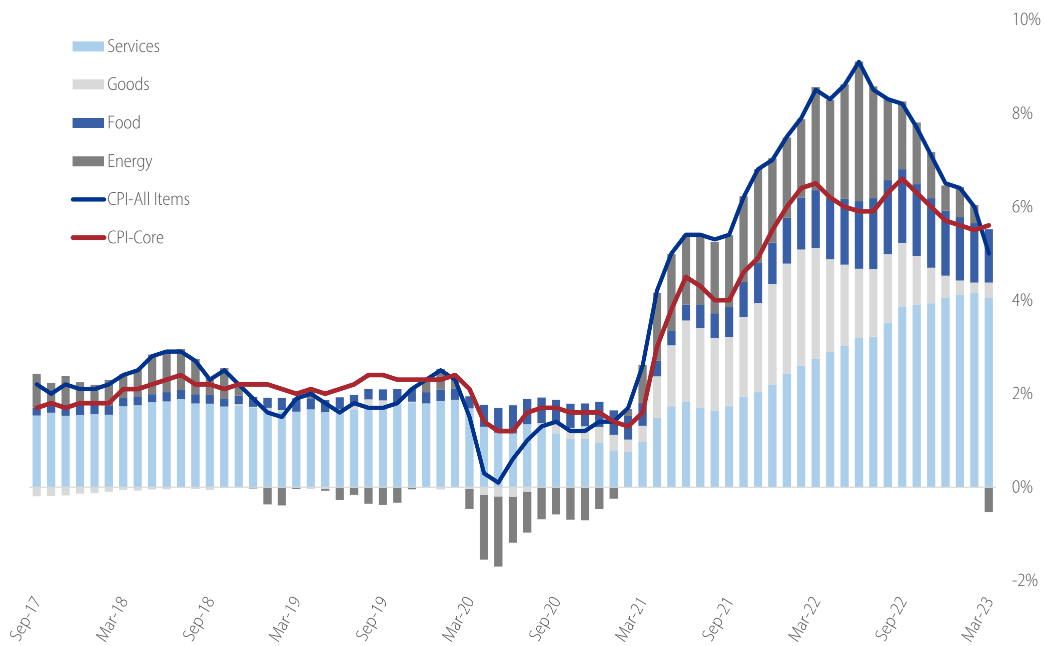
Markets Cheer Cooler CPI, but Elevated Underlying Prices Still Point to May Hike

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

The overall consumer price index (CPI) rose by just +0.1% in March, bettering the +0.2% median forecast after a +0.4% increase the previous month. On a year-over-year basis the optics were impressive, as headline consumer inflation dropped from +6.0% to +5.0%. *The financial markets celebrated in early trading, but the news wasn't all good.*

Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

The financial markets celebrated in early trading, but the news wasn't all good.

Core CPI rose +0.4% in March, matching forecasts, while the annual pace crept *higher* from +5.5% to +5.6%. Bloomberg noted it was the first time in over two years that the year-over-year core exceeded the headline.

Shelter costs rose +0.6% in March, the smallest increase since November, but still the biggest contributor to overall inflation last month. Housing costs are notoriously sticky, but the trend is decidedly lower. It'll take a while.

Shelter costs rose +0.6% in March, the smallest increase since November, but still the biggest contributor to overall inflation last month.

Overall food prices were *unchanged* in March, although food at home (grocery prices) were actually down -0.3%. Food costs are still +8.5% higher than a year ago, but the monthly decline in grocery prices is a relief . . .and makes a great headline.

Energy prices fell -3.5% last month with gas prices tumbling -4.6%. Another relief for consumers. However, with the price of crude oil roughly 25% higher since mid-March, it's likely that the energy component will weigh *to the upside* in the next report.

Used vehicle prices continued to sink from extremely elevated levels, down -0.9% for the month and -11.2% year-over-year. At one point in 2022, used vehicle prices were up over +40% on an annual basis. As new car production increases, there's still plenty of room for used car prices to fall.

With the price of crude oil roughly 25% higher since mid-March, it's likely that the energy component will weigh to the upside in the next report.

Airfare was up +4.0% in March and +17.7% year-over-year. As the summer approaches, higher fuel costs, strained capacity, and rising personnel costs should keep pressure on air travel.

Daycare and preschool costs jumped +6.8% in March, the biggest increase ever. This simply reflects a shortage of workers, and it's hard to imagine a quick fix.

The March CPI report isn't quite as upbeat as the markets are signaling for a number of reasons:

- Energy prices, which fell significantly in March, are expected to reverse direction in April.
- Core CPI, actually climbed on an annual basis in March and remains higher than it was at the end of 2021.
- Powell's newest focus point, so-called Supercore inflation (service prices, ex food, energy and housing) is still increasing at a +5.8% pace.

If price pressures continue to cool, it's reasonable to expect a pause at the June meeting, but the idea of a rate cut before yearend is a stretch.

The somewhat cooler CPI report isn't likely to alter the path of policymakers at the May 3rd FOMC meeting. Given the stubbornness of core inflation, and the Fed's determination to reach its +2.0% long-term inflation goal, it's too early to declare victory. At least one more quarter point hike is still the most likely outcome. If price pressures continue to cool, it's reasonable to expect a pause at the June meeting, but the idea of a rate *cut* before yearend is a stretch.

Market Indications as of 9:32 A.M. Central Time

DOW	Up 145 to 33,829 (HIGH: 36,800)
NASDAQ	Up 39 to 12,071 (HIGH: 16,057)
S&P 500	Up 22 to 4,130 (HIGH: 4,797)
1-Yr T-bill	current yield 4.68%; opening yield 4.63%
2-Yr T-note	current yield 4.00%; opening yield 4.02%
3-Yr T-note	current yield 3.73%; opening yield 3.76%
5-Yr T-note	current yield 3.50%; opening yield 3.53%
10-Yr T-note	current yield 3.42%; opening yield 3.42%
30-Yr T-bond	current yield 3.65%; opening yield 3.62%