THOUGHTS OF THE WEEK
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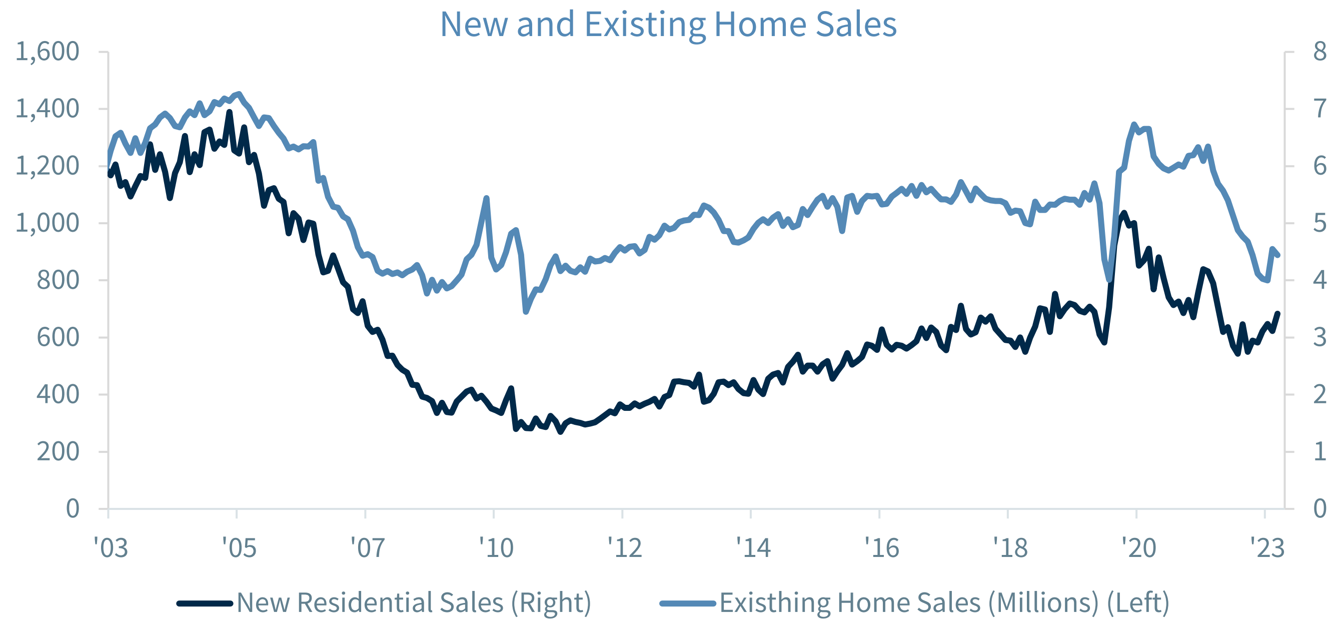
WEEKLY ECONOMICS

Inflation Continued its Disinflationary Path in April…

This week's inflation numbers were mostly positive and benign for the US economy as well as for the Federal Reserve (Fed) and confirms our view that, at least for now, the Fed is done increasing interest rates for this monetary tightening cycle. However, the data also confirmed our concern that while better and on a disinflationary path, the speed of this disinflationary process continues to be less than stellar. This means that any pivot in interest rates by the Fed is going to remain highly uncertain compared to what markets are expecting. Furthermore, as we have argued for some time, the market's misreading of the Fed's intentions regarding interest rates could result in the Fed having to continue to increase interest rates in the future.

Recall that the Fed determines only one interest rate in the markets, the federal funds rate, while the rest of the rates are determined by market forces. That is, if market forces believe the Fed is going to reduce the federal funds rate in the near future because market participants think the US economy is heading toward a recession, then this may prevent the Fed to continue to bring down inflation going forward. That is, if interest rates, other than the federal funds rate, move lower because markets think a recession will be enough to make the Fed relax monetary policy, then the Fed's monetary policy campaign is going to be put at risk.

We saw some of this happening during the first quarter of the year when the yield on the 10-year Treasury declined and thus pushed mortgage interest rates lower, which improved the state of the US housing market during the first quarter of the year as existing home sales, as well as new homes sales, increased during the period (see graph below). Fortunately for the Fed, home prices have continued to decline on a year-over-year basis during the first quarter of the year, but if interest rates on mortgages continue to decline or remain as low as they were during the first quarter of the year, quantity demanded of housing may increase enough to start pushing home prices higher again, which will threaten the efforts by the Fed to lower shelter costs and keep them contained until inflation stabilizes close to the 2% target over the longer term.



