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MARKET SIGHTLINES

March Inflation Reports: Mixed to Positive Results

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Recent banking sector problems have had us focused on how those troubles might affect Federal Reserve (Fed) policy and earnings. However, given the continued relatively strong job market, the Fed's dual mandate has it still focused on inflation, waiting and watching for signs of sufficiently cooler inflation. And fed funds futures show that investors are unclear if the Fed will pause its rate hike policy or continue, an important determinant of the direction of the economy.

In this week's Sight|Lines, we review the March consumer price index (CPI) and producer price index (PPI) reports, along with a couple of other important releases, and we discuss the implications for Fed policy and the prospect of a deep recession.

THE TAKEAWAY: CPI AND PPI WERE MIXED, BUT INFLATION IS COOLING. SMALL BUSINESS CONFIDENCE DIMS FURTHER, WHILE THE LABOR MARKET LOOSENS.

While the labor market is showing signs of loosening, the March inflation reports generally moved in the right direction, with three of four key measures well below expectations and helping inflation get to the Fed's 2% target. In summary:

- Headline CPI eased in March, with the monthly rate coming in at 0.1%, below expectations. Declines in food at home, energy, and used cars and trucks offset increases elsewhere.
- Monthly core CPI, which excludes food and energy, also remained firm at a 0.4%, in line with expectations. Transportation services and shelter prices rose materially.
- Headline PPI also remained firm in March, with the monthly rate coming in at -0.5%, well below expectations. There were price declines in energy and transportation and warehousing.
- Monthly core PPI, which excludes food and energy, also remained firm at -0.2%, below expectations.
- Also released this week, the National Federation of Independent Business (NFIB) Small Business Optimism Index showed business confidence dimming further, with firms focused on inflation and deteriorating conditions and sales prospects.
- Employment remains tight but has started to loosen, with wage pressures easing some.

The Fed has adopted a tight monetary policy to soften demand by loosening the labor market. March reports show we are moving in the right direction.

IN-DEPTH: SMALL BUSINESS CONFIDENCE DIMS FURTHER ON WORRIES OF DETERIORATING CONDITIONS AND SALES PROSPECTS, AND THE LABOR MARKET IS LOOSENING. THESE RESULTS CONTRIBUTE TO THE COOLING OF COMPONENTS OF CPI AND PPI, AS REFLECTED IN THE MARCH INFLATION REPORTS.

The labor market has been tight, so the Fed has implemented its monetary policy to loosen the labor market, soften demand, and lower inflation. The March inflation reports show more improvement, with three of four key measures well below expectations. We're making more progress towards the Fed's 2% target. Going deeper:

- Diving deeper into the March CPI report:
  - The monthly headline CPI rate came in at 0.1%, contributing to a three-month average of 0.3%.
  - Food was flat (0%) in March, and energy declined -3.5%.
  - Core CPI, excluding food and energy, was reported to be 0.4% for the month.
  - Shelter remained elevated at 0.6% in March but did ease from the 0.8% February level.
  - Transportation services rose 1.4%.
  - Core services less shelter, a focus for the Fed, rose 0.3%, still elevated but lower than February.
- Diving deeper into the March PPI report:
  - The monthly headline PPI rate came in at -0.5%, contributing to a three-month average of -0.1%.
  - Core PPI, excluding food and energy, was reported to be -0.2% for the month.
  - The energy component fell -6.4% for the month. Transportation and warehousing declined -1.3%.
  - Year-over-year headline PPI was 2.7%, the first of these primary inflation measures to reach a level relatively close to the Fed's 2% target.
- The NFIB Small Business Optimism Index showed business confidence dimming further:
  - Almost 25% of firms still list inflation as their most important problem.
  - Small business confidence fell to 90.1, the 15th consecutive reading below the 49-year average reading of 98.
  - Hiring intentions dropped to a 34-month low, a signal of fewer jobs in coming months.
- Employment remains tight but has started to loosen. Wage pressures are easing but still above pre-pandemic levels.
  - Nonfarm payrolls rose 236,000 in March, below the average of 334,000 over the last six months.
  - The openings/unemployed ratio was 1.7 in March, below a recent high of 2 but still elevated.

CONCLUSION

The Fed has implemented a tighter monetary policy to dampen demand so that inflation cools back to its 2% target. The drivers of lower demand can be seen in muted business confidence as well as signs that a tight labor market is starting to loosen. While we have more to go, March inflation reports are a step in the right direction.

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