

Economic Indicator — September 11, 2024

August CPI: Probably a 25 bps Rate Cut Next Week

Summary

August's inflation data probably cement a 25 bps, rather than a 50 bps, reduction in the federal funds rate at next week's FOMC meeting in our view. The 0.2% increase in headline CPI was in line with expectations, while the 0.3% increase in core CPI was slightly higher than consensus forecasts.

Another month of tepid food inflation and falling energy prices kept headline inflation in check. Excluding food and energy, the deflation in core goods remained in effect, led by a 1.0% drop in prices for used autos. A larger-than-expected drop in prices for core goods was more than offset by faster-than-expected services inflation. A bounce back in travel-services prices such as lodging away from home and airfares ended a run of unusually soft readings for these categories. Primary shelter inflation also came in high relative to our expectations and at odds with leading indicators from private sector data sources. Overall, we see the lingering split between goods and services inflation as a sign that the unwinding of pandemic-era effects on prices is taking somewhat longer, rather than as an indication disinflation is running out of steam.

On balance, today's data suggest that a 25 bps rate cut is more likely than 50 bps next week, but we would not be completely shocked if the FOMC elected to move by 50 bps. Furthermore, starting with a 25 bps move does not rule out a pickup in the pace of policy easing at future meetings. The ongoing deterioration in the labor market has become an increasing focus for the FOMC, and inflation is slowly but surely returning to 2% on trend. The core CPI has increased at a 2.1% annualized pace over the past three months, a slow enough pace that 50 bps rate cuts at future meetings remain squarely on the table if the labor market data spur faster action. Regardless, all signs point to additional rate cuts beyond next week in our view.

Economist(s)

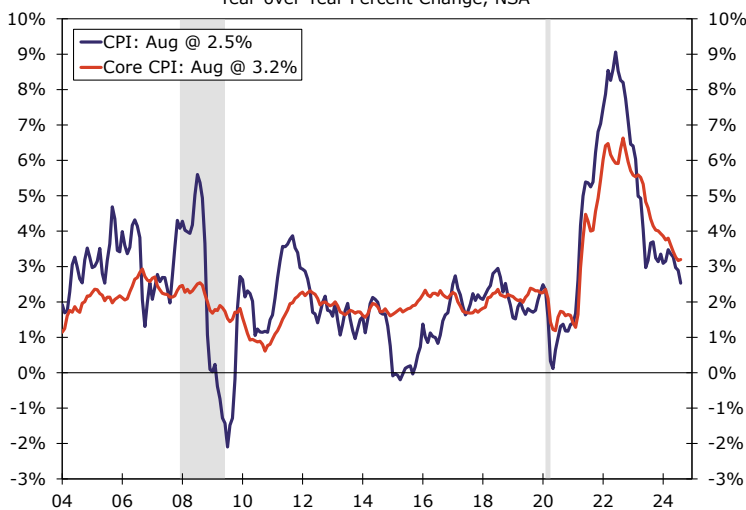
Sarah House

Senior Economist | Wells Fargo Economics
Sarah.House@wellsfargo.com | 704-410-3282

Michael Pugliese

Senior Economist | Wells Fargo Economics
Michael.D.Pugliese@wellsfargo.com | 212-214-5058

