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Status quo monetary policy

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- April's CPI print provides little insight as to when the "data dependent" Fed will begin cutting rates. From an annual price growth perspective, the general trend remains largely the same: core inflation is gradually easing, energy prices are growing, and food inflation remains elevated. When observing monthly growth, the trend now appears flat (as opposed to accelerating) with growth in core CPI less shelter and Owners' Equivalent Rent (OER) falling in April. More rapid disinflation or a deterioration in the labor market will be needed to the Fed to break the status quo.

Easing, but elevated April growth

Annual growth in core CPI fell to 3.6% in April, down from 3.8% in March. Core goods inflation remains comfortably in negative territory (-1.3%) while core services inflation hovers above 5% (Chart 1). Energy prices are trending upward, but the magnitude will likely need to be much higher and the duration longer for it to passthrough into core prices. Food inflation remains elevated, which on its own does not signal much for the broader picture given the unique and volatile drivers in the food industry, but sustained price growth can upend inflation expectations. The risk as of now, though, appears low.

For annual growth, the general trend can be characterized as slow and steady disinflation, but base effects certainly play a large role. When observing the month-to-month trend, we could see much more of an acceleration in prices since the middle of last year, even when excluding the elevated shelter component. Monthly growth in core CPI excluding shelter has been trending upward since July 2023, with the only sign of a reversal coming now in April where annualized growth fell to 2.7%, down from 3.8% in March (Chart 2). For the months ahead, easing price growth is expected to continue given that delayed inflation from key spending categories that exhibit sticky-prices, or infrequent price change, likely drove much of the monthly acceleration prior to April.

Chart 1: Annual core inflation continues to ease, with support from negative price growth of core goods

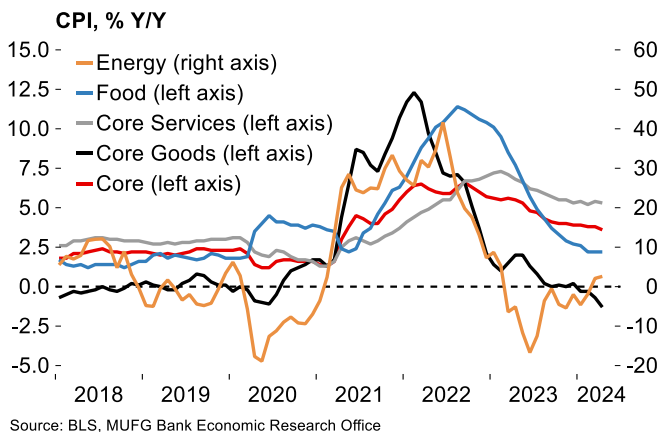
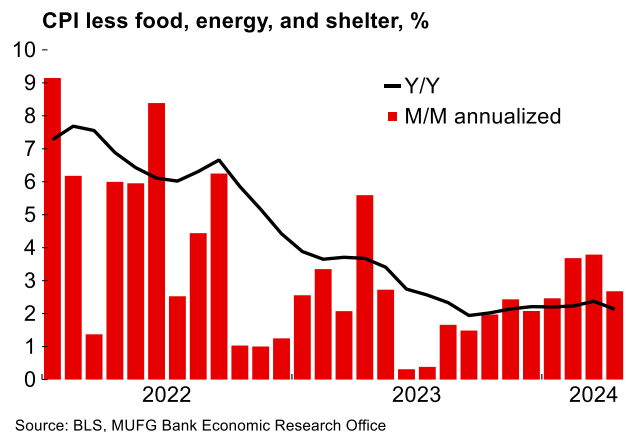


Chart 2: The trend of accelerating monthly price growth reversed in April



One example of this is motor vehicle insurance, where prices surged in the beginning of 2023 and in the beginning of 2024 (Chart 3). Prices infrequently change for this spending category, and when they do, they reflect past inflationary pressures. In this case, the rise in auto insurance was likely a delayed response to the rise in prices of cars, car parts, and mechanic labor costs from months prior.

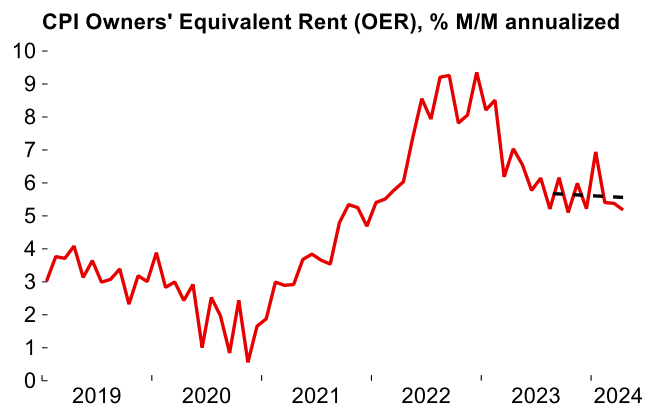
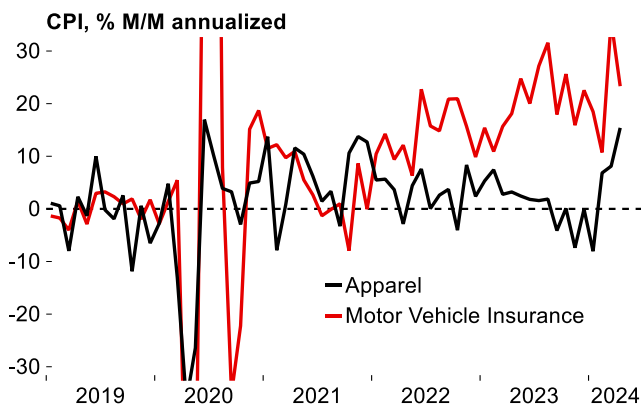
With that said, not all of the acceleration can be attributed to sticky-priced items and delayed inflation. For one, apparel prices have been accelerating in recent months, where price changes are much more flexible (Chart 3). Part of this may be a correction from months of deflation, but strong demand is likely also be a factor.

Additionally, there has been little progress in the shelter component of inflation, specifically in Owners' Equivalent Rent (OER). Since August of last year, monthly price growth has been virtually flat and well above what will be needed to bring overall core prices down close to target (Chart 4).

There is an expectation that monthly inflation will ease in the coming months, but the pace of easing will likely be slow given that upward price pressures are still present in many industries. Wage growth remains elevated above what would be consistent with 2% inflation, the labor continues to be tight, and consumer spending remains strong. Inflation will need to decelerate at a much stronger pace for the Fed to consider rate cuts as early as this summer.

Chart 3: Delayed price growth for auto insurance and re-accelerating apparel prices helped drive recent inflation trend

Chart 4: The shelter component of the CPI continues to lack disinflationary momentum



Source: BLS, MUFG Bank Economic Research Office

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