WELLS FARGO

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August CPI Preview: The Possible Tiebreaker Between a 25 or 50 Bps Cut?

Economist(s)

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Summary

Consumer price inflation likely picked up in August in a reminder that the road to restoring price stability will still have some bumps along the way. We estimate the core index rose 0.25%, which would still be less than the average increase in Q1 that set back the clock on expectations for Fed easing and would keep the year-over-year rate of the core unchanged at 3.2%. Headline inflation for August will likely offer further evidence that through the month-to-month moves, inflation's progress is not going into reverse. We look for a 0.2% increase in headline CPI that would bring the year-over-year rate to 2.6%—the smallest increase since the pandemic's one-year anniversary in March 2021.

A rate reduction at the FOMC's upcoming meeting on September 18 looks all but certain, but the upcoming CPI report could serve as a tiebreaker between a 25 or 50 bps cut if the August jobs report lands in the gray zone between clearly weak and clearly strong. A 0.3% (or larger) increase in the core CPI could make some of the more hawkish members hesitant to begin cutting at all, making a 25 bps rate reduction the compromise outcome. In contrast, another unexpectedly-low print (below 0.2%) could make enough officials comfortable with a 50 bps cut—not because the labor market is falling apart, but because the significant progress on the price-stability side of its mandate no longer requires such a restrictive stance of policy.

August 2024 Forecast

	Wells Fargo Economics			Consensus	
Seasonally Adjusted	MoM (%)	3-M Ann. (%)	YoY (%)	MoM (%)	YoY (%)
CPI	0.19	1.2	2.6	0.2	2.6
Food	0.16	2.3	2.1	-	-
Energy	-0.39	-9.3	-3.6	-	-
Core CPI	0.25	1.9	3.2	0.2	-
Goods	-0.03	-1.9	-1.5	-	-
Services	0.34	3.2	4.9	-	-
Primary Shelter	0.33	4.0	5.1	-	-
"Super Core"*	0.35	2.0	4.4	-	-
Not Seasonally Adjusted	Index	MoM (%)	YoY (%)	Index	MoM (%)
CPI	314.999	0.1	2.6	-	-

Forecast as of: September 05, 2024; Bloomberg Consensus

*Core services CPI excluding rent of primary residence and owners' equivalent rent (i.e., excluding "Primary Shelter")

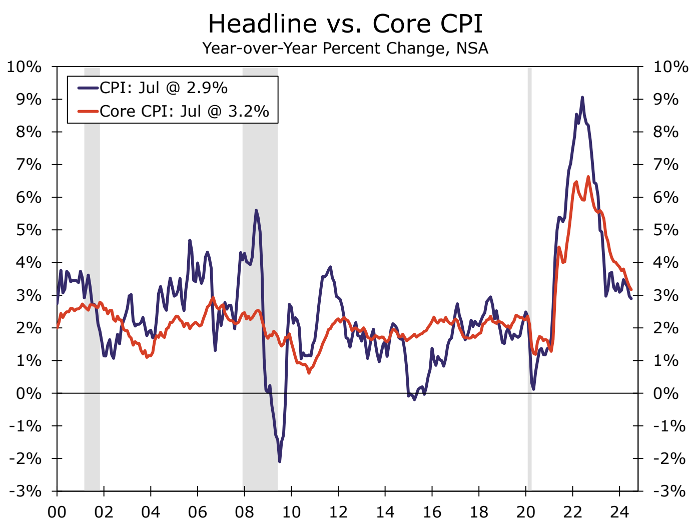
Source: U.S. Department of Labor, Bloomberg Finance L.P. and Wells Fargo Economics

The Road Back to Price Stability Remains a Bit Bumpy

The first few inflation prints of this year made clear that the road to restoring price stability would have some bumps along the way. August's CPI report is likely to be another reminder that, despite inflation pressures generally dissipating, inflation's path back to the Fed's target won't be entirely straight. We expect the core CPI in August to register its largest increase in four months. Specifically, we estimate the core index rose 0.25%, which would leave us unsurprised to see either an on-consensus print of 0.2% or a slightly hotter-than-expected print of 0.3% after rounding. Yet the "low" 0.3% increase we expect would mark a smaller increase than the 0.37% monthly average registered in Q1 that set back the clock on expectations of Fed easing, and it would keep the year-over-year rate of the core unchanged at 3.2%.

