

US Watch

August CPI Inflation: Core strength

Still making progress

The August Consumer Price Index (CPI) report was roughly in line with expectations. Headline inflation rose by 0.6% m/m (0.63% unrounded) resulting in a five-tenth increase in the y/y rate to 3.7%. Meanwhile, core inflation rose by 0.3% m/m (0.28% unrounded), which was above consensus and our expectations for a 0.2% m/m print. As a result, the y/y rate fell four-tenths to 4.3%, the lowest reading since September 2021. Despite the stronger than expected core print, core inflation continues to progress towards the Fed's 2% target. Indeed, on a three-and-six-month annualized basis, core inflation is running at 2.4% and 3.1%, respectively.

Pain at the pump

Headline inflation was boosted by a surge in energy prices (+5.6% m/m) owing to higher gasoline prices. Given further increases in crude oil prices and unseasonably warm weather, energy prices could continue to put upward pressure on headline CPI in the near-term. Food prices also rose on the month, increasing by 0.2% m/m for a second consecutive month as both food at home and food away from home rose.

More narrowly driven core goods deflation

Core goods prices fell by 0.1% m/m, above our expectations for a 0.3% m/m decline. The decline was driven by used cars as core goods ex used cars rose by 0.07% m/m after a 0.2% m/m decline in July. In August, there were fewer goods categories that recorded price declines including a 0.3% m/m increase in new vehicles, which rose for the first time since March. We think the increase in new vehicle prices can be partly attributed to more unfavorable seasonal factors relative to recent months. Elsewhere within core goods, household furnishings and supplies rose for the first time since March, and apparel increased after a slight decline in July. While this is just one month of data, it could be a sign that deflation driven by supply-side factors is waning.

Core services in line but noise below the hood

Core services meanwhile rose by 0.4% m/m, in line with our expectations. Shelter inflation advanced by 0.3% m/m, a deceleration from recent months that can be attributed in large part to a 3.0% m/m decline in lodging away from home. Outside of lodging away from home, we saw a divergence in rent and owners' equivalent rent (OER) inflation. Rent inflation picked up to 0.49% from 0.42%, while OER inflation fell to 0.38% from 0.49%. Part of the divergence could be due to utility costs, which are included in rent inflation but stripped out of OER. We recommend not putting too much emphasis on the decline in OER given it is just one month. That said, we do think OER and rent inflation will continue to slow as the rental market is seeing balanced demand and supply and asking rent inflation continues to show signs of easing. *(continued on next page)*

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Glossary

CPI = Consumer Price Index

PPI = Producer Price Index

PCE = Personal Consumption
Expenditures (Price Index)

OER = Owners' Equivalent Rent

NSA = Not Seasonally Adjusted

OIS- Overnight Indexed Swap

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Fade core services ex housing acceleration

Core services ex rent and OER, or core services ex housing, accelerated to 0.4% m/m from 0.2% m/m previously. This is a meaningful step higher from the recent trend as the three-month moving average of the month-over-month change was 0.14% in July. While it is an acceleration, we recommend not overemphasizing this print. Transportation services drove the acceleration owing to a reversal of the decline in airfares and an acceleration in motor vehicle insurance. We felt airfares posed an upside risk to our forecast heading into the print. Airfares are noisy and had helped push down core services ex housing in June and July. Given this we recommend looking at a three-or-six month moving average for the series to get a better sense of the underlying trend. Both are currently at 0.2% m/m as of August.

Fed implications: maintain the hike

We retain our call for a 25bp hike in November. Core CPI was stronger than we expected, and activity has been robust to start 3Q. Given this backdrop, we think the Fed will continue to err on the side of doing too much rather than too little and follow through with one more 25bp hike.

Rates and FX Market reaction

A narrowly led CPI report allowed the rates market to bull steepen on net. While the modestly above market pricing and consensus expectations report supported breakevens by 1-2 bps across the curve, real rates compressed led by the front-end of the curve. The market pricing of an incremental hike is roughly unchanged since before the print, with 14bps priced by the December meeting or about 55% probability of another 25bps hike by the end of the year.

The greater than 100bps of cuts priced in 2024 also wasn't challenged by the print. Pricing of cuts in '24 will likely be sensitive to the suite of data, not just CPI as the Fed assess risk around the inflation outlook in the medium term. As Powell's comments suggested at Jackson Hole, the Fed does not believe in immaculate disinflation being sustained and so we think the market pricing of cuts are about the resilience of US economy: how long will it take for labor market to come back into balance & for GDP growth to slow below trend.

