

US Core Inflation: Temporary Relief?

- Core inflation is still hot, but climbed at a slower pace in July
- Used vehicle prices were the main driver of cooler core CPI
- Airfare, clothing, health insurance, cell phone bills also eased
- Grocery prices are rising strongly
- Shelter costs face most of the upside risk into 2022
- A full-cycle view on inflation's drivers still leaves major risks ahead

US CPI, m/m % // y/y %, July:

Actual: 0.5 / 5.4

Scotia: 0.5 / 5.4

Consensus: 0.5 / 5.3

Prior: 0.9 / 5.4

US core CPI, m/m % // y/y %, July:

Actual: 0.3 / 4.3

Scotia: 0.6 / 4.5

Consensus: 0.4 / 4.3

Prior: 0.9 / 4.5

US core inflation did not land sharply higher than expected for the first time in four months. Headline CPI readings were in line with expectations, but core inflation was a little softer than expected. That doesn't mean that core inflation was soft last month, but it does provide one month's relief in what remains a full cycle debate over transitory and longer-lived drivers.

At an annualized rate, the 0.3% m/m seasonally adjusted rise in US core inflation translates into a 4% pace which continues to strongly overshoot the Fed's run slightly hotter revised goals statement. As chart 1 shows, that annualized pace pulled back, but it was still strong. Chart 2 shows the year-over-year increases in core CPI and the connection with core PCE that will arrive on August 27th.

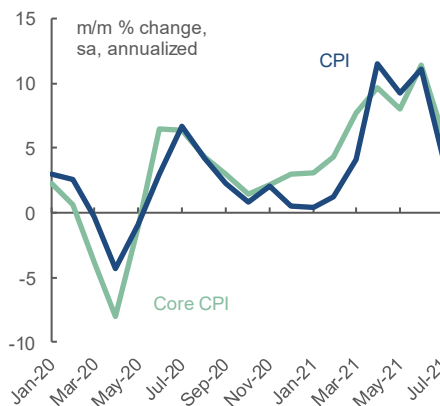
Chart 3 shows that both core goods CPI and core services CPI registered slightly softer increases last month.

The main driver of the softer core inflation reading was used vehicle prices that contributed less than a tenth of a percentage point to the month-over-month change in core CPI during July. Chart 4 shows how used vehicle price increases sharply decelerated last month to +0.2% m/m after three straight months of large gains in the 7–10% m/m range. That stands in stark contrast to the prior couple of months when, for example, used vehicles contributed 0.4% in weighted terms to the 0.9% rise in core prices during June. That used vehicle price inflation dropped out in July was known in advance through industry guidance. Chart 5 shows how expensive used vehicles have become relative to new vehicles which has put an affordability squeeze on the used segment and limits its ability to serve as an escape valve on new vehicle shortages going forward.

CONTACTS

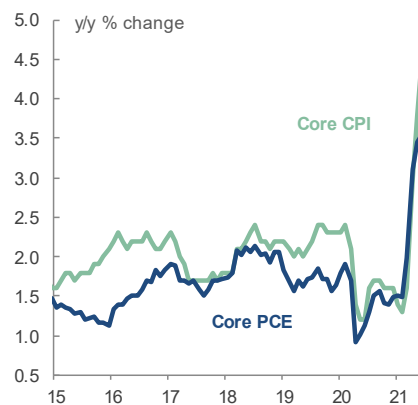
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Chart 1 US CPI & Core CPI



Sources: Scotiabank Economics, BLS.

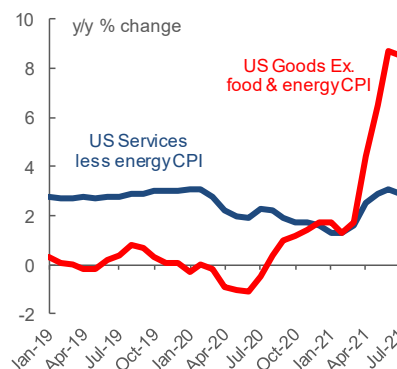
Chart 2 US Core PCE & CPI



Sources: Scotiabank Economics, BLS, BEA.