Source: FactSet

...But the Road Ahead is Still Long, According to Our Inflation Heatmaps

We have used these heatmaps in the past to show how different potential inflation scenarios could play out assuming that we have ‘constant’ monthly increases/decreases in prices over time. This is a very simple way of approaching the issue of inflation, but it helps get an idea of what could be the path forward. Of course, it is a very simple look at different potential paths of inflation if we assume constant monthly increases/decreases in prices, which is not what is going to happen. However, it is clear that, by looking at them, the path that will take us to a 2% rate of inflation is a path of inflation that goes from 0% to about 0.15% per month over the next year.

Needless to say, a path that includes a slight deflation—in our tables, this is the -0.1% column—is the fastest path to achieve the 2% inflation rate target for the Fed. However, a deflationary environment may require the Fed to provoke a deeper recession than what we have forecast for the US economy growing below potential during the next two years. However, it is conceivable that there are going to be some deflationary months going forward. This means that we can include some deflationary months in our range of monthly inflation rates, which means that the path to a 2% inflation target rate is probably going to include monthly inflation in the range of -0.1% to 0.2%. That is, anything above that range for monthly inflation is probably not going to take us to the promise land during the next year and we will have to wait longer to get there.

Below and on the next page, we include four heatmaps with both CPI, headline and core, as well as the PCE price index, headline and core for reference.

Year-Over-Year CPI Percentage Change	Month-Over-Month CPI Percentage Change							
	-0.1%	0.0%	0.1%	0.2%	0.3%	0.4%	0.5%	0.6%
Apr-23	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%	4.9%
May-23	3.9%	4.0%	4.1%	4.2%	4.3%	4.4%	4.5%	4.6%
Jun-23	2.6%	2.8%	3.0%	3.2%	3.4%	3.6%	3.8%	4.0%
Jul-23	2.5%	2.8%	3.1%	3.4%	3.7%	4.0%	4.4%	4.7%
Aug-23	2.2%	2.6%	3.0%	3.4%	3.8%	4.2%	4.6%	5.0%
Sep-23	1.6%	2.1%	2.6%	3.2%	3.7%	4.2%	4.7%	5.2%
Oct-23	1.0%	1.7%	2.3%	2.9%	3.5%	4.1%	4.7%	5.4%
Nov-23	0.7%	1.4%	2.2%	2.9%	3.6%	4.3%	5.0%	5.8%
Dec-23	0.5%	1.3%	2.1%	2.9%	3.8%	4.6%	5.4%	6.2%
Jan-24	-0.1%	0.8%	1.7%	2.6%	3.5%	4.5%	5.4%	6.3%
Feb-24	-0.6%	0.4%	1.4%	2.4%	3.5%	4.5%	5.6%	6.6%
Mar-24	-0.7%	0.4%	1.5%	2.6%	3.7%	4.9%	6.0%	7.2%
Apr-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%
May-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%

Source: FactSet, RJ Economics

Year-Over-Year CPI Percentage Change	Month-Over-Month Core CPI Percentage Change							
	-0.1%	0.0%	0.1%	0.2%	0.3%	0.4%	0.5%	0.6%
Apr-23	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
May-23	4.7%	4.8%	4.9%	5.1%	5.2%	5.3%	5.4%	5.5%
Jun-23	4.0%	4.2%	4.4%	4.6%	4.9%	5.1%	5.3%	5.5%
Jul-23	3.6%	3.9%	4.2%	4.5%	4.8%	5.1%	5.5%	5.8%
Aug-23	2.9%	3.3%	3.7%	4.1%	4.5%	5.0%	5.4%	5.8%
Sep-23	2.2%	2.7%	3.2%	3.8%	4.3%	4.8%	5.3%	5.8%
Oct-23	1.8%	2.4%	3.0%	3.6%	4.2%	4.9%	5.5%	6.1%
Nov-23	1.4%	2.1%	2.8%	3.5%	4.2%	4.9%	5.7%	6.4%
Dec-23	0.9%	1.7%	2.5%	3.3%	4.1%	4.9%	5.8%	6.6%
Jan-24	0.3%	1.2%	2.2%	3.1%	4.0%	4.9%	5.9%	6.8%
Feb-24	-0.2%	0.8%	1.8%	2.8%	3.8%	4.9%	5.9%	7.0%
Mar-24	-0.7%	0.4%	1.5%	2.6%	3.8%	4.9%	6.0%	7.2%
Apr-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%
May-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%

