Why US CPI Is Tamer Than The Headlines

United States, CPI / Core CPI, y/y %, June:
Actual: 2.9 / 2.3
Scotia: 2.8 / 2.3
Consensus: 2.9 / 2.3
Prior: Unrevised from 2.8 / 2.2

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

- **US inflation came in generally in line with expectations but there are three reasons to view it as a tamer inflation report than the headline figures might otherwise suggest.**
- First, the seasonally adjusted month-ago annualized trend in core CPI inflation was 2.0% in June, down from 2.1% the prior month but up from the 1.2% reading the month before that. **The three month moving average of this way of looking at core CPI changes is below the 2.3% year-ago core CPI inflation rate. That indicates stalled pressure of late.** Indeed, upside momentum to the year-ago rate is stalling out before the disinflationary effects of USD appreciation since April and most of the inflationary effects of tariffs complicate the ability to read true underlying inflation gauges.
- Second, **transitory one-offs continue to play a role in lifting core CPI from last year's soft patch**. Witness the reversal of wireless telephone service pricing following price cuts earlier last year with this effect shaking out and changes to prescription drug prices that were decelerating throughout much of last year but that have since stabilized (see chart 1).
- Third, **there really isn't a whole lot of breadth to the inflation pick-up upon poring over the detailed components which is always what takes time post release**. A fuller graphical break down of the core CPI basket is provided in chart 3 at the bottom by drawing upon the detailed breakdown of the CPI basket that is available here for inflation traders, or perhaps just the morbidly curious reader in addition to those among us who have to do the deeper dive. The sources of upward pressure on CPI inflation are rather narrowly based. The chart shows the weighted contributions to headline CPI's rise in year-ago terms. A large portion of the basket is either contributing nothing to CPI inflation or is a mild drag. Most of the pressure is coming from just a handful of categories.
    - In weighted contribution terms, 'rent of shelter' added 1.1 percentage points to the year-ago seasonally adjusted total CPI change. It carries a 32% weight and climbed by 3.4% y/y. The sources of upward pressure on this component were diverse and included a 3.6% y/y rise in 'rent of primary shelter,' 2% y/y rise in 'housing at school', a 3.4% rise in owners' equivalent rent, and more muted increase in tenants and household insurance (+1.1%).

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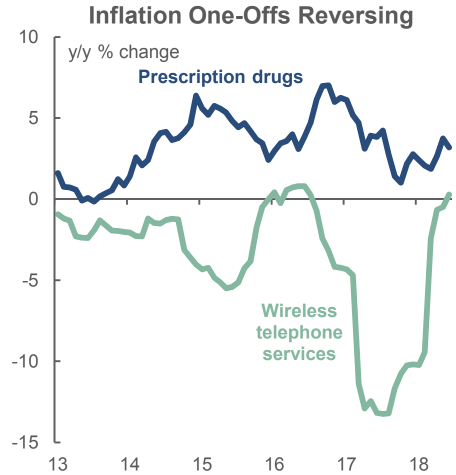
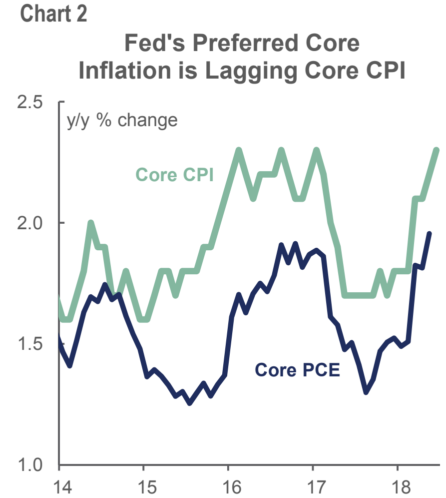
Chart 1



Sources: Scotiabank Economics, BLS.