Chart 3

US Goods vs. Services Inflation



Sources: Scotiabank Economics, BLS.

Nothing else accelerated by enough to offset the deceleration in used vehicle price inflation. Chart 4 also shows that new vehicle price inflation was fairly stable (+1.7% m/m) and in line with the pattern over the past several months. Given how unaffordable used vehicles have become relative to history, we could see faster increases in new vehicle prices going forward as something to monitor.

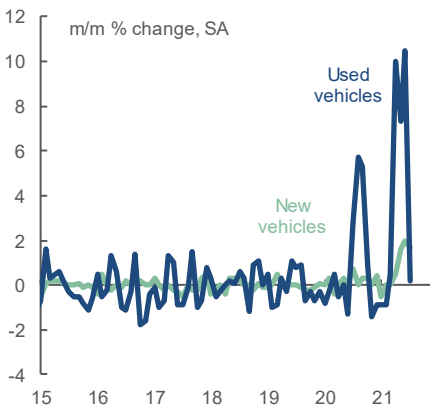
Shelter prices were up by 0.4% m/m which is in line with the multi-month trend but not accelerating off an otherwise rapid annualized pace. Within shelter, owners equivalent rent was up by 0.3% m/m again and lodging away from home (ie: accommodations) saw another strong gain of 6% m/m. Chart 6 shows that much of the upside risk to OER likely lies ahead in lagged reaction to rising house prices.

Medical care contributions to inflation also continued to ebb. Medical care commodities were up only 0.2% m/m while medical care services were up by just 0.3% m/m. Overall medical care services inflation continues to decline in year-over-year terms. Chart 7 shows one of the drivers. Chart 8 shows the continued drag from prescription drug prices. Medical disinflation runs against many years of pre-pandemic pressures and may be transitory in response to one-off adjustments to policy changes and given the year-over-year rates are based off high prices early in the pandemic.

Airfare inflation also ebbed. After gains of 7% m/m in May and 2.7% m/m in June, prices were flat (-0.1%) in July. Chart 9 also shows how volatile the pattern is so it's unlikely this driver has gone away.

Chart 4

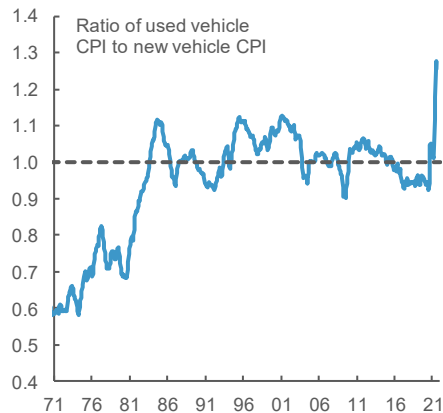
New vs Used Vehicle Inflation



Sources: Scotiabank Economics, Bloomberg.

Chart 5

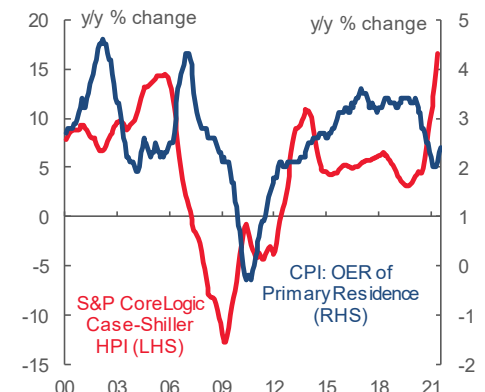
Used Vehicles Are Expensive



Sources: Scotiabank Economics, BLS.

Chart 6

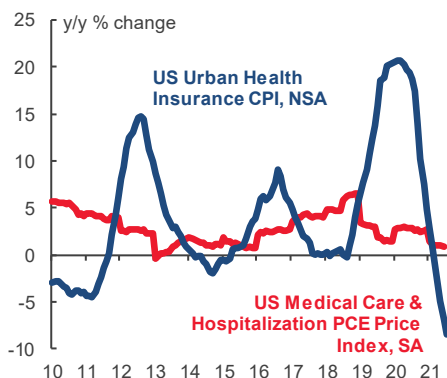
Homebuying Price Surges May Cause Upward Pressure on Rents



Sources: Scotiabank Economics, BLS, S&P.