Year-Over-Year CPI Percentage Change	Month-Over-Month PCE Percentage Change							
	-0.1%	0.0%	0.1%	0.2%	0.3%	0.4%	0.5%	0.6%
Mar-23	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%	4.2%
Apr-23	3.8%	3.9%	4.0%	4.1%	4.2%	4.3%	4.4%	4.6%
May-23	3.1%	3.3%	3.5%	3.7%	3.9%	4.1%	4.3%	4.5%
Jun-23	2.0%	2.3%	2.6%	2.9%	3.2%	3.6%	3.9%	4.2%
Jul-23	2.0%	2.4%	2.8%	3.2%	3.6%	4.0%	4.5%	4.9%
Aug-23	1.6%	2.1%	2.6%	3.2%	3.7%	4.2%	4.7%	5.2%
Sep-23	1.2%	1.8%	2.4%	3.0%	3.6%	4.2%	4.9%	5.5%
Oct-23	0.7%	1.4%	2.1%	2.8%	3.5%	4.2%	5.0%	5.7%
Nov-23	0.4%	1.2%	2.0%	2.8%	3.6%	4.5%	5.3%	6.1%
Dec-23	0.1%	1.0%	1.9%	2.8%	3.7%	4.7%	5.6%	6.5%
Jan-24	-0.6%	0.4%	1.4%	2.4%	3.4%	4.5%	5.5%	6.5%
Feb-24	-1.0%	0.1%	1.2%	2.3%	3.4%	4.6%	5.7%	6.9%
Mar-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%
Apr-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%

Year-Over-Year CPI Percentage Change	Month-Over-Month Core PCE Percentage Change							
	-0.1%	0.0%	0.1%	0.2%	0.3%	0.4%	0.5%	0.6%
Mar-23	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%	4.6%
Apr-23	4.2%	4.3%	4.4%	4.5%	4.6%	4.7%	4.8%	4.9%
May-23	3.7%	3.9%	4.1%	4.3%	4.5%	4.7%	4.9%	5.1%
Jun-23	2.9%	3.2%	3.5%	3.9%	4.2%	4.5%	4.8%	5.1%
Jul-23	2.7%	3.1%	3.5%	4.0%	4.4%	4.8%	5.2%	5.6%
Aug-23	2.1%	2.6%	3.1%	3.6%	4.1%	4.6%	5.2%	5.7%
Sep-23	1.5%	2.1%	2.7%	3.3%	4.0%	4.6%	5.2%	5.8%
Oct-23	1.1%	1.8%	2.5%	3.2%	3.9%	4.7%	5.4%	6.1%
Nov-23	0.8%	1.6%	2.4%	3.2%	4.0%	4.8%	5.7%	6.5%
Dec-23	0.3%	1.2%	2.1%	3.0%	3.9%	4.9%	5.8%	6.8%
Jan-24	-0.4%	0.6%	1.6%	2.7%	3.7%	4.7%	5.8%	6.8%
Feb-24	-0.8%	0.3%	1.4%	2.5%	3.6%	4.8%	5.9%	7.1%
Mar-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%
Apr-24	-1.2%	0.0%	1.2%	2.4%	3.6%	4.9%	6.1%	7.4%

Source: FactSet, RJ Economics

Economic Releases:

