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Research

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August inflation recap: Hot core CPI but cooler core PCE

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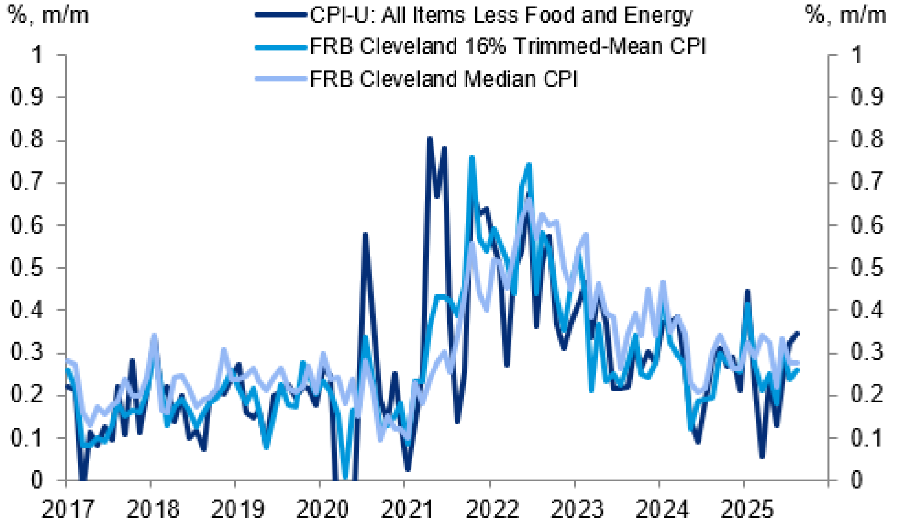
- Both headline (+0.38% vs. +0.20% previously) and core (+0.35% vs. +0.32%) were marginally stronger (~2bps) than our expectations. The year-over-year rate for the former picked up two-tenths to 2.9% while the latter rose one-tenth to 3.1%. Shorter-term trends in core accelerated, with the three-month annualized rate increasing by eight-tenths (to 3.6%) and the six-month rate rising to 2.7% (from 2.4%).
- As was the case in July's data, monthly gains in trimmed mean (+0.26% vs. +0.24%) and median CPI (+0.28% vs. +0.28%) were slightly weaker than core, given the particularly large gain in airline fares. The year-over-year rate for the former ticked up a tenth (to 3.3%), while the latter remained roughly unchanged (at 3.6%).
- In terms of the breakdown within the expenditure basket, core goods prices were strong again, increasing by +0.28% (vs. +0.21%). However, much of this was a function of larger gains in used cars and trucks and alcoholic beverage prices. Some goods which had previously shown strength because of tariffs moderated, while others have potentially begun to see tariff-related pass through into prices (e.g. apparel and new vehicles).
- On the services side, airline fares and lodging away posted large gains, while owners' equivalent rent spiked. The latter was largely geographically confined to smaller cities in the South, suggesting that the rise is more noise than signal.
- Today's CPI data and yesterday's PPI data point to an 0.22% August gain in core PCE, which would have the year-over-year rate continue to round to 2.9%. On balance, the CPI data point to continued strength in service prices, but potentially more moderate tariff impacts going forward than we had previously expected. With respect to the Fed, the more muted read through to core PCE likely locks in a rate cut at next week's meeting and could argue for further easing this year.

August inflation data

Both headline (+0.38% vs. +0.20% previously) and core (+0.35% vs. +0.32%) were marginally stronger (~2bps) than our expectations. The year-over-year rate for the former picked up two-tenths to 2.9% while the latter rose one-tenth to 3.1%. Shorter-term trends in core accelerated, with the three-month annualized rate increasing by eight-tenths (to 3.6%) and the six-month rate rising to 2.7% (from 2.4%).

Figure 1: Alternative trend measures softer than core

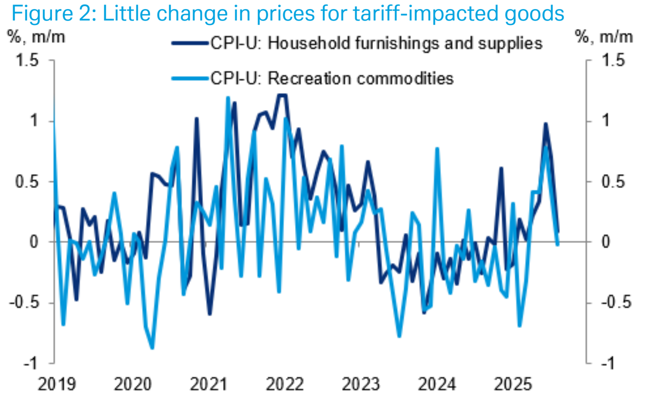


Source: BLS, Cleveland Fed, Haver Analytics, Deutsche Bank

As was the case in July's data, monthly gains in trimmed mean (+0.26% vs. +0.24%) and median CPI (+0.28% vs. +0.28%) were slightly weaker than core, given the particularly large gain in airline fares. The year-over-year rate for the former ticked up a tenth (to 3.3%), while the latter remained roughly unchanged (at 3.6%).