Chart 2

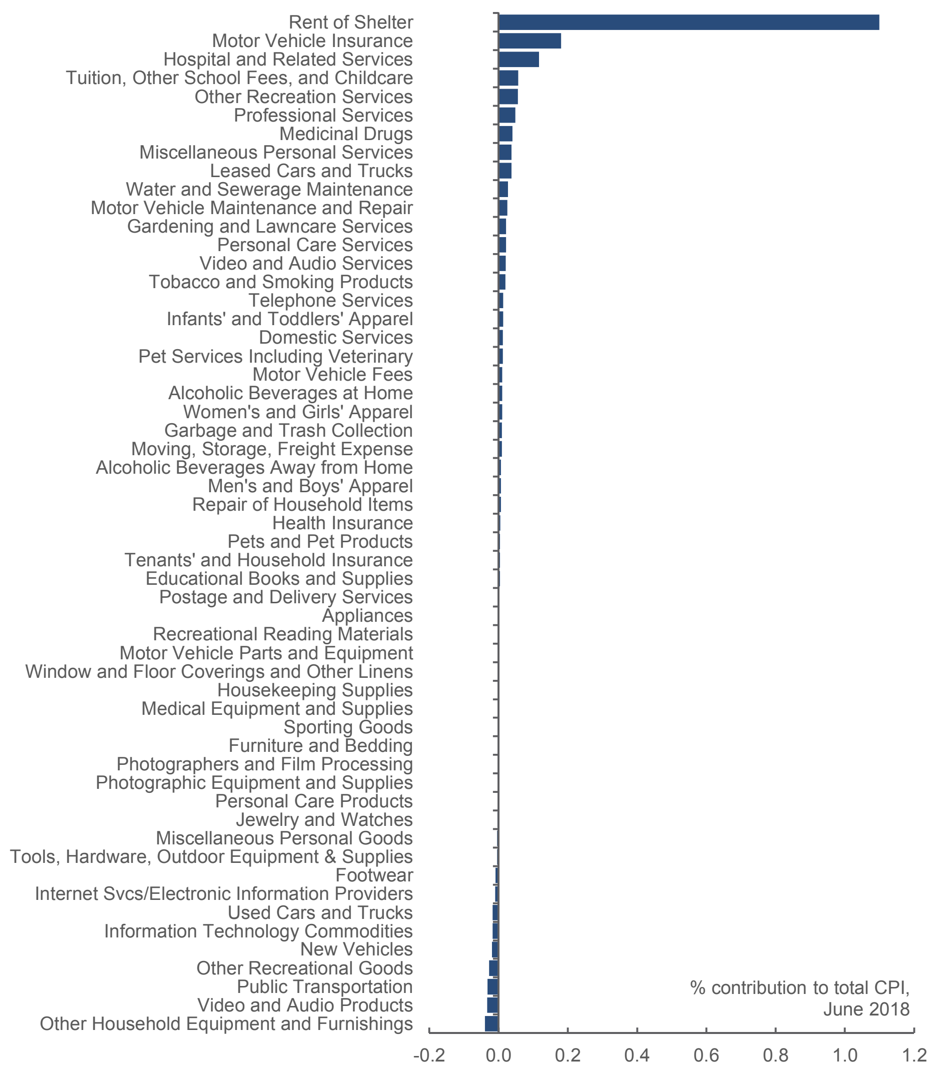


Sources: Scotiabank Economics, Bloomberg.

- In weighted contribution terms, motor vehicle insurance played a distant second place role. Insurance prices were 7.6% higher in year-ago terms with a 2.4% weight.
- Hospital services jumped 4.7% y/y with a 2.3% weight.
- "Tuition, other school fees and childcare" prices were up 2% y/y with a 3.6% rise in elementary and high school tuition and fees driving much of that.
- Tariff effects are already showing up including major appliance prices that were up by 5.6% y/y including a 13.1% y/y jump in laundry equipment prices. Major appliances carry only a 0.08% weight in overall CPI so this isn't a big deal overall but it is a big deal to appliance retailers, manufacturers and consumers. Laundry equipment prices had been falling from 2013 through to early this year, but are now up by a cumulative seasonally-adjusted but non-annualized 20% since the bottom in February. It may be a welcome gesture if members of the Trump administration went with dirty or no clothes out of sympathy for the American consumer that is getting hit by these tariffs. I suspect appliance demand is cratering with this morning's update for real paycheques still dead flat in June.

- Finally, the bigger question is the extent to which core PCE inflation will converge upon core CPI in the July 31st update for June. Chart 2 is updated with the June core CPI print but even at May the core PCE measure was trailing core CPI by about a couple of tenths.

Chart 3 **US Core CPI Is About Much More Than Phones And Drugs**



Sources: Scotiabank Economics, BLS.