

ECONOMIC UPDATE

 REGIONS

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August Consumer Price Index: Core Inflation Picking Up Steam

- › The total CPI rose by 0.1 percent (.054 percent unrounded) in August; the core CPI rose by 0.3 percent (0.256 percent unrounded)
- › On a year-over-year basis, the total CPI is up 1.7 percent and the core CPI is up 2.4 percent as of August

The total CPI rose by 0.1 percent in August, matching the consensus forecast, while the core CPI rose by 0.3 percent, topping the 0.2 percent increase we and the consensus expected. Our forecast anticipated the headline CPI being unchanged, but as we noted in our weekly *Economic Preview*, the difference between this and a 0.1 percent increase would basically be a rounding error. The unrounded increase reported by BLS – a 0.054 percent increase – shows this to have been the case, and the same is pretty much the case with the increase in the core CPI (note to self: next time, round up, not down). Either way, the 2.4 percent year-on-year increase in the core CPI is the fastest pace of core CPI inflation in over a year. Keep in mind, however, that the PCE Deflator is the FOMC's preferred gauge of inflation and that over time core CPI inflation has outrun core PCE inflation by 30-40 basis points. As such, it will be some time before core PCE inflation tops the FOMC's 2.0 percent target, and longer still before the FOMC actually becomes concerned about it doing so. Clearly, with their focus squarely on sustaining the expansion and mitigating the downside risks from global trade disputes, the August CPI data will not deter the FOMC from cutting the funds rate at their September meeting.

One thing that stands out in the details of the August CPI report is the sudden reversal of what in recent months have been sharp increases in many of the components. For instance, prices for household furnishings and operations rose by 0.786 percent in June and by 0.355 percent in July, the largest two-month increase in this series since the first two months of 1991. In August, however, this component fell by 0.1 percent. After the prior three months saw increases of 0.7 percent, 0.9 percent, and 0.7 percent, prices for furniture and bedding sank by 1.1 percent in August. Similar patterns are seen in other components of this broad category, but it is hard to come up with a plausible story that would account for these patterns, with "the numbers are what the numbers are" not being all that satisfactory of an answer. In any event, gasoline prices were down 3.5 percent on a seasonally adjusted basis, as the 4.5 percent decline in unadjusted prices swamped the seasonal adjustment factor. Food prices were flat in August, as prices for food consumed at home fell by 0.2 percent and prices for food consumed away from home rose by 0.2 percent. While this leaves prices for food consumed away from home up 3.2 percent year-on-year, it is odd that the monthly increases have moderated of late, as this has been one of the top performing categories in the retail sales data, suggesting operators have more, but not unlimited, pricing power than is the case in other retail segments.

One thing apparent in the CPI data is that there is more to the recent acceleration in core inflation than rising rents. For instance, core goods prices have posted three consecutive monthly increases and are up 0.84 percent year-on-year. While that may not seem like much of a story, keep in mind that core goods prices had been falling over the past several years. August's year-on-year increase is the largest since July 2012, and to the extent tariffs are imposed on a wider range of consumer goods, core goods prices would post larger advances. At the same time, core services prices rose by 0.3 percent in August, leaving them up 2.9 percent year-on-year. August's increase in the broad category comes despite below-trend increases in rents and a steep decline in lodging costs acting as drags. Medical care costs jumped 0.7 percent in August, the largest monthly advance in three years, leaving them up 3.5 percent year-on-year. Hospital services and health insurance premiums were the driving forces behind August's increase. More broadly, while service providers are largely immune from the effects of trade disputes, they do have more latitude to pass along higher labor costs in the form of higher prices to consumers, which will sustain faster core services inflation in the months ahead. Though methodological differences largely account for the gap between inflation as measured by the CPI and the PCE deflator, it seems likely that the broader patterns in core CPI inflation seen in recent months will make their way into the PCE deflator before long. But, given what remain downside risks to growth, it may take longer for the FOMC to become overly concerned.