Consumer Price Index: Although the rate of inflation for April was in line with expectations, the year-over-year rate declined slightly. Furthermore, shelter costs, which have a very large weight in the Consumer Price Index, slowed down considerably from previous months, up 0.4%. This was the lowest increase in shelter costs since January of 2022 and could be pointing to further weakness in shelter costs going forward. This is in line with market expectations and could help accelerate the disinflation process going forward, which should be good for the Federal Reserve as well as for markets.The Consumer Price Index (CPI) increased 0.4% during the fourth month of the year on a seasonally adjusted basis after inching up 0.1% in March, according to the US Bureau of Labor Statistics. The year-over-year, non-seasonally adjusted CPI declined to 4.9% in April compared to a rate of 5.0% for the year ended in March. The core CPI, that is, the CPI excluding food and energy prices increased a more than expected 0.4% during the month, and the year-over-year rate declined from 5.6% in March to 5.5% in April. Food prices remained flat for a second consecutive month due to a decline in food at home prices of 0.2% while food away from home increased 0.4%. Energy prices increased 0.6% during the month after declining 3.5% in March. Energy commodities increased 2.7% during the month with gasoline prices increasing 3.0% while fuel oil prices declined 4.5%. Energy services declined 1.7% as electricity prices dropped 0.7% and utility (piped) gas services declined 0.7%. Commodities less food and energy commodities increased 0.6% as used cars and trucks prices increased 4.4% while new vehicles prices dropped 0.2%. Services less energy services increased 0.4% with shelter costs increasing 0.4%, the lowest increase since January 2022, while transportation services prices declined 0.2% and medical care services prices dropped 0.1%. Hourly earnings increased 0.5% in April compared to March while increasing 4.4% compared to the same month a year earlier while the average workweek stayed at 34.4. Monthly inflation for April came in as expected by FactSet consensus expectations while inflation excluding food and energy was stronger than expectations. The year-over-year rate of inflation declined slightly and was better than FactSet expectations.

Producer Price Index: The better-than-expected PPI for final demand should be good news for markets as well as for the Federal Reserve even though we saw some stability in the year earlier measures for the service economy while goods prices continued their disinflationary trajectory. As has been the case in consumer prices, goods prices continue to weaken, but service sector prices have remained more stubborn. The Producer Price Index (PPI) for final demand increased at a less than expected seasonally adjusted rate of 0.2% in April, according to the Bureau of Labor Statistics. Final demand prices fell 0.4% in March and remained unchanged in February. On a year earlier basis, and non-seasonally adjusted, the PPI for final demand increased 2.3% in April. According to the report, 80% of the increase in the PPI for final demand was attributable to a 0.3% increase in prices for final demand services. Meanwhile, the PPI Index for final demand goods increased 0.2%. The PPI for final demand less foods, energy, and trade services increased 0.2% during April compared to a 0.1% increase in March. The year over year PPI for final demand less foods, energy, and trade services was up 3.4% compared to April of last year. Within the PPI final demand goods, foods prices declined 0.5% while energy prices increased 0.8% while the PPI final demand services showed a 0.5% increase in the trade component, a 1.7% decline in the transportation and warehousing component, and a 0.4% increase in the “other” component during the month of April. The PPI report on April showed continued disinflationary pressures building on a year earlier basis, particularly on the goods side of the economy while the service side showed some stability in the year earlier comparison.

Economic Releases:

Jobless Claims: Initial Jobless Claims increased yet again and they are now at the highest level since October 2021. Similarly, the four-week moving average is at the highest level since November of 2021. Normally, this persistent increase in applications for US unemployment insurance would indicate that the labor market might be weakening, but last week's employment report beat expectations, showing once again the resilience of the US labor market, which reached the lowest unemployment rate since May 1969. Initial jobless claims increased by 22,000, to 242,000 during the week ending May 6, 2023, according to the Department of Labor. The four-week moving average increased by 6,000 to 245,250 from the previous unrevised average of 239,250. Meanwhile, the seasonally adjusted insured unemployment rate was 1.2% for the week ending April 29, 2023. This rate was unchanged from the previous week's revised rate. Only two states reported increases in unadjusted initial claims of more than 1,000. These states were Massachusetts (+3,801) and Kentucky (+3,659). On the other hand, the largest decreases were experienced by New York (-9,456), Illinois (-2,693), and Georgia (-1,278).