Headline vs. Core CPI
Year-over-Year Percent Change, NSA

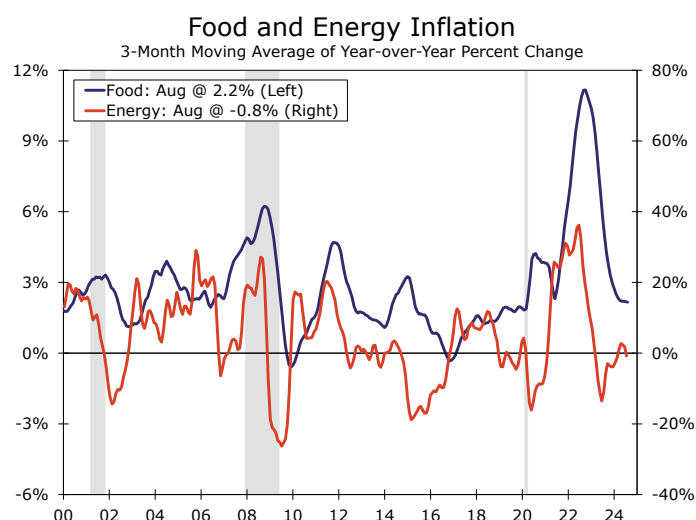


Source: U.S Department of Labor and Wells Fargo Economics

Split Between Goods and Services Inflation Was Amplified in August

Inflation in August came in roughly in line with expectations, rising 0.2% in the month and 2.5% over the past year according to the Consumer Price Index. A relatively small 0.8% decline in energy prices in the month helped keep headline inflation in check, led lower by a 0.6% dip in gasoline prices and a 1.9% drop in utility gas service. Based on the limited data available for September and the recent trend in oil prices, another decline in energy prices appears likely to come in next month's CPI release. Food inflation also continued its run of relatively benign gains, rising 0.1% in August. Price growth for food consumed away from home (0.3% month-over-month and 4.0% year-over-year) once again outpaced inflation at the grocery store (prices unchanged over the month and up 0.9% compared to one year ago).

Monetary policymakers like those at the Federal Reserve tend to focus on inflation excluding food and energy given that these two components are quite volatile and their prices are often determined by factors other than the stance of monetary policy. That said, headline inflation better reflects the price growth that consumers experience in their daily lives. Much slower food and energy inflation over the past year has brought good news for households on the inflation front. The 2.5% increase in the headline CPI over the past 12 months is more or less in line with where this indicator was on the eve of the pandemic (2.3% in February 2020).

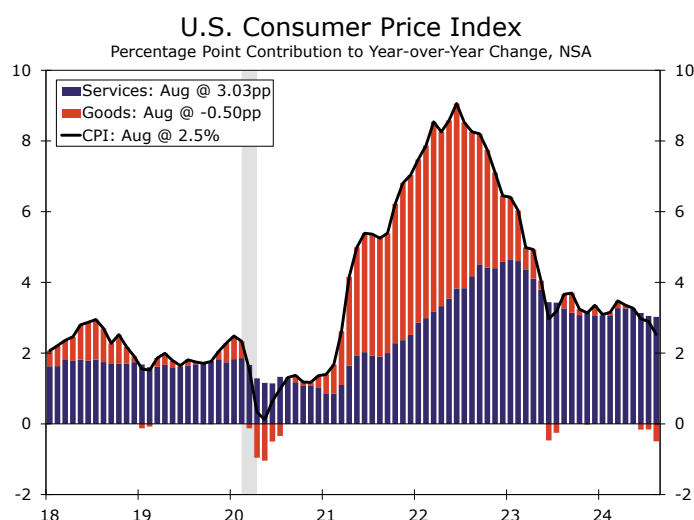


Source: U.S. Department of Labor and Wells Fargo Economics

Core inflation picked up in August, rising 0.3% after a 0.2% gain in July. The slower pace of disinflation when excluding food and energy comes amid what is still rather sticky services inflation. Core services prices advanced 0.4% in August, the largest increase since April. The moderation in shelter inflation remains painfully slow. Despite the notably lower pace of rental inflation signaled by private sector measures, primary shelter (the weighted average of rent of primary residences and owners' equivalent rent) rose 0.5% in August. We have not given up the view that shelter inflation should slow more materially ahead, with the BLS's All Tenant Rent Index having fallen sharply. That said, the stubbornly high pace of official shelter inflation raises some doubts about the extent to which it may ultimately ease further this cycle.

