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## **Inflation Persisted Above the Fed's Target in March, Pushing Back Financial Markets' Pricing of a First Rate Cut to July or September**

- **CPI ran hot again in March, fueled by another big increase in gasoline prices.**
- **The core CPI basket ran hot, too, with an unchanged year-over-year increase.**
- **Shelter inflation is cooling but Supercore Services CPI has picked up recently and is running well above its pre-pandemic level.**
- **After the CPI report, financial markets price in the Fed holding interest rates steady until a first cut in July or September.**

The CPI rose 0.4% in March, above the consensus forecast of 0.3% and following 0.4% in February. From a year earlier, the CPI picked up to a 3.5% increase from 3.2% in February and rose by the most since September. Energy prices rose a big 1.1% in March on a 1.7% seasonally-adjusted increase in gasoline prices (Up an even larger 6.4% before adjusting for the month's typical seasonal jump). From a year earlier, energy prices rose 2.1% in March. Food prices edged up 0.1%, with food at home unchanged on the month and food away from home up 0.3%. Food at home was up 1.2% on the year in March, while food away from home rose 4.2%.

The core CPI excluding food and energy rose 0.4% in March, also above the 0.3% consensus and repeating January and February's 0.4% increases. From a year earlier, core CPI was unchanged at 3.8%. Year-ago core inflation was actually 0.04% faster in March than February before rounding. Within the core index, core goods excluding food and energy fell 0.2% on the month and 0.7% on the year. New vehicles edged down 0.2% in March, while used cars and trucks fell 1.1%. Shelter costs rose 0.4% in March and slowed by a tenth of a percentage point in year-over-year terms to 5.7%, their slowest increase since July 2022. Shelter accounts for about a third of the CPI and about two fifths of the core basket. Rent of primary residence and owners' equivalent rent of primary residences both rose 0.4%, while lodging away from home edged up 0.1%.

Core services excluding energy services and housing rose a hot 0.7% in March and were up 4.8% from a year earlier, the largest year-ago increase in twelve months. Motor vehicle insurance jumped 2.6% on the month and 22.2% on the year. Motor vehicle maintenance and repair jumped 1.7% on the month and 8.2% on the year. Hospital and related services rose 1.2% on the month after falling 0.3% in February and were up 7.7% on the year. This included a 5.9% jump in costs for in-home care services for disabled and elderly persons, which surged 14.2% on the year. Airfares fell 0.4% on the month after jumping 3.6% in February; airfares fell 7.1% on the year in March.

Inflation slowed dramatically from mid-2022's peak to the end of 2023 as the shock from Russia's invasion of Ukraine fell out of the year-over-year comparison, and as pandemic-related supply chain problems abated. But since the turn of the year, most measures of inflation have either increased or moved sideways. Gas prices are higher as war smolders in the Mideast, Ukraine attacks Russian refineries, and U.S. oil production levels off near a record high.

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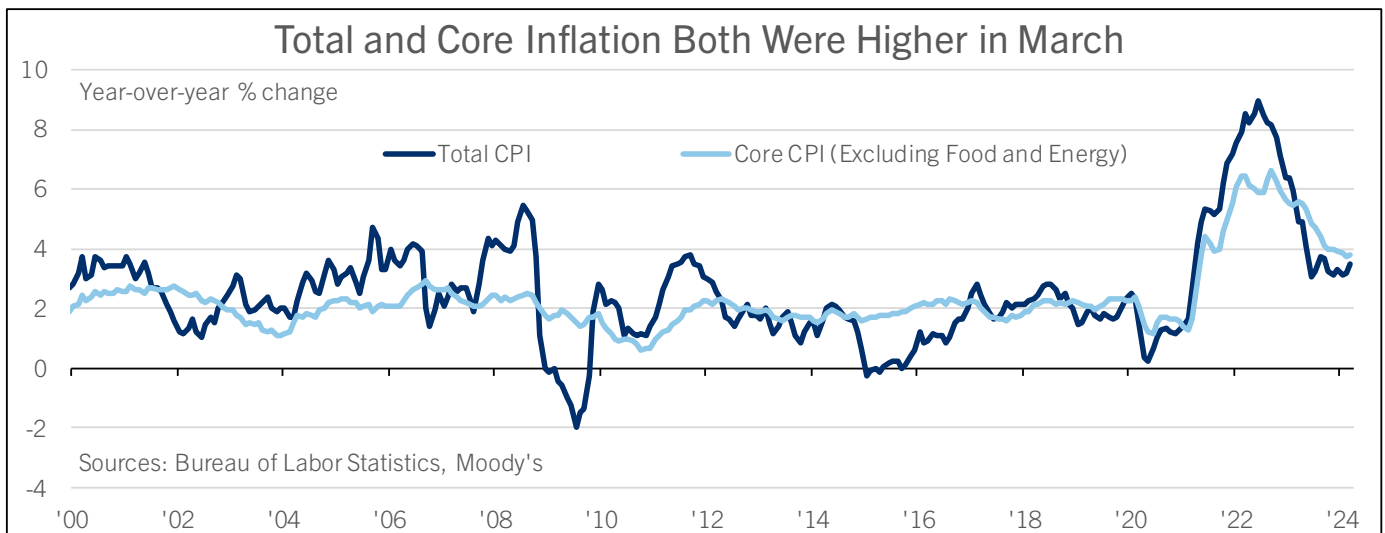
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Particularly concerning for the Fed, inflation of service prices excluding energy and housing has persisted well above the pre-pandemic rate, and if anything picked up a bit since the turn of the year. Service providers who tend to change prices less frequently, like insurers and hospitals, have made big price increases in recent months to pass on higher operating costs. Inflation of labor-intensive services, like in-home eldercare and food services, is running well above the Fed's 2% target, pointing to ongoing shortages of the workers who perform these tiring, physically-demanding jobs. These factors are contributing to the stickiness of inflation in the first half of 2024.

When talking about inflation, the way it is measured makes a big difference. The CPI report shows inflation running over 3%, but inflation is closer to the Fed's 2% target by the Fed's preferred measure, the personal consumption expenditures price index. Where the CPI aims to measure the cost of consumers' direct expenditures, the PCE price basket also includes prices paid on behalf of consumers by third parties, including private insurers, Medicare and Medicaid. That difference has caused the PCE index to run considerably slower than the CPI recently. PCE inflation was 0.3% in February and 2.5% from a year earlier, and core PCE inflation was 0.3% on the month and 2.8% from a year earlier. In recent decades, inflation as measured by the CPI has averaged about a quarter percent higher per year than inflation as measured by the PCE index, but the gap is considerably larger in 2024. Even so, the trend in both indexes is similar. The March CPI report suggests the next PCE report will also show little progress toward tamer inflation.

In short, progress toward the Fed's inflation target took a step back in the first quarter after two steps forward in the second half of 2023. Following the CPI report's release, the two-year Treasury note yield jumped to the highest since November as financial markets price in fewer federal funds rate cuts. As of midday April 10, markets price in only half of a percentage point of rate cuts by December, less than the three quarters of a percent in cumulative cuts projected by the median member of the FOMC in their last published Summary of Economic Projections, a.k.a. Dot Plot. Financial markets have likewise pushed back the pricing of the most likely timing of the Fed's first cut to July or September from June previously.



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