## In the Spotlight



## **Inflation Surprise, Pause or Fog?**

Ron Madey, CFA<sup>®</sup> June 12, 2025

Yesterday's Consumer Price Index (CPI) report came with a positive surprise. On a month-over-month basis, CPI came in 0.1% below economist expectations and core CPI came in 0.2% lower. Both stocks and bonds initially rallied. However, core CPI on a year-over-year basis, at 2.8%, remains well above the Fed's inflation target.



CPI has come in below expectations for the past three months. So, where is the supposed tariff impact? Perhaps it is just a pause while businesses decide whether to accept lower margins or pass through tariff costs.

The chart shows the divergence between the Institute of Supply Management (ISM) survey of prices paid versus annualized change in CPI. It is significant. The ISM survey tends to lead CPI by about a quarter.

The "surprise" and "pause" interpretations of the CPI report rely on confidence in the quality of the data. Confidence is dwindling. Foggy Bottom is a neighborhood in D.C. known for being the location of the State Department. The Bureau of Labor Statistics (BLS) may soon be moving there.

A June 4<sup>th</sup> article in the Wall Street Journal (WSJ), *Economists Raise Questions About the Quality of U.S. Inflation Data*, suggests the reporting is becoming increasingly suspect, not based on some conspiracy theory that the Trump administration is deliberately manipulating the data, but based on staffing shortages hampering the ability of the BLS to conduct the massive monthly survey.

To calculate the inflation rate, the first step is for hundreds of government "price-checkers" to fan out across the country each month to collect data on what businesses charge by product. To be effective, they need to ensure that the product they are price-checking this month is the same as the product they price-checked last month. If the price of a bag of chips did not change but the size of the bag was reduced by - 10%, that is an effective 11% price increase. The second step is for statisticians to roll up the price-checked data into the CPI Index.

When the price-checkers can't identify a specific price in a specific city, they make an educated guess using a close substitute. An example the WSJ used was cargo pants instead of slacks. If they can't find a close substitute, statisticians base their guesses on less comparable products or other regions of the country. This process is called different-cell imputation.

Over the last several years, about 10% of prices were estimated using different-cell imputation. Today, it is close to 30%. Why? A hiring freeze and staffing cuts. The BLS reduces collection efforts to match the provided resources. The BLS has stopped collecting data in Lincoln, NE, Provo, UT, and Buffalo, NY.

Let's hope that the Trump administration takes steps to ensure the quality of the CPI report, upon which so much depends (Social Security, tax rates, inflation-protected bonds, contracts, etc.). In the meantime, it is wise to explore the moment before acting on the reported data. As it turns out, despite an initial rally on the positive CPI surprise, the S&P 500 closed down on the day.

Email research@wealthcarecapital.com with questions, comments or requests. Sources include the Bloomberg, the Wall Street Journal, Google and Wealthcare.

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