Inflation Takes a Breather: June CPI Surprises to the Downside

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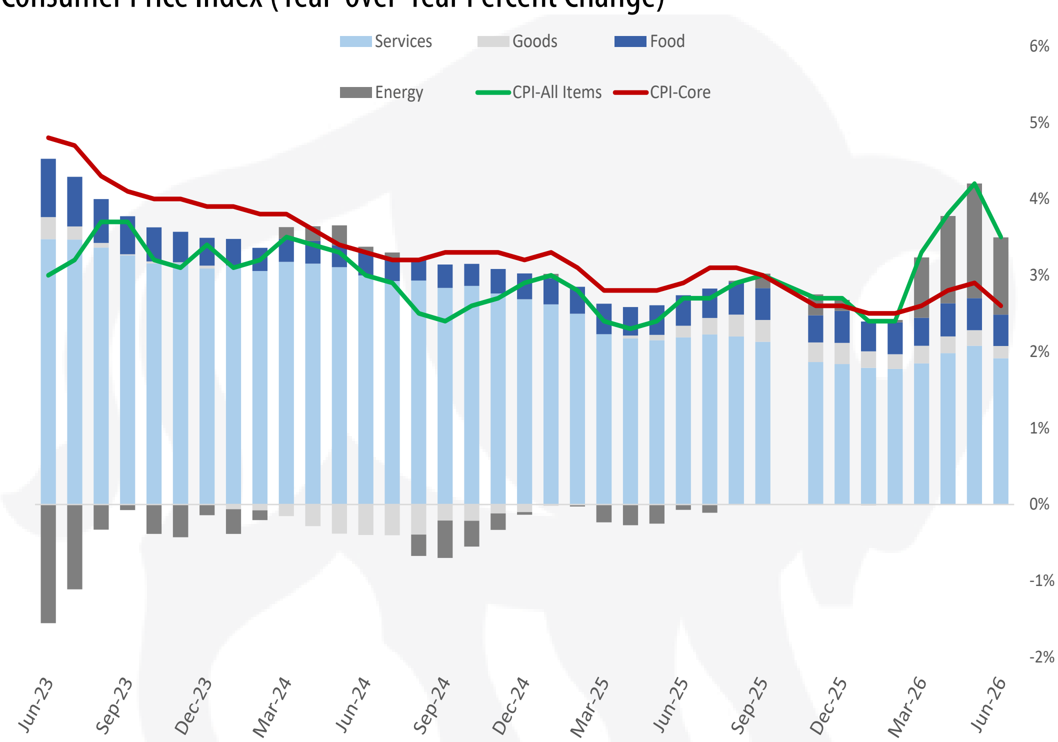
Consumer prices surprised to the downside in June as falling energy costs pushed headline CPI down 0.4%, double the expected 0.2% decline. The largest monthly drop since April 2020 lowered the year-over-year inflation rate from a four-year high of 4.2% to 3.5%. Core CPI was unchanged during the month, versus expectations for a 0.2% increase, pulling the annual core inflation rate down from 2.9% to 2.6%.

The primary driver of overall CPI during the month was a 5.7% decline in energy, the largest since August 2022, after increases of 3.9% in May, 3.8% in April, and 10.9% in March. The decrease in the energy index was propelled by a 9.7% decline in gasoline prices, and more than offset the modest increases in shelter and food during the month. The benefit of lower energy costs for consumers was real, but fragile, as any positive impact may not persist if energy prices climb in subsequent months.

The magnitude of the decline in overall CPI may dominate the headlines, but core inflation was a more important surprise. The flat month-over-month change in core CPI suggests that moderation extended beyond energy in June and moves core inflation in a direction more consistent with the Fed's desired path. The improvement was supported by declines in commodities, used cars and trucks, and apparel.

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



Source: Bureau of Labor Statistics

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At the same time, services inflation broadly was flat, and shelter rose only 0.1% during the month, both of which have been among the stickiest CPI categories over the last several years. The combination of flat services inflation and slowing shelter inflation reduces the immediacy of re-acceleration concerns following the May CPI release, but it does not settle the trend.

Despite these welcome improvements, Fed officials are unlikely to treat one soft CPI report as confirmation that inflation risk has been resolved. The June release gives policymakers more room to wait for additional evidence before tightening, but it is unlikely to justify a pivot toward cuts on its own. The report improves the near-term policy outlook, and the market reaction appears consistent with that interpretation as near-term tightening risk declined following the release.

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For investors, the key implication is to consider a wider range of rate outcomes. Short-duration strategies retain value while policy uncertainty and reinvestment opportunities remain elevated, but the long end of the curve still requires caution, as conditions may continue to pressure yields even as near-term inflation data improves.