COMMERZBANK

Economic Research

Economic Briefing

US inflation cools further

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Dr. Christoph Balz
Bernd Weidensteiner

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Inflationary pressure continues to ease in the US. Consumer prices rose by 0.2% in July from June, both overall and excluding energy and food (core rate). While service prices rose slightly more than expected, goods prices fell more sharply. The data support our forecast of a first Fed rate cut in September.

The data...

US consumer prices rose by 0.2% in July compared to the previous month. The year-on-year rate fell from 3.0% to 2.9%. The more important core rate, which excludes the volatile prices for energy and food, printed 0.2%, too. The year-on-year rate fell here from 3.3% to 3.2%. The report was therefore in line with consensus expectations and our forecast.

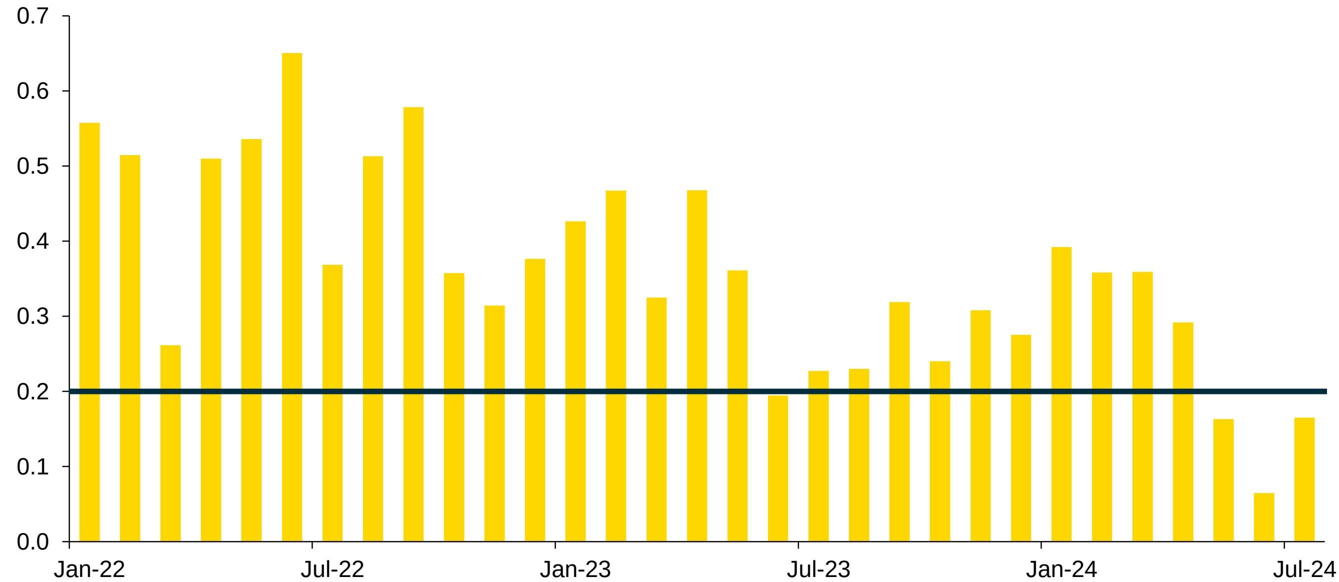
... and the background

The consumer price data for July was almost exactly in line with our forecast. In our preview, we pointed out that although the general expectation of a month-on-month rate of 0.2% was realistic, the data would probably only just round higher to 0.2%. In fact, the month-on-month rates were 0.15% (headline) and 0.17% (core rate). This continues the string of favorable inflation reports. Over the last three months, consumer prices have risen at an annual rate of only 0.4%, excluding energy and food by 1.6%.

The only weak point in the report is that the typically highly volatile (and therefore uninformative) prices, such as those for used cars and airline tickets, have significantly dampened price increases, while rent increases, which are actually quite stable, have again contributed somewhat more to inflation. However, rental inflation remains on a downward trend. Inflationary pressure should therefore tend to decrease further in the coming months.

Chart 1 - Underlying inflation slowed considerably

Consumer prices excluding energy and food, month-on-month change in %. Horizontal line: monthly rate of 0.2% which is approximately consistent with the Fed's 2% annual target which refers to the PCE deflator



Source: BLS, S&P Global, Commerzbank Research

Fed: Inflation no longer on top of the agenda

The Fed has always stated as a prerequisite for rate cuts that inflation must be "sustainably" on its way towards the 2% target. Today's figures at least point in this direction. This is because the monthly rate of change in the consumer price index excluding food and energy was below the 0.2% mark for the third time in a row (chart). A monthly increase in the consumer price index of 0.2% is roughly consistent with the Fed's target of an annual inflation rate of 2% based on its preferred price index, the PCE deflator.

Inflation is therefore no longer the most important issue for the Fed. The rise in the unemployment rate in recent months is bringing the second part of its mandate – maximum employment – to the fore. A rate cut at the September meeting is therefore almost certain. Until then, another round of labor market data will be published, as well as another set of inflation figures.

Analysts

Dr. Christoph Balz
Senior Economist
+49 69 9353 45592
christoph.balz@commerzbank.com

Bernd Weidensteiner
Senior Economist
+49 69 9353 45625
bernd.weidensteiner@commerzbank.com

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Commerzbank Offices

Frankfurt	**London**	**New York**	**Singapore**
Commerzbank AG	Commerzbank AG	Commerz Markets LLC	Commerzbank AG
DLZ - Gebäude 2, Händlerhaus	PO BOX 52715	225 Liberty Street, 32nd floor,	128 Beach Road
Mainzer Landstraße 153	30 Gresham Street	New York,	#17-01 Guoco Midtown
60327 Frankfurt	London, EC2P 2XY	NY 10281-1050	Singapore 189773
Tel: + 49 69 136 21200	Tel: + 44 207 623 8000	Tel: + 1 212 703 4000	Tel: +65 631 10000