Are The USD & Fed Funds Futures Misreading A More Encouraging US CPI Report?

United States, CPI / Core CPI, y/y %, July:
Actual: 1.7 / 1.7
Scotia: 1.8 / 1.7
Consensus: 1.8 / 1.7
Prior: Unrevised from 1.6 / 1.7

United States, CPI / Core CPI, m/m %, July:
Actual: 0.1 / 0.1
Scotia: 0.2 / 0.2
Consensus: 0.2 / 0.2
Prior: Unrevised from 0.0 / 0.1

- Big whoop. While the rates market was little affected by the latest inflation update as Treasuries largely shook it off with minor noise around the release, the USD is weakening and markets continue to be too complacent toward pricing fed rate hike risks. **In my opinion the USD and fed funds futures markets are reading the report wrongly.** Overall while I wouldn't overstate it for reasons given below, the report could be construed as indicating stabilizing disinflationary pressures if not a downright end to them and better underlying details that if anything suggests markets are too aggressive in pricing out another Fed hike until well into next year versus our continued forecast for a hike in December. Clearly that call faces far broader risks than the underlying macroeconomic environment, however, and not least of which including geopolitical developments and US fiscal policy including the prospect of Washington shutting down again by October.

- In month-ago terms, core CPI slightly missed expectations at 0.11% m/m versus consensus at 0.2%. In year-ago terms, core CPI was unchanged for the third straight month at 1.7% y/y and indicates stabilization. That's the first part of what should get emphasized here as the persistent downsides that were being posted in the year-ago rates from January through April have stopped.

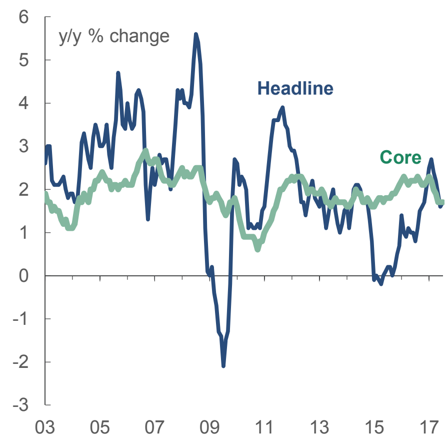
- The second thing that should get emphasized is that the details are more encouraging. **Five significant categories recorded improvements in m/m terms.** They include food prices that were up 0.2% m/m (0% prior), clothing prices that were up 0.3% m/m (-0.1% prior), the recreation category that was up 0.3% m /m (-0.1% prior), energy (-0.1% m/m, -1.6% prior) and transportation (-0.1% m/m, -1.7% prior). Only two categories worsened including education and communications (-0.1% m/m, 0% prior), and miscellaneous 'other' goods and services (+0.1% m/m, 0.2% prior). The rest of the categories were stable notably including services (+0.2% m/m), housing including OER and fuels/utilities, and medical care. The details read firmer than the headline core CPI reading in my opinion as the sources of disinflationary pressure ebbed.

- Overall I don't think the report matters a great deal at the margin given geopolitical tensions are dominant and given that this is not the Fed's preferred inflation gauge (August 31st for that). But **at the margin this report could be interpreted as playing to the transitory arguments on inflation downsides while still remaining low.**

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

US CPI



Sources: Scotiabank Economics, BLS.

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