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Data disconnect

Behavioral economics posits that people do not always behave rationally, especially when it comes to the cost of gasoline.

Last week, the Department of Labor's Bureau of Labor Statistics revealed that the May US Consumer Price Index (CPI) rose 4.2% on an annualized basis, up from a 3.8% growth rate in April. The core reading, however, barely changed, rising at a 2.9% annualized rate compared to 2.8% in April, and the month-over-month rate actually fell. As you have read many times in these weekly memos, core figures exclude volatile items such as energy prices. So that suggests the increase in crude oil costs since the onset of the Iran conflict played a large role in CPI's jump, and that consumers should be pessimistic about the economy. After all, oil is integral to much of the economy, both as a "service," fueling manufacturing and transport, and as a "good," used to make plastics and other products. Gasoline for automobiles is just one slice, even if it is a large one.

Yet, the University of Michigan's consumer sentiment index actually improved over the last few weeks. It reported that confidence increased in the early days of June to 48.9, a considerable jump from its all-time low reading of 44.8 in May.

The reason? Likely the numbers on signs above gas stations. Turns out, despite the inability for Iran and the US to come to a diplomatic agreement, prices at the pump in the US declined over May and into the first week of June. AAA said that the national average per-gallon price dropped to \$4.11 last week from more than \$4.50 in early May. That's as straight-forward example of how American consumers tend to cherry pick the costs that drive their behavior.

But the optimism might not last for long. Inflation on the wholesale level, the Producer Price Index, leapt in May to a rate of 6.5% year-over-year (y/y) from 5.7% in April. Core also soared, to 5.1% from 4.4%. That could eventually filter into the retail economy and dampen sentiment despite prices at the pump.

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