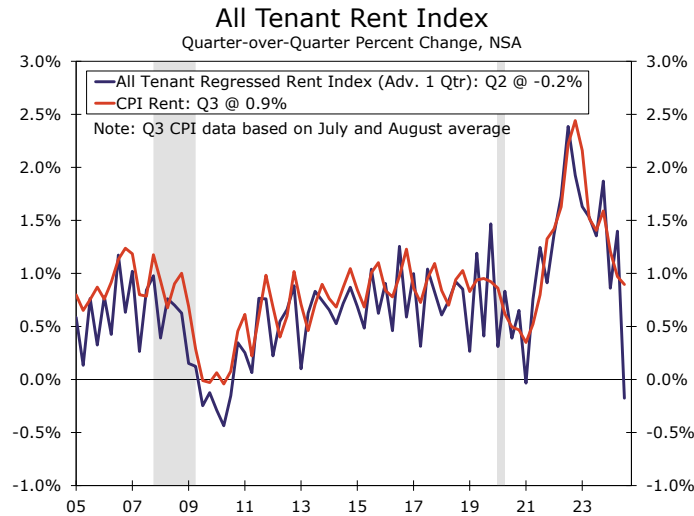
Core services ex-shelter also got a boost in August from higher travel-related prices (lodging away from home +1.8%, airfares +3.9%). Given that these categories are some of the more volatile components of core services, we are less concerned about their monthly rise in the context of further services disinflation ahead. Meanwhile, outright deflation in the goods sector continues. Core goods fell 0.2%, led by a drop in used autos (-1.0%). While auction prices point to a rebound in used vehicle prices over the next month or two, outside the auto space, goods prices also declined in August, signaling the benefits of smoother supply chains and cooler demand have yet to run their course.

While core prices rose more in August relative to the prior three-month average pace of monthly gains (0.13%), the early summer pace likely understated the trend in inflation just as the first quarter's average gain of 0.37% seemed to overstate it. August's figures likely give a somewhat cleaner read,

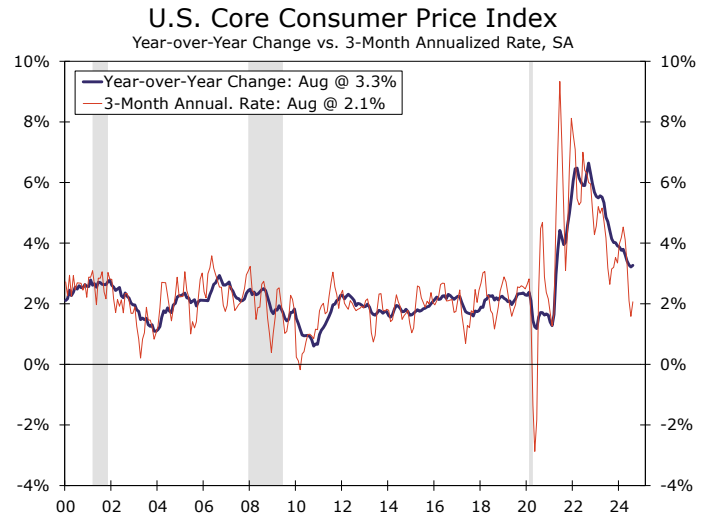


Source: U.S. Department of Labor and Wells Fargo Economics

in our view. The three-month annualized rate of core CPI inflation was just 2.1% in August, below the year-over-year pace of 3.2%. With food and energy related commodity prices having retreated of late and ongoing cooling in the labor market, we expect inflation to remain in check in the months to come.



Source: U.S. Department of Labor and Wells Fargo Economics



Source: U.S. Department of Labor and Wells Fargo Economics

The combination of today's CPI report, last Friday's employment report and recent communication from key Fed officials leads us to believe that the FOMC will reduce the federal funds rate by 25 bps at its meeting next week. That said, we would not be completely shocked if the FOMC opted for a 50 bps rate cut instead. Nonfarm payroll growth has slowed significantly in recent months, and the upward trend in the unemployment and under-employment rates is concerning. The pickup in core CPI inflation from July to August is unwelcome news for those hoping for a larger cut next week, but the underlying trend in price growth remains down in our view.

