Datanote: US CPI, July

In one line: Another month of “good data”, implying a 0.13% core PCE print.

- The July CPI rose by 0.2%, matching the consensus.
- The core increased by 0.17%, in line with the consensus, 0.2%.

July’s CPI data continue the run of “good data” that the Fed wants to see before starting to ease. Prices for core services ex-rents increased by just 0.21%, even though slight falls in the previous two months hinted at scope for a rebound. Prices for core services ex-rent rose at a 2.0% annualized rate in the three months to July, compared to the previous three months, the lowest rate on this basis since November 2021 and much better than the 3.9% increase in the three months to June. Admittedly, an erratic-looking 1.0% fall in hospital services prices subtracted 0.09pp from July's core services ex-rent index, and a 1.6% drop in airline fares subtracted a further 0.05pp. Both likely will rebound in August. But auto insurance premiums likely will not continue to rise at July’s 1.2% pace for much longer, given that both new and used vehicle prices are falling sharply. Moreover, the recent further slowdown in wage growth suggests that the downshift in services price rises will be sustained.

The 0.49% increase in primary rents—the biggest since May 2023—almost certainly is not the start of a rising trend. Primary rents lag Zillow's

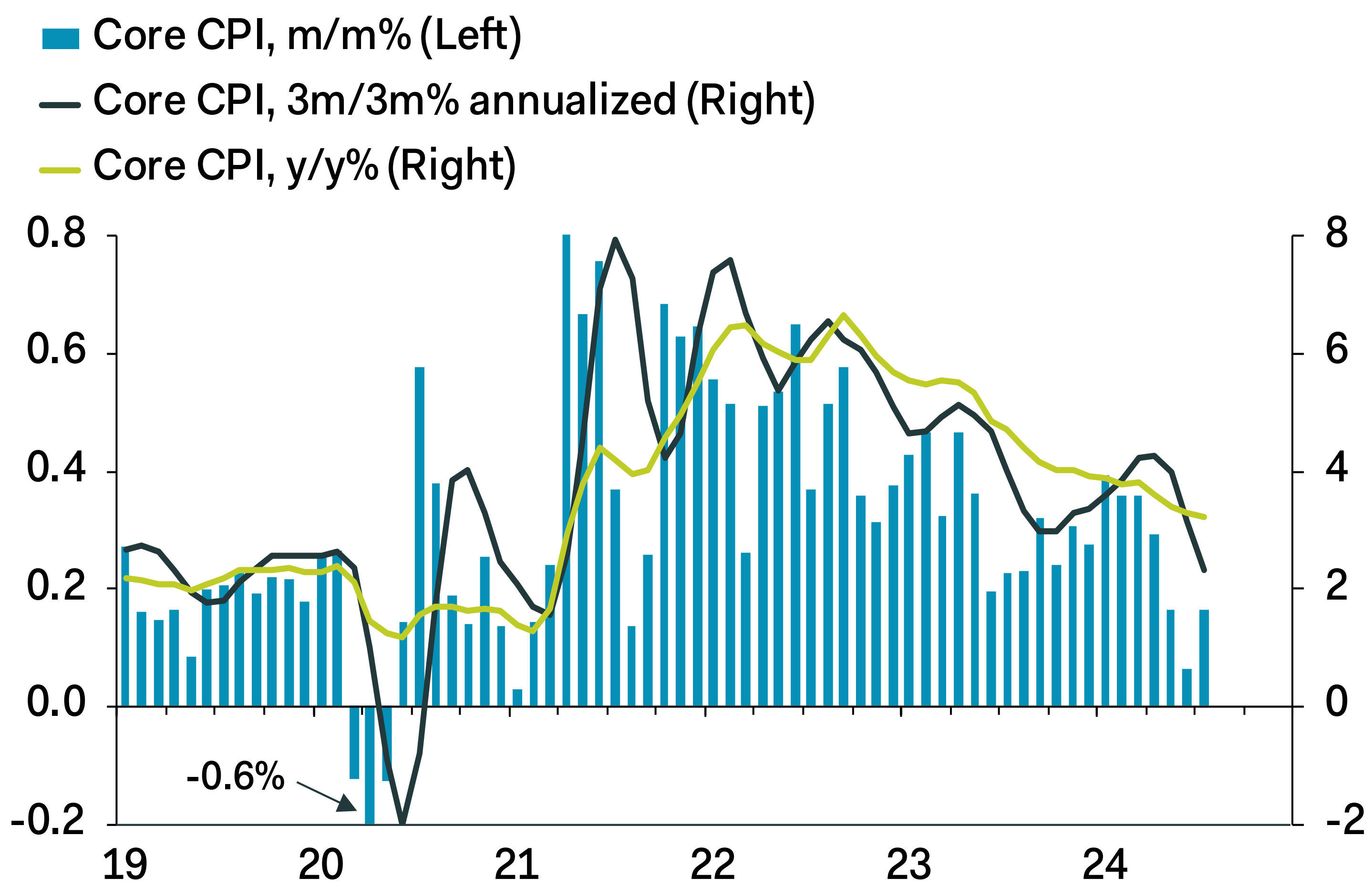
Observed Rent Index, which increased at an average month-to-month rate of 0.25% in the six months to July, down from 0.32% in the previous six months. Meanwhile, owners' equivalent rent rose by a much weaker 0.36%. A 0.13pp difference is not unprecedented, but this was the second-biggest gap since October 2012. The month-to-month change in OER is the sixth root of the change from six months earlier, so July was the first month when the month-to-month change in OER was not boosted by the increase in the weight of single-family homes in OER sample in January. We look for 0.3% increases in both primary rent and OER over the rest of Q3.

