

Inflation relief boosts case for US rate cuts

A surprise 0.2% MoM core CPI inflation print after a similar reading for April core PCE deflator offers good news for the Fed in its fight to ease price pressures. This needs to become the trend after a series of far too hot readings at the start of the year. We think it will be and with unemployment on the rise we expect the Fed to cut rates in September



A 0.2% month-on-month core CPI reading is good news for the Fed, and we expect rate cuts in September

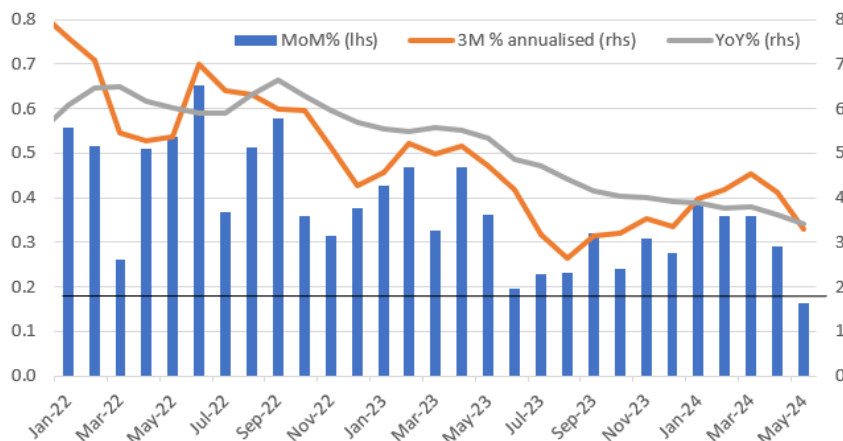
0.163% The MoM change in US prices ex food & energy

CPI finally tracking for 2%, but more good news is needed for rate cuts

After a string of far too high inflation prints at the start of the year we are now seeing some much better readings. The April core PCE deflator came in at 0.2% and today's core CPI for May has repeated the feat (0.2% versus the 0.3% consensus) and to 3 decimal places is even better at

0.163% month-on-month. At the same time headline consumer price inflation came in at 0.0% MoM versus the 0.1% consensus and is below every single forecast. The year-on-year headline rate slows to 3.3% from 3.4% and core slows to 3.4% from 3.6%, but the focus is on the MoM run rate and today's outcome has boosted the chances of a September start point for rate cuts considerably.

US core CPI MoM%, 3M annualised & YoY%



Source: Macrobond, ING

Looking at the details we have to thank a 3.6% MoM drop in airfares for doing a lot of the heavy lifting in getting the soft core inflation print, but the prices of recreation, new vehicles and apparel all fell too. An important story is that motor vehicle insurance prices also dropped. This has been an 'engine' of inflation pressures in recent months and today's developments are a real relief (YoY it is still up 20.3% though).

There are areas of lingering strength in pricing power. The housing numbers aren't really showing any softening with owners' equivalent rent holding at +0.4% MoM for the fourth consecutive month and primary rents doing the same. Used car prices rose 0.6%, but this is unlikely to last given movement in Manheim used car auction prices which lead the used price car series by a couple of months. Medical care prices also remain hot, rising 0.5%.

Nonetheless all other components were in the 0-0.2% range, which is what we want to see and this ties in with what the Fed wrote about price pressures in its most recent Beige Book, "prices increased at a modest pace over the reporting period. Contacts in most Districts noted consumers pushed back against additional price increases, which led to smaller profit margins as input prices rose on average".

Dovish Powell to leave the door open for a September rate cut

Today's outcome following on from the April core PCE deflator and the Beige Book summary should give the Fed the confidence to amend the sentence in the FOMC statement that previously said "In recent months, there has been a lack of further progress toward the Committee's 2 percent inflation objective". It should also allow a dovish spin from the Fed's Powell this afternoon even if the Fed themselves surprise and switch to projecting just one rate cut from the three cuts they projected at their March forecast update.

We think the Fed will opt for two in their forecast update, but remember the forecasts were submitted well ahead of the recent data prints. Expectations for a September rate cut have risen, but not significantly with 20bp of a 25bp cut now priced. A November cut is fully priced with 49bp of cuts priced by year-end.

We look for a September start point for rate cuts with additional cuts in November and December. What we think will generate such an outcome is 1) two or three more 0.2% MoM core inflation prints, 2) unemployment convincingly breaking above 4% to say 4.2% or 4.3% and 3) more softening in consumer spending.

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