market conditions are growing increasingly tight, driving up wages.

**StanChart: Strength Particularly Focused In A Few Areas**

Standard Chartered see the data as less market-unfriendly than the headline surprise suggests but not nearly as market-friendly as investors had hoped for.

- The good news is that the overshoot to expectations came from a very narrow set of surprises.
- When removing new and used auto purchases, hotels, car rentals and airfares, StanChart see core inflation running at just +0.36% M/M, on a shallow downward trend since Jan and the lowest since Nov.
- Based on recent market behaviour, such misses to the upside would have pushed up both the USD and bond yields; but as of noon ET, BBDXY and 10Y UST yields were essentially unchanged versus just prior to the release despite inflation breakevens acknowledging the overshoot.

**TD: Fourth Consecutive 50bp Hike Also In Play**

TD see concern for the Fed given price gains in the core segment appear to be spreading, and not only contained within the shelter category. They continue to look for the Fed to maintain its aggressive tightening bias in the months ahead and see 50bp hikes in June and July, with a fourth 50bp increase in Sep also in play.

- Strength in core services inflation was not only attributable to the shelter component. Core services prices ex-shelter are rising much more firmly than shelter on a monthly basis with gains from medical care services, recreation and airfares although the latter is unlikely to keep advancing at such strong pace.

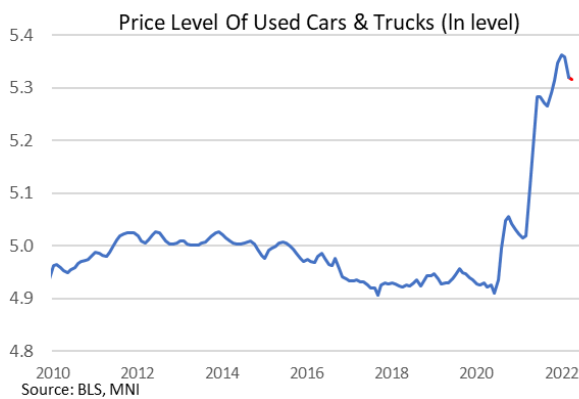
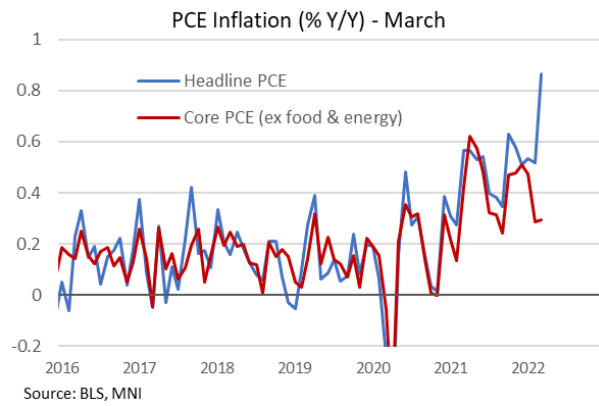
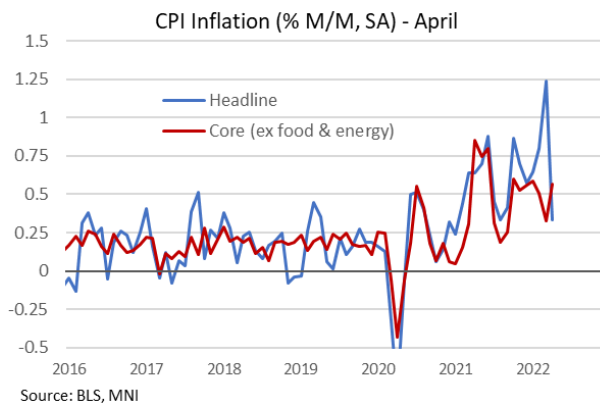
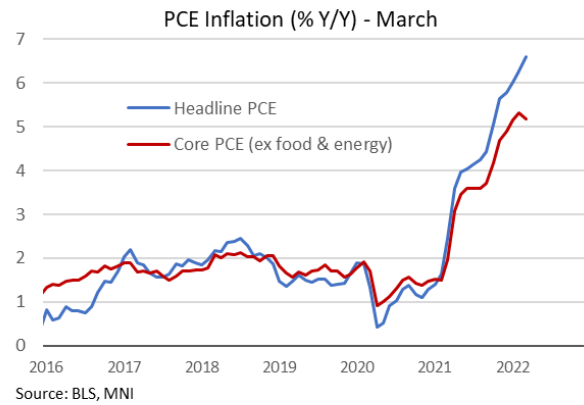
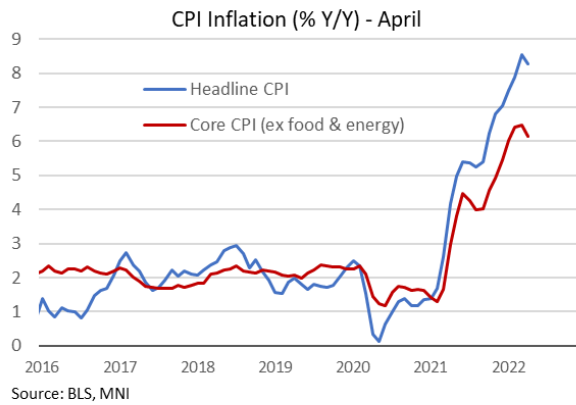
- The expected transition from core goods to core services spending is happening, at least as seen through the inflation lens
- Core CPI data remains strong and we expect prices to continue to register firm gains in the near term on the back of a still solid backdrop for services prices and lingering supply-chain headwinds
- Risk assets and long-end rates (especially real rates) are more vulnerable to high inflation prints than the front end. The TIPS BE curve flattened, which makes sense. We are long 3y, in 5s30s steepener and in 2s10s BE flatteners.
- The positive surprise in core prices will not be favorable for currencies not named the US dollar. We think the market is far too premature in reducing the Fed's optionality set for tightening. This should leave the USD resilient for now.