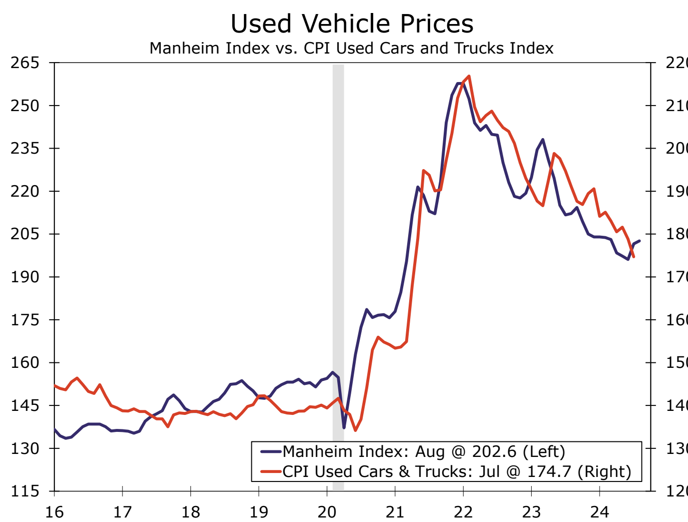
Headline inflation for August will likely offer further evidence that through the month-to-month ups and downs, inflation's progress is not going into reverse. We expect the overall CPI to increase 0.2% in August (0.19% unrounded), which would push the year-over-year rate down to 2.6%—a level not seen since March 2021 (Figure 1). An unusually large drop in gasoline prices this past August points to an outright decline in energy costs. Food inflation looks to have been little changed as a rebound in price growth for food away from home was likely offset by softer grocery inflation.

Figure 1



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

Figure 2



Source: Bloomberg Finance L.P., U.S. Department of Labor and Wells Fargo Economics

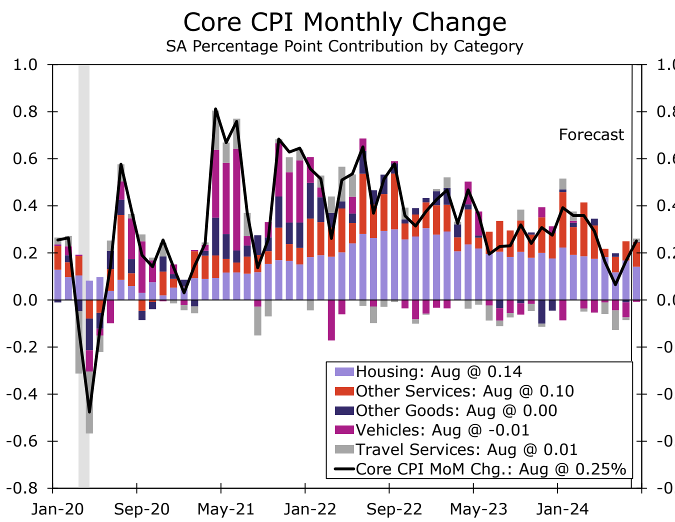
August's pickup in the core will likely be driven by firmer goods prices and stronger growth in non-housing services. After delivering a sizable drag to core goods prices the past two months, used vehicle prices are likely to be a more neutral force in August before offering a noticeable lift in September (Figure 2). We look for core goods prices to be little changed in August, and for the annual pace of decline to moderate from -1.7% to -1.5% in a sign the disinflationary impulse from goods is likely past its peak.

The anticipated pickup in non-housing services to 0.4% in August from 0.2% in July, however, is likely to reflect some noise. After the largest-ever drop in hospital services prices, some payback is likely in store for medical services pricing in August. Meantime, prices in the volatile travel-services component look ripe for an increase after five straight months of declines in airfares have left the index below its pre-COVID level. Notably, the healthcare and airfare components of the PCE deflator are based on PPI data, so if realized, a pickup in these CPI categories would not necessarily translate into a stronger PCE "super core" reading. We currently estimate that the core PCE deflator to rose 0.2% in August, with prices for core services less housing likely having increased 0.25%.

In contrast to core goods and non-housing services, we look for primary shelter cost growth to have slowed in August (Figure 3). After jumping 0.5% in July, we think rent for primary residences increased 0.3% in August as the upward climb in apartment vacancy rates and drop in the BLS's All Tenant Rent Index point to the trend in rent growth continuing to moderate. Owners' equivalent rent growth should also ease to a 0.3% gain as the slowdown in private sector measures of single-family rents is gradually reflected in the official measures of shelter inflation.

