

## U.S. Inflation Accelerates in April; Japan Core Inflation Spikes to 41-Year High in May

**UNITED STATES:** An acceleration in inflation in April complicates the outlook for the Federal Open Market Committee meeting in mid-June. Both the overall and core (excluding food and energy) personal consumption expenditure price indices, the Fed's preferred inflation measures, increased 0.4% in April from March. This was up from monthly 0.1% overall inflation, and 0.3% core inflation, in March. Nominal personal income was up 0.4% in April from March, with labor market compensation up 0.5%. Nominal after-tax income rose 0.4% in April. Real (inflation-adjusted) personal income was flat in April from March, as was real after-tax income. Real after-tax income increased 0.2% in both March (revised lower from 0.3%) and February (unrevised). The outlook for consumer spending is softening. The job market is still strong, although job gains and wage growth are slowing. But high inflation, high interest rates, a weakening housing market, and growing recession concerns are weighing on households. A further slowing in job growth through the rest of this year, with job losses toward the end of 2023 as the U.S. economy enters into recession, will lead to real declines in consumer spending in late 2023 and early 2024.

Real GDP growth in the first quarter of 2023 was revised slightly higher in the second estimate, to 1.3% at an annual rate, from 1.1% in the advance estimate. There were upward revisions to investment in inventories, business fixed investment, consumer spending, and exports; these were partially offset by a downward revision to investment in housing. Demand in the first quarter was strong, with real final sales of domestic product (GDP minus the change inventories) up 3.4%. In particular, consumer spending rose sharply, up 3.8% after adjusting for inflation, including a huge 16% increase in durable goods purchases as auto sales rose. But inventories were an enormous drag, subtracting more than 2 percentage points from growth in the quarter. On a year-ago basis real GDP growth was 1.8%, close to the economy's long-run potential. Corporate profits fell 5.1% in the first quarter of 2023 from the fourth quarter of 2022 (not annualized). Profits have now fallen for three straight quarters as businesses are finding it more difficult to pass along higher costs to their customers. Overall profits were down by \$151 billion annualized in the first quarter, including a decline of \$109 billion for nonfinancial domestic industries. Profits for domestic financial corporations fell \$25 billion, and profits from abroad fell by \$16 billion.

According to the minutes from the Federal Open Market Committee meeting on May 2 and 3, participants were divided about the potential need for further increases in the fed funds rate. Participants agreed that inflation remained too high, that economic growth was slowing, and that the recent problems in the banking system were likely to weigh on growth. But there was uncertainty about the cumulative impact of monetary policy tightening to date, the hit to lending from the problems in the banking system, and the expected near-term paths for inflation and the labor market. The minutes also noted that "some participants" thought that "additional policy firming would likely be warranted at future meetings." But at the same time, "several participants" thought that "further policy firming after this meeting may not be necessary." This language, in particular "some" versus "several," suggests that more FOMC participants are in favor of holding the fed funds rate steady in mid-June as opposed to hiking, although these opinions could obviously change depending on incoming economic data.

Initial claims for unemployment insurance (UI) increased by 4,000 to 229,000 for the week ending May 20 from 225,000 (revised down sharply from 242,000) in the previous week. There was also a large downward revision to initial claims to 231,000 (from 264,000) in the week ending May 6. These big downward revisions mostly reflect a correction attributed to

**Gus Faucher**  
*Chief Economist*

**Stuart Hoffman**  
*Senior Economic Advisor*

**Kurt Rankin**  
*Senior Economist*

**Abbey Omodunbi**  
*Senior Economist*

**Ershang Liang**  
*Economist*

fraudulent claims activity in Massachusetts (MA). The four-week moving average of claims, which smooths out some of the weekly volatility and reflects these corrections for fraudulent MA claims activity, was steady at 232,000 in the week ending May 20 (revised down from 244,000 in the week ending May 13). A new plateau in initial claims does seem to have formed at close to 232,000.

