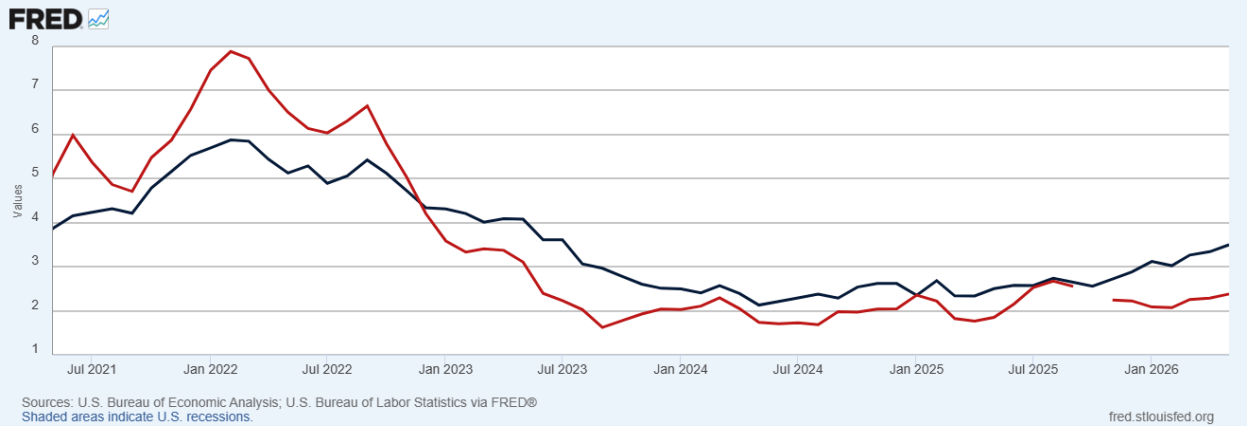
MILLER TABAK + CO., LLC

June 25, 2026

Inflation Concerns Will Fall Away by October

Although the headline figures from the May PCE-inflation report were about as expected (core was 3.8% annualized, m/m), it will still stoke the FOMC's growing concerns about elevated inflation. Our focus remains on measures of core inflation that exclude shelter. For PCE, this figure came in at an annualized rate of 3.8% to bring the y/y reading (black in Figure 1) to 3.5%. This latter figure is the basic motivation for Chairman Warsh's more aggressive posture against inflation. It also displays a growing discrepancy with core-CPI, ex-shelter, (red in Figure 1), which is a more subdued 2.4%. This is unusual, on average CPI is about 0.3% higher than PCE.

Figure 1: Core-inflation, ex-shelter): PCE (black) versus CPI (red)



The Fed focuses more on the higher PCE figure than CPI, but this is not cause for concern. The biggest reason for the current gap is that service inflation, which is a bigger part of PCE, has run especially ahead of goods inflation in recent months. This is unlikely to continue, and the PCE and CPI will converge over the next year. **The truth is in the middle, with underlying inflation around 3%.**

This 3% figure does reflect significant passthrough from the March energy spike to core-inflation. **Nevertheless, our firm position remains that inflation concerns are badly overstated, and that core-inflation will show a clear downward trend by October.** Critically, there remains no source for sustained inflation. Energy prices are in decline following the admittedly fragile U.S-Iran deal. Interest rates remain restrictive, and both the labor market and

aggregate demand are far from overheated. One risk is that inflationary expectations could become elevated, causing firms to preemptively raise their own. It is very good news that our favorite measure of inflationary expectations, **the Atlanta Fed's survey of businesses year-ahead inflation expectations, dropped from 2.4% to 2.3% in June, its first decline since energy prices surged in March.** There remains no need for the Fed to raise rates. It simply needs to just wait as inflation comes down along with energy prices.

Other Developments in Macroeconomics:

1. Another big story from the PCE data is that consumption rebounded in May following weak data from January through April. In 1Q2026, consumption grew at an annualized rate of just 0.54%, its slowest rate in four years. Households' debt service also fell from 11.33% to 11.16%, a small drop, but one that reversed an upward trend. April's consumption growth then turned negative, **hinting that households may be starting to de-lever, which could signal a broader slowdown.** The May reading, however, showed real consumption growth at a solid 3.1% annualized rate. This reduces, but does not eliminate, concerns that consumption is trending downward. One caveat is that this figure does include strong growth in automobiles which had turned sharply negative in April. Still, it matches last week's good May retail sales report. For upcoming June data, consumption growth is as important as inflation or employment to determine if May is an outlier or a true recovery in consumption.

2. An underemphasized part of Chairman Warsh's first press conference is his clear skepticism towards the Fed's large balance sheet, which largely reflects the legacy of quantitative easing. This raises two issues. First, our original concern about Warsh is how he would respond to a severe recession that requires the Fed to lower rates to near zero. While one is unlikely to occur during Warsh's tenure, we suspect that he would repeat his 2008 error when he incorrectly identified the key threat as inflation rather than deflation. Second, it will take time, but Warsh's Fed is likely to drive term premiums higher by significantly reducing its long-term Treasury holdings. If the Fed reverted all the way to its pre-2008 posture, this could raise long term yields by as much as 70 bps. **For now, we are bumping our medium-term target (late 2027) for the 10-year Treasury yield up from 340 bps to 350 bps.**

3. Another driver of higher inflation remains shelter, which is up 3.4% y/y and which mysteriously spiked in April. We maintain that the FOMC should just ignore shelter inflation. In addition to being poorly measured, higher rates have the effect of making housing less affordable. **There is little risk, however, that shelter will continue to push inflation higher.** Following last week's poor housing starts report, new home sales unexpectedly fell from 632,000 to 580,000 in May. Housing may still eek out its first

positive quarter in 2Q2026 since 2024, but high rates, as Warsh mentioned last week, are still crushing housing. Shelter inflation will surely fall over the next year as a result.

-Paul Shea

Strategic Economist, Miller Tabak