

June 10, 2021

US Core Inflation Surprises Higher Again!

- Core CPI increased by more than expected
- The market reaction was dirtied by simultaneous ECB headlines...
- ...as Treasuries cheapened, before returning to focus on liquidity..
- ...while the dollar retained post-release appreciation
- 70% of the y/y rise in CPI and core CPI is not due to base effects
- There was high breadth to the acceleration...
- ...but autos and housing played the largest roles
- The Fed needs to sound less certain about transitory factors...
- ...and consider both transitory upside and downside pressures

US headline CPI, y/y % change // m/m % change SA, May :

Actual: 5.0 / 0.6 Scotia: 4.5 / 0.4 Consensus: 4.7 / 0.5 Prior: 4.2 / 0.8

US core CPI ex-food and energy, y/y % change // m/m % change SA, May: Actual: 3.8 / 0.7 Scotia: 3.3 / 0.2 Consensus: 3.5 / 0.5 Prior: 3.0 / 0.9

Base effects? Oh please. Transitory? We'll see, but it's not obvious that price pressures will prove to be fully fleeting. For now, we have yet another upside surprise to core CPI inflation to evaluate and markets didn't take it so well. See the tables above for the prints as both headline and core inflation came in higher than expected.

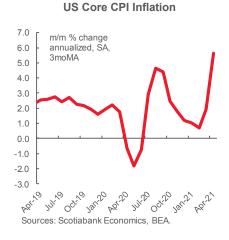
Markets

The US 10 year Treasury yield's reaction was a bit dirtied by the fact that the ECB press conference was unfolding around a similar time frame to markets taking down the inflation figures, but the cheapening tendency before the data that drove the 10 year yield up by about 3bps this morning got an added instant boost with about another 3bps rise immediately following the release. That has since all been reined in likely due to a return to the liquidity pressures that have been driving yields lower over recent weeks (see the morning Daily Points). The USD appreciated a touch post-release and has remained firmer since then.

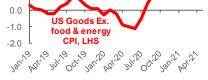
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Chart 1

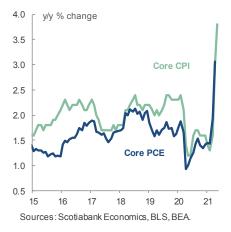






Sources: Scotiabank Economics, US BLS.

Chart 3 US Core PCE & CPI





June 10, 2021

The Fed Connection

Before turning to the individual drivers, it's worth considering a few points on how this may affect Fed-thinking. In short, the Fed's base effect argument is getting overwhelmed by data. Had we only been dealing with shifting base effects over the past couple of months, then year-over-year headline CPI would have risen from 2.6% in March before factoring in the m/m acceleration in prices through April and May to 3.3% y/y now. Instead we're at 5% y/y.

As for core, if we were only dealing with shifting base effects over the past couple of months, then core CPI would have risen from 1.6% y/y in March to 2.2% now and instead we're at 3.8%. Base effects are indeed playing a role, but only about 30% of the acceleration in headline and core year-over-year inflation rates since March can be explained by base effects with the other 70% of the rise explained by month-over-month changes.

It remains uncertain how durable these gains may prove to be. That in itself is a point against strident insistence that this is all transitory. It's too difficult to wean out potentially (but not certainly) transitory supply chain issues from reopening effects from stimulus effects. I still don't think we hold at numbers like these, but there is a good case for more persistence than the Fed is letting on. To be frank, the Fed's conviction to date sounds more like a macro hedge fund talking its position rather than a central bank focused upon risks.

The Numbers

The broad takeaway to what follows is that there is high breadth to US inflationary pressures when the numbers are decomposed. This observation is buttressed by the following points.

Chart 1 (front page) takes the month-over-month seasonally adjusted change in core CPI and annualizes that change to show price pressures free of year-over-year base effects. It applies a smoothed 3 month moving average to the volatile data. Without smoothing, annualized month-over-month core inflation was 8.3% in May after 5.6% in April.

Chart 2 (front page) shows that core goods price inflation is running off the charts and at a pace that cannot be explained by weakness a year ago. Goods price inflation is running at 6.5% y/y now after hitting a low of -1.1% last June. The chart also shows that services price inflation is accelerating and this area is likely to have greater upside as pandemic effects on less socially distanced services gradually ease. If some transitory factors that may be boosting goods price inflation at least partially abate this effect may coincide with an acceleration in services inflation.

Chart 3 (front page) shows the acceleration in core CPI as a guide to where core PCE is likely to go on June 25th. Core PCE is likely to land around 3 ½% y/y.

Chart 4 (next page) shows the weighted contributions to the year-over-year change in CPI by category. Vehicles—used and new — and related insurance premiums along with housing are the hottest drivers. Chart 5 does the same thing for the month-overmonth weighted contributions to changes in CPI with a similar conclusion.

Charts 6–12 (page 4) show patterns across some individual contributions. One takeaway is that the earlier acceleration in food prices (at home, 7.7% weight) and medical care (~8% total weight) have fully subsided now. Prescription drug price inflation remains weak. Airfare, cellphone services, apparel and appliances are under upward inflationary pressure. Financial services price inflation has firmed compared to earlier weakness.