Chart 7

US Medical Care Insurance Inflation



Sources: Scotiabank Economics, US BLS, US Bureau of Economic Analysis.

Chart 8

Falling Prescription Drug Prices



Sources: Scotiabank Economics, BLS.

Chart 9

US Airfare



Sources: Scotiabank Economics, BLS.

There was also some relief in terms of cell phone bills (chart 10). Given early pandemic effects, this disinflationary pattern will be monitored to see if it is more than just re-basing to when bills were soaring early on in the pandemic.

Clothing prices dropped out as a driver (0% m/m) after a couple of months of notable gains along a noisy trend (chart 11). Depending upon what happens to restrictions, we're likely to see the trend remain pointed toward significant but volatile gains.

On the flip side, food at home (ie: groceries) price inflation accelerated last month (chart 12) and so did financial services pricing (chart 13) while appliances eased a touch along a prolonged upward trend (chart 14).

Charts 15 and 16 break down seasonally adjusted price changes by component in unweighted (chart 15) and weighted (chart 16) contribution terms.

Charts 17 and 18 do the same thing in year-over-year terms.

Chart 10

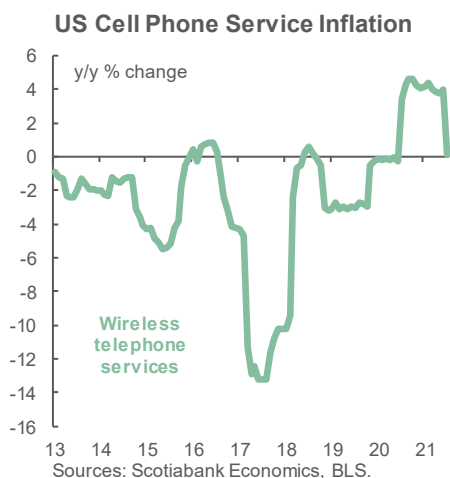


Chart 11

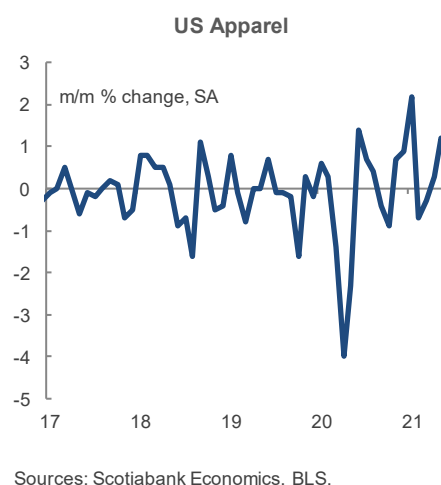


Chart 12

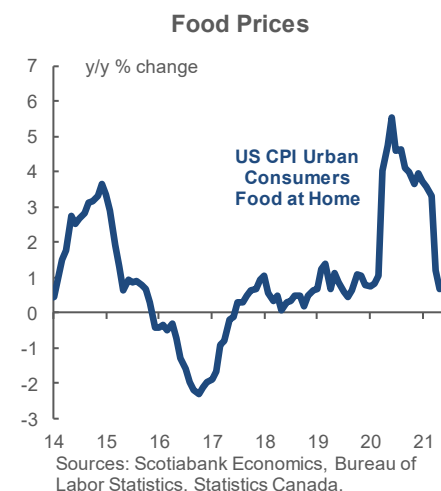


Chart 13

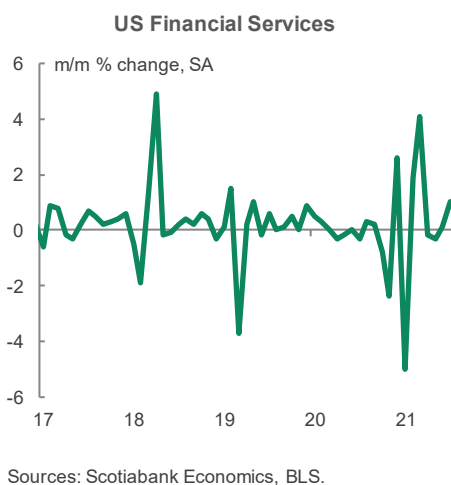


Chart 14

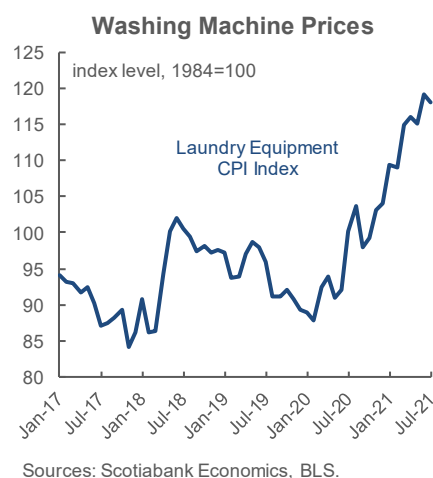
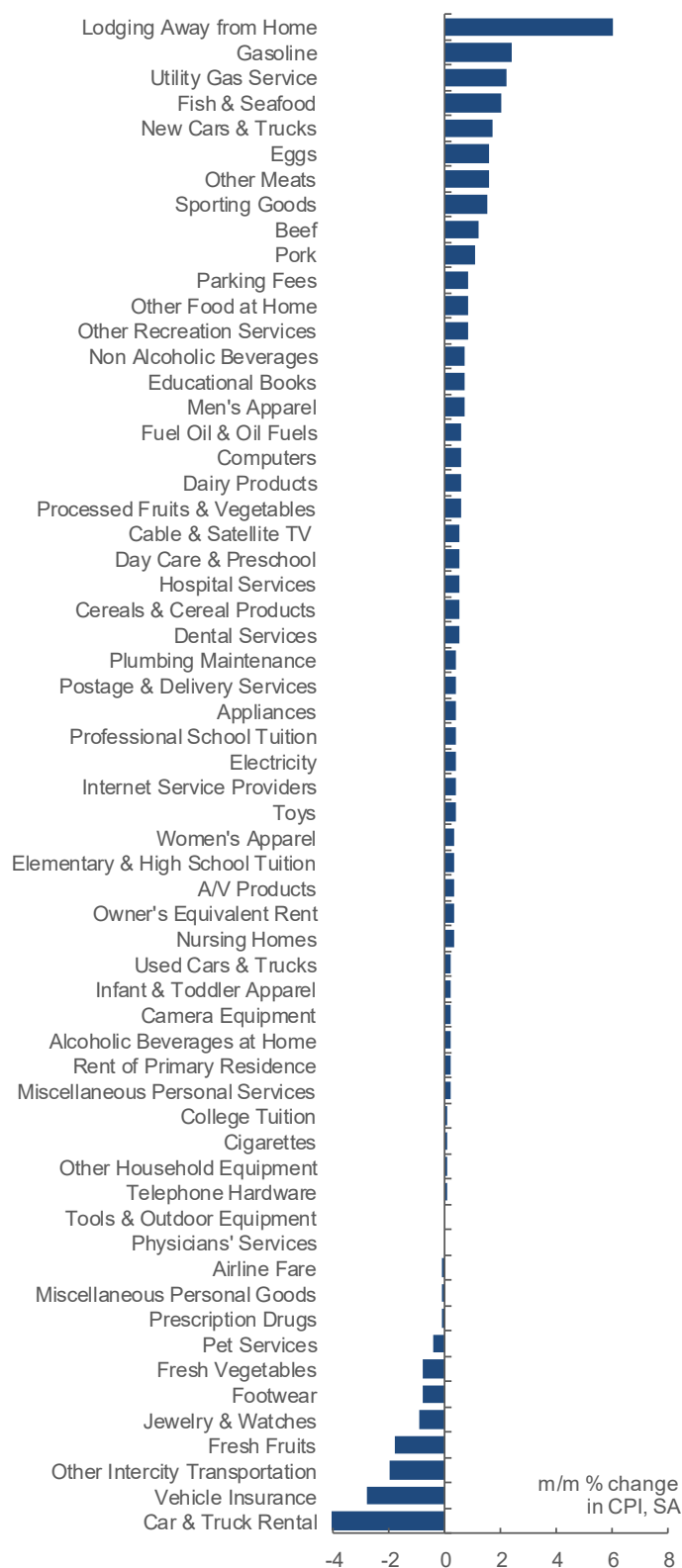


