

# Economics

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### US CPI: Victory on price stability in sight

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| Consumer Price Index<br>(monthly change, %) | Jul<br>2024 | Jun<br>2024 | May<br>2024 | Apr<br>2024 | Mar<br>2024 | Feb<br>2024 | Jul<br>NSA YoY% |
|---------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-----------------|
| All items                                   | 0.2         | -0.1        | 0.0         | 0.3         | 0.4         | 0.4         | 2.9             |
| Ex-food/energy                              | 0.2         | 0.1         | 0.2         | 0.3         | 0.4         | 0.4         | 3.2             |
| • Ex-food                                   | 0.2         | -0.1        | 0.0         | 0.4         | 0.4         | 0.5         | 3.0             |
| • Ex-energy                                 | 0.2         | 0.1         | 0.2         | 0.3         | 0.3         | 0.3         | 3.0             |
| Energy                                      | 0           | -2          | -2.0        | 1.1         | 1.1         | 2.3         | 1.1             |
| Services                                    | 0.3         | 0.1         | 0.2         | 0.4         | 0.5         | 0.5         | 4.9             |
| Housing                                     | 0.4         | 0.2         | 0.3         | 0.2         | 0.4         | 0.4         | 4.4             |
| Fuels & util.                               | 0.1         | -0.1        | -0.1        | -0.3        | 0.5         | 0.7         | 4.1             |
| Food/beverages                              | 0.2         | 0.2         | 0.1         | 0.0         | 0.1         | 0.0         | 2.2             |
| • Food                                      | 0.2         | 0.2         | 0.1         | 0.0         | 0.1         | 0.0         | 2.2             |
| Apparel                                     | -0.4        | 0.1         | -0.3        | 1.2         | 0.7         | 0.6         | 0.2             |
| Transportation                              | -0.1        | -1.3        | -1.1        | 0.7         | 0.8         | 1.4         | 1.0             |
| Medical care                                | -0.2        | 0.2         | 0.5         | 0.4         | 0.5         | 0.0         | 3.2             |
| Recreation                                  | 0.1         | 0.1         | -0.2        | 0.2         | -0.1        | 0.2         | 1.4             |
| Education, comm.                            | 0.2         | -0.1        | 0.0         | 0.2         | 0.0         | 0.4         | 0.9             |
| Other good, serv.                           | 0.2         | 0.6         | 0.2         | 0.4         | 0.4         | -0.3        | 4.2             |
| Commodities                                 | -0.1        | -0.4        | -0.4        | 0.2         | 0.1         | 0.4         | -0.4            |

Source: Haver Analytics.

- Today's July CPI report showed price pressures continuing to cool. Core CPI prices rose 0.2% m/m in July, in line with consensus expectations, and the third straight reading consistent with underlying inflation around the Fed's target. Three-month annualized core CPI sits at 1.6% as of July, down from the 4% range at the start of the year. Headline inflation also came in at 0.2% m/m in July, matching forecasters predictions. In year-over-year terms, headline inflation was 2.9% and core was 3.2%, both down one tick from the month prior. Core goods prices declined yet again, as the used car market continues to rebalance. Service prices strengthened a bit relative to the prior month as shelter inflation rebounded, particularly rents. Monthly shelter prices can be noisy but we expect a firmer downward trend to emerge eventually, making the last mile smoother. But overall the Fed will walk away from today's release with more confidence that underlying inflation is headed in the right direction. Of course it's no longer just about inflation. There are reasonable worries about the labor market starting to crack, which will have them move a bit faster than they signaled in the June SEP. We expect three consecutive quarter point rate cuts for the remainder of the year.
- As of writing, the market continues to price in large moves with about 100 basis points of easing priced until December. September still has an outsized cut priced in but is headed towards a normal quarter point cut. Markets

are more focused on the risk of a recession and tomorrow's retail sales report will have a greater influence on attitudes about the Fed than today's inflation report.

- The most interesting detail in today's data was the pick up in shelter inflation. Shelter prices rose to 0.4% in July, up from the 0.2% m/m in June, which makes the dip last month seem like a blip. The main cause of the pick up was a surge in the rental component, which was up 0.5% m/m compared to 0.3% the month prior, with the July reading the highest rate seen since May of last year. In contrast, Owner's Equivalent Rent (OER) rebounded a bit in the month but still clearly shows a downward path. It came in at 0.4%, up from 0.3% but below the pace seen most of the past year.
- We view the strength in rents as noise because all other rental measures are increasingly pointing in the opposite direction, suggesting rental inflation in the CPI will eventually come down, and that could be quite sharp. For example, the BLS and Cleveland Fed's All Tenant's Regressed Index has shown significantly softening and Zillow's Observed Rent Index has cooled even further since the start of the year. We don't expect the Fed to lose much sleep over the strong rental print today, being encouraged by the downward trend in OER as a more enduring signal of where shelter costs are headed. At some point once the dust has settled, given everything we have seen on this component, we hope the BLS will sit down and ask themselves whether this is truly the best way to shelter prices in the economy.
- Non-housing services, which matters more for PCE inflation, was rebounded to a still cool pace of 0.2% after two consecutive flat readings. Medical services contracted in the month by 0.3% in the month while transportation services rebounded to 0.4%. Under the hood of transportation, car insurance rates continued to climb but were offset partly by a further dip in airfares. That is the fifth consecutive decline for airfares, and we may start to see some rising pricing boost non-housing services at some point this year given the sharp deflation in this category.
- Core goods contracted by 0.3% in the month, largely because used car prices fell again (-2.3%). A rebalancing of the auto sector is likely going to continue to put downward pressure on goods as auction prices for used cars continue to edge down. Stripping out used cars, other core goods prices declined by 0.1%. Supply in the global goods market remains robust and the US consumer demand for durables looks like it has come down a few gears after the spending spree in 2023.
- Overall, today's report is a further sign that the Fed can now see victory on its price stability mandate. The broader balance of supply and demand is keeping price pressures in check and we expect another 0.2% m/m core PCE reading for July. With shelter inflation likely to come down further and goods deflation unlikely to continue over the course of the next year, the ingredients of stable inflation around target are in place, barring a sharp slowdown in activity. The Fed's focus is now on the latter and we expect steady policy easing, and a stronger signal of more to come, to help calm nerves.

## Implications & actions

**Re: Economic forecast** — No surprises today with more good news on the inflation front. We expect three quarter point cuts for the remainder of the year, as the Fed guards against the risk of a more rapid deterioration of the labor market.

**Re: Markets** — Bond yields bounced around this morning and are about unchanged as of writing, while the dollar has drifted down a bit.

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