**Wells Fargo: CPI Release Won't Shift Fed's Tone**

Wells Fargo still eyes March's 6.5% Y/Y core CPI reading as "likely" the "high watermark for core inflation this year", so even with April's above-expected release, "glass half-full optimists" can point to increasing likelihood that inflation has stopped getting worse. However, they doubt that's enough for the Fed to shift its tone, and see further 50bp hikes in the pipeline.

- "Price growth on a sequential basis is also likely to remain much too high as far as the Fed is concerned, running a little over 5% annualized in Q3."
- In the April release, Wells Fargo notes the "softening trend in goods prices was not enough to overcome the upward trend in services".
- For core, they note strong vehicle price inflation but outside of that, goods inflation "largely slowed on a sequential basis".
- Core services, in contrast, "continue to heat up", with pandemic "reopening" categories posting strong gains. And shelter prices have yet to peak, in Wells' view.

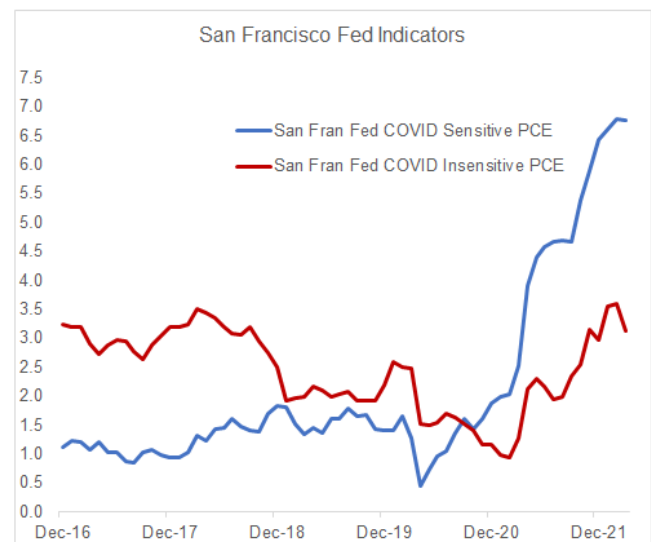
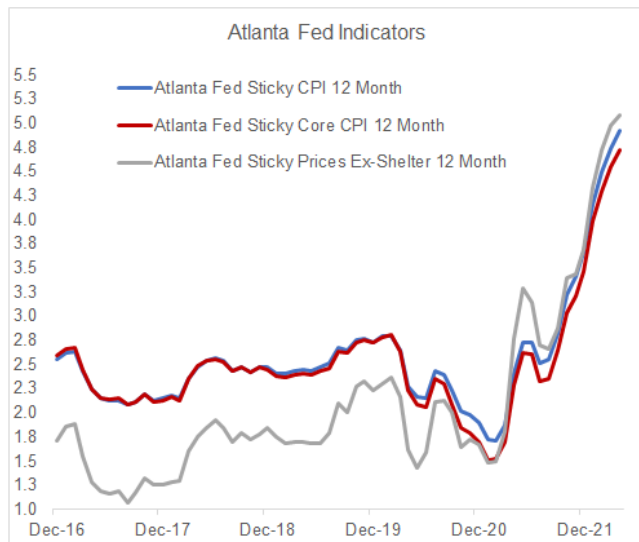
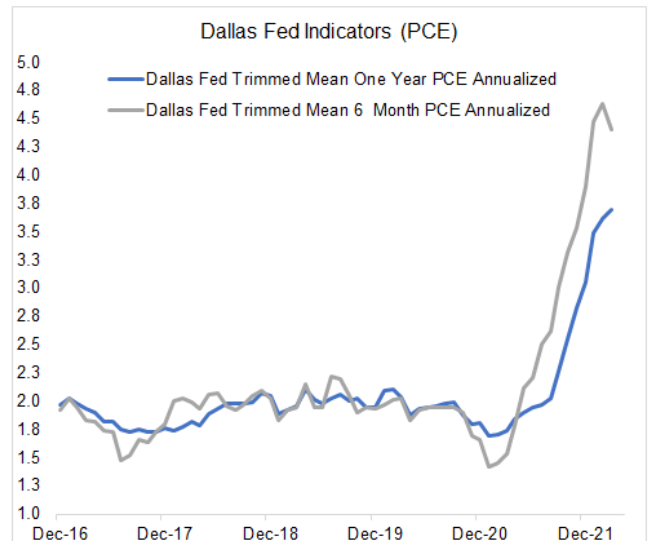
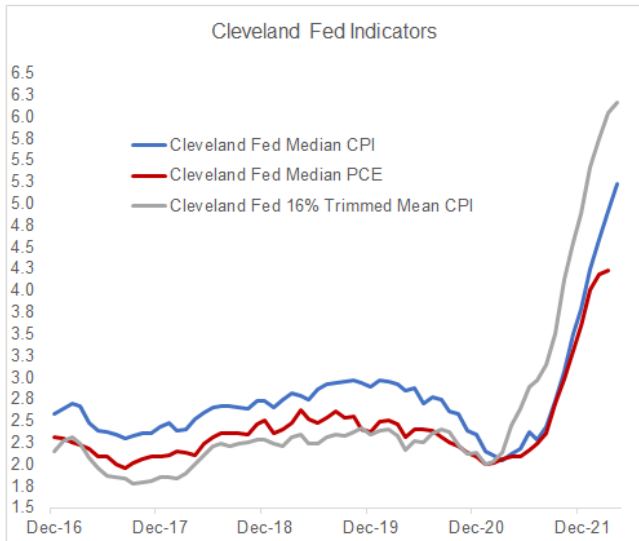
## Inflation Overview



(Red denotes April change for levels charts)