Chart 15

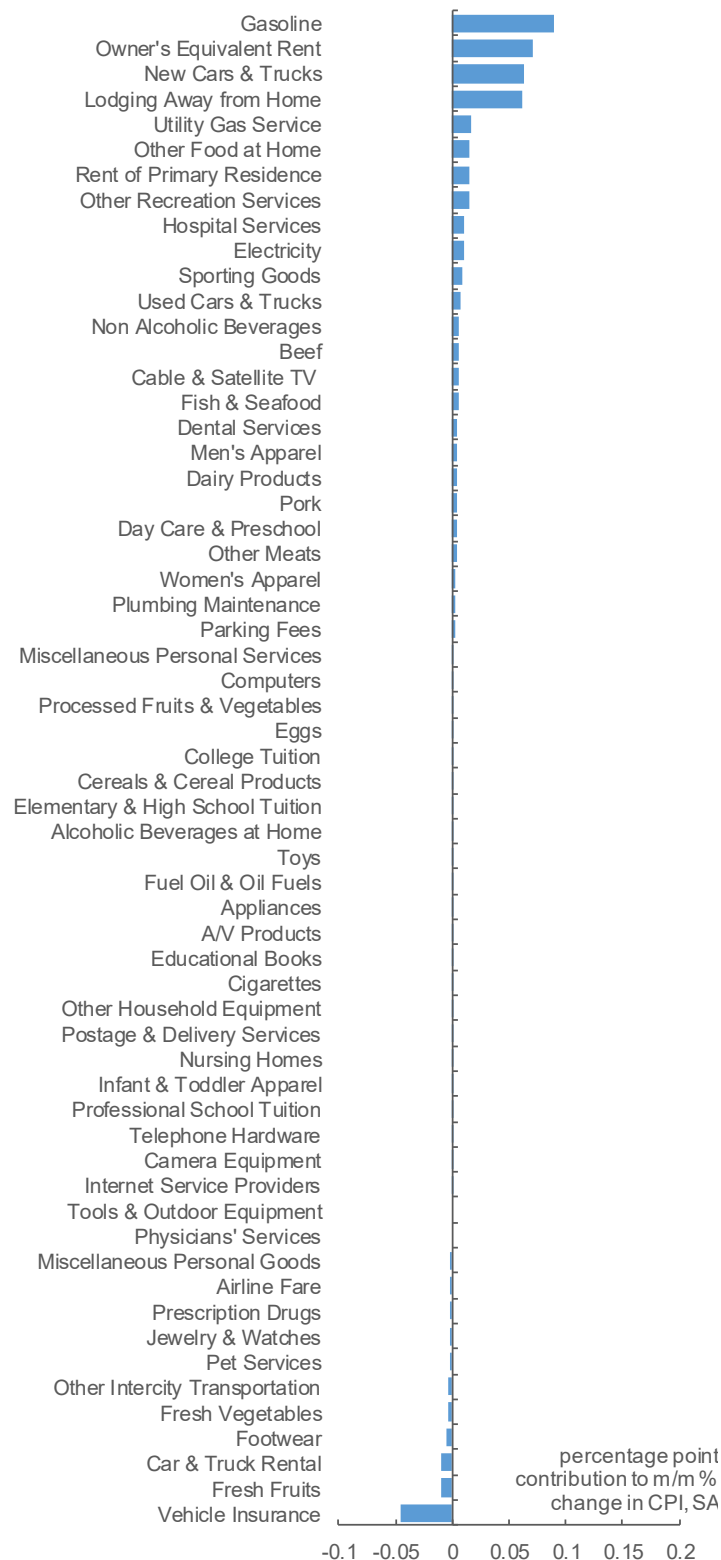
July Changes in US Headline CPI Categories



Sources: Scotiabank Economics, US BLS.

