



# Economics Group

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## CPI: Core Inflation Rebounds, But Fed Still Concerned

**CPI rose 0.1%, driven by a 0.3% jump in core prices. The core's gain makes up for some exaggerated weakness in recent months. Inflation is getting back on track to meet the Fed's target, but not fast enough.**

### Core Inflation Leaps in June

Overall inflation remained tame in June. The Consumer Price Index increased just 0.1% for a second straight month, sending the year-over-year rate down to 1.6%.

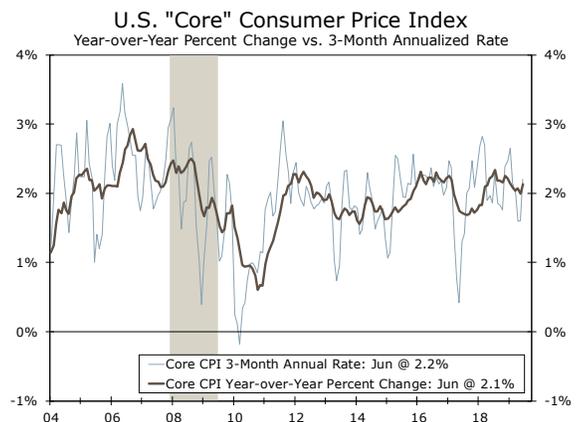
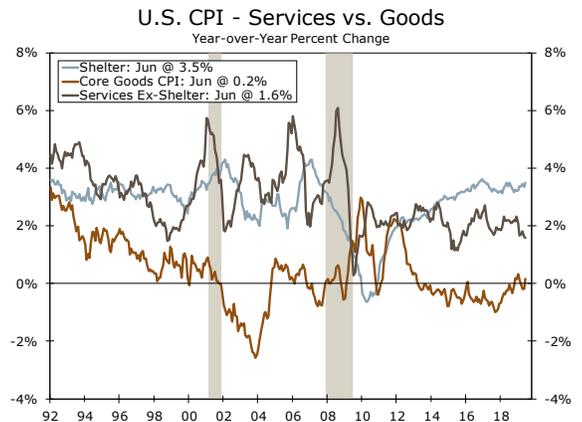
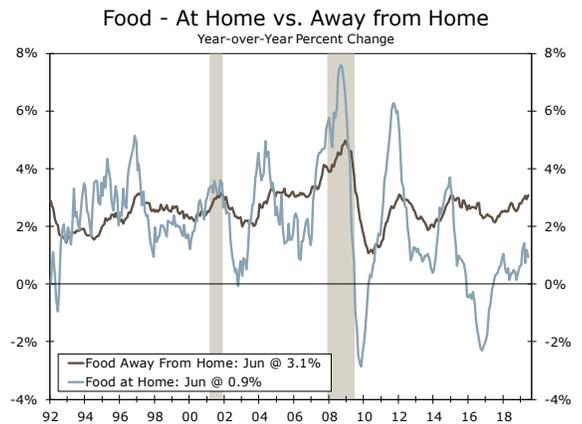
Energy prices were a drag on the headline as gasoline prices posted an unusually steep decline for this time of year. Food inflation also eased up, at least at the grocery store, with prices for food at home falling 0.2%. The cost of eating out, however, picked up in June and continues to gradually strengthen on trend. Over the past year, prices for food away from home are up 3.1%, which matches this cycle's top rate (top chart).

After a string of subdued readings, core inflation bolted back in June. Prices for goods and services rose 0.3% (0.29% before rounding), ending a four-month run of 0.1% gains. The increase reflects payback for undue softness in recent months, rather than the start of a sharp pickup in the trend. For example, apparel prices jumped 1.1% after falling 2.8% between March and May following the introduction of a new collection procedure for a major department store. Used vehicle prices jumped 1.6% after declining more than 1% in each of the past two months, despite a turnaround in auction prices according to other sources.

Elsewhere, gains in core inflation looked more in line with recent trends. Core services prices rose 0.3% on the back of continued strength in shelter inflation (middle chart). Low vacancies in the apartment market and new construction skewed toward high-end units have pushed rental prices up nearly 4% over the past year, while owner-occupied housing costs have risen 3.4%. Medical care inflation has also picked up in recent months, while transport services inflation, including airfare, has been more subdued.

### Fed Losing Patience on Inflation

Today's report is consistent with inflation climbing back toward the FOMC's target in the coming months (bottom chart). But Fed officials are increasingly concerned about the generalized weakness in inflation that has persisted this expansion. Although it is starting to get back on track, Fed officials have grown impatient over the time it is taking inflation to return to target on a sustained basis. Declining inflation expectations suggest a more arduous road ahead in getting there. Consumers' long-term inflation expectations are at a historic low, while market-based measures have moved lower over the past year. The minutes of the June FOMC meeting released yesterday showed "many" officials thought inflation expectations might already be below levels consistent with the Fed's goal, with "a few" thinking that warranted more policy support in the "near term." We continue to look for the FOMC to cut the fed funds rate 25 bps at its meeting later this month, in no small part due to the cumulative weakness in inflation.



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