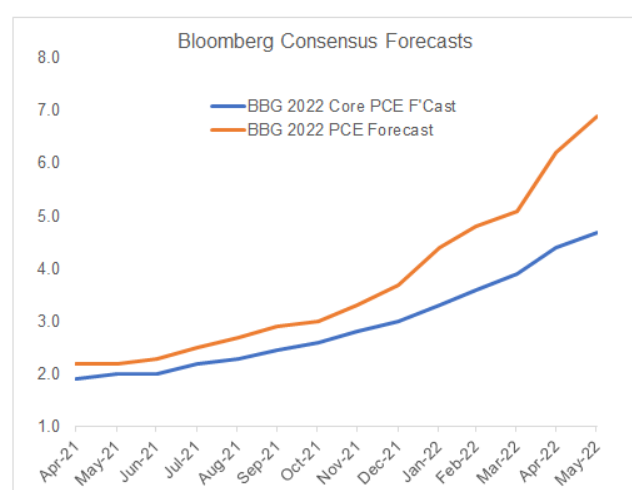
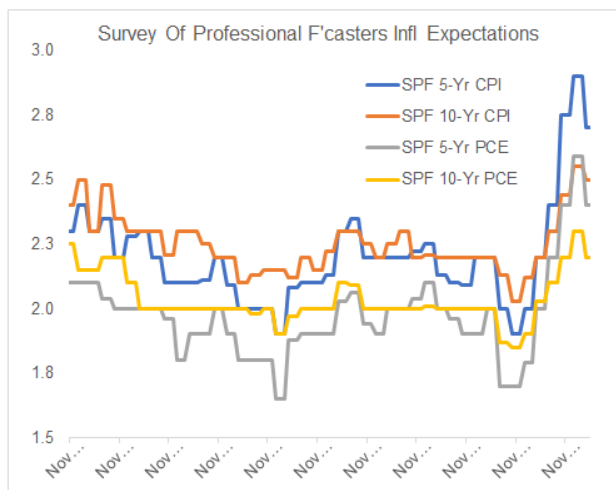
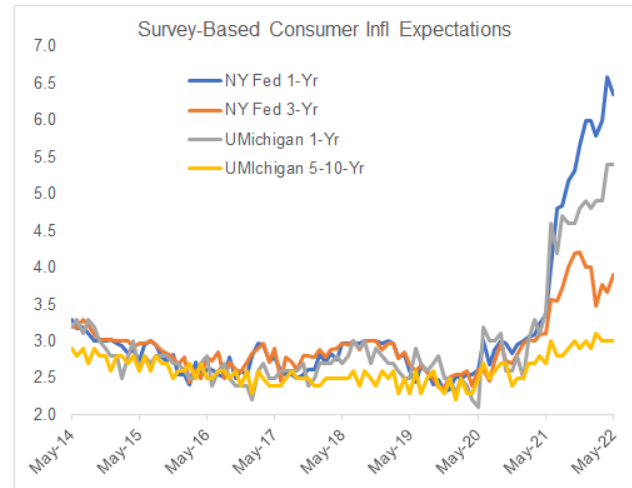
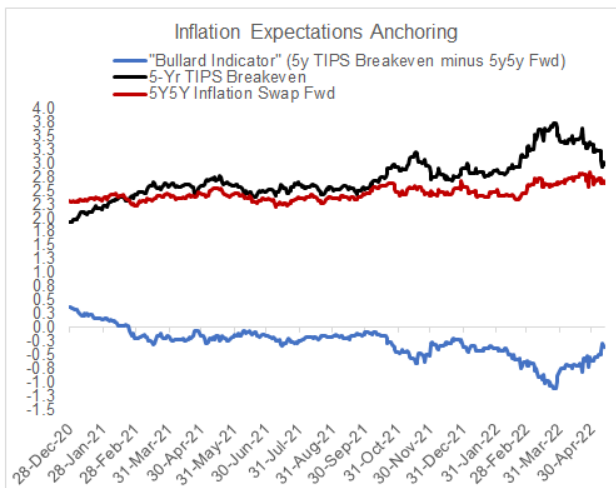
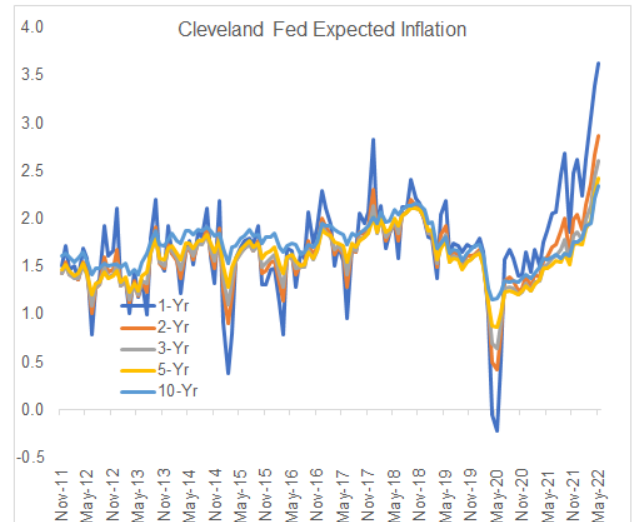
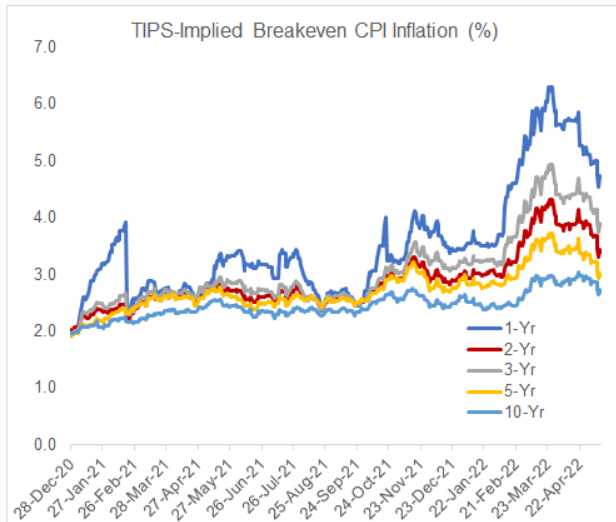
## Regional Fed Inflation Indices



\*Sources: Respective regional Federal Reserve banks. Dallas Fed and SF Fed indicators to Mar 2022.



## Inflation Expectations



\*Sources: Bloomberg, Cleveland Fed, NY Fed, UMichican Survey, SPF, MNI

## MNI Policy Team Insights

### MNI INTERVIEW: Fed's Barkin Says Hikes Not On Set 50BP Course

*By Evan Ryser and Pedro Nicolaci da Costa*

WASHINGTON (MNI) - Federal Reserve Bank of Richmond President Tom Barkin told an MNI podcast Friday interest rate increases are not on a preset course and he would like to see interest rates on a path to normal that is as fast as feasible, backing this week's historic FOMC decision to raise the fed funds rate 50bps, while not ruling out the potential for a supersized 75bp increase if needed.

