Capital Markets Strategy
Essential insights for the C-Suite

MUFG

# Policy Note

**Headline Numbers:** US headline inflation slowed to 8.3% in April, down from a 40 year high of 8.5% in March, though persistently high and above consensus expectations of 8.1%. Core CPI decelerated to 6.2% in April from 6.5% in March, which was the highest level since August 1982.

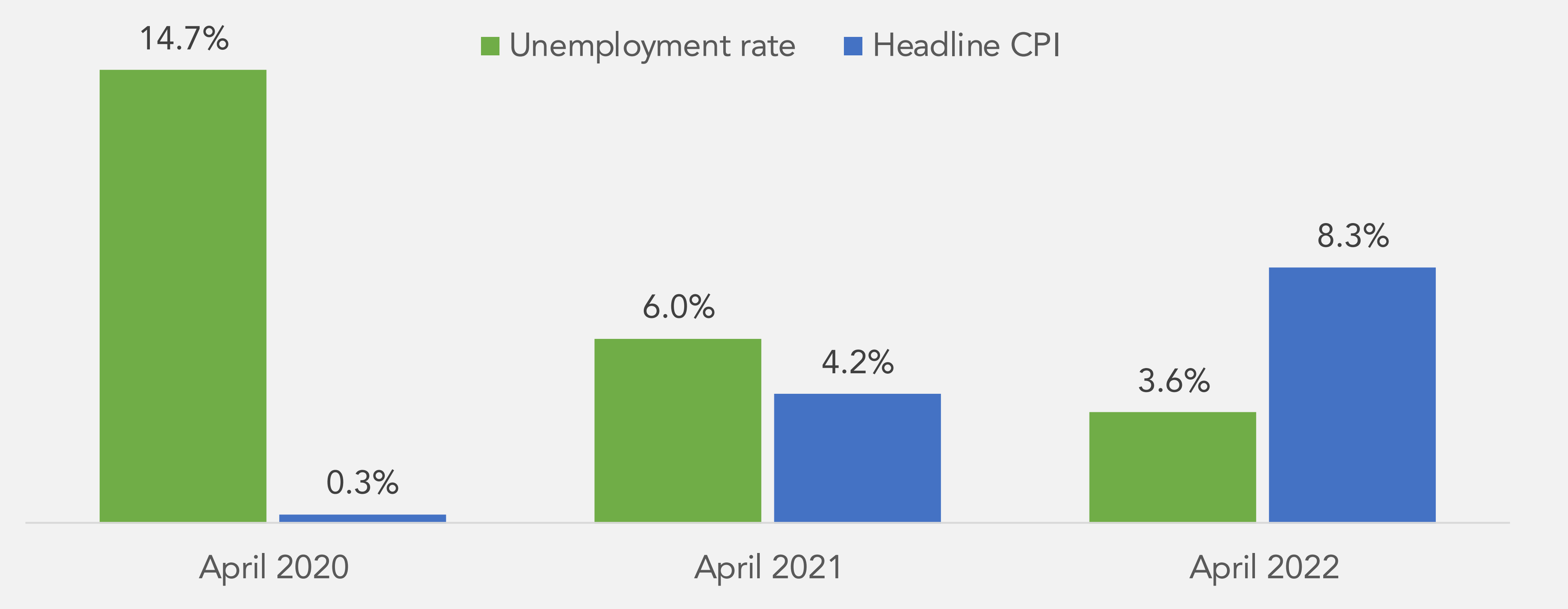
**Looking "Under the Hood":** After decades of disinflation, the US economy is pivoting from "COVID" inflation to "Conflict" inflation, a transition that has implications for the durability and strength of impact on US GDP growth. For much of the last two years, "COVID" inflation was centered largely around increased demand for "durable goods", which by definition, was more "discretionary", more "transitory," and therefore "less" detrimental to growth. Following Russia-Ukraine and China's Omicron lockdowns, COVID inflation has now combined with "conflict inflation", which by comparison is more driven by services and commodities, and unfortunately, likely to be more "enduring" and "more" detrimental to US growth.

