Macro Signposts | Underlying Inflation Gauges: Trimming Noise or Trimming Signal?

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Underlying Inflation Gauges: Trimming Noise or Trimming Signal?

By repeatedly describing standard inflation gauges as “imperfect measures of underlying inflation,” Federal Reserve Chair Kevin Warsh has pushed a long-running technical debate into the center of the policy conversation: What is the best way to measure underlying inflation?

With most measures of underlying U.S. inflation still running above the Fed’s 2% target, policymakers are understandably concerned about these gauges and what they mean for the inflation outlook – and for monetary policy.

Our analysis of key measures suggests that underlying U.S. inflation is running around 2.2% to 2.8% through June 2026 relative to a year earlier. That’s well below the 3.3% rate of core Personal Consumption Expenditures (PCE) inflation – how the Fed generally gauges progress toward its inflation target (data as of June 2026, according to the U.S. Bureau of Economic Analysis (BEA)). But relative to other inflation measures, the recent acceleration in core PCE inflation appears to be more of an outlier.

Our base case remains that core inflation will cool over time, and that the Fed likely will keep its policy rate on hold this year. But the risks argue for diligence in monetary policy, and key to managing risk is measuring it.

First, as of the most recent readings (June 2026), all of the underlying inflation measures are running above 2% but, importantly, below 3% – the “two-point-something” zone, as we have called it.

Second, comparisons across the various measures show that core PCE inflation (year-over-year) is currently an outlier on the high side. A look at the underlying distribution of recent price changes shows that core PCE skewness has drifted toward zero from its typical left-skew territory, largely due to fewer goods price declines and large increases. We haven’t seen that same skew drift in CPI, although the price sources are very similar.

Third, these measures just provide a gauge of underlying inflation today, which could itself be driven by larger fundamental developments, such as supply shocks, that should ultimately fade. The acceleration in core goods prices that has shifted the skew of the distribution of price increases is likely to diminish as price pressures from tariffs, energy, and AI-related components diminish. Furthermore, as my colleague Richard Clarida recently reminded us, over time measures of core inflation do tend to converge to labor costs, and right now unit labor cost inflation (according to the Bureau of Labor Statistics) is firmly in line with the Fed’s 2% target.

Source: https://www.pimco.com/us/en/insights/underlying-inflation-gauges-trimming-noise-or-trimming-signal