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22 July 2014

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US CPI softer-than-expected in June, but structural drivers of inflation remain in place

The CPI rose by 0.3% in May (0.257% unrounded), softer than our forecast (0.4%) and in line with the consensus (0.3%). The NSA index printed 238.343, below our forecast of 238.6, consistent with a y/y rise of 2.1%. The core CPI climbed by only 0.1% (0.129% unrounded), below our forecast and consensus (both 0.2%), leaving the core up 1.9% y/y. Last month's strong reading in core inflation came, in part, from airlines and lodging away from home, which rose sharply and boosted the overall report. We expected this would prove transitory and reverse in June, which was the case. Airline fares rose only 0.4% in June and lodging away from home fell 1.9%, offsetting last month's 2.0% increase. The miss in core relative to our expectation came in medical care services, which was flat on the month after having risen 0.3% for three consecutive months. Our view is that medical care services inflation will rebound this year and reverse the disinflation in this category following the implementation of sequester last year. The remainder of core inflation came in line with our expectation; rents (0.3% m/m, 3.2% y/y) and OER (0.2% m/m, 2.6% y/y) continue to drive core services inflation, and core goods prices rose 0.1% on the month. Through March of this year core goods had been a drag on headline inflation and our outlook is for this drag to wane through the remainder of the year.

Headline inflation was dragged lower by food, which rose only 0.1% on the month, while energy rose 1.6%. We had expected fuel and gas to boost headline inflation, which was indeed the case, but a softer-than-expected reading in food offset this strength and left the headline rate of inflation below our expectation. Food is now up 2.4% y/y, while energy is up 3.1%.

Overall, we see this report as softer than we expected, but we see the structural drivers of a gradual reflating in the US economy as remaining in place. Our outlook is for shelter and medical services inflation, plus a more neutral contribution from core goods, to push the CPI higher by year-end and we read the June CPI report as consistent with this view. That said, the underlying trends were a bit softer than we had expected, and we look to the July and August data to see if this softness reverses.