Looking more closely at the composition of inflation in April, price pressures have clearly shifted in recent months from goods to commodities and services. Notably, the modest moderation in April's inflation numbers benefitted from a 6.1% m/m retreat in gasoline prices, following an 18.3% surge in March. Oil and natural gas, by comparison, were up around 3%.

Food prices are up over 9% y/y on Russia-Ukraine, with grains up nearly 11%. Shelter, the largest component of CPI (41%), rose for the third straight month, with owner equivalent rents up 4.8% y/y, the highest level since Feb 1991. Rental rates and hotel prices also increased.

Among goods, used and new vehicle prices stand out sharply with increases of 23% and 13% y/y, respectively, as semiconductor shortages exert enormous downward pressure on inventory levels and upward pressure on prices. Among services, airline fares rose 33%, the highest since Dec 1980, on higher seasonal demand and rising fuel costs.

As the economy has recovered closer to full employment during the two year COVID crisis, successive demand and supply shocks (COVID, Ukraine, China lock-down) have driven inflation sharply higher

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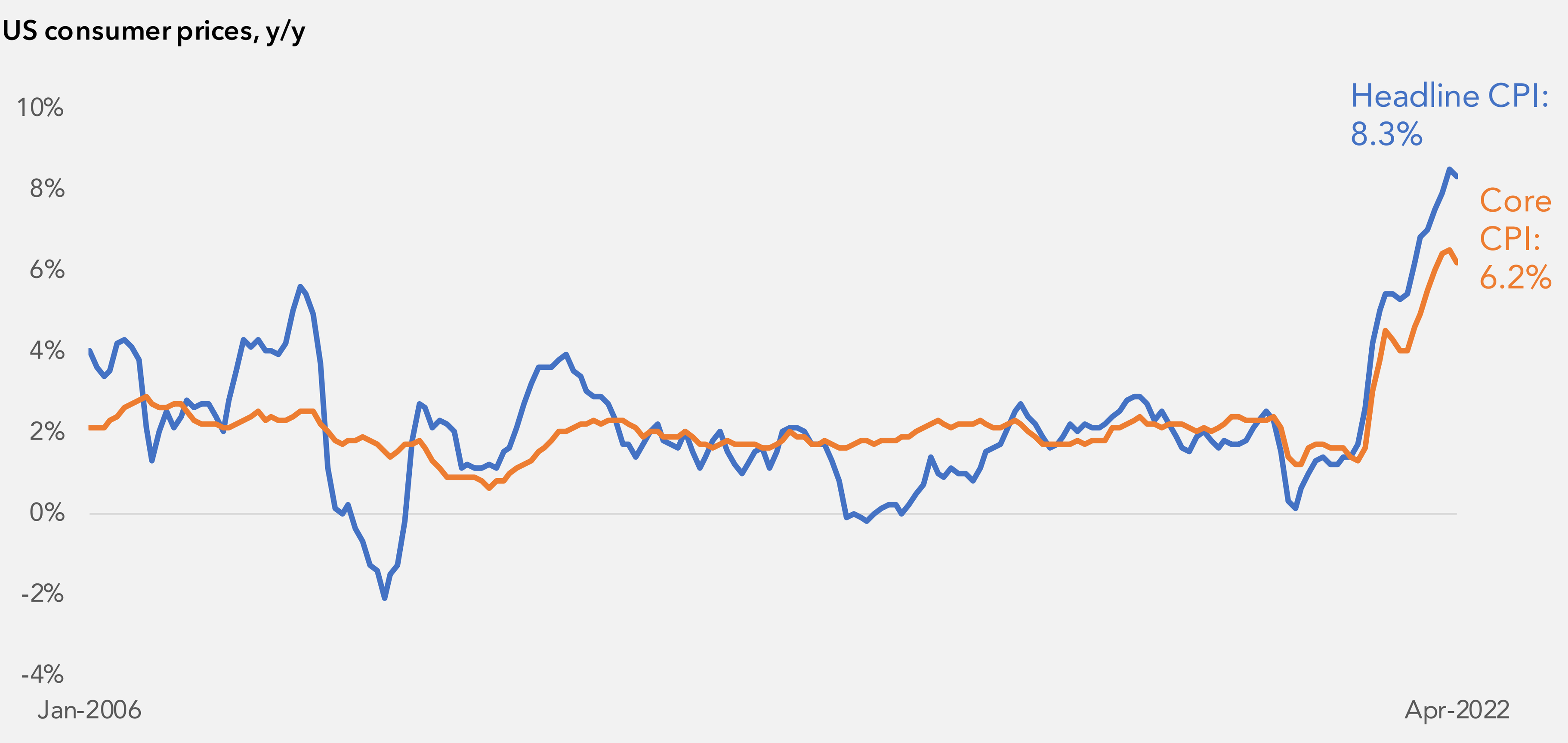


