

Mortgage Rates Unaffected, Fed Likely to Hold Rates Steady on Latest Inflation Data



Today's CPI data should have little effect on mortgage rates. The report came in better than last month, but that was expected. It should keep the Fed on hold at their meeting next week.

Higher energy prices pushed overall headline CPI higher again while core CPI, which excludes food and energy, was relatively tame as forecasters had expected.

- ✓ Headline CPI showed overall prices increasing 0.5% in May from the prior month and 4.2% from the prior year. This is the first time we've gone over 4% annual inflation since May 2023, a time when the Fed was aggressively hiking rates. It was 2.4% in February before the war started and the increase is largely due to an increase in energy prices.
- ✓ Core CPI fell to a 0.2% monthly increase after last month's 0.4% increase though the annual gain ticked up to 2.9%. The monthly decline was expected since last month had a one-off increase in shelter inflation which resulted from the unwinding of a zero inflation assumption that the BLS made when they were unable to collect data during the government shutdown. Also, computer software and accessories, which had been increasing 4 and 5% monthly the last two months in the midst of the AI boom, fell to 0% this month.
- ✓ Overall, inflation is behaving largely as expected given the ongoing closure of the Strait of Hormuz. The Fed will be relieved to see no further deterioration in core inflation, but will be concerned that there is little sign of it heading back to their target level of 2%.

The Fed will almost certainly hold rates steady at Kevin Warsh's first meeting as Chair next week and they are likely to signal an equal willingness to hike or cut at future meetings, a deviation from recent meetings.

- ✓ For the past couple of years, the Fed has debated between two policy options: to hold or to cut. In monetary policy jargon, that's called an "easing bias." Now, with both an energy crisis with no end in sight and an AI boom that keeps heating up, they increasingly view a hike as likely as a cut.
- ✓ The question at next Wednesday's meeting is whether the committee's formal statement changes that "easing bias" to a "hiking bias" or keeps the language neutral. Today's inflation data gives them permission to just keep it neutral, but last Friday's hot jobs report could push them all the way to a "hiking bias".

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