Export and Import Prices: This was the first increase in fuel import prices since June of 2022. Recall that June of 2022 was the month when US inflation peaked, so the Federal Reserve is going to pay close attention to further increases in import fuel prices in order to see the effects on the US rate of inflation. Import prices increased a more than expected 0.4% (versus FactSet consensus of 0.3%) after declining by 0.8% in March, according to the US Bureau of Labor Statistics. Fuel prices drove the large increase in import prices in April. Furthermore, the export price index increased 0.2% in April after declining 0.6% during March of this year. Year-over-year import prices were down 4.8% in April, unchanged from the year-over-year rate recorded in March of this year. Year-over-year export prices declined by 5.9% in April compared to a decrease of 5.2% for the year ending in March. Fuel import prices surged 4.5% in April compared to a 3.9% decrease in March compared to the previous month. The increase in fuel prices in April was the first monthly increase since June of 2022. Furthermore, import fuel prices were down 25.9% in April of this year compared to April 2022. The price of all imports excluding fuel remained flat in April after declining 0.5% in March, according to the report. The increase in export prices, by 0.2% in April, was due to a 0.4% increase in agricultural export prices as well as a 0.2% increase in all exports excluding agriculture. Import prices surged in April due to the large increase in imported fuel. Export prices also inched up due to a relatively strong increase in agricultural export prices as well as a smaller increase in non-agricultural export prices.

Consumer Sentiment: The preliminary Survey of Consumer Sentiment from the University of Michigan was much worse than expected across the board. Consumer sentiment is now at the lowest level since July 2022 as respondents to the survey expressed concerns about the economy going forward and the debt ceiling standoff. Additionally, year-ahead consumer expectations dropped even more than current sentiment did. However, the most concerning aspect of this report is the next five-year inflation expectations breaching the narrow range they've been contained to and reaching the highest level in over a decade. The increase in long-term inflation expectations and the worsening economic sentiment, combined with the political standoff regarding the debt ceiling dilemma, could mean trouble ahead for the Federal Reserve and ultimately have an impact on their monetary policy decisions. The preliminary Survey of Consumer Sentiment from the University of Michigan decreased much more than expected, from 63.5 in April to 57.7 in May. This is lower than the FactSet estimate for April of 63.0. The Current Economic Conditions Index and the Consumer Expectations Index declined as well, from 68.2 and 60.5 in April to 64.5 and 53.4, respectively. Inflation expectations for next year decreased slightly from 4.6% to 4.5%, but the more important five-year inflation expectations increased to 3.2%, the highest level since March 2011. After surprising to the upside in April, the Survey of Consumer Sentiment from the University of Michigan lost all of the improvement it made since the historic low in July of 2022. Overall, consumer spending is the largest component of Gross Domestic Product, and if sentiment weakens further, it could spell trouble for the US economy as a whole.

Forecast Table:

	Quarterly Historical					Quarterly Forecast							Historical		Forecast	
	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	3Q24	4Q24	2021	2022	2023	2024
GDP (annual rate)	**-1.6**	**-0.6**	**3.2**	**2.6**	**1.1**	**1.4**	**-1.3**	**4.1**	**2.0**	**2.7**	**2.8**	**2.8**	**5.9**	**2.1**	**1.2**	**1.2**
Year-over-year	3.7	1.8	1.9	0.9	1.6	2.1	0.9	0.1	0.3	0.6	1.6	2.5				
Private Domestic Final Purchases	**2.1**	**0.5**	**0.1**	**0.0**	**2.7**	**0.8**	**-1.7**	**-1.1**	**1.6**	**2.7**	**2.7**	**2.7**	**8.1**	**2.0**	**0.6**	**1.1**
Year-over-year	4.3	1.8	1.3	0.7	0.8	0.9	0.5	0.2	-0.1	0.4	1.5	2.5				
CPI (y/y)	**8.0**	**8.6**	**8.3**	**7.1**	**5.8**	**4.1**	**3.5**	**3.2**	**2.9**	**2.7**	**2.5**	**2.4**	**4.7**	**8.0**	**4.1**	**2.7**
Ex-food & energy	6.3	6.0	6.3	6.0	5.6	5.2	4.7	4.1	3.5	2.9	2.5	2.4	3.6	6.1	4.9	2.9
PCE Price Index (y/y)	**6.5**	**6.7**	**6.4**	**5.8**	**4.9**	**3.8**	**3.6**	**3.4**	**2.9**	**2.8**	**2.5**	**2.3**	**3.9**	**6.3**	**3.9**	**2.7**
Ex-food & energy	5.3	5.0	4.9	4.9	4.7	4.4	4.1	3.7	3.1	2.8	2.5	2.3	3.4	5.0	4.2	2.7
Unemployment Rate	**3.8**	**3.6**	**3.6**	**3.6**	**3.5**	**3.8**	**4.3**	**4.7**	**4.7**	**4.6**	**4.5**	**4.4**	**5.4**	**3.7**	**4.1**	**4.6**
Fed Funds Rate	0.50	1.75	3.25	4.50	5.00	5.25	5.25	5.25	5.25	5.00	4.75	4.50	0.25	4.50	5.25	5.00

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Economic and market conditions are subject to change.

