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US CPI: Pieces of disinflation puzzle coming together

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Consumer Price Index (monthly change, %)	July 2023	June 2023	May 2023	Apr 2023	Mar 2023	Feb 2023	July NSA YoY%
All items	0.2	0.2	0.1	0.4	0.1	0.4	3.2
Ex-food/energy	0.2	0.2	0.4	0.4	0.4	0.5	4.7
• Ex-food	0.2	0.2	0.1	0.4	0.1	0.4	2.9
• Ex-energy	0.2	0.1	0.4	0.4	0.3	0.4	4.7
Energy	0.1	0.6	-3.6	0.6	-3.5	-0.6	-12.5
Services	0.3	0.3	0.3	0.2	0.3	0.5	5.7
Housing	0.4	0.3	0.2	0.2	0.3	0.5	6.2
Fuels & util.	0.2	0.3	-1.1	-1.1	-1.7	-1.4	-0.6
Food/beverages	0.2	0.1	0.2	0.1	0	0.3	4.8
• Food	0.2	0.1	0.2	0	0	0.4	4.9
Apparel	0	0.3	0.3	0.3	0.3	0.8	3.2
Transportation	-0.1	0.2	-0.2	1.2	-0.5	0.2	-3.0
Medical care	-0.2	0	0.1	0	-0.3	-0.5	-0.5
Recreation	0.1	0.1	-0.1	0.5	0.1	0.9	4.1
Education, comm.	0	-0.2	-0.2	0	0.2	0.1	1.2
Other good, serv.	0.1	0.2	0.5	0.9	0.5	0.9	6.1
Commodities	-0.1	0.1	-0.2	0.6	-0.3	0.2	-0.6

Source: Haver Analytics.

- The pieces of the US disinflation puzzle are starting to come together. Today’s no-surprise US CPI print provides more evidence that the disinflationary forces are firming and monetary policy tightening is working. Core inflation came in at 0.2% m/m for the second straight month, which in annualized terms is broadly consistent with the 2% target. In year-over-year terms, core inflation edged down a tick to 4.7%. Headline inflation matched the same month-over-month move but rose in year-over-year terms to 3.2% from 3% due to less favourable base-effects. The Fed’s preferred measure of prices tied to underlying demand, core services ex. shelter, remained at a still subdued pace of 0.2% m/m following a flat reading in June. We are maintaining our call for a September rate hike given the FOMC is looking to assess the "totality of the data". There is still one more CPI print and an employment reading before the September FOMC decision, and firmness in either or both could tilt the odds more in favour of a final hike.

- Service inflation came in 0.4% m/m, a modest tick up from 0.3% m/m from June but is well below the pace the six months prior to June. Shelter inflation stood at 0.4% m/m, unchanged from last month, and should continue to trend down as the index gradually incorporates new rental agreements, which are rising at a slower pace. Recent research by the San Francisco Fed forecasts shelter inflation to meaningfully decelerate from its current 7.7% year-over-year pace and turn negative by mid-2024. This should anchor a downward trend in service inflation and core inflation more broadly.

- Within the core services ex. shelter group, airline fares sustained their negative momentum with a second consecutive 8.1% m/m drop. This is a volatile category and creates some upside risk for future months particularly given that the recent rebound in oil prices could show up in a recovery in airfares in the next report. Other core service sub-categories showed mixed readings, with recreation prices and education & communication prices picking up while medical services prices decelerated again.
- Core goods prices showed a broad-based easing for the second consecutive month, consistent with supply chain improvements and the impact of tighter monetary policy. Used car prices dropped 1.3% m/m, its second consecutive monthly decline. This appears to have arrested what looks like a temporary resurgence in prices in the spring. Inventories at car dealers are on an upward trajectory but are still lean. For retailers outside of auto dealers, the inventory-to-sales ratio is around its pre-pandemic level, which should keep a lid on core goods prices outside of autos ahead.
- Energy prices rose in monthly terms for the second consecutive month. A further material oil price increase is an important risk not just for headline inflation but also because oil prices feed into core inflation gradually and inflation expectations. Food prices rose in the month by 0.2%. This is a modest acceleration from the previous months, but with food commodity price indices still falling, we continue to expect food prices to remain contained.

Implications & actions

Re: Economic forecast — For the past two months core inflation has been at a pace broadly consistent with the Fed's target of 2%. This is unambiguously good news but policymakers will want to see pace maintained and more encouraging forward-looking information. We are maintaining our call for a September rate hike given the FOMC is looking to assess the "totality of the data". There is still one more CPI print and an employment reading before the September FOMC decision, and firmness in either or both could tilt the odds more in favour of a final hike.

Re: Markets — Bond yields fell and the greenback depreciated on the data, as they reduce the odds that the Fed will have to press ahead with additional rate hikes this fall.