Subscription Information

To subscribe please visit: www.wellsfargo.com/economicsemail

Via The Bloomberg Professional Services at WFRE

Economics Group

Jay H. Bryson, Ph.D.	Chief Economist	704-410-3274	Jay.Bryson@wellsfargo.com
Sam Bullard	Senior Economist	704-410-3280	Sam.Bullard@wellsfargo.com
Nick Bennenbroek	International Economist	212-214-5636	Nicholas.Bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	704-410-3283	Tim.Quinlan@wellsfargo.com
Sarah House	Senior Economist	704-410-3282	Sarah.House@wellsfargo.com
Azhar Iqbal	Econometrician	212-214-2029	Azhar.Iqbal@wellsfargo.com
Charlie Dougherty	Senior Economist	212-214-8984	Charles.Dougherty@wellsfargo.com
Michael Pugliese	Senior Economist	212-214-5058	Michael.D.Pugliese@wellsfargo.com
Brendan McKenna	International Economist	212-214-5637	Brendan.Mckenna@wellsfargo.com
Jackie Benson	Economist	704-410-4468	Jackie.Benson@wellsfargo.com
Shannon Grein	Economist	704-410-0369	Shannon.Grein@wellsfargo.com
Nicole Cervi	Economist	704-410-3059	Nicole.Cervi@wellsfargo.com
Jeremiah Kohl	Economic Analyst	212-214-1164	Jeremiah.J.Kohl@wellsfargo.com
Aubrey Woessner	Economic Analyst	704-410-2911	Aubrey.B.Woessner@wellsfargo.com
Delaney Conner	Economic Analyst	704-374-2150	Delaney.Conner@wellsfargo.com
Anna Stein	Economic Analyst	212-214-1063	Anna.H.Stein@wellsfargo.com
Ali Hajibeigi	Economic Analyst	212-214-8253	Ali.Hajibeigi@wellsfargo.com
Coren Miller	Administrative Assistant	704-410-6010	Coren.Miller@wellsfargo.com

Required Disclosures

This report is produced by the Economics Group of Wells Fargo Bank, N.A. ("WFBNA"). This report is not a product of Wells Fargo Global Research and the information contained in this report is not financial research. This report should not be copied, distributed, published or reproduced, in whole or in part. WFBNA distributes this report directly and through affiliates including, but not limited to, Wells Fargo Securities, LLC, Wells Fargo & Company, Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Europe S.A., and Wells Fargo Securities Canada, Ltd. Wells Fargo Securities, LLC is registered with the Commodity Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. WFBNA is registered with the Commodity Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC and WFBNA are generally engaged in the trading of futures and derivative products, any of which may be discussed within this report.

This publication has been prepared for informational purposes only and is not intended as a recommendation, offer or solicitation with respect to the purchase or sale of any security or other financial product, nor does it constitute professional advice. The information in this report has been obtained or derived from sources believed by WFBNA to be reliable, but has not been independently verified by WFBNA, may not be current, and WFBNA has no obligation to provide any updates or changes. All price references and market forecasts are as of the date of the report or such earlier date as may be indicated for a particular price or forecast. The views and opinions expressed in this report are those of its named author(s) or, where no author is indicated, the Economics Group; such views and opinions are not necessarily those of WFBNA and may differ from the views and opinions of other departments or divisions of WFBNA and its affiliates. WFBNA is not providing any financial, economic, legal, accounting, or tax advice or recommendations in this report, neither WFBNA nor any of its affiliates makes any representation or warranty, express or implied, as to the accuracy or completeness of the statements or any information contained in this report, and any liability therefore (including in respect of direct, indirect or consequential loss or damage) is expressly disclaimed. WFBNA is a separate legal entity and distinct from affiliated banks, and is a wholly-owned subsidiary of Wells Fargo & Company. © 2024 Wells Fargo Bank, N.A.

Important Information for Non-U.S. Recipients

For recipients in the United Kingdom, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority ("FCA"). For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 (the "Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Act for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. For recipients in the EFTA, this report is distributed by WFSIL. For recipients in the EU, it is distributed by Wells Fargo Securities Europe S.A. ("WFSE"). WFSE is a French incorporated investment firm authorized and regulated by the Autorité de contrôle prudentiel et de résolution and the Autorité des marchés financiers. WFSE does not deal with retail clients as defined in MiFID2. This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED - MAY LOSE VALUE - NO BANK GUARANTEE