Elsewhere, the 0.3% drop in core goods prices was driven almost entirely by the 2.3% fall in used auto prices. Excess inventory, improved supply of new vehicles, high borrowing costs and more cautious consumer demand will continue to drive down used vehicle prices over the coming months. Meanwhile, new auto prices fell for the sixth straight month, albeit by only 0.2%. Other core goods prices fell by 0.1%, with a 0.3% rise in furniture prices—potentially reflecting the recent pick-up in shipping costs—being offset by a 0.4% decline in apparel prices, which are continuing to reverse their April jump. Fundamentally, the trend in core goods ex-auto prices still looks flat.

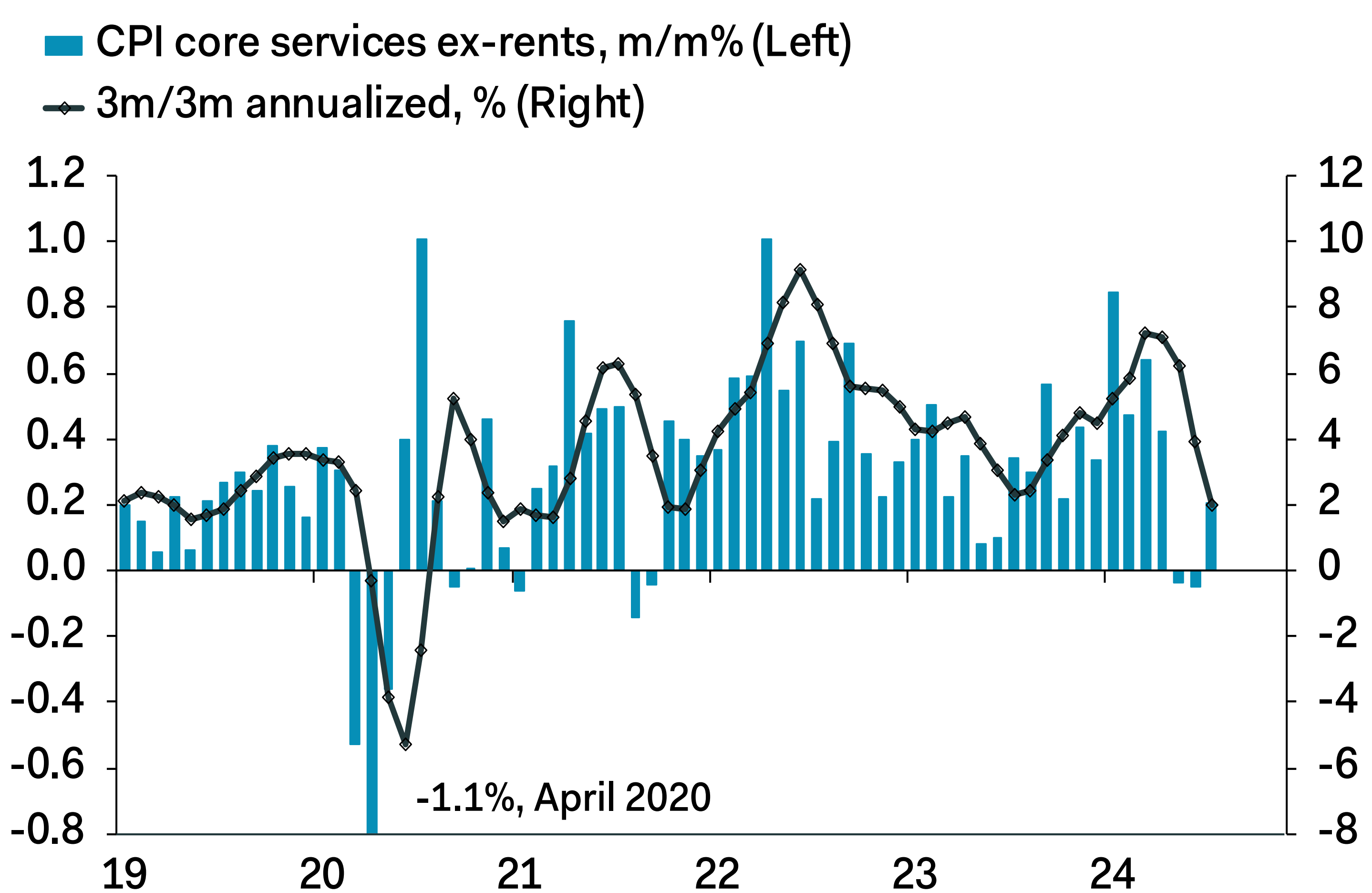
Our mapping of today's CPI data and yesterday's PPI numbers implies that the core PCE deflator increased by 0.13% in July. This would undershoot the average May-to-December increase of 0.19% implied by the Fed's June SEP forecasts for the third straight month. Accordingly, it's looking a foregone conclusion that the Fed will ease policy next month, and PCE data won't stand in the way of a 50bp cut if August payrolls are as lackluster as July's.

Looking ahead, we expect core CPI inflation to decline to about 2.7% by December, from 3.2% in July, and to average just 2% in 2025. The labor market is slackening quickly, dragging down wage growth and new rent increases, while PPI data highlight substantial scope for retailers to respond to slowing growth in consumers' spending by reducing their margins. In addition, shipping costs have fallen for three weeks straight, according to data from Drewry, and business surveys show input cost inflation remains mild, despite the jump in shipping costs in H1. Furthermore, below-average capacity utilization in the manufacturing sector and excess inventory levels suggest that core goods

