

Markets Rally on May's Mild CPI Release

For the second consecutive month, CPI came in lower than the previous month and lower than market expectations. Overall CPI was unchanged for the month, beating the +0.1% expectation and falling from +0.3% last month. CPI ex-food and energy, a widely watched metric that strips out the most volatile elements in order to sharpen the focus on trend inflation, was +0.2% - down from +0.3% last month and better than the market's +0.3% expectation.

Gasoline prices led the way for this month's positive inflation report, falling by -3.6%. Some of the price increases most visible, and vexing, to consumers moderated this month. Food was up only +0.1%, led by a -0.5% decrease in dairy products. Apparel prices fell -0.3% in May. Vehicle prices presented a mixed bag, with new vehicles falling -0.5% while used vehicles rose +0.6%. On the flip side of the coin, some price pressures remain naggingly persistent, such as shelter costs, which were +0.4% in May.

On an annual basis, overall CPI edged slightly lower to +3.3% from +3.4% last month, while core CPI fell from +3.6% to +3.4%. Food-away-from-home continues to feel pricing pressures, rising +0.4% this month and now up 4.0% year over year. Motor vehicle insurance is still up a whopping +20.3%, despite slipping slightly in May by -0.3%. Services-less-energy-services rose again in May and are now up +5.3% on an annual basis.

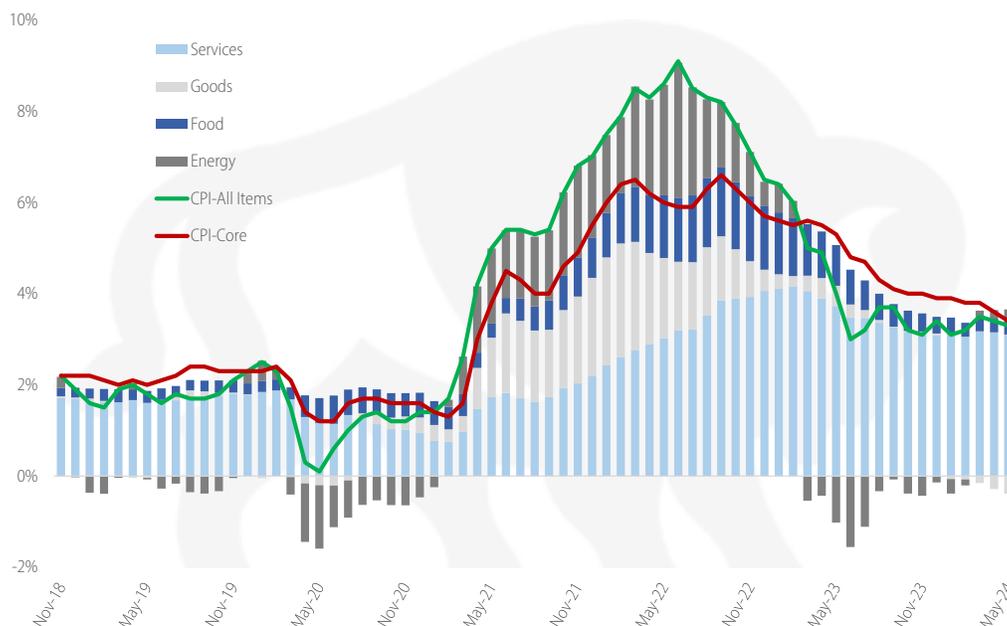
Despite areas of pressure, this was a positive report for inflation, and this change in trajectory is welcome news for the markets. While year over year CPI shows little improvement this year, core CPI's trend is more evident.

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



Source: Bureau of Labor Statistics

The fourth quarter of 2023 saw inflation releases each month of +0.1% or +0.2%. The Fed and markets cheered those figures, which are consistent with the Fed's desired target for inflation. But the first four months of 2024 saw inflation reaccelerate into the +0.3 to +0.4 range – a result that is well above the Fed's target range. May's release, while only a single month, is a welcome reversal and the first unchanged print in CPI since July 2022.

Bond and equity markets have rallied on the news, with equities up about 1% in early trading and bond yields down by 12-15 bps. In addition to the strong daily market activity, the market has projected this more benign inflation report into its expectations of Fed activity. Market forecasts, expressed through the fed funds futures market, have increased the expectation for the Fed to cut rates. Last night, the probability of a September cut was 58%; this morning, that has moved to 84%. The market has adjusted its year-end expectations in a similar manner, moving from an expectation of 1.5 rate cuts (of 25 bps each) to 2 full cuts. The central question in all of this is whether today's inflation report is the beginning of a welcome downward trend in inflation or more of a blip that may see another reversal.

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Market Indications as of 8:45 A.M. Central Time

DOW	Up 331 to 39,078 (HIGH: 40,004)
NASDAQ	Up 265 to 17,608 (NEW HIGH)
S&P 500	Up 46 to 5,421 (NEW HIGH)
1-Yr T-bill	current yield 5.16%; opening yield 5.13%
2-Yr T-note	current yield 4.68%; opening yield 4.84%
3-Yr T-note	current yield 4.44%; opening yield 4.60%
5-Yr T-note	current yield 4.26%; opening yield 4.42%
10-Yr T-note	current yield 4.28%; opening yield 4.41%
30-Yr T-bond	current yield 4.46%; opening yield 4.54%

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Sources: Bloomberg and HilltopSecurities research.

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