The advance nominal-goods trade deficit widened sharply in April to a six-month high. It widened \$14.1 billion in April to \$96.8 billion from \$82.7 billion in March, according to data from the U.S. Census Bureau. This was worse than the consensus expectation for a slight widening to \$85.9 billion. Exports fell 5.5% in April from the prior month while imports rose 1.8%. Trade was neutral for U.S. economic growth in the prior quarter but will likely be modestly negative for growth in the second quarter as a weak Chinese economy, high inflation, and tight financial conditions outside the U.S. weigh on exports and U.S. imports slightly improve with easing global supply-chain networks.

The May final print of the University of Michigan's consumer sentiment survey showed a decline to 59.2 from 63.5 in April. Year-ahead inflation expectations pulled back to 4.2% from 4.6% in April. Long-term (five to 10 years ahead) inflation expectations rose slightly to 3.1% from 3.0% in April.

The Bureau of Labor Statistics Employment Situation Summary for May, to be released June 2, will likely show employment up 190,000 from April with the unemployment rate edging up to 3.5% in May, and average hourly earnings up 0.4% on the month.

**JAPAN:** Consumer price index (CPI) inflation decelerated in May mainly driven by declines in food, energy, and housing prices. The Tokyo CPI rose 3.2% in May from a year ago, following a 3.5% increase in April. Despite the slowing in headline inflation, the acceleration in core inflation will be a big concern for the Bank of Japan (BoJ). The core CPI index, which excludes fresh food and energy prices, rose 3.9% in May from a year ago, following a 3.8% increase in April. The increase in the core CPI index in May was the fastest pace since April 1982. Inflation remains above the BoJ's 2% objective, but it is very unlikely that BoJ policymakers will tweak monetary policy in 2023.

The first estimate of the Jibun Bank Japan purchasing managers index (PMI) showed strength in the private sector as the composite PMI rose to 54.9 in May from April. The services PMI picked up steam, rising to 56.3 in May from 55.4 in April and the manufacturing PMI jumped into expansionary territory, increasing to 50.8 from 49.5 in April.

**UNITED KINGDOM:** Yearly headline inflation dropped below 10% in April for the first time since August 2022 but core inflation, which excludes food and energy costs, accelerated. The consumer prices index (CPI) rose 8.7% in April from twelve months earlier, down from the 10.1% increase in the prior month. The consensus expectation was for a yearly increase of 8.2%. The deceleration in headline inflation was mainly due to base effects following last year's surge in food and energy prices. Core inflation accelerated to 6.8% in April from 6.2% in March. The consumer prices index including owner occupiers' housing costs (CPIH) rose 7.8% in April from a year ago following an 8.9% increase in the prior month. The acceleration in core inflation suggests that the Bank of England will lift its policy rate again at its next meeting on June 22.

Retail sales volumes including auto fuel grew faster than expected in April thanks to the government's extension of the Energy Bill Support Scheme. Retail sales including auto fuel rose 0.5% in April from March, better than the consensus expectation for a 0.3% increase, and following a 1.2% decline in March.

**EUROZONE:** Germany's economy slid into recession in the first quarter of this year, according to data from the German Federal Statistical Office. GDP shrunk 0.3% in the first quarter from the prior quarter, following a 0.5% decline in

the fourth quarter of 2022. Private consumption and government spending were drags on GDP while capital investment was a positive. Trade grew in the prior quarter as imports declined and exports rose slightly. Looking ahead, rising interest rates will likely continue to weigh on consumer spending in the near term.

Economic confidence deteriorated in the eurozone in May as inflation and rising interest rates continue to weigh on consumers and businesses. The May European Commission Economic Sentiment index fell to 96.5, the weakest reading since November, from 99.0 in April. The weakness in sentiment was broad based with declines in the services and industrial sectors. Industrial confidence fell sharply to -5.2 in May, the lowest reading since November 2020, from -2.8 in the prior month while services confidence fell to 7.0 in May from 9.9 in April.

**MEXICO:** Economic activity fell in March after increasing in the prior three months. The economic activity index fell 0.3% in March following a 0.1% increase in February. The index rose 2.7% in March from twelve months earlier following a 3.8% increase in February.

GDP growth picked up pace in the first quarter as Mexico's economy grew 1.0% on a quarterly basis, following a 0.6% expansion in the fourth quarter. GDP grew 3.7% in the first quarter of this year from a year ago following a 3.9% increase in the prior quarter.

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