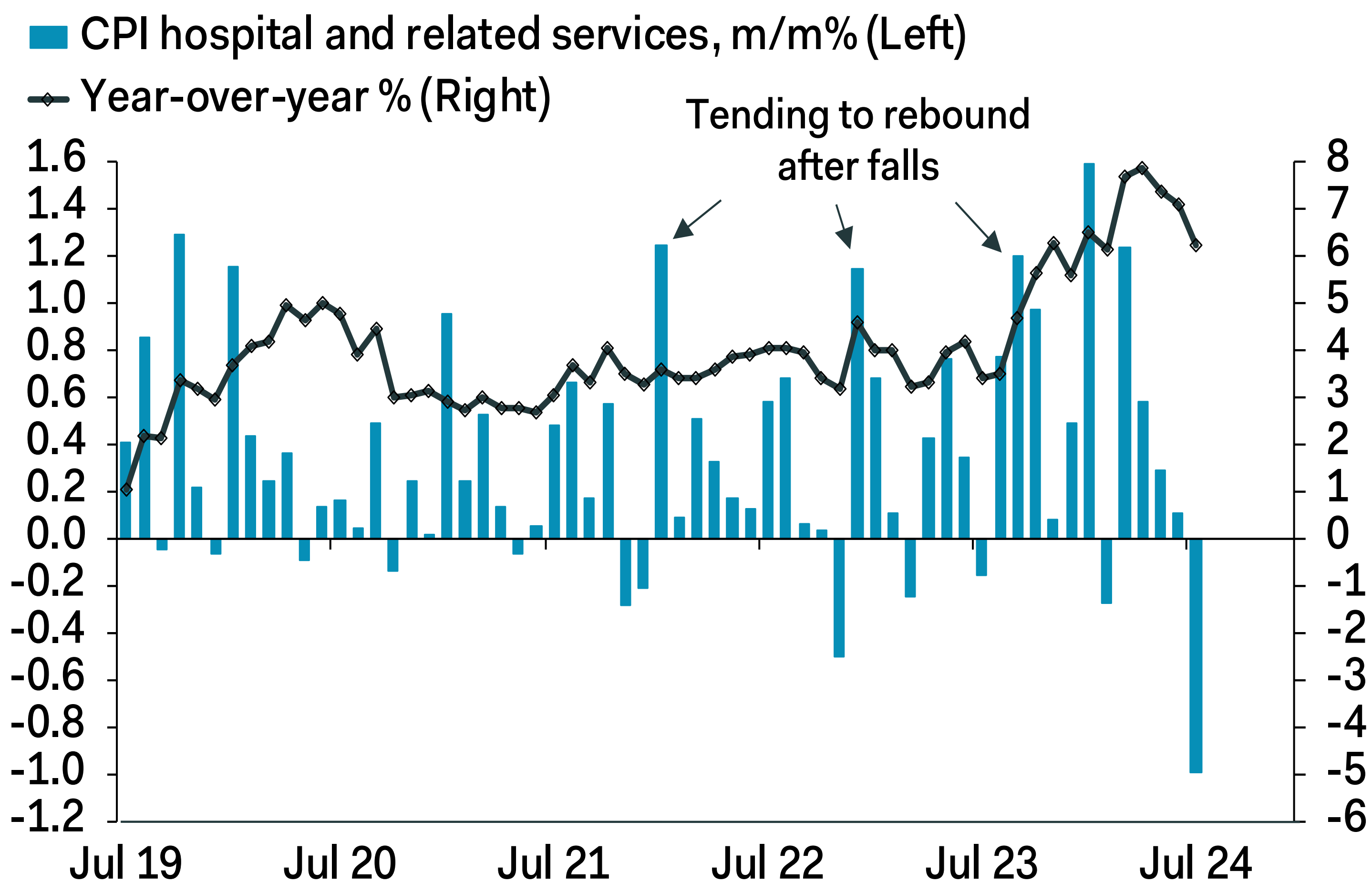
CPI inflation will continue to hover about zero. Meanwhile, recent falls in vehicle prices point to sharp declines in the inflation rates for auto insurance and repair ahead. Accordingly, the CPI outlook suggests that the FOMC would be fully justified in returning interest rates rapidly to their neutral level. We continue to think that the Committee will have reduced the fed funds rate target range to 2.50%-to-2.75% by this time next year.