The USD depreciated slightly following the release, with the Bloomberg Dollar index just 0.1% lower on net, amid choppy bi-lateral price action in the G10. With the market essentially fully priced for an unchanged fed funds rate next week, there remains a full set of top-tier data before the Nov FOMC to give the market and the Fed better clarity regarding a potential final hike in November. Market pricing for the Fed did not materially change on this print, and the Fed's "balanced" risk narrative is unlikely to change as a result.

The lack of broad USD appreciation on a higher-than-expected core CPI print suggests that after an 8-week USD rally, the bar is likely higher for the next leg up. We still see broad yet modest USD upside into year end, but today's price action adds to the idea that the dollar is slightly overbought at the moment. Risks seem to point to a further pullback in the USD should retail sales come in soft tomorrow, which is what we are forecasting.

Exhibit 2: CPI Forecast vs. Actual (SA % m/m unless specified otherwise)

Below is a table that compares our bottoms-up CPI forecasts to actuals

	August Forecast		
	Actual	Forecast	Error
NSA Index (level)	307.026	306.958	0.068
Headline CPI (All Items)	0.63%	0.61%	0.02%
Food	0.2%	0.2%	0.1%
Energy	5.6%	5.9%	-0.3%
Core CPI	0.28%	0.22%	0.06%
Core goods	-0.10%	-0.28%	0.18%
Household furnishings and supplies	0.3%	-0.2%	0.5%
Apparel	0.2%	0.1%	0.1%
Transportation commodities less motor fuel	-0.3%	-0.5%	0.2%
<i>Of which:</i>			
New vehicles	0.3%	0.1%	0.2%
Used cars and trucks	-1.2%	-1.5%	0.3%
Medical care commodities	0.6%	0.4%	0.1%
Recreation commodities	-0.4%	-0.5%	0.1%
Other recreational goods	0.4%	-0.8%	1.1%
Education and communication commodities	-0.7%	-0.9%	0.2%
Alcoholic beverages	0.0%	0.2%	-0.2%
Other goods	0.1%	0.3%	-0.2%
Core Services	0.39%	0.40%	-0.02%
Shelter	0.3%	0.4%	-0.1%
<i>Of which:</i>			
Rent	0.48%	0.42%	0.06%
Lodging away from home	-3.0%	0.2%	-3.2%
OER	0.38%	0.44%	-0.06%
Water and sewer	0.5%	0.5%	0.0%
Medical care services	0.1%	-0.2%	0.3%
<i>Of which:</i>			
Health insurance	-3.6%	-3.9%	0.3%
Transportation services	2.0%	1.2%	0.8%
<i>Of which:</i>			
Airfares	4.9%	0.5%	4.4%
Recreation services	-0.1%	0.4%	-0.5%
Education and communication	0.1%	0.2%	-0.1%
Other personal services	0.7%	0.2%	0.5%

Source: BofA Global Research, Bureau of Labor Statistics, Bloomberg

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Exhibit 3: CPI heatmap (%m/m)

