The Wall Street Journal recently featured a piece entitled “Stubbornly High Rents Prevent Fed From Finishing Inflation Fight,” which notes that the Fed “expects a slowdown in housing costs to eventually drag inflation close to its 2% target.” The pace of shelter inflation matters so much because shelter is one-third of the Consumer Price Index (CPI) and one-sixth of the Personal Consumption Expenditures price index.

The dilemma is displayed below. The orange line depicts year-over-year shelter inflation, which stood at 1.6 percent in January 2021 and ramped up steadily to peak at 8.2 percent in March 2023. Notice that this is a bit less than a year after the overall CPI inflation peaked at 9.1 percent in June 2022. This is a reminder that CPI shelter inflation reacts with a lag.

Since then, shelter inflation has fallen to 5.7 percent. Unfortunately, with that rate of shelter inflation, the remainder of the CPI must show zero inflation to hit the overall 2 percent target. The more troubling aspect of the graph, however, is the fact that the most recent three months of data have been at an annualized rate above the year-over-year pace. In other words, if the past three months repeat themselves, the year-over-year rate will rise.

This puts a lot of importance on the release of the Producer Price Index this morning and, especially, the CPI on Wednesday. That importance is heightened by
news from the New York Fed that inflation expectations have reversed course and rose from 3.0 to 3.3 percent in the most recent survey. Inflation expectations can be self-fulfilling prophecies, so it is much easier to fight inflation when they are on the decline.

Buckle up for a big week on the inflation data front.