



The Daily Dish

Taking Stock of the Inflation Outlook?

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This past week saw two readings on inflation that came in softer than expected. On Wednesday, the May Consumer Price Index (CPI) showed that the CPI was unchanged – zero inflation – and over the past year rose at a 3.3 percent rate. Core inflation came in at a 0.2 percent rate for the month – below the 0.3 percent expected rate – and also at a 3.3 percent year-over-year rate. Similarly, on Thursday the Producer Price Index (PPI) declined by 0.2 percent, driven by a 0.8 percent decline in goods prices, while services prices were unchanged. Over the past year, PPI inflation was 2.2 percent. Core PPI inflation was flat in May, while rising 3.2 percent over the past year.

Despite the soft report, the Fed chose to leave interest rates and quantitative tightening unchanged, while the interest rate projections suggest one rate cut this year, down from three implied rate cuts as recently as March.

It is not surprising that the most recent inflation readings had little impact on the Fed’s stance. The decline in top-line CPI inflation was largely gasoline/energy prices, which could easily reverse. As for the core, the softer inflation was in categories like airline prices, not the shelter inflation that has been the Fed’s nemesis. The PPI came out after the decision, but given the weak correlation in month-to-month changes in the PPI and CPI, it says little about the future near-term outlook.

The main news was the projection of a single rate cut – a reinforcement of the “higher for longer” message from the Fed. Harvard economist Jason Furman has a nice [exposition](#) of the workhorse inflation model in *The Wall Street Journal*. It suggests that it may take some time for inflation to descend from 3.0 percent to 2.0 percent. In a similar vein, the [minutes](#) of the Federal Open Market Committee from the April 30-May 1 meeting indicate that the Fed staff outlook includes:

Total and core PCE price inflation were both projected to move lower this year relative to last year, though the expected pace of disinflation was slower than in the March projection, as incoming data pointed to more persistence in inflation in coming months. Inflation was expected to decline further beyond this year as demand and supply in product and labor markets continued to move into better balance; by 2026, total and core PCE price inflation were expected to be close to 2 percent.

The upshot is that the Fed has laid the groundwork to not pre-emptively cut rates until after the election. This insulates the Fed from accusations of playing politics with interest rate policy. Notice, however, that pre-emptive rate cuts are part of the soft-landing playbook. The Fed could also move as a reaction to economic events, suggesting a material weakness in the economy. Nobody would confuse such a cut with playing politics. Put differently, *why* the Fed cuts next is just as important as when it cuts next.