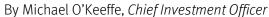
MARKET SIGHT LINES



The Debate on Inflation Continues: April Inflation Is Firm, With Signs of Improvement







Last week we discussed <u>risks all around</u>, like the potential for Federal Reserve (Fed) policy error, more bank failures, the debt ceiling, and the prospect of recession. In each case, market experts are debating a wide range of possible outcomes. We can trace many of our current troubles back to the pandemic and related economic shutdown and reopening. But, along the way, a real culprit has been elevated inflation.

Higher prices have had the attention of the Fed, which quickly reversed course from a historic accommodative policy to a hawkish one, hiking its benchmark funds rate 500 basis points over 14 months to cool inflation. In this Sight|Lines, we review the April 2023 consumer price index (CPI) and producer price index (PPI) inflation reports.

THE TAKEAWAY: CONSUMER PRICES ROSE FIRMLY OVER THE LAST MONTH, WHILE PRODUCER PRICES REMAINED MORE SUBDUED.

Consumer and producer prices rose in April, but inflation is improving some. In summary:

- CPI rose 0.4% in April after a 0.1% increase in March. For the full year ended April, the index rose 4.9%.
- The main contributors to the April increase were shelter, used cars and trucks, and gasoline. The food index, which had been elevated, was unchanged both in March and April.
- Core CPI, which excludes food and energy, rose 0.4% over the month and 5.5% over the last year.
- PPI rose 0.2% for the month. Over the last year, PPI rose 2.3%. Overall, PPI has been cooling.
- Core PPI, which also excludes food and energy, was up 0.2% in April and 3.4% over the last year.

The Fed has set its policy to cool inflation and is watching for improvements, as it will be "data dependent" in evaluating future hikes or, eventually, cuts. We are therefore monitoring inflation carefully, and the CPI and PPI reports for April show improvement, but remain above the Fed's preferred target.

IN-DEPTH: PRICES ROSE OVER THE LAST MONTH, AND WHILE CONSUMER PRICES WERE FIRM OVERALL, SOME STICKY INFLATION COMPONENTS HAVE COOLED OR ARE EXPECTED TO COOL

Consumer prices rose firmly in April, and the producer prices increase was more subdued. Going deeper:

- CPI rose 0.4% in April and 4.9% over the last year:
 - For the last three months, the index averaged 0.3%, still elevated compared to 0.17%, the monthly figure related to the Fed's 2% target.



- Core services prices, which exclude housing, rose just 0.11% versus the prior three-month average of 0.42%. This is a move in the right direction, as Fed Chair Jerome Powell pointed to non-housing services inflation being "quite stable" and as one of the reasons "it wouldn't be appropriate for us to cut rates."
- Shelter increased 0.4% over the month and has been sticky, but is expected to decline soon as real-time data, which is showing declines, makes their way into the official index.
- Used cars and trucks rose 4.4%, and gasoline increased 3%.
- The food index, which has been sticky, was unchanged in April, with the food-at-home index actually falling 0.2%. This is a good step toward cooling inflation.
- The annual increase of 4.9% was much improved from the peak of 9.1% in June 2022.
- Core CPI, which excludes food and energy, rose 0.4% over the month and 5.5% over the last year. A less volatile index, core CPI peaked at an annual increase of 6.6% back in September 2022.
- PPI, sometimes considered a leading indicator to CPI, has been more muted than CPI:
 - April PPI rose 0.2% for the month, after a decrease of 0.4% in March.
 - PPI has been cooling, averaging -0.07% and 0.17% over the last three and six months, respectively.
 - Core PPI, which also excludes food and energy, was also up 0.2% in April and averaged 0.1% and
 0.3 % over the last three and six months, respectively.
 - These monthly average PPI numbers compare favorably to 0.17%, which, as previously mentioned, relates to the Fed's 2% target.

The Fed has set its policy to cool inflation and is watching for improvements, as it will be "data dependent" in evaluating future hikes or, eventually, cuts. We are therefore monitoring inflation carefully, and the CPI and PPI reports for April show improvement. Traders of fed funds futures are almost certain (97.4% probability) that the Fed will not hike rates at the June meeting and may begin cutting rates as soon as July (45.9% probability). This is contrary from commentary from Chair Powell that "If the (Fed's) forecast is broadly right, it would not be appropriate to cut rates."

CONCLUSION

The <u>risks we've been discussing</u>, like the potential for Fed policy error, can be linked back to inflation that has remained well above the Fed's 2% target for some time.

Higher prices have had the attention of the Fed, which quickly reversed course from a historic accommodative policy to a hawkish one, hiking its benchmark funds rate 500 basis points over 14 months to cool inflation. The latest inflation data points to a Fed pause on rate hikes, for the time being, as the Fed will be "data dependent" in evaluating future hikes or, eventually, cuts.

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