Economic Indicator — August 12, 2025

July CPI: Broad Heat in the Core

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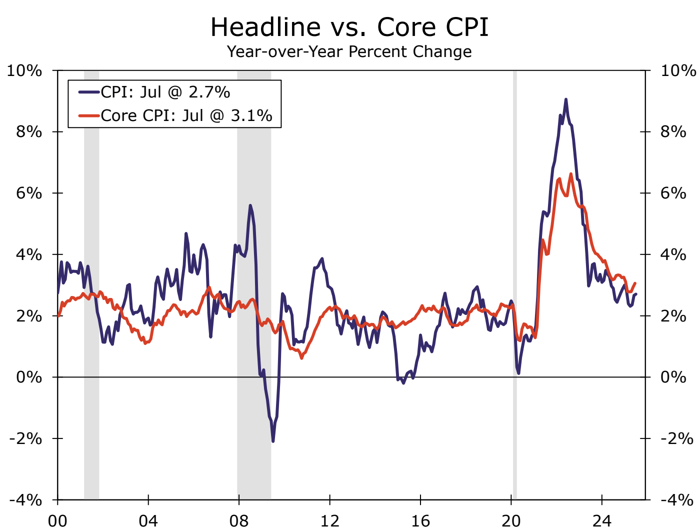
Summary

Consumer prices rose roughly in line with expectations in July. Headline CPI moderated to a 0.20% gain, keeping the year-over-year rate steady at 2.7%. Excluding food and energy, the core CPI was hotter, rising 0.32% over the month and pushing the year-over-year rate up to 3.1%—its highest year-ago reading since February. The details show tariff-related price increases continuing to seep into the economy, with core goods prices rising 0.2% in July amid additional increases for heavily imported items, such as household furnishings and recreational goods. Core services inflation picked up a stronger-than-expected 0.4% as a rebound in airfares and a strengthening in medical care services prices overtook the gradual moderation in primary shelter cost growth. Yet, with medical care and airfares not serving as source data for the PCE deflator, we currently estimate the core PCE index rose a softer 0.22% in July.

Today's CPI report illustrates the challenges the Fed faces in its efforts to balance its price stability and maximum employment dual mandate. The labor market is showing signs of lost momentum, but inflation is 1) still above the 2% target and 2) drifting in the wrong direction. We are skeptical of rate cuts much deeper than our current forecast of 25 bps cuts at the FOMC's next three meetings given the prospects for above target inflation over the next year. Unless the labor market deteriorates more markedly, it is hard to make the case that monetary policy should be accommodative at present, in our view.



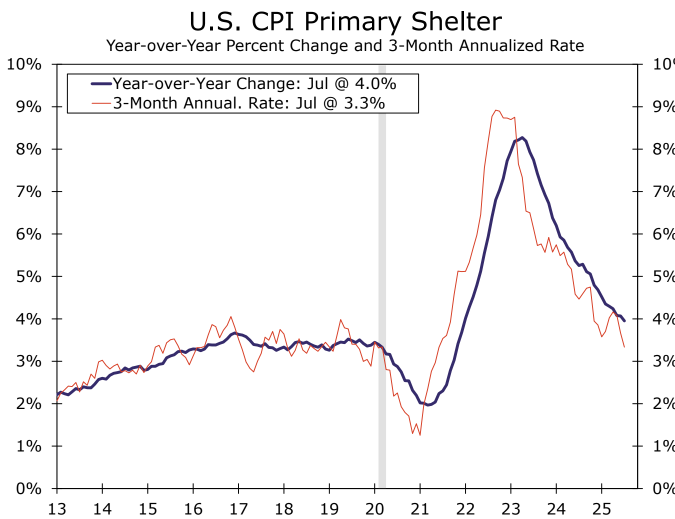
Source: U.S. Department of Labor and Wells Fargo Economics

Core Inflation Heats Up in July

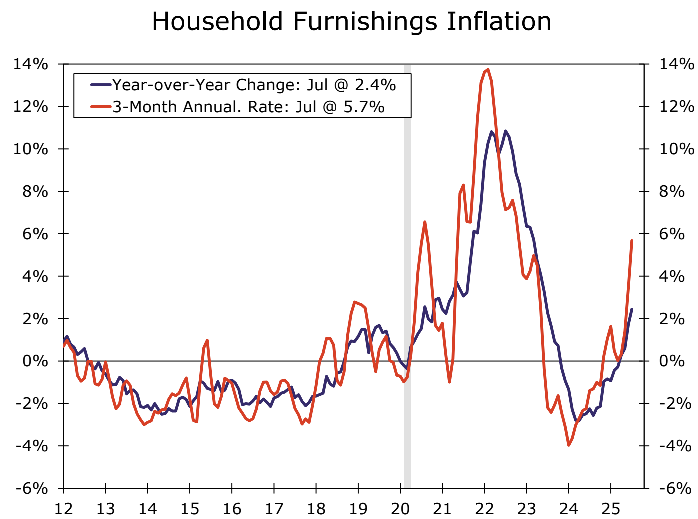
Consumer prices rose mostly in line with expectations in July. Headline CPI moderated to a 0.20% gain over the month, keeping the year-over-year rate steady at 2.7%. Excluding food and energy, price growth was hotter. The core index rose 0.32% in July, which marked the strongest gain since January. On a year-over-year basis, the core CPI increased 3.1%, the highest reading since February.