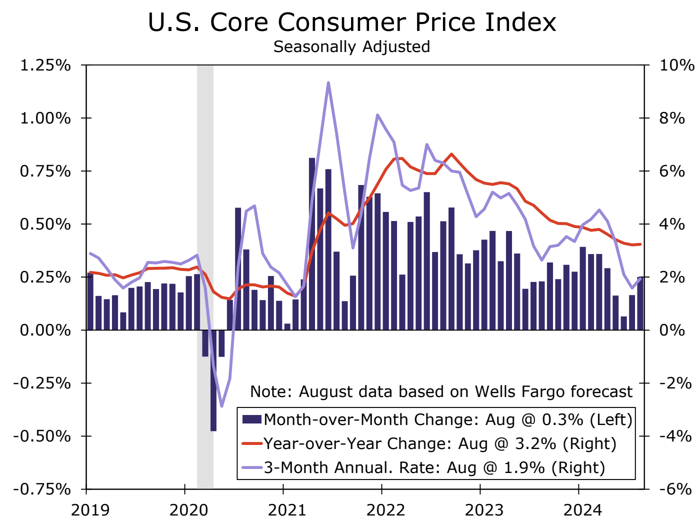
Overall, the past few months' core inflation readings, which show prices increasing at a three-month annualized rate of 1.6%, likely understated the current trend in inflation, just as the 4.5% three-month annualized clip in March overstated it. August will thus be an important barometer of how quickly inflation is easing on trend, and the extent to which goods prices could fall further and services—particularly shelter—can carry the disinflation baton.

Figure 3



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

Figure 4



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

While all eyes are on the August jobs report to determine if the FOMC begins its easing cycle with a 25 bps or 50 bps cut, the upcoming CPI report could be what sways the consensus among Fed officials one way or the other if the jobs report is neither clearly weak nor clearly strong. A 0.3% (or larger) increase in the core CPI could make some of the more hawkish members hesitant to begin cutting at all, making a 25 bps rate reduction the compromise outcome of the FOMC's September 18 meeting. In contrast, another unexpectedly-low print (below 0.2%) could make enough officials comfortable with a 50 bps cut—not because the labor market is falling apart, but because the significant progress on the price-stability side of its mandate no longer requires such a restrictive stance of policy.

We continue to look for inflation to grind lower in the coming months. While seasonal factors are not as favorable as they were earlier this summer, inflation pressures continue to generally abate. The more tepid jobs market continues to put downward pressure on nominal income growth, while improving productivity is also helping to keep unit labor costs benign. With commodity prices in check and it becoming harder for businesses to pass on prices as consumers become more discerning, we look for core CPI to ease to around 2.5% by the middle of next year, with the core PCE deflator subsiding to around 2.25% (Figure 5).

Figure 5

Wells Fargo U.S. Inflation Forecast

	Actual								Forecast							
	2023				2024				2025				2026			
	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q	1Q	2Q	3Q	4Q
CPI (YoY)	5.7	4.0	3.6	3.2	3.2	3.2	2.6	2.5	2.2	2.2	2.4	2.4	2.4	2.3	2.3	2.3
QoQ Annualized	3.8	3.0	3.4	2.7	3.8	2.8	1.3	2.2	2.7	2.5	2.3	2.3	2.4	2.3	2.3	2.2
Core CPI (YoY)	5.5	5.2	4.4	4.0	3.8	3.4	3.2	3.0	2.6	2.4	2.6	2.5	2.5	2.5	2.4	2.4
QoQ Annualized	4.9	4.7	3.0	3.4	4.2	3.2	2.1	2.7	2.4	2.6	2.5	2.5	2.5	2.4	2.4	2.4
PCE Deflator (YoY)	5.0	3.9	3.3	2.8	2.6	2.6	2.3	2.3	2.1	2.0	2.2	2.2	2.1	2.1	2.0	2.0
QoQ Annualized	4.2	2.5	2.6	1.8	3.4	2.5	1.4	1.8	2.5	2.3	2.1	2.1	2.1	2.0	2.0	1.9
Core PCE Deflator (YoY)	4.8	4.6	3.8	3.2	2.9	2.6	2.6	2.6	2.3	2.2	2.2	2.3	2.2	2.1	2.1	2.0
QoQ Annualized	5.0	3.7	2.0	2.0	3.7	2.8	2.0	2.1	2.4	2.3	2.2	2.2	2.1	2.1	2.0	2.0

Forecast as of: September 5, 2024
Note: All numbers are percent change.

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

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