A point to these last slides is that when we talk of transitory drivers that may come off from present rates, we should also speak to what may be transitory weakness in other areas like the base effects operating against food price inflation that is unlikely to go away, or medical care price inflation that is unlikely to go away etc. Transitory doesn't just mean looking at the presently hot prices and dismissing them.



May Weighted Contributions to

the 12-Month Change in US Headline CPI

GLOBAL ECONOMICS

June 10, 2021

Chart 4

Chart 5

May Weighted Contributions to Monthly Change in US Headline CPI

		F
Used Cars and Trucks	Used Cars & Trucks	-
Rent of Shelter	Owner's Equivalent Rent	-
Motor Vehicle Insurance	- New Cars & Trucks	-
Public Transportation	- Airline Fare	-
New Vehicles	- Women's Apparel Car & Truck Rental	-
Professional Services	Rent of Primary Residence	-
Telephone Services	Tools & Outdoor Equipment	-
Furniture and Bedding	Utility Gas Service	-
Hospital and Related Services	- Vehicle Insurance	
	Beef	
Sporting Goods	Footwear	-
Women's and Girls' Apparel	- Sporting Goods	
Footwear	Electricity	
Tobacco and Smoking Products	Fish & Seafood	
Video and Audio Services	- Hospital Services	Ī
Domestic Services	- Lodging Away from Home	Ī
Personal Care Services	Jewelry & Watches	Ī
Motor Vehicle Maintenance and Repair	Elementary & High School Tuition	
Men's and Boys' Apparel	Day Care & Preschool	
Tuition & Childcare	Other Intercity Transportation	
Pet Services Including Veterinary	Fuel Oil & Oil Fuels	l l
Water and Sewerage Maintenance	Cable & Satellite TV	
Tools, Hardware, & Supplies	Pet Services	
Jewelry and Watches	Parking Fees	
Other Household Equipment	Dairy Products	_
Appliances	Cereals & Cereal Products	-
Moving, Storage, Freight Expense	Alcoholic Beverages at Home	-
Garbage and Trash Collection	Fresh Vegetables	-
Miscellaneous Personal Services	- Plumbing Maintenance	-
Internet Service Providers	- Miscellaneous Personal Services	-
Motor Vehicle Fees	Computers Appliances	-
Alcoholic Beverages Away from Home	College Tuition	-
Motor Vehicle Parts and Equipment	Pork	-
Other Recreational Goods	Infant & Toddler Apparel	-
Alcoholic Beverages at Home	Educational Books	-
Repair of Household Items	Other Household Equipment	-
Gardening and Lawncare Services	Cigarettes	-
0	Camera Equipment	
Recreational Reading Materials	Eggs	
Housekeeping Supplies	- Postage & Delivery Services	
Infants' and Toddlers' Apparel	- Dental Services	
Postage and Delivery Services	- Other Food at Home	
Video and Audio Products	- Nursing Homes	_
Pets and Pet Products	- Internet Service Providers	_
Educational Books and Supplies	Physicians' Services	<u> </u>
Photographers and Film Processing	Professional School Tuition	<u>}</u>
Photographic Equipment and Supplies	Miscellaneous Personal Goods	
Tenants' and Household Insurance	A/V Products	-
Window and Floor Coverings	Processed Fruits & Vegetables	-
Personal Care Products	Telephone Hardware	}
Miscellaneous Personal Goods	Toys Fresh Fruits	}
Medical Equipment and Supplies	Other Recreation Services	ł
Information Technology Commodities	Other Meats	ł
Leased Cars and Trucks	percentage point Properties Drugs	F
Medicinal Drugs	Contributions to New Aleshelia Deverses	- percentage point
Other Recreation Services	y/y % change in CPI, Non Alcoholic Beverages	- contribution to m/m %
Health Insurance		change in CPI, SA
-0		06 0 0.06 0.12 0.18 0.24
Source: Scotiabank Economics, BLS.		
	Sources: Scotiabank Economics, U	JO DLO

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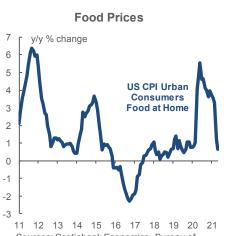


Chart 6

Sources: Scotiabank Economics, Bureau of Labor Statistics, Statistics Canada.

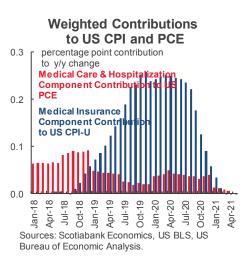


Chart 7



Chart 9

8

6

4

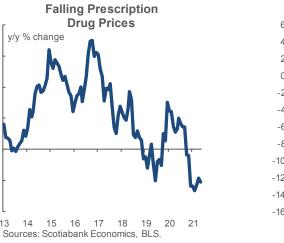
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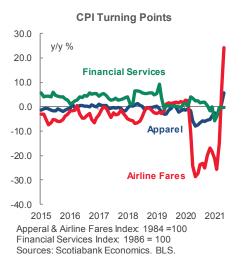
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Chart 10





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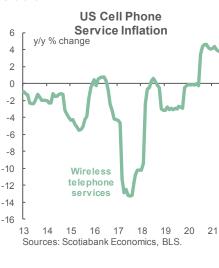


Chart 8





Sources: Scotiabank Economics, Bureau of Labour Statistics.



June 10, 2021

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