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March CPI tempers rate cut expectations

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- March’s CPI print complicates expectations of a rate cut in the first half of 2024. Core goods are in deflation territory, but shelter inflation remains elevated and core services excluding shelter accelerated in March.
- Under the current trajectory, a June rate cut would likely be premature. Indeed, there are weaknesses in sectors of the US economy, including in the labor market, in the commercial real estate sector, and in personal income growth, but headline growth is strong, and a pre-emptive rate cut is only justifiable if inflation is “sustainably” at the 2% target. That target is unlikely to be reached by June.

Inflation remains stubbornly high in Q1 2024

Most inflation drivers have been suggesting that price growth should continuously ease toward the Fed’s 2% target. But despite this, annual growth in core CPI remains elevated at 3.8% (Chart 1).

Shortages still characterize the overall housing market, which can help explain why shelter inflation remains elevated (0.4% m/m and 5.7% y/y). But monthly growth in core CPI excluding shelter has been on an upward trend since the middle of 2023 (Chart 2). Core goods inflation is least troublesome, with annual price growth remaining in negative territory since January 2024 (Chart 1). The latest acceleration in energy prices should only be slightly concerning, with suppressed supply driving most of the growth rather than accelerating global demand. Core services less shelter is most concerning, and it has been the major driver of reaccelerating prices despite slowing wage growth.

Growth in some spending categories can be considered a “bump in the road,” but more confidence will be needed for the Fed to cut rates in June. The economy is on pace to show strong growth in Q1 (Chart 3), supported by elevated consumer spending growth, and headline jobs growth remains strong.

Chart 1: Core inflation remains elevated above 2%, mostly driven by core services

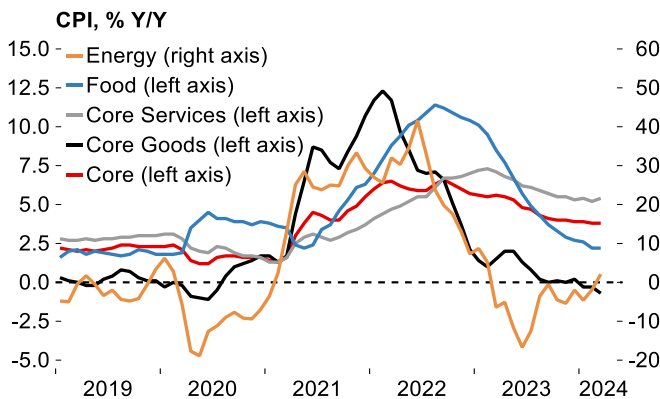
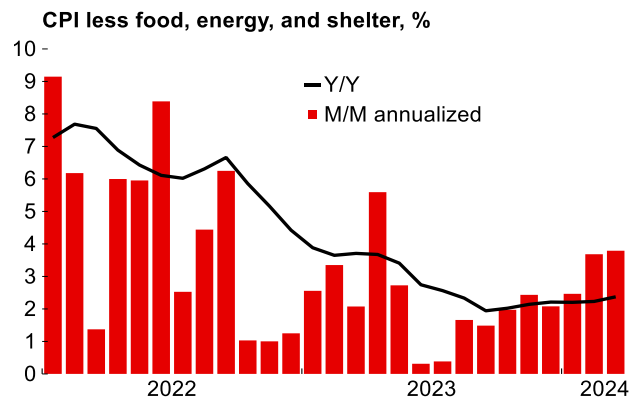
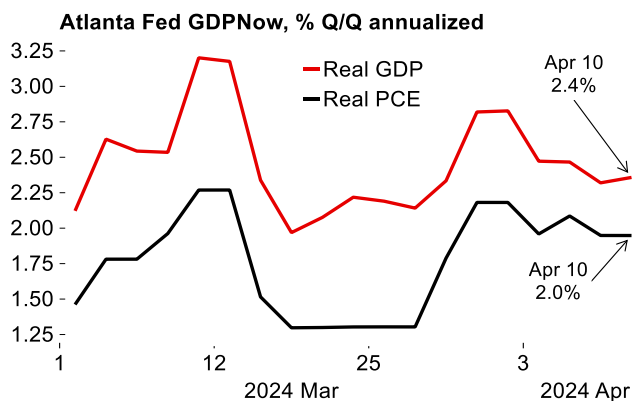


Chart 2: Core inflation less shelter has been accelerating since the middle of 2023



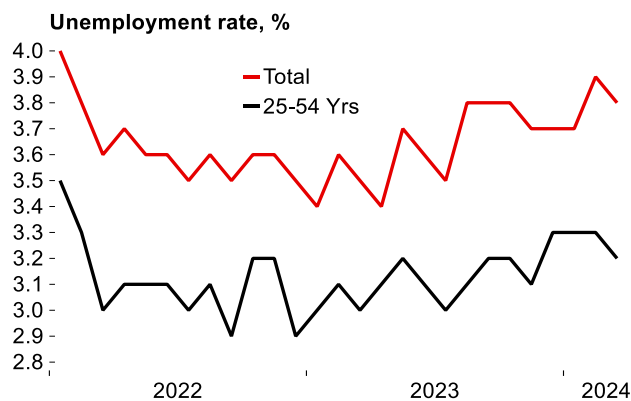
While there are weaknesses present in the economy, the Fed's primary goal is for inflation to "sustainably" reach 2%, which likely means several months at or very near target. And as of now, that seems unlikely to happen by June. For the Fed to cut rates before inflation reaches target, it is likely that the unemployment rate would need to rise above 4% for the Fed to justifiably intervene and adhere to their dual mandate of maximum employment and stable prices. And again, that seems unlikely to happen by June given that the unemployment rate has been hovering between 3.7-3.9%, and even lower for prime-age workers (Chart 4).

Chart 3: The latest forecast shows real GDP growing by 2.4% annualized in Q1 2024



Source: Atlanta Fed, MUFG Bank Economic Research Office

Chart 4: The unemployment rate has hovered between 3.7-3.9% since August 2023



Source: BLS, MUFG Bank Economic Research Office

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