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US CPI: OER you serious right now?

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Consumer Price Index (monthly change, %)	Aug 2024	Jul 2024	Jun 2024	May 2024	Apr 2024	Mar 2024	Aug NSA YoY%
All items	0.2	0.2	-0.1	0.0	0.3	0.4	2.5
Ex-food/energy	0.3	0.2	0.1	0.2	0.3	0.4	3.2
• Ex-food	0.2	0.2	-0.1	0.0	0.4	0.4	2.6
• Ex-energy	0.3	0.2	0.1	0.2	0.3	0.3	3.0
Energy	-0.8	0.0	-2.0	-2.0	1.1	1.1	-4.0
Services	0.3	0.3	0.1	0.2	0.4	0.5	4.8
Housing	0.3	0.4	0.2	0.3	0.2	0.4	4.4
Fuels & util.	-0.7	0.1	-0.1	-0.1	-0.3	0.5	3.0
Food/beverages	0.1	0.2	0.2	0.1	0.0	0.1	2.0
• Food	0.1	0.2	0.2	0.1	0.0	0.1	2.1
Apparel	0.3	-0.4	0.1	-0.3	1.2	0.7	0.3
Transportation	0.1	-0.1	-1.3	-1.1	0.7	0.8	-1.0
Medical care	-0.1	-0.2	0.2	0.5	0.4	0.5	3.0
Recreation	-0.1	0.1	0.1	-0.2	0.2	-0.1	1.6
Education, comm.	0.1	0.2	-0.1	0.0	0.2	0.0	1.0
Other good, serv.	0.2	0.2	0.6	0.2	0.4	0.4	3.9
Commodities	-0.1	-0.1	-0.4	-0.4	0.2	0.1	-1.2

Source: Haver Analytics.

- The August inflation report showed inflation core surprise on the upside, due to an acceleration in service prices. Core CPI prices rose 0.28% m/m in the month, above consensus expectations of a 0.2% rise. Three-month annualized core CPI, however, still sits at a very cool 2.1% pace. Headline inflation came in at 0.19% m/m in July, matching forecasters predictions of a 0.2% gain. In year-over-year terms, headline inflation came down four ticks on favorable base-year effects to 2.5%, while core was unchanged at 3.2%. Core goods prices declined yet again, aided by further rebalancing in the used car market. Service prices strengthened due to a pick up in shelter and transportation service categories. Shelter inflation has proved more difficult to tame, and today's report is more evidence of that, with Owner's Equivalent Rent (OER) picking up for the second consecutive month. While today was not the best report for the Fed, inflation momentum is still in very good shape and the progress seen over the past year makes us confident that inflation is headed toward target even if the last mile for shelter disinflation is somewhat bumpy. The Fed's focus now is on whether the jobs market is "normalizing" or "deteriorating", and that means inflation reports are taking a back seat to labor market data.
- We estimate that today's CPI reading will translate into a 0.2% core PCE, so still within the range of target. Shelter has a lower weight in PCE with housing services accounting for 18% of the core PCE basket as compared to 46% in

CPI. Healthcare is actually the largest service component in PCE and that came in weak in today's report at -0.1% m/m, although PCE healthcare prices are broader than the in-pocket expenditures covered in the CPI medical services. As a result, PCE's healthcare prices are also informed by PPI data which we will see tomorrow.

- Today's report is telling us that the increased progress we thought we saw on shelter disinflation over the summer could actually be a mirage. Shelter prices rose to 0.5% m/m in July, the fastest pace seen since January. A 0.5% rise in OER was the main cause with rents coming down to 0.4% m/m. On a six-month annualized basis, there is more visible progress with rents at 4.6% and OER at 5.0%, but that is agonizingly slow and far above the implied pace from measures such as the Cleveland Fed's All Tenant Regressed Index, which now has an over 1%-point gap with rental CPI inflation, the largest gap observed over the history of the series. Perhaps it is the role of single family houses, or refinements in the panel of surveyed houses that mean the feed-through of market rents takes longer.
- Non-housing services, rose to 0.3% in August from 0.2% the month prior, largely due to an increase in airfares after five consecutive months of decline. Motor vehicle insurance premiums also moderated in the month, consistent with the improving profitability of auto insurers. In time, that could switch to becoming a material drag. The Fed will view the modest increase in non-housing services as a blip.
- Core goods contracted by 0.2% in the month. There were broad-based declines across categories. Household furnishings, IT-related products, recreational goods, medical goods and of course, used cars dropped again. Stripping out used cars, other core goods prices declined by 0.1% for the second consecutive month. The durable goods market remains in excess supply.

Implications & actions

Re: Economic forecast — The upside surprise in core inflation today likely won't be repeated in the Fed's preferred inflation gauge, core PCE, later this month, which we expect will still come in at 0.2% m/m. No barriers to the easing cycle beginning in September from today's report.

Re: Markets —Bond yields rose initially and have since retreated, while the broad dollar has sustained a modest increase.

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