Core CPI suprisingly contracts, weakening the case for rate hikes

Brian LeBlanc
brian.leblanc@pnc.com

Rayhan Momin
rayhan.momin@pnc.com

Headlines

- **Core CPI came in significantly below expectations in June, declining 0.02% on the month**. Falling gasoline prices pushed headline CPI even further into negative territory, declining 0.42% m/m. The weakness was broad-based, with notable improvements across shelter, services, and goods inflation.

- **The most encouraging development in today's release was the continued moderation in core goods prices**. Core goods prices have contracted at a 0.7% annualized pace over the past three months, a marked improvement from the 0.8% increase over the past year. The improvement appears concentrated in tariff-sensitive categories such as furniture and apparel.

- **Equally important was the improvement in services inflation excluding shelter, or "supercore," which also contracted in June**. Airfares eased alongside jet fuel prices, but the largest source of weakness was a 2% decline in auto insurance prices.

- **Shelter inflation**, **which accounts for roughly 45% of core CPI, also slowed notably** in June, although much of the improvement was driven by a sharp decline in hotel prices that is unlikely to be repeated in coming months.

- **Today's report weakens the case for a July rate hike and gives the Fed greater scope to remain patient**. Market-implied odds of July tightening fell sharply following the release. However, the report does not provide an all-clear on inflation: June predates the recent rebound in oil prices, and core PCE in June will likely come in hotter than this core CPI reading.

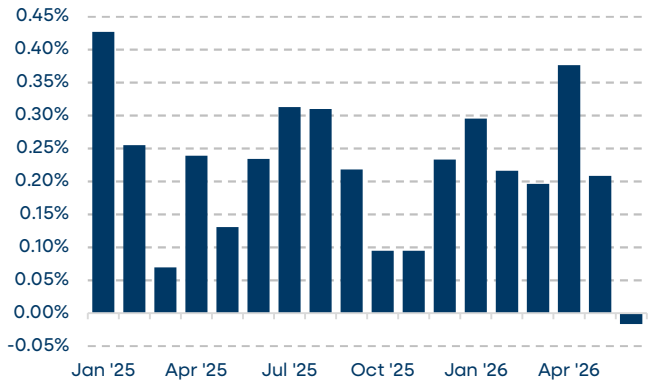
Table 1: CPI and components (% chg., m/m)

Indicator	Avg. 2025	Avg. YTD	Feb '26	Mar '26	Apr '26	May '26	Jun '26
Headline	0.22%	0.33%	0.27%	0.87%	0.64%	0.47%	-0.42%
Core	0.22%	0.21%	0.22%	0.20%	0.38%	0.21%	-0.02%
Shelter	0.26%	0.29%	0.23%	0.27%	0.61%	0.32%	0.12%
Core Services ex. Shelter	0.24%	0.27%	0.32%	0.17%	0.35%	0.26%	-0.09%
Core Goods	0.12%	0.01%	0.08%	0.11%	0.03%	-0.11%	-0.09%

Core CPI falls 0.02% on the month...

Core CPI came in significantly below expectations in June, falling 0.02% on the month. The weakness was broad-based, with notable improvements across shelter, services, and goods inflation.

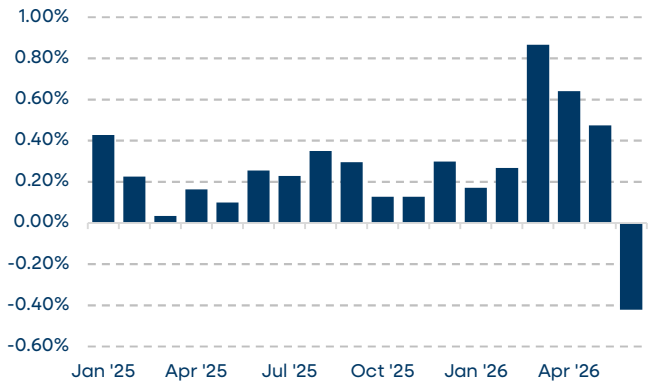
Figure 1: Core CPI (% chg., m/m)



Sources: BLS, PNC

Falling gasoline prices also helped push headline CPI further into negative territory. Headline CPI declined 0.42% on the month, the steepest monthly drop since April 2020. As a result, headline inflation fell from 4.2% to 3.5% in June.

Figure 2: Energy Commodities CPI (% chg., m/m)

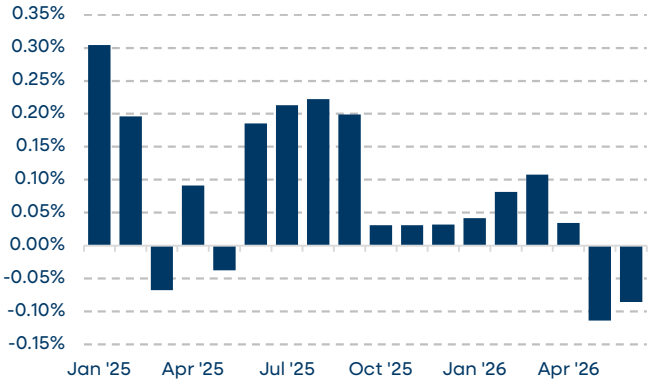


Sources: BLS, PNC

... driven by continued improvement in core goods prices ...

