



The Daily Dish

Inflation Watch

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At the moment, all macroeconomic issues lead to the war in Iran, global energy prices, their inflationary impacts, and the Fed. Yesterday the Bureau of Economic Analysis (BEA) released the May [data](#) for the Fed's preferred measure of inflation: the personal consumption expenditures (PCE) price index. The PCE index is especially of interest because it is based on the actual mixture of goods and services purchased in the economy. This is why it is the Fed's preferred measure and it is also the most relevant for assessing the "affordability" of those things people actually want to buy. A brief summary of the data are shown at the bottom. (All figures are at annual rates).

The most commonly cited numbers are the top-line PCE inflation of 5.5 percent for May (up from 5.0 percent in April) and 4.1 percent for the past year (up from 3.8 percent last month). The table also includes the rate of increase for the past 3 months (6.3 percent), the past 6 month (5.3 percent), and the past 9 months (4.5 percent). The pattern clearly points to the hostilities in Iran and their impact on energy prices (shown in the Memo line at the bottom).

Notice, as well, that there is not an isolated problem located in, for example, durable goods. Instead, over the past year there has been above-target inflation in durable goods, nondurable goods, and services. (As an aside, housing or shelter services are no longer a uniquely powerful source of inflation pressures.) The U.S. simply has an inflation problem.

To further focus on the underlying inflation trends, analysts prefer the "core" PCE index, which excludes the volatile food and energy categories. Core inflation is the best predictor of future overall inflation. Core inflation is much lower; 3.9 percent in May (compared to 3.0 percent in April) and 3.4 percent year-over-year (up from 3.3 percent in April). Also shown is "market-based" core inflation, which uses only data from actual market transactions (as opposed to imputations by the BEA). In both cases, the pattern is the same. The good news is that inflation is lower, but still well above the 2.0 percent target. The bad

news is that inflation is rising.

These data argue strongly against any near-term cuts in interest rates by the Fed. Do they call for interest rate hikes? Not yet. But if the core inflation numbers do not begin to decline, Fed officials will feel increasing pressure to take actions. The Fed is most likely on hold for a while, but the main risk is for higher rates.

	<u>1 Month</u>	<u>3 Months</u>	<u>6 Months</u>	<u>9 Months</u>	<u>1 Year</u>
Personal consumption expenditures (PCE)	5.5%	6.3%	5.3%	4.5%	4.1%
Goods	5.4%	10.9%	7.8%	5.9%	4.8%
Durable goods	-0.3%	4.0%	6.1%	4.1%	3.3%
Nondurable goods	8.5%	14.8%	8.7%	6.8%	5.6%
Services	5.6%	4.3%	4.3%	3.8%	3.8%
Core PCE	3.9%	3.5%	4.1%	3.6%	3.4%
Market-based Core PCE	3.0%	3.4%	4.0%	3.4%	3.2%
Memo:					
Energy goods and services	60.6%	111.8%	43.2%	32.5%	24.3%