For all the consternation over the impact of tariffs on goods prices, it was mostly service-related categories that accounted for the firmer core reading in July. Medical care services (+0.8%) and airfares (+4.0%) posted monthly readings that were stronger than we were expecting and above their recent trends. Rent of primary shelter and owners' equivalent rents were spot on, matching expectations at 0.3% month-over-month. Primary shelter inflation continues to moderate on trend and is starting to approach its pre-pandemic pace (chart). Core goods inflation was 0.2%, below the 0.3% we were expecting but above the 0.05% that this category averaged in the 12 months ending in June. Tariff-related price increases continued to seep slowly into the data, with prices for household furnishings, apparel and recreational goods once again climbing higher. Prices for used autos rose 0.5% in the month, while new vehicle prices were roughly flat in July.

With medical care and airfares not serving as source data for the PCE deflator, the Fed's preferred measure of inflation looks likely to be somewhat softer in July. We currently estimate the core PCE index rose 0.22% last month. We will update our estimate following Thursday's PPI report.

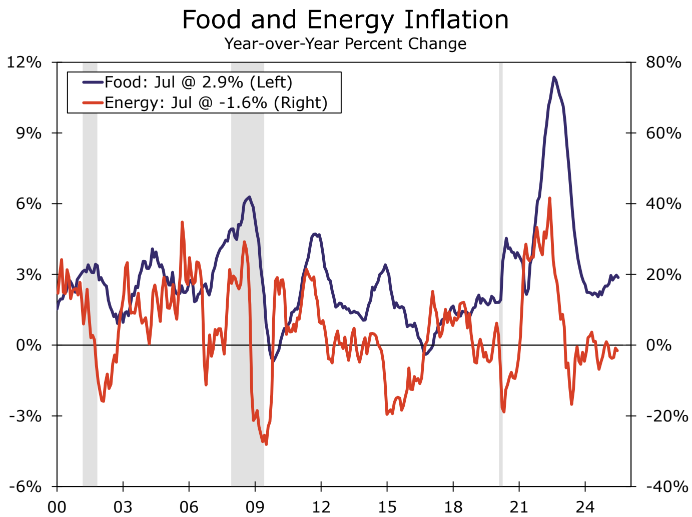


Source: U.S. Department of Labor and Wells Fargo Economics

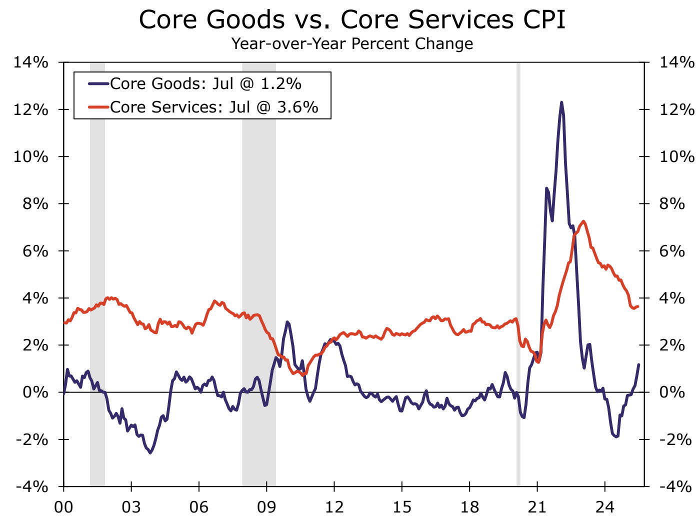


Source: U.S. Department of Labor and Wells Fargo Economics

The firmness in core inflation was counteracted by softness in food and energy inflation. Food prices were essentially flat in July, as prices at the grocery store slipped 0.1% and partially unwound the previous month's stronger-than-expected 0.3% rise. While consumers saw some relief at the grocery store, prices for food away from home continue to rise at a solid pace, with the 0.3% monthly gain on par with its average run-rate over the past 12 months. Meantime, energy prices slid 1.1% in July with broad-based declines in gasoline (-2.2%) and energy services (-0.3%). Over the past year, energy prices are down 1.6% (chart) and have served as a source of deflationary pressure on overall consumer prices. Yet the downdraft has been due largely to lower oil prices. Energy services, while dipping in July, are up more than 7% over the past year. Further strength is likely in store, specifically for electricity prices, as utilities contend with higher upkeep costs and growing demand for nonresidential uses.



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



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

Even with tariffs generating some upward pressure on goods prices, the overall trend in inflation is moving back up only gradually. At 2.7%, the year-over-year rate of inflation has rebounded from its recent low, but it has trended sideways in a range of 2.3%-3.0% for more than a year now. We look for CPI inflation to remain stuck near its current pace over the next year or so. The pass-through to prices from higher tariffs is not a one-month event. Stockpiling and reluctance to immediately raise prices has helpedmitigate the impact to consumers thus far. However, with tariff rates settling higher and no reason to think they will come down for the foreseeable future, we expect the added costs will continue to seep through to selling prices in the months ahead, leading to further strength in goods prices. Core services inflation is likely to slow only somewhat further in the near term, with primary rents, airfares, motor vehicle insurance and medical care services all at or near their disinflation nadir.

Today's CPI report illustrates the challenges the Fed faces in its efforts to balance its price stability and maximum employment dual mandate. The labor market is showing signs of lost momentum, but inflation is 1) still above the 2% target and 2) drifting in the wrong direction. Our current forecast for the fed funds rate looks for the FOMC to cut 25 bps at its September, October and December meetings. If realized, this would move monetary policy to a more neutral stance, with the fed funds rate only 25 bps above our estimate of the neutral rate. That said, we are skeptical of rate cuts much deeper than this given the prospects for above target inflation over the next year due to higher tariffs and fiscal stimulus that will start to hit the economy sometime in H1-2026. Unless the labor market deteriorates more markedly, it is hard to make the case that monetary policy should be accommodative at present, in our view.

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