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Disinflation in the COVID-19 Era

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The idea that prices of most goods and services will fall in 2020 has been widely accepted, so investors mostly don't care about the details. Still, the inflation numbers have changed dramatically since the year began and are worth mentioning. On Wednesday, both the consumer price index (CPI) and core CPI for the month of May fell by -0.1%. It was the first time in 60+ years of series history that core consumer prices had declined over three consecutive months. The majority of price categories declined, led by vehicle insurance (-8.9%), airfare (-4.9%), car and truck rental (-3.5%), gasoline (-3.5%) and clothing (-2.3%). Food prices were the big category exception, climbing +0.7% during the month. Much of the increase in food prices resulted from supply shortages stemming from the closure of COVID-19 infected meat packing plants. Overall meat prices were up +5.9%, but beef/veal jumped +10.8%, the biggest increase in 73 years.

New vehicle prices climbed +0.3%, the first increase since February, but used car and truck prices fell -0.4% for the second straight month. Other notable consumer price increases were in sewing machines and fabric (+2.0%), alcoholic beverages (+0.8%), sporting goods (+0.6%), and cable & satellite TV and radio (+0.5%). On an annual basis, overall CPI slipped from -0.3% to -0.1%, while the year-over-year core CPI pace decreased from +1.4% to +1.2%.

Yesterday, the headline producer price index (PPI) for May unexpectedly rose +0.4%, due primarily to a +4.5% rise in energy and a +6.0% increase in food prices. Core PPI, which excludes food and energy prices, fell -0.1% in May after slipping -0.3% in the previous month. On an annual basis, overall producer prices are down -0.8%, a marginal improvement from April's -1.2% reading, which was the lowest since October 2015. The year-over-year core PPI pace slipped from +0.6% to +0.3%.

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The Fed's annual inflation target is thought to be around +2.0%, although Fed officials have indicated a tolerance for allowing the target to drift higher in the future. Right now, inflation is a back-burner issue. Normally, the Fed might cut rates to boost economic growth thereby driving prices up. Obviously, this isn't an option. The inflation equation is simple; *prices rise when more dollars chase fewer goods*. This doesn't happen when much of the economy is operating at limited capacity and tens of million are unemployed. Earlier this week, Fed officials released their core PCE inflation forecasts indicating a gradual expected rise through 2022, but falling well short of their +2.0% target. As long as inflation remains historically low, the Fed will be in no hurry to raise rates. Of the Fed's two stated mandates, inflation has become largely irrelevant, while employment is…*everything*.

Yesterday, initial unemployment claims declined for the tenth consecutive week; that's the good news; the bad news is that another 1.5 million Americans filed for unemployment benefits the first week in June. Continuing claims also fell last week, but the total number receiving benefits in early June is still around 21 million. Fed Chairman Powell is clearly concerned about lingering joblessness. His belief that the unemployment rate will end the year at 9.3% seemed to be one of the underlying reasons for yesterday's stock market dive. Whether or not most of the lost jobs reappear this year will depend largely on whether the virus disappears. Amid reports of recent COVID-19 outbreaks in Arizona, Texas, Florida and Oregon, this hope has diminished.

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Please see disclosure on page 2.

Market Indications as of 2:45 P.M. Central Time

DOW	UP 348 to 25,477 (HIGH: 29,551)
NASDAQ	UP 51 to 9,544 (HIGH: 10,020)
S&P 500	UP 15 to 3,017 (HIGH: 3,386)
1-Yr T-bill	current yield 0.17%; opening yield 0.18%
2-Yr T-note	current yield 0.19%; opening yield 0.20%
5-Yr T-note	current yield 0.33%; opening yield 0.32%
10-Yr T-note	current yield 0.70%; opening yield 0.67%
30-Yr T-bond	current yield 1.46%; opening yield 1.40%

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