Given that inflation remains uncomfortably high, broad-based, and persistent and with demand extremely strong, raising rates by 50bps was "pretty straightforward," Barkin said in his first public comments after the FOMC meeting, backing the Committee's move.

Asked whether he'd back two more consecutive 50bp moves, he said: "In my mind, were conditions to stay the same which of course is a pretty big if, I think let's normalize as fast as we can feasibly get there."

But whether the U.S. central bank needs to continue to move beyond estimates of neutral is uncertain, he said. While currently demand and inflation both are pointing in the direction for a relatively quick rise in rates, he said, it's going to depend on the state of the economy and "the time to reassess is when inflation starts to come down or when underlying demand starts to come down, and we'll see what happens then."

#### --NOT RULING OUT 75BP

The Richmond Fed president did not completely rule out a larger 75bp move. "I think anything would be on the table," he said. "I think you've been around me long enough to know I never rule anything out."

"I'll just say our pace is pretty accelerated right now," he added. "If you started seeing signs, as imperfect as inflation expectation assessments are, but if you started convincing yourself that inflation expectations have started to move, that to me is the strongest case to try to move faster."

Chair Jerome Powell earlier this week said a "75 basis point increase is not something the Committee is actively considering."

As to when the Fed would likely need to downshift and begin to hike rates in smaller 25bp increments, Barkin stressed the ambiguity of assessments of neutral. "I'll say I'm sensitive to our inability to understand exactly where neutral is," he said. "As you enter the intersection, you might be more inclined to slow down and look around."

#### --LONG WAY ON QT

And as the central bank is set to begin shrinking its balance sheet June 1, Barkin said markets and the Fed do have a better sense of how quantitative tightening works but acknowledged there is still a learning process. "I remind myself this is only the second time we've done this," he said.

Barkin expressed more confidence that markets can handle QT in its first steps. "It seems odd to me to imagine that there's going to be too much stress removing, taking our balance sheet from USD9 trillion to USD8 trillion. We're at very elevated levels," he said. "We're a long way from the point of what ought to be causing market stress."

"We should and are always concerned about whether there's enough liquidity in the market, whether the markets are going to function in the right way," he said. "To suggest that we know exactly how it's going to play out I think is a little aggressive."

## MNI INTERVIEW2: Fed's Barkin-Tamping Inflation Will Take Time

By Pedro Nicolaci da Costa and Evan Ryser

WASHINGTON (MNI) - Bringing high U.S. inflation down to more acceptable levels will take time because the economy is still booming, employment is robust and supply chain issues are taking longer than expected to get resolved, Richmond Fed President Thomas Barkin told MNI.

"I think it's going to take us a while to get inflation under control and that's one of the reasons why I'm supportive of that accelerated rate increase path that we talked about," Barkin told MNI's FedSpeak podcast (<https://marketnews.com/mni-podcast-fedspeak-barkin-wants-hikes-as-fast-as-feasible>), saying he would not rule out a larger 75 basis point (<https://marketnews.com/mni-fed-s-barkin-says-rates-not-on-preset-course>) rate hike if inflation expectations look to be getting out of hand.

"Demand is still extremely strong," he said. "I don't see any quieting in that yet."

Barkin said business contacts in the Fed's 5th district expect inflation pressures to persist. "People would like the supply chain stuff to get solved but it's just taking longer and longer and longer and it's sort of like whack-a-mole, the latest issues of course being the Ukraine and being the shutdown in China."

---BROAD-BASED

One of the difficulties with tamping inflation, which has surged to a 40-year high of 8.5%, is that price pressures have broadened as supply chain issues clashed with increased demand due to fiscal and monetary support following the pandemic.

"A lot of us thought a year ago that this was about getting chips in cars, and as soon as we got chips in cars inflation would ease," Barkin said. "What we've seen, of course, is that it's much broader than that. And the longer that you have elevated inflation, the higher the risk that firms and consumers are going to think that inflation is going to stay elevated. That informs my forward-leaning, look on normalizing rates."

Still, he's encouraged that business managers' price setting habits do not yet reveal a deeper inflationary psychology.

"You ask them, what kind of pricing power do you think you're going to have a year from now? They have not yet convinced themselves that this pricing power is continuous or long lasting," he said. "They do not see this as a long-term regime change. They see this as a shorter term thing that we're gonna get to the other side of at this point."