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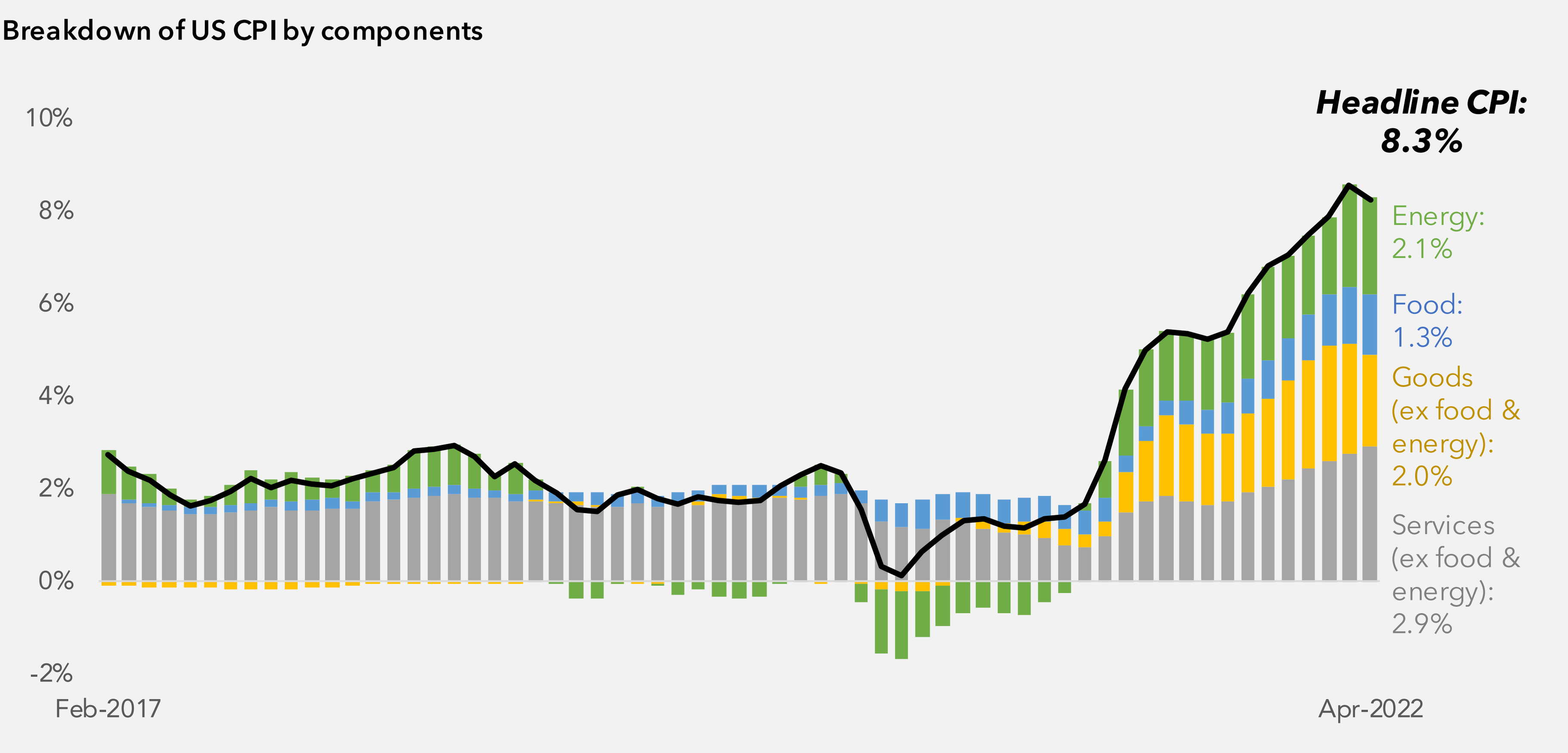
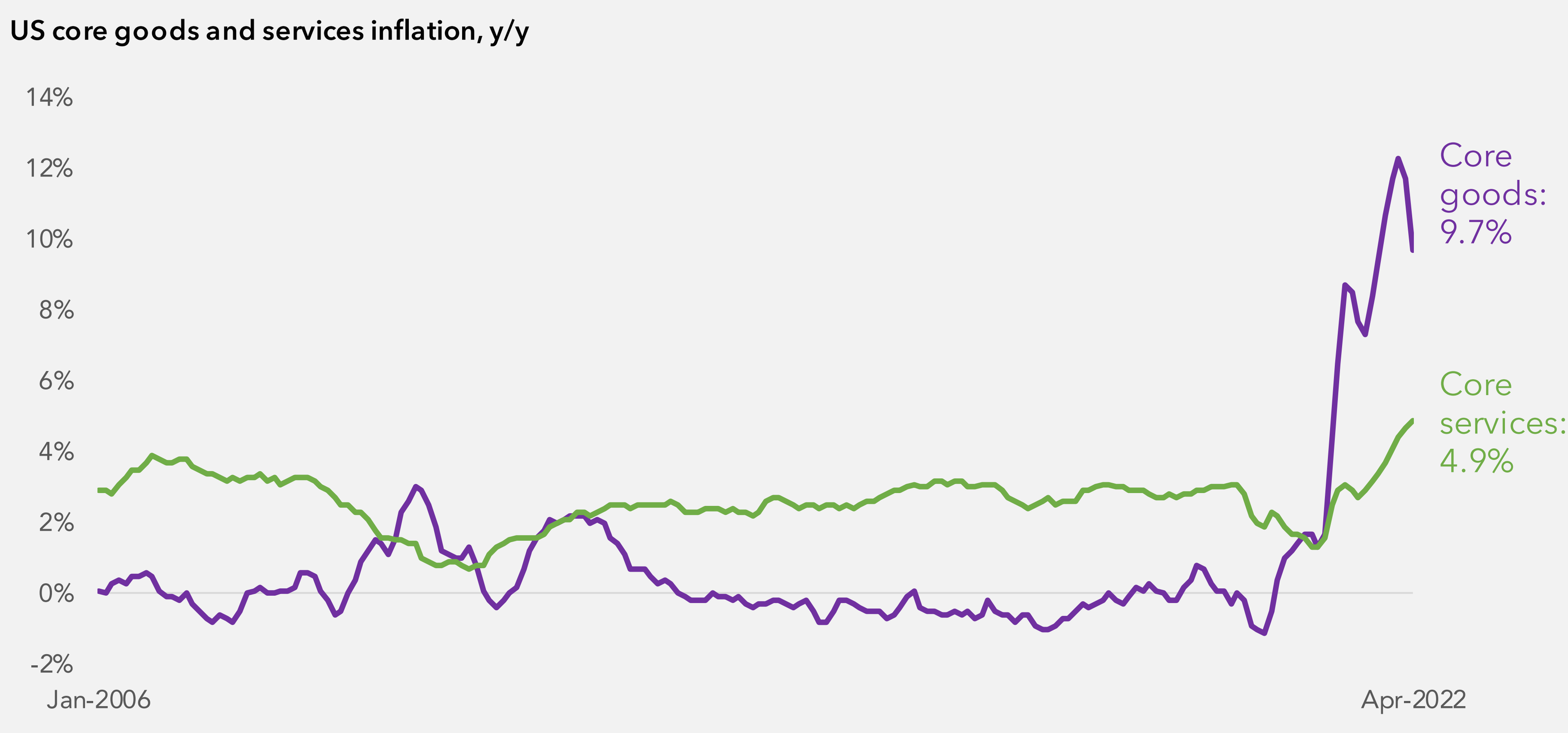