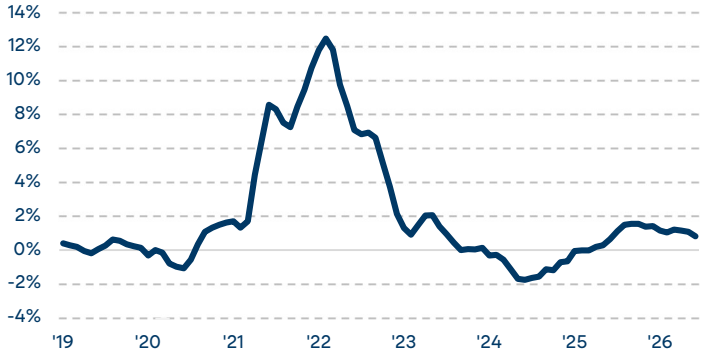
Perhaps the most encouraging signal in the report was the continued moderation in core goods prices. Core goods prices began to accelerate in early 2025 following the implementation of new tariffs and have been one of the primary drivers of inflation's reacceleration in 2026. However, core goods prices have contracted at a 0.5% annualized pace over the past three months, a marked improvement from the 0.8% increase recorded over the past year. The improvement appears concentrated in tariff-sensitive categories such as furniture and apparel.

Figure 3: Core Goods CPI (% chg., m/m)



Sources: BLS, PNC

Figure 4: Core Goods CPI (% chg., y/y)



Sources: BLS, PNC

Many FOMC participants have repeatedly pointed to the fading tariff-impact on core goods inflation as one reason for why the Fed could afford to remain patient and on hold through 2026.

... and a surprising drop in "supercore" inflation

The biggest downside surprise in the report came from services inflation excluding shelter, or

"supercore" inflation, which contracted 0.1% m/m in June. Airfares eased alongside jet fuel prices, but the largest source of weakness was a 2% decline in auto insurance prices. Supercore inflation has remained stubbornly elevated despite continued labor market cooling and slower wage growth. It is unclear how much of June's weakness will persist in the months ahead, but it is nonetheless an encouraging step after the firm inflation readings seen during the first half of the year.

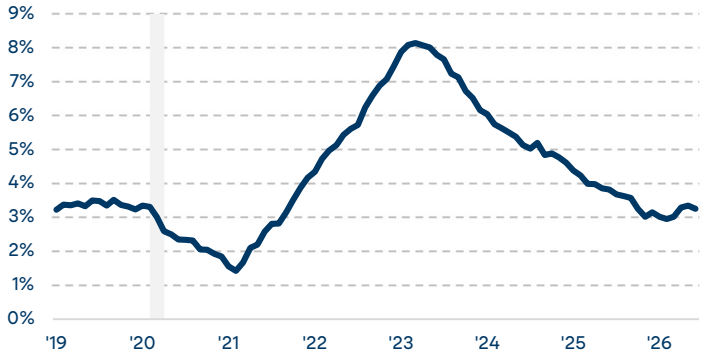
Figure 5: Core Services ex. Shelter (% chg., y/y)

Sources: BLS, PNC

Shelter inflation slows, driven by hotel/lodging inflation

Shelter inflation, which carries the largest weight in the CPI basket, slowed to 0.12% m/m in June. However, much of the improvement was driven by a sharp decline in hotel and lodging prices that is unlikely to be repeated in coming months. Shelter inflation has been the primary source of disinflation over the past several years, reflecting the lagged effects of cooling market rents on newly leased apartments. That process now appears to be nearing completion, suggesting shelter is unlikely to provide much additional disinflation going forward. Future progress will likely need to come from further improvements in core goods prices and supercore inflation.

Figure 6: Shelter CPI (% chg., y/y)



Sources: BLS, PNC

Core PCE likely comes in higher, but this still gives the Fed breathing room

Core PCE inflation will likely come in somewhat firmer than core CPI because shelter carries less weight in PCE and several weak CPI categories, including medical care, airfares, and insurance, are measured using different source data. Our initial estimates place June core PCE inflation around 0.2%, down from pre-release estimates of roughly 0.3%, though the PPI report will be important for refining that estimate.

Today's report materially weakens the case for a July rate hike and gives the Fed greater scope to remain patient. Market-implied odds of a July hike fell sharply following the release. At the same time, the report does not provide an all-clear on inflation. June data precede the recent rebound in oil prices, which is likely to put upward pressure on headline inflation in the months ahead.

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