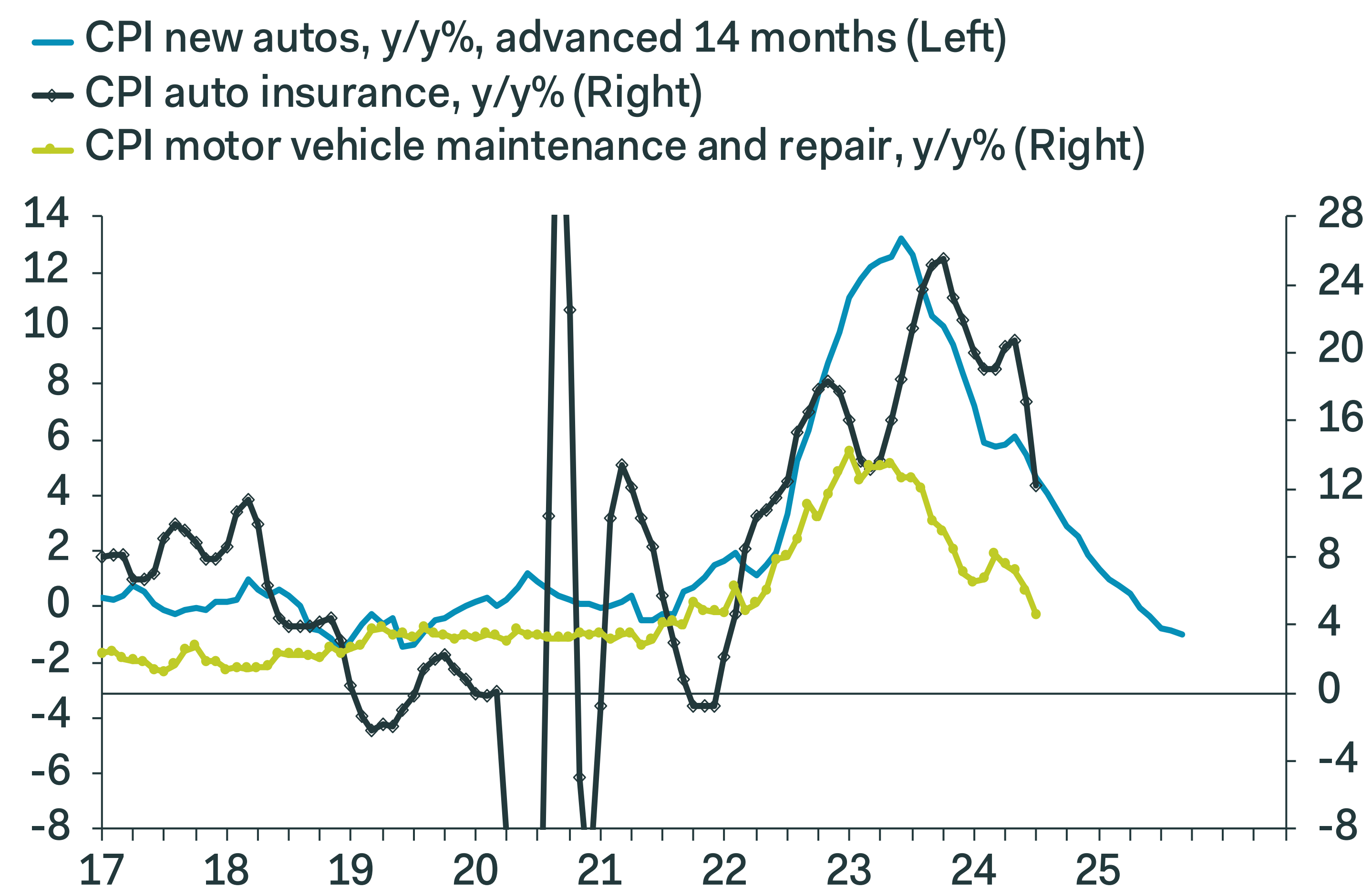
Core CPI, m/m% (Left)
Core CPI, 3m/3m% annualized (Right)
Core CPI, y/y% (Right)
0.8
0.6
0.4
0.2
0.0
-0.2
8
6
4
2
0
-2
-0.6%
19
20
21
22
23
24



