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Economics Group

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Don't Expect the Softness in the July CPI to Last

The CPI was unchanged in July as energy prices fell and core inflation softened. The weaker print in core inflation, however, stemmed from the more volatile components and is not the start of a new trend.

Drags From Food and Energy Expected to Ease

Inflation softened a bit in July, with headline CPI flat over the month. We do not expect the weakness implied by the July report to last, however.

As expected, energy prices were a drag on the headline. Gasoline prices fell nearly 5 percent, more than offsetting a rise in electricity and utility services. While oil prices headed lower in July, they have already bounced back through the first half of August. Moreover, the year-over-year decline in oil prices has moderated sharply, with prices thus far in August nearly flat compared to this time last year. We expect the trend in gasoline prices, which remain down around 20 percent over the past year, to follow suit.

Food at home prices fell 0.2 percent and have been a drag on the headline in four out of the past five months. Food at home prices should pick up between the autumn and end of the year, however. The food index typically lags agriculture and livestock prices by about six months, and food-related commodities rose steadily between March and June.

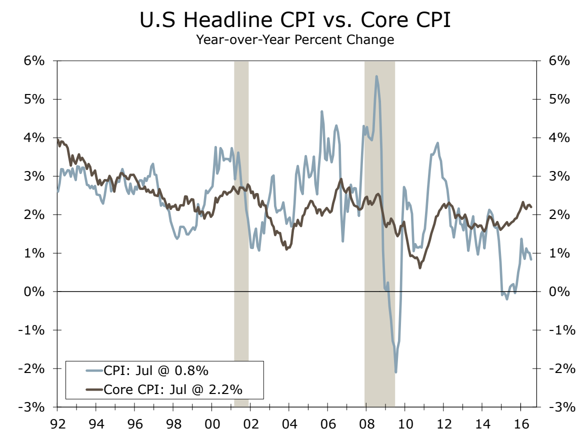
The previous drop in prices for food at home suggests some forthcoming downward pressure on prices for food away from home, which moved up a trend-like 0.2 percent in July. This is likely to be muted though by the growing number of states and cities raising minimum wages, as minimum wage workers are most likely to be employed in food prep and serving jobs.

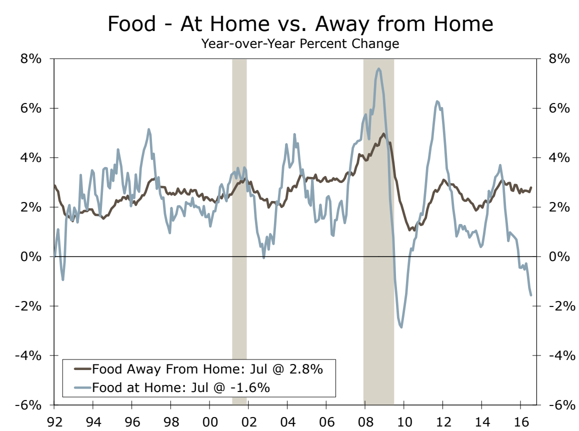
July Softness in Core CPI Temporary

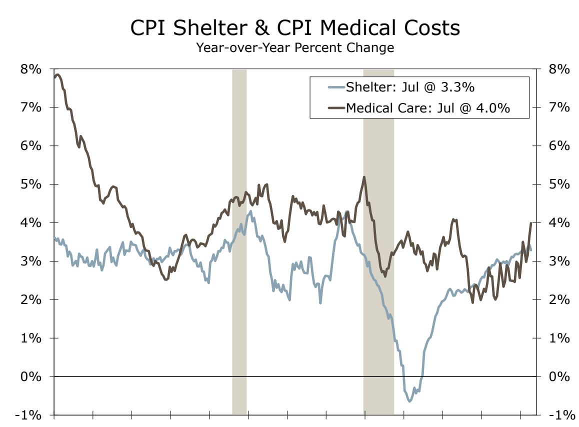
Core inflation eased in July, up 0.1 percent, but the softness can be traced to the more volatile components of the index. Goods prices fell 0.1 percent following another drop in used car prices. Prices for core services—the less volatile part of the core—continued to trek higher, rising 0.2 percent. One notable exception to this, however, was the nearly 5 percent drop in airline fares, which do bounce around sharply from month to month. More telling of the trend in core CPI was the further rise in shelter costs, as well as strengthening in medical care. Medical care costs rose 0.5 percent, cementing its end as a source of disinflation.

Upward Drift Not Going to Hurry Fed

Today's CPI report likely does little to change the Fed's view of inflation. Core inflation continues to trend higher on the back of services, which is unlikely to change as long as the labor market continues to tighten and wages are rising. Nevertheless, there are no signs of inflation picking up rapidly. Inflation expectations have come off the lows set earlier this year, but remain too low for many FOMC members' comfort. While we expect CPI to pick up over the remainder of the year as the drag from food and energy prices fade and core inflation grinds higher, we believe the pace will be moderate enough to where the Fed will hold off on another rate rise until its December meeting.







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

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