US Core CPI Turns Lower

United States, CPI / Core CPI, y/y %, August:
Actual: 2.7 / 2.2
Scotia: 2.8 / 2.4
Consensus: 2.8 / 2.4
Prior: Unrevised from 2.9 / 2.4

United States, CPI / Core CPI, m/m %, August:
Actual: 0.2 / 0.1
Scotia: 0.3 / 0.2
Consensus: 0.3 / 0.2
Prior: Unrevised from 0.2 / 0.2

- US core CPI inflation pulled back to 2.2% y/y and came in lower than not only the median consensus call for 2.4% (unchanged) but lower than every single one of the 49 estimates. The USD broadly softened and the yield on 2 year Treasuries fell by about 3bps post data. This follows on yesterday's downside surprise to core producer prices as an indication that perhaps inflation pressures are beginning to turn lower. While for quite some time now I've been a fan of the view that USD strength would ultimately serve to cap inflation as 2018 data evolved, there are also idiosyncratic developments that helped to drive softer core inflation. Recall Fed estimates that every 10% appreciation in the broad dollar index drives core PCE inflation lower by about 0.5% within six months and 0.3% after a full year. The broad USD index has appreciated by about 10% since January and so much of any effect on inflation still likely lies ahead. I'm still of the belief that this should counsel caution at the Fed on the path to two hikes this year as indicated in the last dot plot with a new one pending.
- One driver is that clothing prices fell by 1.6% m/m for the biggest single month drop since way back in 1949. That drove clothing prices down by 1.4% y/y with a 3% weight in the overall CPI index.
- Second is medical care prices. They fell by 0.2% m/m for the second month in a row and that pulled the year-ago rate to 1.5%. Recall that CPI only captures direct medical spending by consumers whereas PCE captures this plus spending on behalf of consumers by governments and employers so PCE later in the month will further inform this category.
- Third is that idiosyncratic changes that were once drivers of CPI continue to revert lower. Examples include wireless telephone services that are now up by only 0.2% y/y, prescription drugs prices that are now up by only 0.8% y/y and nonprescription drug prices that are now down by 1.6% y/y.
- Base effects drove a slightly softer contribution to headline CPI from gasoline prices and this will be a greater effect in the next report.
- Homeowners equivalent rent continues to be among the upside performers, but at a slightly reduced pace of 3.3% y/y in August versus 3.4% the prior month.
- Food prices were up by 1.4% y/y. The recreation category was down 0.1% m/m and flat in year-ago terms (+0.1% y/y).

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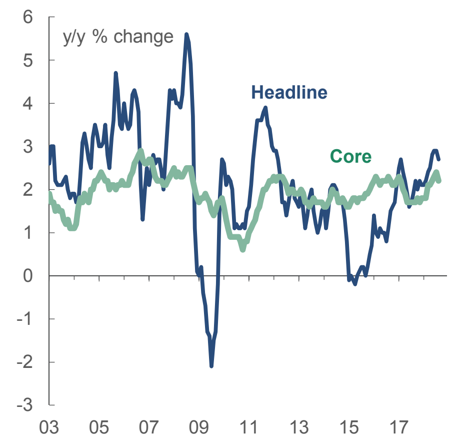

Sources: Scotiabank Economics, BLS.