

The energy shock is hitting consumers, but not yet overall prices.

An Inflation Silver Lining

Inflation was too high again in May, with the consumer-price index coming in at 0.5% for the month and 4.2% for the last 12 months. The silver lining is that this was better than markets expected given the oil price shock, and core inflation (sans food and energy) slowed in the month.

Energy prices made up 60% of the monthly CPI increase, which was expected given the Iran war's impact on oil supply and prices. The price of gasoline rose an ugly 7% and has climbed 40.5% over the last year. This is a big hit for consumers and is one reason they are in a sour mood about the economy despite a reviving jobs market.

Yet without food and energy, prices were up only 0.2% in May, which is 2.9% at an annual rate. Prices fell for medical-care commodities, new vehicles, utility gas service, household furnishings and transportation services, among other things.

The core rate is still too high, but its decline to 0.2% from 0.4% in April suggests the oil shock isn't spreading into the broader economy, at least so far. This is ammunition for those who think the Federal Reserve should look through the oil price shock when its Open Market Committee (FOMC) meets next week.

That's the tough call for new Fed Chair Kevin Warsh as he faces FOMC members who may want to raise interest rates based on the move in overall consumer prices. Count us in the hold rates steady camp. A rate hike doesn't seem warranted until price increases start to spread beyond energy, and no one knows when the Iran war will end. The oil shock is a blow to economic growth, and it doesn't need the Fed raising the price of borrowing to compound the blow.

This isn't a repetition of the Fed's happy talk in 2021 that inflation was "transitory." That era's inflation was caused by excessively easy monetary policy that accommodated blowout federal spending. The FOMC didn't move its target interest rate from near-zero until March of 2022, if you can believe it. Inflation hit 9.1% on an annual basis three months later.

Today the fed funds rate is 3.5% to 3.75%. Inflation vigilance is always necessary, but caution may be the better part of that vigilance given the energy price shock.

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Average price for regular gasoline

\$4.50 a gallon

