

Economics

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Red hot core inflation spells trouble for the Fed

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Consumer Price Index (monthly change, %)	July 2022	June 2022	May 2022	April 2022	March 2022	February 2022	July NSA YoY%
All items	0.1	0.0	1.3	1.0	0.3	1.2	8.3
Ex-food/energy	0.6	0.3	0.7	0.6	0.6	0.3	6.3
• Ex-food	0.0	-0.2	1.4	0.9	0.2	1.3	7.8
• Ex-energy	0.6	0.4	0.7	0.7	0.6	0.4	7.1
Energy	-5.0	-4.6	7.5	3.9	-2.7	11.0	23.8
Services	0.7	0.3	0.9	0.8	0.8	0.7	6.8
Housing	0.8	0.4	0.8	0.8	0.6	0.7	7.8
Fuels & util.	1.5	-0.3	2.5	2.9	1.2	2.0	17.2
Food/beverages	0.8	1.1	1.0	1.1	0.8	1.0	10.9
• Food	0.8	1.1	1.0	1.2	0.9	1.0	11.4
Apparel	0.2	-0.1	0.8	0.7	-0.8	0.6	5.1
Transportation	-2.3	-2.1	3.8	2.0	-0.4	3.9	13.4
Medical care	0.7	0.4	0.7	0.4	0.4	0.5	5.4
Recreation	0.2	0.3	0.3	0.4	0.4	0.2	4.1
Education, comm.	0.1	-0.2	0.2	-0.1	-0.2	-0.2	0.5
Other good, serv.	0.7	0.4	0.5	0.5	0.4	0.5	6.6
Commodities	-0.8	-0.5	2.1	1.3	-0.3	2.1	10.6

Source: Haver Analytics.

- Americans saved on gasoline, but paid more for just about everything else in August. The result was that core inflation was red hot, raising the odds that the Fed will consider either a 100bp move at next week's FOMC, or a higher terminal rate than 4%. The 0.6% monthly advance in ex. food and energy prices was twice the pace expected by the consensus and left annual core inflation at 6.3% (vs. 6.1% expected), a four tick acceleration from the prior reading. Shelter and medical care services were key contributors to price pressures in the core measure, amongst other categories. Adding energy and food prices back into the mix showed a 0.1% monthly advance (vs. -0.1% expected), leaving the annual inflation rate at 8.3% (vs. 8.1% expected).
- The acceleration in the shelter component was not unexpected given the lag with which other measures of housing market activity, that looked hotter during the peak of the pandemic, translate into the CPI. Shelter costs are the single-largest weighted component of the CPI basket, and given the lags, the Fed understands that it could be the last component to turn softer. At 6.2% y/y, shelter costs are rising at the fastest pace seen since the early 80s and will continue to leave core inflation elevated this year as resetting rents continue to feed through to the index.

- There were broad-based advances in core categories that weren't expected in August, as health insurance and dental service prices accelerated, adding to strong increases in car insurance and car repair costs, along with new car prices. The increase in new car prices was unexpected given the fading of supply chain issues in that industry, and the impact of higher borrowing costs on demand.
- While gasoline prices fell sharply as expected, energy services, specifically for electricity and natural gas, rose strongly. That added to pressure in food prices, which decelerated to what was still a hefty monthly advance, and stood up 11.4% y/y. The index of global food prices has fallen consistently since April, but feeds through to CPI prices with a lag. Moreover, other costs for consumer food prices, including transportation, an industry where there remains a labor shortage, could limit the deceleration of that component in the CPI.
- Airfare prices continued to ease in August, along with the price of fuel, and perhaps also reflecting slower demand for discretionary travel services, which could also be behind flat hotel prices.

Implications & actions

Re: Economic forecast — We'll admit that this data was far enough above our expectations to have at least some consequence for our Fed call. We were looking for a 75 bp point September move and a peak of 4%, and while softer economic reports still suggest that the Fed will have to pause by year end, either a 100 bp move in September, or a peak of 4.25%, are more in play than we thought ahead of these data.

Re: Markets — Bond yields jumped and investors bolstered expectations for interest rate hikes ahead, and the USD gained ground.

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