Chart 16

July Weighted Contributions to Monthly Change in US Headline CPI



Sources: Scotiabank Economics, US BLS

Chart 17

July 12-Month Changes in US Headline CPI Categories

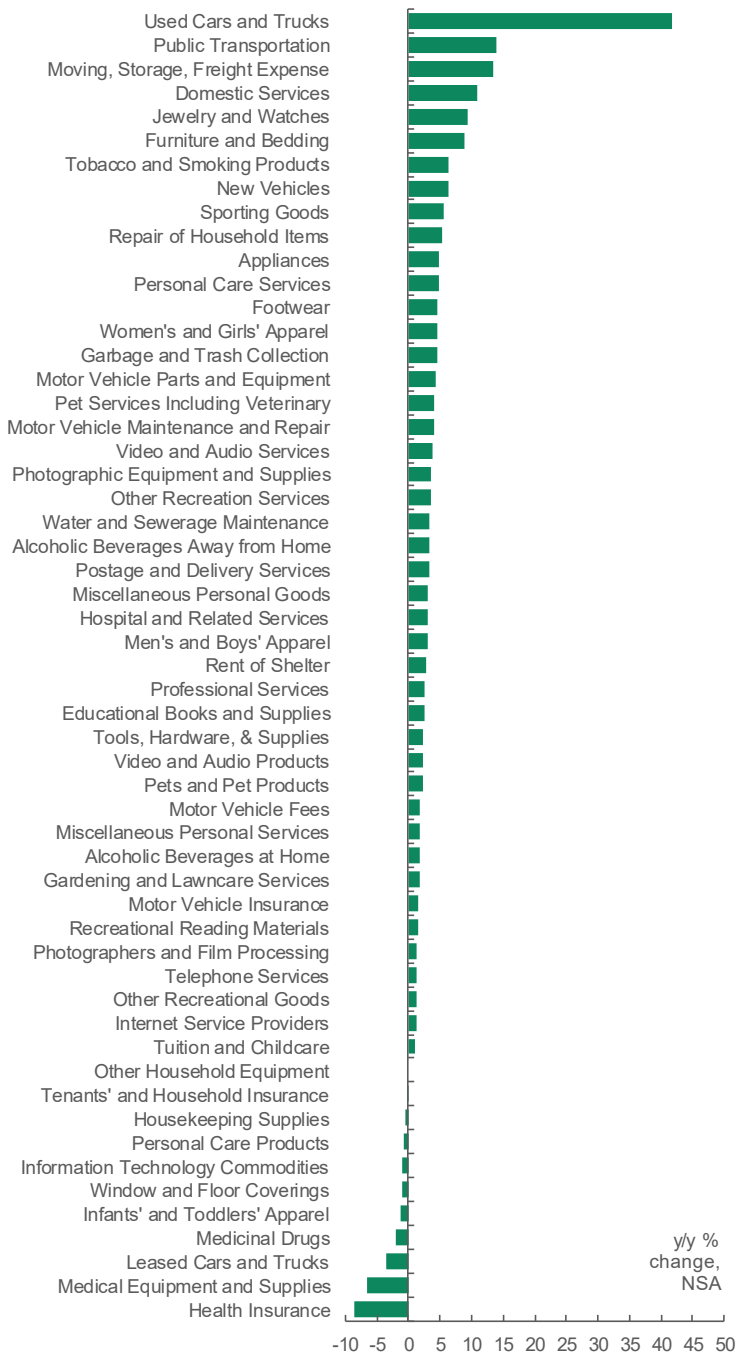


Chart 18

July Weighted Contributions to the 12-Month Change in US Headline CPI



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