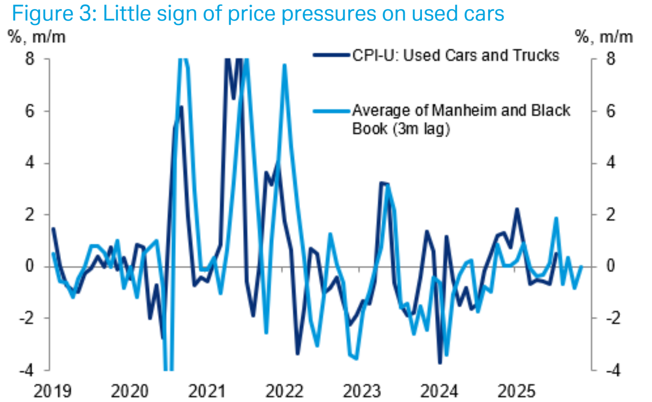
In terms of the breakdown within the expenditure basket, core goods prices were strong again, increasing by +0.28% (vs. +0.21%). However, much of this was a function of a 1.0% (vs. +0.5%) gain in prices for used cars and trucks and a +0.6% (vs. +0.1%) increase in alcoholic beverage prices. Goods which had shown previous evidence of tariff impacts posted smaller than expected gains, like household furnishings and supplies (+0.1% vs. +0.7%), or even declined slightly, like recreation commodities (-1bp vs. +0.4%). One exception to more moderate tariff-related inflation in the August data was motor vehicle parts and equipment (+0.6% vs. +0.9%) which had another solid increase from last month.

Figure 2: Little change in prices for tariff-impacted goods



Source: BLS, Haver Analytics, Deutsche Bank

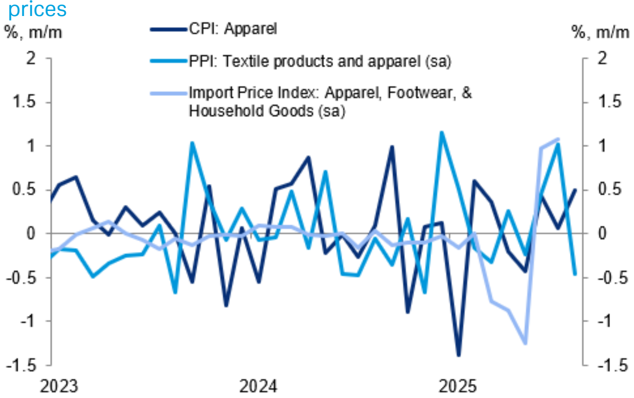
Figure 3: Little sign of price pressures on used cars



Source: BLS, Black Book, Manheim, Haver Analytics, Macrobond, Deutsche Bank

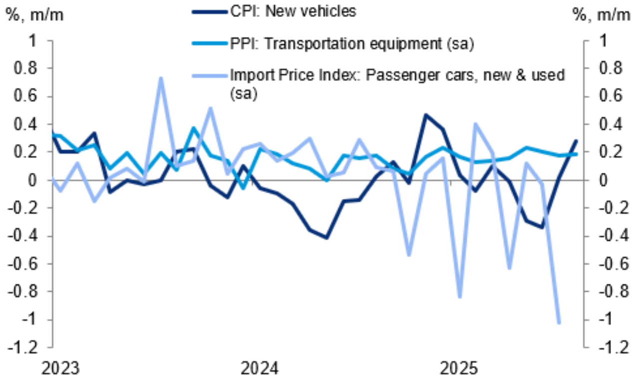
Apparel (+0.5% vs. +0.1%) and new vehicles (+0.27% vs. unch.) both picked up relative to last month, potentially a result of tariffs beginning to show up. Neither have seen much passthrough from tariffs as of yet, likely because of lower import prices offsetting some of the increased tariff costs. For apparel at least, import prices have turned up in recent months indicating that tariff passthrough could begin to show up soon.

