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TRENDMACRO LIVE!

On April CPI: Oh, What a Relief It Is

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Donald Luskin

If it weren't for just four items, April CPI would have been downright deflation.

A seemingly hot headline Consumer Price Index reading at 3.82% for April at an annual rate, above the Fed's 2.5% CPI target, wouldn't seem to be enough to propel US stocks to new all-time highs. The correction we predicted two days early is over (see "One Year On, Bank Credit Finally Shakes Off Silicon Valley Bank" March 26, 2024).

- That's because headline CPI slightly beat consensus expectations, and core CPI met expectations. After yesterday's horrible Producer Price Index miss, that was a substantial relief.

Our preferred measure of inflation, core CPI ex-owners' equivalent rent, fell to a new cycle low at 2.31%, below the Fed's CPI target now for eight

Update to strategic view

US MACRO, FEDERAL RESERVE, US STOCKS: Headline and core CPI both reported above the Fed's target in April at an annual rate. But headline beat consensus, and core met consensus. This was a substantial relief after …

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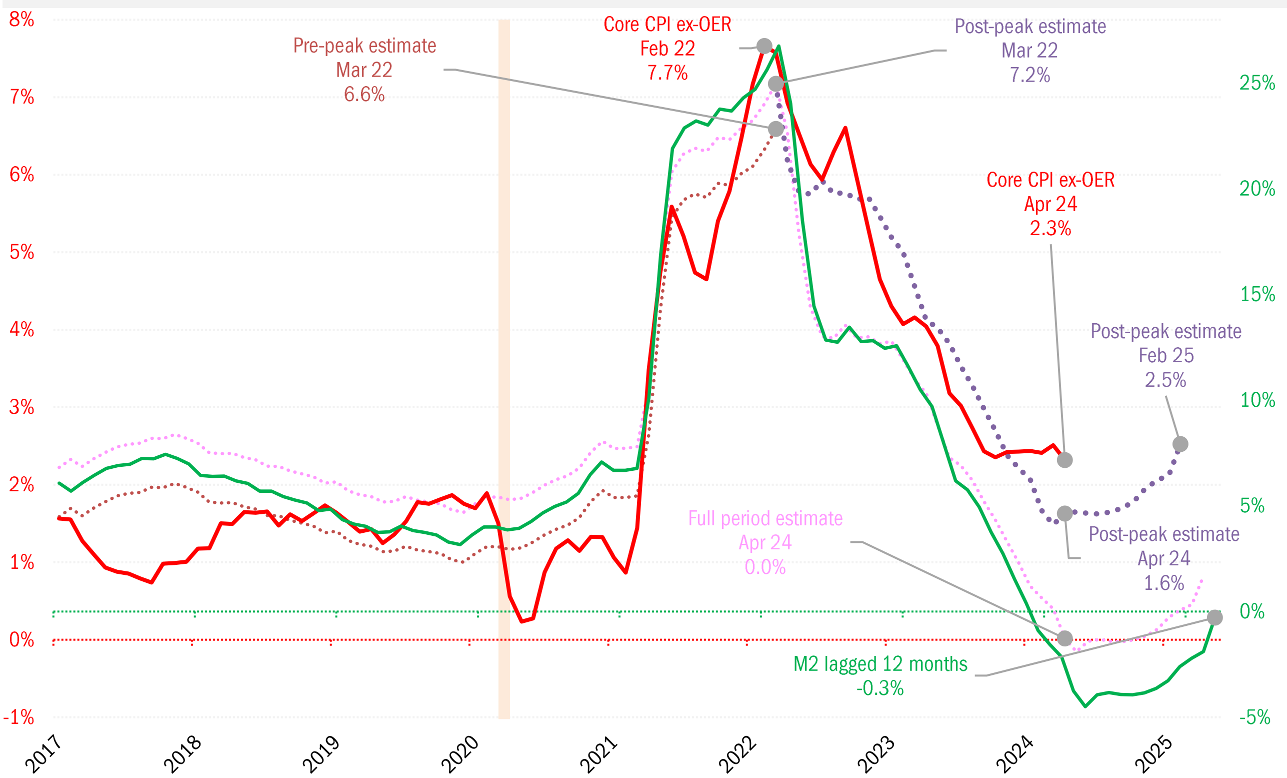
Our monetarist inflation model



Source: BLS, FRB, TrendMacro calculations *months*. It is converging with the output of our revised monetarist model, which estimates 1.6% (please see the chart on the previous page).

- This is very encouraging to us, having had to recalibrate our monetarist model for a disinflation that has proceeded more slowly than we had expected (see "Video: What you're not hearing about the shrinking money supply and the prospect of deflation" April 24, 2024).
- Models aside, the April internals should ease fears that inflation is staging a come-back, despite the three disappointing prior months which have gotten clients asking us frequently whether we think the Fed will have to raise rates.
- *The entire April inflation is due to just four irreducible categories among about 175 in the CPI census* (an "irreducible category" is one that has no sub-categories, thus there is no double-counting).
- *Owner's equivalent rent of primary residences, at 4.16% in April at an annual rate, contributed 0.11% to the 0.30% overall monthly headline CPI reading. Yes, the single hottest item happens to also be the most heavily weighted, at 25.3%.*
- Gasoline, transportation services, and motor vehicle insurance were the next three hottest. Taken together, the hottest four, which cumulatively represent 38.1% of the index weighting, explain all the April inflation, with 1.2 bp left over. *That means all the other categories, taken together, representing 61.9% of the index weighting, were on average in slight deflation in April.*
- *That cumulative deflation is very broad-based*. The four coolest categories – which include three of the bad-boys that did so much damage on the way up: used cars, new vehicles and eggs – only took 0.72% off April headline CPI, and represent only 6.2% of the index weight.
- For your information, we now report the five hottest and five coolest irreducible categories ranked by weighted contribution, along with their index weights, each month (see "Data Insights: CPI/PPI" May 15, 2024).
- Confirming all this, all but three of the 18 unconventional CPI metrics we look at are decelerating – that is, with April at an annual rate below the trailing three-month annual rate (see "Data Insights: Unconventional CPI" May 15, 2024).

Q1-2024 was something of a scare for resurgent inflation. It was never more than a pause in the disinflation process that has been going on for two years now. And with the money supply still in slight contraction, there was never a risk of a repeat of the 1976 false victory (see "Video: What you're not hearing about that horrible March CPI report" April 10, 2024). We – and futures markets that have built in another half rate cut today – take this morning's April CPI report as welcome confirmation of that.

Bottom line

Headline and core CPI both reported above the Fed's target in April at an annual rate. But headline beat consensus, and core met consensus. This

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… yesterday's hot PPI report, and propelled stocks to new all-time highs (ending the correction we predicted in late March). Core ex-OER printed at a new cycle low on a year-over-year basis, converging with our revised monetarist model, at or below the Fed's target now for eight months straight. Just four items out of about 175, representing about 38% of index weight, explain more than all April's inflation. That means April would have been downright deflation without them. Most unconventional inflation metrics confirm an April deceleration. After an interruption in the first quarter of a disinflation that began more than two years ago, with the money supply still in slight contraction, there was never going to be a 1970s-style resurgence of inflation. Futures markets have built in another half rate cut.

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