Economic Research

Economic Briefing

US core inflation is rising only slowly

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Table of contents

US consumer prices rose by 0.2% in July from the previous month. However, price pressure was dampened by the decline in gasoline prices. Excluding energy and food ("core rate"), the month-on-month rate was 0.3%, the highest since January. However, the latest acceleration is due more to higher services prices than to tariffs on imported goods. There is still little sign of a massive price surge. The Federal Reserve is therefore likely to cut interest rates in September.

The data

US consumer prices rose by 0.2% in July from the previous month, in line with consensus and our expectations. The year-on-year rate remained at 2.7%. The more important core rate, which excludes volatile energy and food prices, was 0.3% in month-on-month terms, also in line with expectations. The year-on-year rate rose from 2.9% to 3.1%.

Background

As expected, price pressure increased slightly in July. The important core rate was 0.3% compared with the previous month, following 0.2% in June (Chart 1). Some of the goods frequently imported from China continued to become more expensive at an above-average rate. This applies, for example, to video/audio products (+0.9%). On the other hand, IT goods (-1.4%) and household appliances (-0.9%), which are also mostly imported, became cheaper this time around, having seen slight price increases in recent months. Customs duties are therefore still only being passed on to consumers in part.

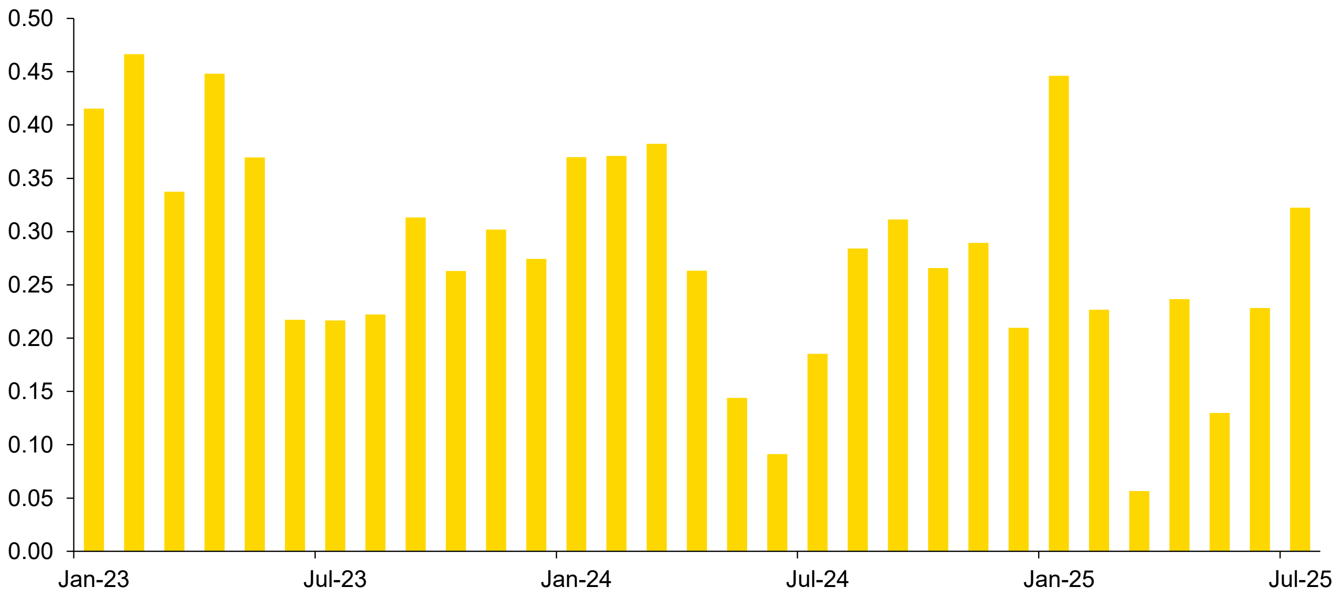
In fact, the higher core rate in July is less due to stronger price increases for goods than to significantly more expensive services. This was partly due to price increases for those services whose prices often fluctuate sharply and where individual monthly values are therefore of little significance, such as hotel accommodation (+4.0%). This development is therefore unlikely to continue.

Since the beginning of the year, goods excluding energy and food have risen in price by 0.8%. This increase could be an indication of tariff effects. In the past, these prices typically flatlined, with the exception of the price surge during the pandemic. Since goods excluding energy and food account for around a quarter of the core rate basket, this rough calculation puts core inflation around two-tenths higher than it would have been without the tariffs.

The tariff effect has therefore been relatively moderate so far. Many companies are clearly absorbing the tariffs themselves for the time being. However, this is likely to be only temporary. We continue to expect tariffs to feed through to consumer prices to an increasing extent.

Chart 1 - Underlying inflation pressure rises slightly

Consumer prices excluding energy and food, month-on-month change in %



Source: BLS, S&P Global, Commerzbank Research

Fed under pressure to cut rates

Today's data does not stand in the way of an interest rate cut by the Federal Reserve at its next meeting (we have been expecting a 25 bp rate cut for the September meeting for some time). Although underlying price pressure, as measured by the core rate, has increased slightly, there is still little sign of the impact of tariffs. This is likely to reinforce the view that this effect will be smaller than originally expected. Securing the Fed's full employment mandate will therefore become more important for US monetary policymakers. More and more members of the Federal Open Market Committee, which is responsible for setting interest rates, are expressing this view. The central bank conference in Jackson Hole, which begins at the end of next week, will give Fed Chair Powell the opportunity to adjust his communication accordingly.

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