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Supercore and core inflation in the US



SUPERCORE AND CORE INFLATION IN THE US

Strong supercore inflation in March was a factor that caused financial markets to reassess their expectations about US interest rates. In this edition of *Infocus*, Chief Economist Stefan Gerlach and Senior Economist GianLuigi Mandruzzato look at the differences between supercore inflation as measured by the CPI and the PCE indices.¹ The implications for future inflation are investigated.

The March US CPI release encouraged investors to reassess the likelihood of future fed rate cuts and pushed Treasury bond yields higher. A key factor was the unexpectedly strong increase in a measure termed supercore inflation: that is, a measure which excludes all goods prices, food and energy prices, and housing costs. This measure represents about a quarter of the overall CPI measure and about half of the PCE deflator measure (the latter being the Fed's preferred measure of inflation).

The significance of supercore inflation

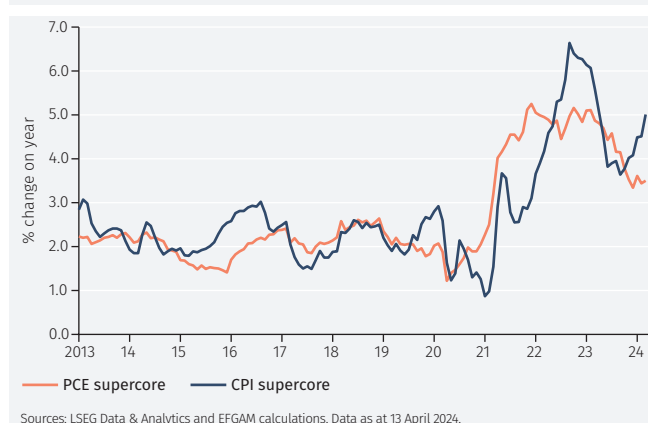
Supercore inflation first attracted investor attention after Chairman Powell stated in a speech on November 30, 2022, that it “*may be the most important category for understanding the future evolution of core inflation*”.²

Powell's comments referred to the PCE measure of inflation, data for which are released towards the end of each month. CPI inflation data are released sooner – around mid-month – and receive a great deal of attention in financial markets. Although supercore CPI measures are not officially reported, they can be constructed. According to our calculations, supercore CPI inflation was 5.01% year-on-year in March 2024, the highest rate since April 2023.

Supercore inflation as captured by the CPI and PCE methodologies can be quite different (see Figure 1). Since January 2021, supercore CPI inflation has been much more volatile than supercore PCE inflation.³ Furthermore, while supercore CPI inflation has risen sharply since mid-2023, supercore PCE inflation has continued to moderate. These two factors alone suggest the need for caution about reading too much into supercore CPI calculations.

Both of the supercore measures shown in Figure 1 exclude shelter (housing) costs, but housing costs are an important influence on core inflation. Housing inflation responds to changes in house prices, but normally with quite a long lag.

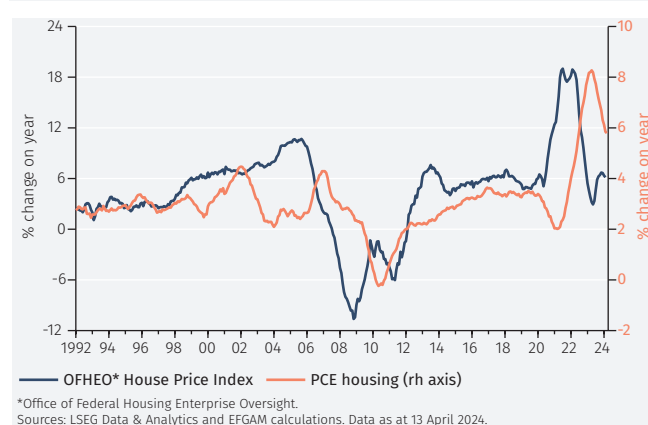
1. Measures of supercore inflation



That is because the stock of rental housing, and any associated rental changes, tends to be slow to turn over. It is thus unsurprising that housing inflation lags trends in US house prices (see Figure 2).

In that sense, the fact that supercore inflation disregards housing price inflation, may mean it provides a timelier evaluation of underlying inflation pressures.

2. US house prices and PCE housing



¹ The two main measures of prices paid by US consumers of goods and services are the Consumer Price Index (CPI) and the Personal Consumption Expenditures (PCE) price index. They differ in terms of coverage (the CPI covers only urban consumers, the PCE all consumers), the weights assigned to different categories and the scope of coverage (PCE is broader).

² See Chairman Powell's speech on *Inflation and the Labor Market*, 30 November 2022.

³ From January 2021 to February 2024, the standard deviation of supercore PCE inflation was 0.74%; for supercore CPI it was 1.45%.

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The fact that supercore inflation tends to be stickier – less volatile – than the core and headline measures also potentially enhances its credentials as an underlying measure of inflation

(see Figure 3).⁴ However, the three series are very strongly correlated, with correlation coefficients all around 0.9.

3. PCE inflation



Does supercore foretell the future?

But how valid is Powell's claim that supercore inflation is the most important category for understanding the future evolution of core inflation? In the *Appendix* we provide an analysis of the relationship between headline, core and supercore inflation. The results establish that supercore is one predictor of future core inflation, but it appears to be less important than headline inflation. It is difficult to reconcile these findings with Powell's view. Analysis of the different drivers of inflation is undoubtedly interesting but we are sceptical whether one sub-component (supercore) is particularly useful in explaining the overall trend of headline or core inflation.

APPENDIX

To address the question of whether supercore inflation is important in understanding the future path of core inflation, we estimate a statistical model comprising month-on-month changes in supercore, core and headline PCE inflation and use it to study whether each of these measures contain information useful for forecasting the other two.⁵

We start by forecasting core inflation. The results suggest that supercore and headline inflation contain information useful for forecasting core inflation. However, looking at the p-values it appears to be less important than headline inflation. These findings are difficult to reconcile with Powell's view that supercore inflation is the most important determinant of core inflation.

Forecast variable	Explanatory variable	p-value
Core	Supercore	1.3%
	Headline	0.0%
Headline	Supercore	12.5%
	Core	5.6%
Supercore	Core	7.0%
	Headline	0.0%

NOTE: Values highlighted in yellow are above 5% and indicate that we **cannot** reject the hypothesis that the variable in the middle column **does not** contain information about the factor in the left hand column.

Turning next to the question of whether core and supercore inflation contain information useful for forecasting headline inflation, we find neither appear to do so. However, it seems likely that the reason for this finding is that these series are so strongly correlated that it is difficult to determine which series is more important.⁶

Finally, we ask whether core and headline inflation contain information useful for forecasting supercore inflation. The results suggests that headline inflation does. However, the finding that core inflation does not may be because it is strongly correlated with headline inflation.

⁴ The standard deviation of supercore is the lowest, 0.9%, closely followed by core inflation, 1.0%, and headline inflation, 1.4% over the period January 2000 to February 2024.

⁵ That is, we test for 'Granger causality'. The VAR(4) model is estimated on monthly data over the period January 2000 to February 2024.

⁶ The reason for this conclusion is that the joint test that both variables are insignificant rejects ($p = 0.4\%$).

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