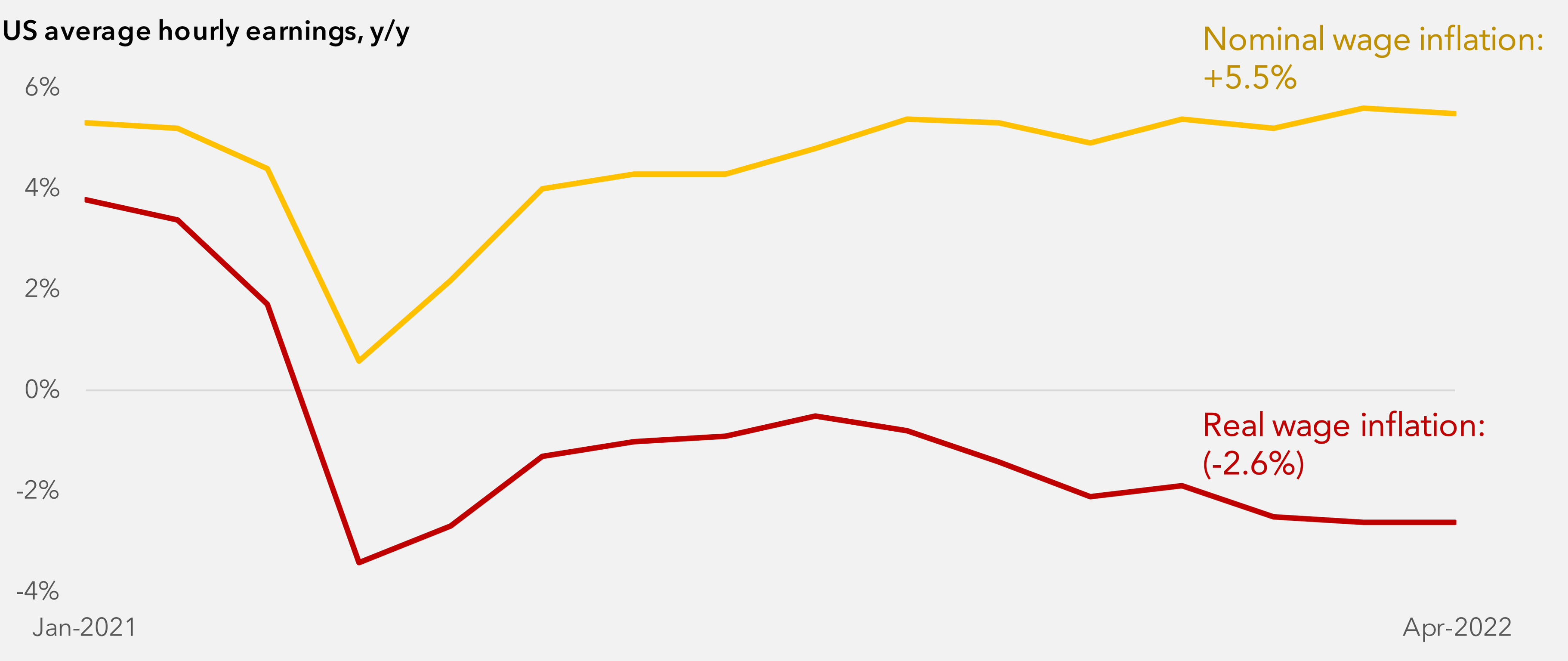