Headline CPI rose by 0.6% m/m in August. Core rose by 0.2% m/m

Jul-23 weight	Component	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22
100.0	Headline CPI	0.631%	0.17%	0.18%	0.12%	0.37%	0.05%	0.37%	0.52%	0.13%	0.21%	0.49%	0.41%
13.4	Food	0.24%	0.24%	0.11%	0.20%	0.02%	0.01%	0.39%	0.51%	0.45%	0.55%	0.68%	0.78%
7.0	Energy	5.58%	0.11%	0.60%	-3.59%	0.56%	-3.52%	-0.56%	1.97%	-3.06%	-1.41%	1.68%	-1.74%
79.6	Core CPI	0.278%	0.16%	0.16%	0.44%	0.41%	0.38%	0.45%	0.41%	0.40%	0.31%	0.33%	0.57%
4.3	Household Furnishings and Supplies	0.32%	-0.35%	-0.27%	-0.41%	-0.40%	0.37%	0.76%	0.51%	0.25%	0.36%	0.04%	0.48%
2.5	Apparel	0.20%	-0.03%	0.31%	0.29%	0.27%	0.26%	0.81%	0.83%	0.21%	0.10%	-0.25%	0.04%
7.8	Motor Vehicles & parts	-0.29%	-0.54%	-0.17%	1.49%	1.45%	-0.04%	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%	-0.16%
4.3	New Vehicles	0.27%	-0.08%	-0.03%	-0.12%	-0.22%	0.38%	0.18%	0.23%	0.58%	0.47%	0.56%	0.67%
2.8	Used Cars and Trucks	-1.23%	-1.34%	-0.45%	4.42%	4.45%	-0.88%	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%	-1.10%
1.5	Medical Care Commodities	0.56%	0.51%	0.19%	0.65%	0.46%	0.59%	0.15%	1.06%	0.11%	0.19%	-0.02%	-0.09%
2.2	Recreation Commodities	-0.44%	-0.78%	-0.36%	-0.05%	0.29%	0.24%	0.44%	0.12%	0.09%	-0.34%	0.78%	-0.05%
0.9	Education and Communication Commodities	-0.70%	-1.25%	-0.07%	-0.20%	-0.18%	-0.50%	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%	-0.53%
0.8	Alcoholic Beverages	-0.01%	0.12%	0.01%	0.51%	0.47%	0.14%	-0.28%	0.41%	0.65%	0.64%	0.69%	0.31%
1.2	Other Goods	0.12%	0.30%	0.08%	0.59%	0.24%	0.53%	0.74%	0.77%	-0.07%	0.62%	0.58%	0.39%
34.8	Shelter	0.29%	0.44%	0.37%	0.56%	0.42%	0.56%	0.76%	0.74%	0.79%	0.64%	0.72%	0.74%
25.6	Owners' Equivalent Rent of Residences	0.38%	0.49%	0.45%	0.52%	0.54%	0.48%	0.70%	0.67%	0.79%	0.65%	0.62%	0.79%
7.6	Rent of Primary Residence	0.48%	0.42%	0.46%	0.49%	0.56%	0.49%	0.76%	0.74%	0.79%	0.77%	0.72%	0.81%
1.2	Lodging Away From Home	-2.97%	-0.34%	-2.01%	1.80%	-2.96%	2.70%	2.26%	1.20%	1.10%	-0.52%	3.49%	-0.51%
1.1	Water & Sewer & Trash Collection Services	0.48%	0.46%	0.40%	0.58%	0.33%	0.27%	0.79%	0.85%	0.25%	0.31%	0.17%	0.79%
0.9	Household Operations	-1.14%	1.79%	0.78%	-1.19%	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
6.3	Medical Care Services	0.06%	-0.40%	-0.02%	-0.05%	-0.14%	-0.50%	-0.70%	-0.68%	0.30%	-0.49%	-0.38%	0.83%
5.9	Transportation Services	1.96%	0.34%	0.13%	0.84%	-0.18%	1.38%	1.14%	0.85%	0.63%	0.33%	0.60%	1.91%
0.5	Airline Fares	4.89%	-8.09%	-8.11%	-2.95%	-2.55%	3.96%	6.38%	-2.15%	-2.05%	-1.63%	-1.16%	0.44%
3.1	Recreation Services	-0.07%	0.77%	0.46%	-0.09%	0.74%	0.01%	1.19%	0.73%	0.29%	0.94%	0.78%	0.19%
4.8	Education and Communication Services	0.08%	0.29%	-0.27%	-0.15%	0.07%	0.29%	0.21%	0.45%	0.26%	0.98%	0.17%	0.17%
1.5	Other Personal Services	0.70%	-0.07%	0.23%	0.47%	1.52%	0.47%	1.06%	0.54%	-0.15%	0.82%	0.36%	0.27%

Source: BofA Global Research, Bureau of Labor Statistics

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Exhibit 4: CPI heatmap (%y/y)