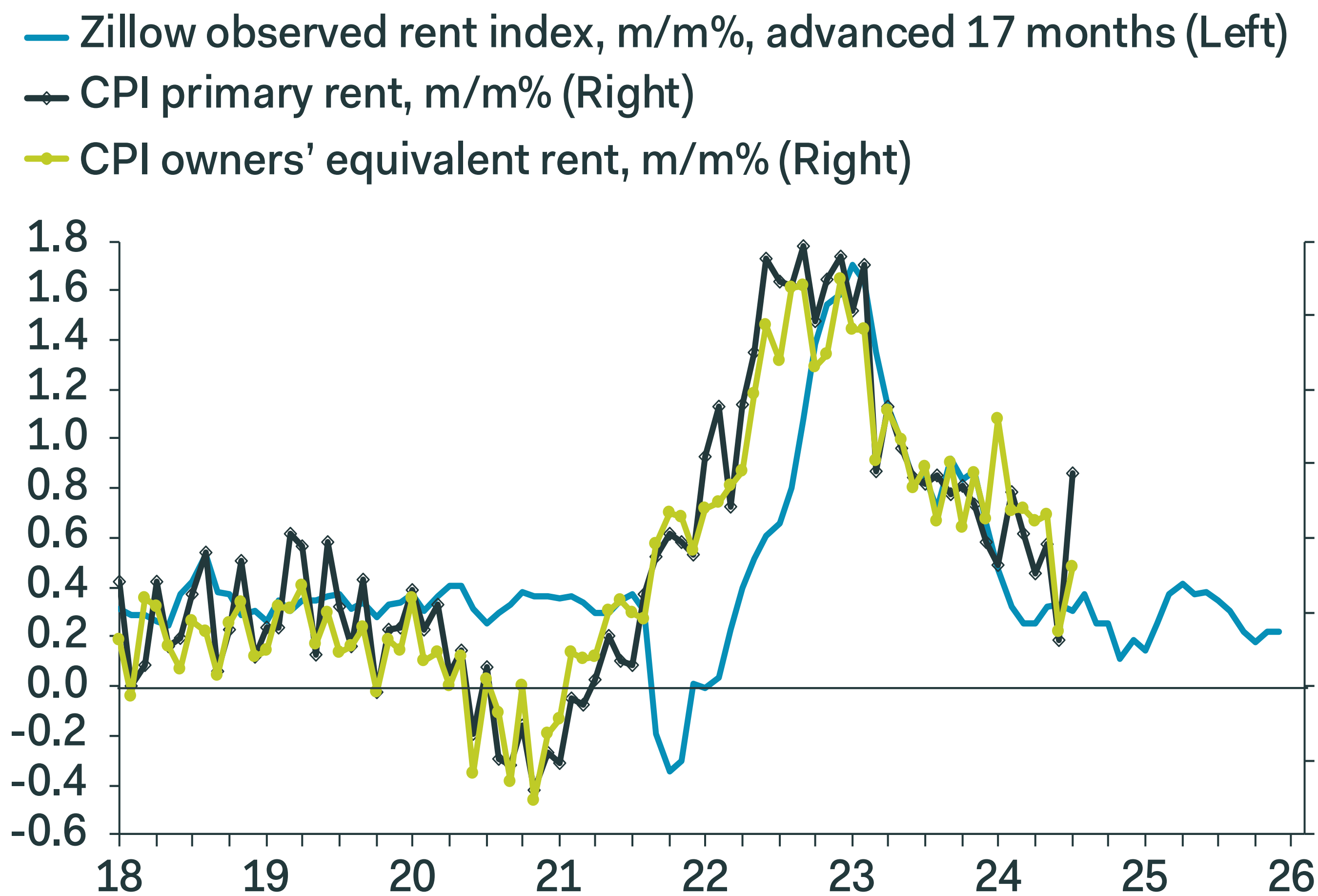
CPI core services ex-rents, m/m% (Left)
3m/3m annualized, % (Right)
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
12
10
8
6
4
2
0
-2
-4
-6
-8
-1.1%, April 2020
19
20
21
22
23
24