As the price of durable goods moderated within a high range in April, the cost of services accelerated rapidly as consumers emerged from a third COVID winter, with high vaccination rates and strong pent-up demand for travel, leisure and "experiences."




As wages continue to rise at the fastest pace in two decades, they are having the two-fold adverse effect of dragging corporate earnings lower, while not keeping pace with inflation




Inflation pressures, which centered around durable goods during the early phase of COVID, have since shifted to services and commodity prices, which by definition, are likely to be more "enduring" and "detrimental" to growth.

**US inflation by sector (y/y)**

Energy | Food | Core goods | Core services

| | |
|---|---|
| Energy commodities | 45% |
| Motor fuel | 44% |
| Airline fares | 33% |
| Energy | 30% |
| Used cars and trucks | 23% |
| Utility gas service | 23% |
| Eggs | 23% |
| Public transportation | 22% |
| Lodging away from home | 20% |
| Tires | 16% |
| Furniture & bedding | 15% |
| Milk | 15% |
| Motor vehicle parts and equipment | 15% |
| Meats | 14% |
| Delivery services | 14% |
| Energy services | 14% |
| New vehicles | 13% |
| New trucks | 13% |
| Vehicle accessories | 13% |
| Outdoor equip. & supplies | 12% |
| Electricity | 11% |
| Food at home | 11% |
| Household furnishings & supplies | 11% |
| Car & truck rental | 10% |
| Tools, hardware & supplies | 10% |
| Health insurance | 10% |
| Laundry & cleaning services | 10% |
| Cereals & bakery products | 10% |

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|---|---|
| Veterinarian services | 10% |
| Nonalcoholic beverages | 10% |
| Transportation services | 9% |
| Housekeeping supplies | 8% |
| Fruits and vegetables | 8% |
| Appliances | 8% |
| Sporting goods | 8% |
| Domestic services | 7% |
| Tobacco & smoking products | 7% |
| Food away from home | 7% |
| Pets & pet products | 7% |
| Moving, storage, freight expense | 7% |
| Financial services | 7% |
| Music instruments & acces. | 7% |
| Legal services | 7% |
| Land-line phone services | 6% |
| Apparel | 5% |
| Motor vehicle maint. & Repair | 5% |
| Rent of shelter | 5% |
| Shelter | 5% |
| Services less energy services | 5% |
| Owners' equivalent rent | 5% |
| Footwear | 5% |
| Garbage & trash collection | 5% |
| Recreation services | 4% |
| Motor vehicle insurance | 4% |
| Water & sewerage maint. | 4% |
| Alcoholic beverages | 4% |

| | |
|---|---|
| Day care and preschool | 4% |
| Nursing homes | 4% |
| Hospital services | 4% |
| Medical care services | 4% |
| Funeral expenses | 3% |
| Photo equipment & supplies | 3% |
| School tuition | 3% |
| Educational books | 2% |
| Medicinal drugs | 2% |
| Recreational reading | 2% |
| Personal care products | 2% |
| College tuition and fees | 2% |
| Intracity mass transit | 2% |
| Professional services | 2% |
| Internet services | 2% |
| Physicians' services | 1% |
| Technical & bus. school tuition | 1% |
| Jewelry and watches | 0% |
| Computers and smart home assistants | 0% |
| Toys | 0% |
| Cosmetics | (-1%) |
| Wireless phone services | (-1%) |
| Audio equipment | (-3%) |
| Computer software and accessories | (-4%) |
| TVs | (-6%) |
| Smartphones | (-16%) |

*Source: (1-6) Bureau of Labor Statistics. CPI Report April 2022. Bloomberg. Data as of May 11, 2022. Core goods inflation is all items less food, energy commodities and services. Oxford Economics, "CPI inflation eases only slightly in April; pressures remain high" (May 12, 2022). FT. WSJ. Capital Economics.*

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