US inflation: Feeding the frenzy

Softer US consumer price inflation data will only fuel the market clamour for interest rate cuts

Source: iStockphoto

Headline inflation rose 0.1% month-on-month in May, leaving the annual rate of CPI at 1.8% year-on-year, down from 1.9% in April. Core inflation was softer though, undershooting the consensus 0.2% MoM prediction by a tenth of a percentage point. This leaves the annual rate of core inflation at 2%, which is the slowest rate since February 2018.

The details show energy prices fell 0.6% MoM, reflecting the declines in gasoline prices, which in turn contributed to softer transportation fares. Apparel continued its soft run with a flat MoM outcome after two consecutive steep drops, while recreation also fell. Most other components saw limited changes relative to recent trends. Food was the only real area of strength, rising 0.3%.

1.8% Headline CPI (YoY%)

Lower than expected

Tariff changes may eventually push up some goods prices, while apparel prices should soon rebound. But for now, inflation pressures in aggregate remain benign. As such, financial markets will see little reason for the Federal Reserve to hold back from rate cuts in coming months to combat the perceived threat of a slowdown caused by intensifying trade tensions.

Given the recent language shift from Fed officials, we believe that they will use next week's June FOMC to signal an easing bias. This would perhaps be through repeating Fed Chair Jerome's Powell use of the "closely monitoring" phrase and downward revisions to the economic projections and the "dot" diagram, which currently has a rate hike priced in for 2020.

While we doubt that the Fed will carry through with the 100 basis points or so of policy easing currently priced by markets, the longer trade tensions drag on, the greater the chance the Fed will be forced to respond aggressively.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

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