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### July Consumer Price Index: Core Inflation Gaining Momentum

- The total CPI rose by 0.3 percent (0.335 percent unrounded) in July; the core CPI rose by 0.3 percent (0.291 percent unrounded)
- On a year-over-year basis, the total CPI is up 1.8 percent and the core CPI is up 2.2 percent in July

The total CPI rose by 0.3 percent in July, as we and the consensus expected, while the core CPI surprised to the upside, rising by 0.3 percent. On an over-the-year basis, the total CPI is up 1.8 percent and the core CPI is up 2.2 percent. July marks the second straight month in which the core CPI surprised to the upside. We noted last month that some outsized increases in a few components – apparel, used motor vehicles, and household furnishings and operations – were the primary culprits behind the jump in the core CPI, and further noted that changes in methodology have rendered the first two of these categories more or less random noise. Our below-consensus of a 0.1 percent increase in the core CPI in July was premised on there being payback for June's outsized gains in these categories. This was not the case, and we think the further increase in the household furnishings and operations category in July is quite telling. Keep in mind, however, that the PCE Deflator is the FOMC's preferred gauge of inflation and that over time core CPI inflation has outrun core PCE inflation by 30-40 basis points. As such, it will be some time before core PCE inflation tops the FOMC's 2.0 percent target, and longer still before the FOMC actually becomes concerned about it doing so. Clearly, the FOMC's focus at present is on sustaining the expansion and mitigating the downside risks from global trade disputes. Whether or not further cuts in the Fed funds rate will accomplish these goals is another question for another day. Either way, the CPI data will not deter the FOMC from cutting the funds rate at their September meeting.

After rising by 0.786 percent in June, prices for household furnishings and operations rose by 0.355 percent in July, yielding the largest two-month increase in this series since the first two months of 1991. Prices for furniture and bedding were up 0.7 percent in July, after increases of 0.9 percent and 0.7 percent in the prior two months, and are up 3.9 percent year-on-year. Prices for floor coverings have posted sizable back-to-back gains and are up 6.0 percent year-on-year. These are a few areas in which you'd expect to see the effects of broader tariffs on imports, which makes the gains seen over the past few months harder to interpret. But, prices in the household operations segment of this broader category, for things such as gardening and lawn care services, and moving and storage services, are up sharply, standing 7.8 percent and 6.8 percent higher on an over-the-year basis, respectively. This suggests that retailers and service providers are passing higher input costs, such as labor costs, along to consumers in the form of higher prices, with a further bump to come in the goods segment once tariffs are imposed on consumer goods. More broadly, core goods prices were up 0.249 percent in July after a 0.383 percent increase in June and, as shown in our middle chart, are now higher on a year-on-year basis. The 0.403 percent increase in July is the largest year-on-year increase since November 2012. Tariffs will help sustain higher core goods prices in the months ahead.

Core services prices are also firming, even aside from rents, meaning that there is more breadth to core inflation over recent months than had previously been the case. Medical care costs are one contributor, with prices for medical care services up 0.5 percent in July, a third straight month of solid increases, leaving prices up 3.3 percent year-on-year. Health insurance prices are up a mind-boggling 15.9 percent year-on-year – a fourth straight double-digit increase – while prices for items ranging from auto maintenance & repair to veterinarian services are rising at an accelerating pace. Toss in the usual suspects, i.e., rents, and it is clear that core inflation has upside momentum that will likely be sustained in the near term. Primary rents were up 0.3 percent in July and are up 3.8 percent year-on-year, while owners' equivalent rents are up 3.4 percent year-on-year.

On a seasonally adjusted basis, retail gasoline prices were up 2.5 percent in July, but this still leaves pump prices down 3.3 percent year-on-year. Food prices were flat in July, with lower grocery store prices countering a below-trend increase in restaurant prices. Food prices are not likely to exhibit sustained strength over coming months and will likely act as a drag on headline inflation.