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Consumer Price Index is a measure of inflation compiled by the US Bureau of Labor Statistics. Currencies investing is generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Consumer Sentiment is a consumer confidence index published monthly by the University of Michigan. The index is normalized to have a value of 100 in the first quarter of 1966. Each month at least 500 telephone interviews are conducted of a contiguous United States sample.

Personal Consumption Expenditures Price Index (PCE): The PCE is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The change in the PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

The Consumer Confidence Index (CCI) is a survey, administered by The Conference Board, that measures how optimistic or pessimistic consumers are regarding their expected financial situation. A value above 100 signals a boost in the consumers' confidence towards the future economic situation, as a consequence of which they are less prone to save, and more inclined to consume. The opposite applies to values under 100.

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GDP Price Index: A measure of inflation in the prices of goods and services produced in the United States. The gross domestic product price index includes the prices of U.S. goods and services exported to other countries. The prices that Americans pay for imports aren't part of this index.

The Conference Board Leading Economic Index: Intended to forecast future economic activity, it is calculated from the values of ten key variables.

The Conference Board Coincident Economic Index: An index published by the Conference Board that provides a broad-based measurement of current economic conditions.

The Conference Board lagging Economic Index: an index published monthly by the Conference Board, used to confirm and assess the direction of the economy's movements over recent months.

The U.S. Dollar Index is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" when compared to other currencies.

The FHFA House Price Index (FHFA HPI®) is a comprehensive collection of public, freely available house price indexes that measure changes in single-family home values based on data from all 50 states and over 400 American cities that extend back to the mid-1970s.

DISCLOSURES

Import Price Index: The import price index measure price changes in goods or services purchased from abroad by U.S. residents (imports) and sold to foreign buyers (exports). The indexes are updated once a month by the Bureau of Labor Statistics (BLS) International Price Program (IPP).

ISM New Orders Index: ISM New Order Index shows the number of new orders from customers of manufacturing firms reported by survey respondents compared to the previous month. ISM Employment Index: The ISM Manufacturing Employment Index is a component of the Manufacturing Purchasing Managers Index and reflects employment changes from industrial companies.

ISM Inventories Index: The ISM manufacturing index is a composite index that gives equal weighting to new orders, production, employment, supplier deliveries, and inventories.

ISM Production Index: The ISM manufacturing index or PMI measures the change in production levels across the U.S. economy from month to month.

ISM Services PMI Index: The Institute of Supply Management (ISM) Non-Manufacturing Purchasing Managers' Index (PMI) (also known as the ISM Services PMI) report on Business, a composite index is calculated as an indicator of the overall economic condition for the non-manufacturing sector.

Consumer Price Index (CPI) A consumer price index is a price index, the price of a weighted average market basket of consumer goods and services purchased by households. Changes in measured CPI track changes in prices over time.

Producer Price Index: A producer price index (PPI) is a price index that measures the average changes in prices received by domestic producers for their output.

Industrial production: Industrial production is a measure of output of the industrial sector of the economy. The industrial sector includes manufacturing, mining, and utilities. Although these sectors contribute only a small portion of gross domestic product, they are highly sensitive to interest rates and consumer demand.

The NAHB/Wells Fargo Housing Opportunity Index (HOI) for a given area is defined as the share of homes sold in that area that would have been affordable to a family earning the local median income, based on standard mortgage underwriting criteria.

The S&P CoreLogic Case-Shiller U.S. National Home Price NSA Index measures the change in the value of the U.S. residential housing market by tracking the purchase prices of single-family homes.

The S&P CoreLogic Case-Shiller 20-City Composite Home Price NSA Index seeks to measures the value of residential real estate in 20 major U.S. metropolitan.

Source: FactSet, data as of 5/12/2023

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