Headline CPI rose by 3.7% y/y in August and core rose by 4.3% y/y

Jul-23 weight	Component	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22	Sep-22
100.0	Headline CPI	3.67%	3.18%	2.97%	4.05%	4.93%	4.98%	6.04%	6.41%	6.45%	7.11%	7.75%	8.20%
13.4	Food	4.25%	4.86%	5.74%	6.69%	7.65%	8.50%	9.49%	10.13%	10.41%	10.63%	10.95%	11.24%
7.0	Energy	-3.62%	-12.47%	-16.74%	-11.66%	-5.06%	-6.42%	5.19%	8.70%	7.31%	13.07%	17.63%	19.79%
79.6	Core CPI	4.35%	4.65%	4.83%	5.33%	5.52%	5.59%	5.54%	5.58%	5.71%	5.96%	6.28%	6.63%
4.3	Household Furnishings and Supplies	1.68%	2.24%	3.24%	4.08%	4.77%	5.79%	6.33%	6.37%	7.28%	8.28%	8.81%	9.90%
2.5	Apparel	3.09%	3.18%	3.07%	3.47%	3.65%	3.25%	3.26%	3.06%	2.91%	3.55%	4.09%	5.46%
7.8	Motor Vehicles & Parts	-1.92%	-1.27%	-0.75%	0.12%	-0.30%	-1.82%	-3.18%	-2.26%	-0.95%	2.37%	5.48%	8.40%
4.3	New Vehicles	2.92%	3.50%	4.07%	4.66%	5.42%	6.12%	5.83%	5.78%	5.89%	7.20%	8.39%	9.40%
2.8	Used Cars and Trucks	-6.64%	-5.64%	-5.15%	-4.22%	-6.56%	-11.15%	-13.58%	-11.62%	-8.83%	-3.34%	2.03%	7.18%
1.5	Medical Care Commodities	4.45%	4.13%	4.21%	4.42%	4.01%	3.59%	3.19%	3.39%	3.21%	3.13%	3.06%	3.67%
2.2	Recreation Commodities	-0.08%	1.02%	1.96%	2.73%	2.90%	3.16%	2.85%	3.27%	4.11%	3.63%	4.31%	4.05%
0.9	Education and Communication Commodities	-8.12%	-7.84%	-7.10%	-6.88%	-8.29%	-10.17%	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%	-8.32%
0.8	Alcoholic Beverages	3.71%	4.10%	4.42%	4.77%	4.64%	4.53%	4.92%	5.82%	5.78%	5.54%	5.01%	4.09%
1.2	Other Goods	5.01%	6.09%	6.13%	6.58%	6.80%	6.91%	6.96%	7.15%	7.17%	7.51%	7.21%	7.90%
34.8	Shelter	7.27%	7.69%	7.83%	8.04%	8.11%	8.18%	8.10%	7.88%	7.51%	7.12%	6.92%	6.59%
25.6	Owners' Equivalent Rent of Residences	7.32%	7.66%	7.81%	8.05%	8.12%	8.04%	8.01%	7.76%	7.53%	7.13%	6.89%	6.68%
7.6	Rent of Primary Residence	7.76%	8.03%	8.33%	8.66%	8.80%	8.81%	8.76%	8.56%	8.35%	7.91%	7.52%	7.21%
1.2	Lodging Away From Home	2.98%	6.04%	4.54%	3.41%	3.31%	7.26%	6.73%	7.69%	3.18%	3.24%	5.86%	2.91%
1.1	Water & Sewer & Trash Collection Services	5.82%	5.83%	5.71%	5.71%	5.41%	5.39%	5.25%	4.97%	4.94%	5.01%	4.77%	4.93%
0.9	Household Operations	4.79%	#N/A	5.21%	4.55%	8.01%	#N/A	#N/A	#N/A	#N/A	#N/A	6.57%	#N/A
6.3	Medical Care Services	-2.14%	-1.53%	-0.76%	-0.08%	0.41%	1.03%	2.15%	2.99%	4.12%	4.38%	5.45%	6.51%
5.9	Transportation Services	10.35%	9.03%	8.23%	10.18%	11.03%	13.88%	14.64%	14.63%	14.58%	14.19%	15.19%	14.60%
0.5	Airline Fares	-13.29%	-18.59%	-18.85%	-13.44%	-0.87%	17.70%	26.54%	25.56%	29.14%	35.90%	43.02%	42.64%
3.1	Recreation Services	6.10%	6.21%	5.92%	5.76%	6.39%	5.94%	6.34%	5.75%	5.71%	5.38%	3.94%	4.06%
4.8	Education and Communication Services	2.57%	2.72%	2.38%	2.79%	3.13%	3.25%	2.86%	2.77%	2.41%	2.24%	1.32%	1.36%
1.5	Other Personal Services	6.38%	5.95%	6.46%	6.67%	6.30%	5.25%	5.21%	5.34%	5.55%	6.49%	5.76%	5.93%

Source: BofA Global Research, Bureau of Labor Statistics

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