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## July Consumer Price Index: Stage Set For Deliberate Pace Of Rate Cuts

- > The total CPI **rose** by 0.2 percent in July (up 0.154 percent unrounded); the core CPI **rose** by 0.2 percent (up 0.165 percent unrounded)
- > On a year-over-year basis, the total CPI is **up** 2.9 percent and the core CPI is **up** 3.2 percent as of July

Both the total CPI and the core CPI rose by 0.2 percent in July, each as expected by the consensus forecast but above the 0.1 percent increase we expected for each measure. On an over-the-year basis, the total CPI is up 2.9 percent, the smallest such increase since March 2021, while the core CPI is up 3.2 percent. We noted in this week's *Economic Preview* that our forecasts for both the total and core indexes were right on the border between 0.1/0.2 percent increases, that our forecasts of the over-the-year changes matched the actual prints is an illustration of our point. The biggest factor in our miss on the month/month change on both the total and core CPI is a bigger increase in shelter costs than our forecast anticipated. As we also noted in this week's *Economic Preview*, the unrounded June increases in owners' equivalent rent and primary rent were the smallest such increases since September 2021, which we and many others interpreted as the beginning of the long-awaited moderation in rents as measured in the CPI data, which significantly lag market-based measures. That proved to not be the case, as owners' equivalent rent rose by 0.5 percent and primary rent rose by 0.4 percent which, given that rents account for over forty percent of the core CPI, more than accounts for our miss on our forecast of the core CPI. Either way, the message from the July CPI data is no different, that message being that while inflation, whether measured by the CPI or the PCE Deflator, remains easily above the FOMC's 2.0 percent target rate, there has been sufficient progress on inflation to warrant the FOMC beginning to cut the Fed funds rate, particularly in conjunction with signs of a slowing pace of economic activity. That said, barring a more pronounced deceleration in the pace of economic activity than we see as being likely, the stage is set for a fairly slow and deliberate cadence of funds rate cuts, or, put differently, a slower pace of rate cuts than many market participants at present seem to be expecting.

Core goods prices fell by 0.3 percent in July, but a 2.3 percent decline in prices for used motor vehicles acted as an outsized drag, as has been the case for most of the period since the onset of the pandemic. That said, the BLS's measure of prices of core goods excluding used motor vehicles, which we see as a more reliable indicator of core goods price pressures, fell by 0.1 percent in July, leaving it down 0.6 percent year-on-year. That core goods prices have remained so soft is somewhat surprising given the weakening of the U.S. dollar along with growing supply chain stresses, and that softness suggests growing margin pressures on the wholesale/retail levels. At the start of this year, our forecast was that core goods prices would transition from being a drag on overall inflation to being a neutral factor, which obviously has not happened and which, given sagging consumer demand in many categories of goods spending, may not happen for quite some time.

Core services prices rose by 0.3 percent in July, leaving them up 4.9 percent year-on-year, the smallest such increase since April 2022. That the July data show stepped-up rent growth is somewhat curious, and more importantly is, given the heavy weight attached to rents in the CPI, impeding disinflation in broader measures of services prices. Our forecast of the July core CPI anticipated further declines in prices for travel services on a not seasonally adjusted basis, which we expected would be magnified by seasonal adjustment. The July data do show declines in the unadjusted measures of air fares and lodging rates, but the decline in lodging rates was smaller than our forecast anticipated, while rental car rates rose. The seasonally adjusted data show a decline in air fares but modest increases in lodging rates and rental car rates. The broader point, however, is that prices for travel services were notably weak during the summer, typically a period of peak demand, and we think this is far more a consumer demand story, as providers of such services have had to resort to discounting to drive volumes. This goes to the point we have been making over the past few months, which is that discretionary services spending was softening markedly.

The overall energy index was flat in July, reflecting flat retail gasoline prices. Prices for food consumed at home rose by 0.1 percent and prices for food consumed away from home rose by 0.2 percent. Overall food prices are up 2.2 percent year-on-year, though it is the cumulative change over recent years that remain the focus for many households.