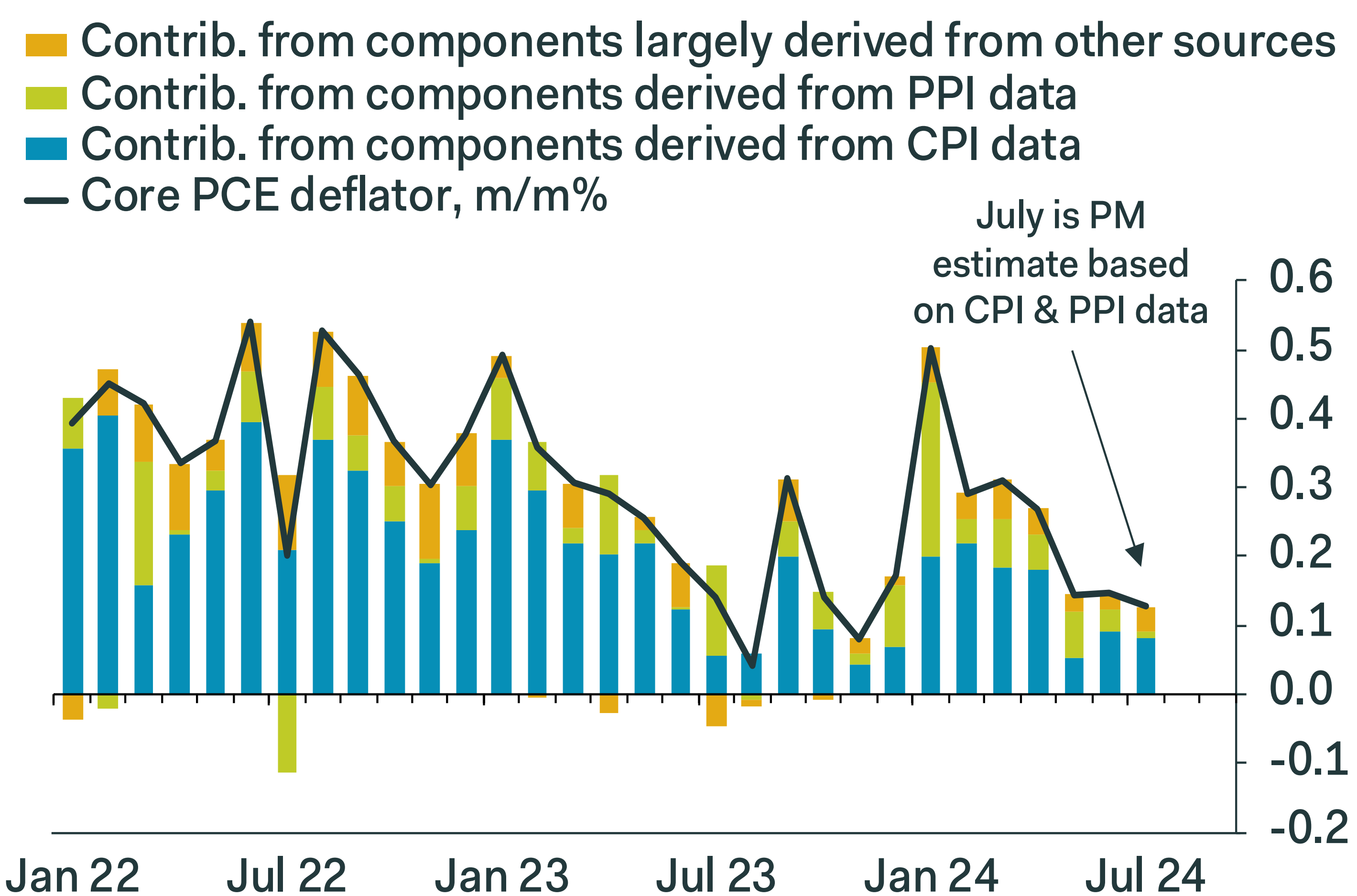
CPI hospital and related services, m/m% (Left)
Year-over-year % (Right)
Tending to rebound after falls
1.6
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
-0.8
-1.0
-1.2
8
7
6
5
4
3
2
1
0
-1
-2
-3
-4
-5
-6
Jul 19
Jul 20
Jul 21
Jul 22
Jul 23
Jul 24



CPI new autos, y/y%, advanced 14 months (Left)
CPI auto insurance, y/y% (Right)
CPI motor vehicle maintenance and repair, y/y% (Right)
14
12
10
8
6
4
2
0
-2
-4
-6
-8
28
24
20
16
12
8
4
0
-4
-8
17
18
19
20
21
22
23
24
25



Zillow observed rent index, m/m%, advanced 17 months (Left)
CPI primary rent, m/m% (Right)
CPI owners' equivalent rent, m/m% (Right)
1.8
1.6
1.4
1.2
1.0
0.8
0.6
0.4
0.2
0.0
-0.2
-0.4
-0.6
0.8
0.7
0.6
0.5
0.4
0.3
0.2
0.1
0.0
18
19
20
21
22
23
24
25
26



Contrib. from components largely derived from other sources
Contrib. from components derived from PPI data
Contrib. from components derived from CPI data
Core PCE deflator, m/m%
July is PM estimate based on CPI & PPI data
0.6
0.5
0.4
0.3
0.2
0.1
0.0
-0.1
-0.2
Jan 22
Jul 22
Jan 23
Jul 23
Jan 24
Jul 24