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April's Inflation Reading Flashes Warning Signs

The April inflation report delivered an unwelcome surprise. Consumer prices rose 3.8 percent over the past 12 months, marking the sharpest annual pace since May 2023,¹ while the pace of monthly gains decelerated only modestly from March's four-year high.

On the surface, energy is the culprit. Gasoline prices jumped 28.4 percent annually, driven by ongoing Middle East supply disruptions. Energy costs more broadly surged by 17.9 percent.² But to focus solely on oil is to miss the darker undercurrent. Core inflation, which strips out more volatile food and energy prices, accelerated to 2.8 percent annually, well above the Federal Reserve's preferred two percent target.³ Other items with notable year-over-year price increases include air fare, apparel, shelter, home furnishings and operation, and medical care.⁴ Even used car prices, which had provided disinflationary relief, have stabilized.⁵

Unanchored Inflation Expectation and Declining Real Wages

What should worry the Federal Reserve most is not what has happened, but what consumers and businesses expect to happen next. Consumer inflation expectations have become unanchored across multiple horizons. According to the University of Michigan's Survey of Consumers, one-year-ahead inflation expectations stood at 4.5% in May, down slightly from 4.7% in April but still substantially elevated from the 3.4% reading in February, before the Iran conflict began.⁶ The Federal Reserve Bank of New York's Survey of Consumer Expectations, meanwhile, captured median one-year-ahead inflation expectations at 3.6% in April, up from 3.4% the prior month.⁷

¹ Cox, Jeff. "Consumer Prices Rose 3.8% Annually in April, the Highest Since May 2023." *CNBC* (May 12, 2026). <<https://www.cnbc.com/2026/05/12/cpi-inflation-april-2026-.html>>.

² "Consumer Price Index - April 2026." *U.S. Bureau of Labor Statistics* (May 12, 2026). <https://www.bls.gov/news.release/archives/cpi_05122026.htm>.

³ *Id.*

⁴ Dickler, Jessica. "Here's the Inflation Breakdown for April 2026 - in One Chart." *CNBC* (May 12, 2026). <<https://www.cnbc.com/2026/05/12/inflation-breakdown-for-april-2026-cpi-chart.html>>.

⁵ "Consumer Price Index - April 2026." *U.S. Bureau of Labor Statistics* (May 12, 2026). <https://www.bls.gov/news.release/archives/cpi_05122026.htm>.

⁶ "Survey of Consumers." *University of Michigan*. <<https://www.sca.isr.umich.edu/files/tbcpx1px5.pdf>>.

⁷ "Short-Term Inflation Expectations Increase Further, Longer-Term Expectations Stable." *Federal Reserve Bank of New York* (May 7, 2026). <<https://www.newyorkfed.org/newsevents/news/research/2026/20260507>>.

The longer-term outlook provides little confidence either. Inflation expectations for the next five years inched down to 3.4% from 3.5% the prior month but still sit above the 2.3-3.0% range recorded in the two years preceding the pandemic.⁸

This matters enormously. When households expect prices to rise faster, they demand higher wage growth. When businesses expect higher input costs, they raise prices preemptively. These expectations may become self-fulfilling prophecies, potentially embedding higher inflation into the economy for years.

There is another signal flashing red: real wages are deteriorating. Average hourly wages fell 0.5% for the month on a real, inflation-adjusted basis and declined 0.3% annually.⁹

Compounding the squeeze on household finances, consumer sentiment has reached historic lows. The University of Michigan's Consumer Sentiment Index fell to 48.2 in early May, a record low, driven by declining current conditions as concerns about high prices weighed on both personal finances and buying intentions.¹⁰

The Fed's Dilemma

The inflation picture leaves the Federal Reserve with few attractive options. Interest rate cuts appear off the table for now; According to CME Group data, Fed funds futures now assign roughly a 30 percent probability to a rate hike by year's end, up from prior expectations.¹¹

The labor market, at least for now, continues to provide a cushion. Unemployment rate has hovered around 4.3 percent in the past few labor reports.¹² However, with unemployment expectations rising and real wage erosion mounting, a period of higher-for-longer interest rates risks tipping the economy toward recession. Goldman Sachs economists now forecast a 30 percent probability of recession within the next 12 months.¹³

The upside case rests on a swift resolution to Middle East hostilities and the assumption that core inflation pressures reflect primarily lagging effects of prior energy and tariff shocks. If those dissipate, inflation could recede toward Fed's target levels. The risk is that inflation expectations remain unanchored long enough to become self-reinforcing. If they do, the Federal Reserve may find itself locked into elevated rates for an uncomfortably long period, even as growth slows and labor market cracks widen.

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⁸ "Survey of Consumers." *University of Michigan*. <<https://www.sca.isr.umich.edu/files/tbcpx1px5.pdf>>.

⁹ "Real Earnings News Release." *U.S. Bureau of Labor Statistics* (May 12, 2026). <https://www.bls.gov/news.release/realer.htm?mod=article_inline>.

¹⁰ "Survey of Consumers." *University of Michigan*. <<https://www.sca.isr.umich.edu/charts.html>>.

¹¹ Cox, Jeff. "Consumer Prices Rose 3.8% Annually in April, the Highest Since May 2023." *CNBC* (May 12, 2026). <<https://www.cnbc.com/2026/05/12/cpi-inflation-april-2026-.html>>.

¹² "Civilian Unemployment Rate." *U.S. Bureau of Labor Statistics*. <<https://www.bls.gov/charts/employment-situation/civilian-unemployment-rate.htm>>.

¹³ "The Outlook for the US Consumer Amid Rising Inflation." *Goldman Sachs* (May 7, 2026). <<https://www.goldmansachs.com/insights/articles/the-outlook-for-the-us-consumer-amid-rising-inflation>>.