Figure 4: Rising import prices to put upward pressure on apparel prices



Source: BLS, Haver Analytics, Deutsche Bank

Figure 5: Little rise yet in import prices for vehicles

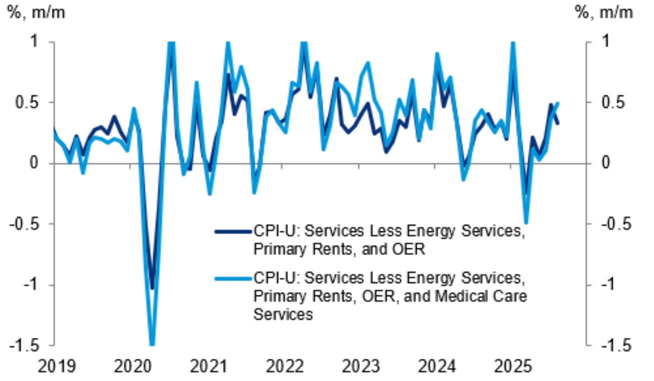


Source: BLS, Haver Analytics, Deutsche Bank

On top of that, there was a moderate price decline in medical care commodities (-0.3% vs. +0.1%) as well as continued weakness in education and communication commodities (-0.3% vs. -1.3%). The latter was mostly driven by a 5.5% plunge in the price for computer software and accessories, the second largest drop on record (back to 1998).

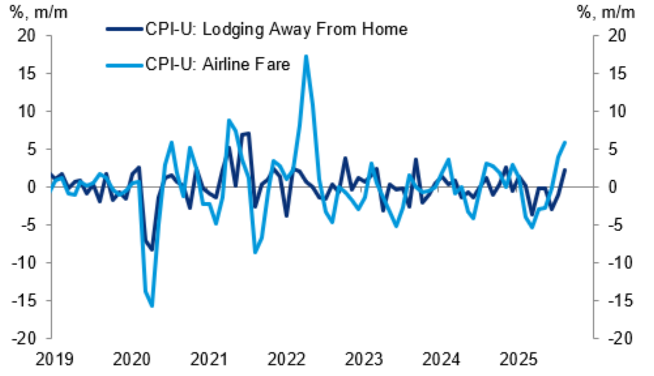
On the core services side (+0.35% vs. +0.37%), much of the strength was due to an almost 6% (vs. 4.0%) increase in airline fares. While the magnitude of the increase was certainly eye-catching, we had previously flagged potential seasonal issues in which over the last couple of years large price declines in the first half of the year were followed by correspondingly large increases in the second half. Other lodging away prices (+2.3% vs. -1.0%) were also stronger than we were expecting. Lodging away data in the CPI over the last couple of months have been weaker than private estimates of average daily hotel rates, so some catchup is not surprising.

Figure 6: Services inflation picking up



Source: BLS, Haver Analytics, Deutsche Bank

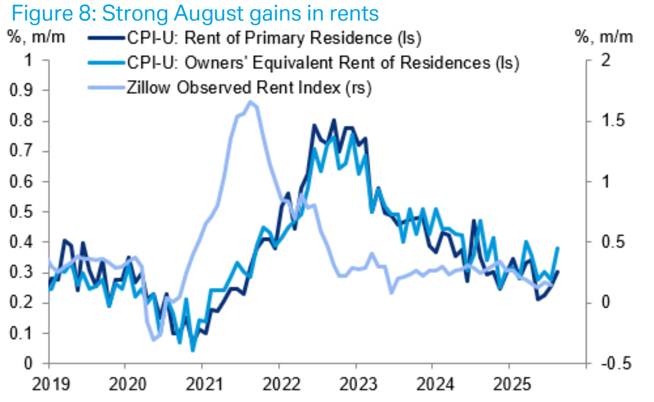
Figure 7: Both airline fares and lodging away prices surprised to the upside



Source: BLS, Haver Analytics, Deutsche Bank

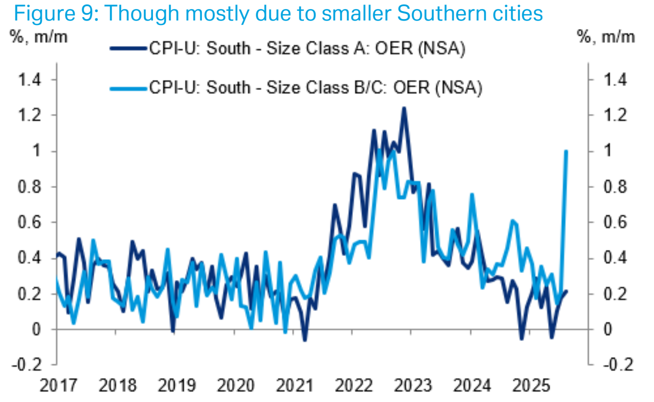
With respect to rents, while primary rents were only slightly stronger than expected (+0.30% vs. +0.26%), owners' equivalent rent sharply accelerated (+0.38% vs. +0.28%). This spike, however, seems geographically confined to the South, more specifically the smaller Class B/C cities (less than 2.5mn people). Those cities saw OER spike from +0.2% m/m (NSA) in July to +1.0% in August, while OER for the Class A cities fell from +0.4% to +0.2%. This speaks to this month's pickup in OER being more noise than signal. Indeed, other leading indicators such the All-Tenant Repeat Rent Index and Zillow's Observed Rent Index continue to point toward rental disinflation.

Figure 8: Strong August gains in rents



Source: BLS, Haver Analytics, Deutsche Bank

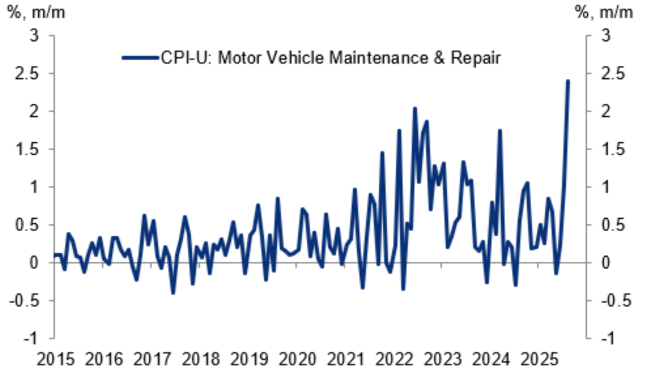
Figure 9: Though mostly due to smaller Southern cities



Source: BLS, Haver Analytics, Deutsche Bank

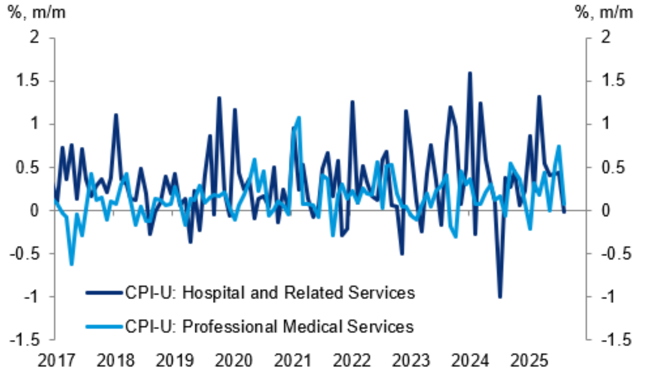
Other services were mixed. On the one hand, motor vehicle repair and maintenance services (+2.4% vs. +1.0%) sharply accelerated, potentially pointing to some pass through from tariffs into services. On the other, medical care services (-0.1% vs. +0.8%) were softer after recent strength in professional services as well as hospital services. Indeed, dental service prices declined by 0.7% after cumulatively increasing by 4% over the prior two months.

Figure 10: Motor vehicle repair prices spiking, potentially due to tariffs



Source: BLS, Haver Analytics, Deutsche Bank

Figure 11: Muted gains in medical services after recent strength



Source: BLS, Haver Analytics, Deutsche Bank

The soft dental services print is important as it is one of the few medical care services that core PCE gets from the CPI rather than the PPI. Given that in addition the particularly large airline fares print in the CPI does not enter core PCE, today's CPI data and yesterday's PPI point to a more moderate 0.22% August gain in the Fed's preferred inflation metric. This would correspond to the year-over-year rising by 5bps but continuing to round to 2.9%, though there is the potential for upward revisions to prior months which could cause it to just round up to 3.0%.

On balance, the CPI data point to continued strength in service prices, but potentially more moderate tariff impacts going forward than we had previously expected. With respect to the Fed, the more muted read through to core PCE likely locks in a rate cut at next week's meeting and could argue for further easing this year.

Appendix 1

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It should be noted that the decision to incorporate ESG factors into any investment strategy may inhibit the ability to participate in certain investment opportunities that otherwise would be consistent with your investment objective and other principal investment strategies. The returns on a portfolio consisting primarily of sustainable investments may be lower or higher than portfolios where ESG factors, exclusions, or other sustainability issues are not considered, and the investment opportunities available to such portfolios may differ. Companies may not necessarily meet high performance standards on all aspects of ESG or sustainable investing issues; there is also no guarantee that any company will meet expectations in connection with corporate responsibility, sustainability, and/or impact performance.

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