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Economic Research

Economic Briefing

US inflation data argue for small rate cut

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In the US, inflationary pressure surprisingly picked up again in August. Consumer prices excluding energy and food (core rate), which are important for the trend, rose by 0.3% compared to July. This was mainly due to rents. The data supports our forecast that the Federal Reserve will “only” cut interest rates by 25 basis points next week and not by 50 basis points as many expected.

The data

US consumer prices rose by 0.2% month-on-month in August. The more important core rate, which excludes volatile energy and food prices, was actually 0.3% month-on-month. The consensus and we had both forecast a monthly rate of 0.2%. However, almost half of the economists had only expected 0.1%. In year-on-year terms, the headline rate, which includes all goods and services, fell from 2.9% to 2.5%; excluding energy and food, it remained at 3.2%.

... and the background

After several relatively favorable inflation reports, the figures for August surprised to the upside. Consumer prices only rose by 0.2% overall from July. However, this was due to the fall in the price of gasoline and natural gas and the only slight increase in food prices.

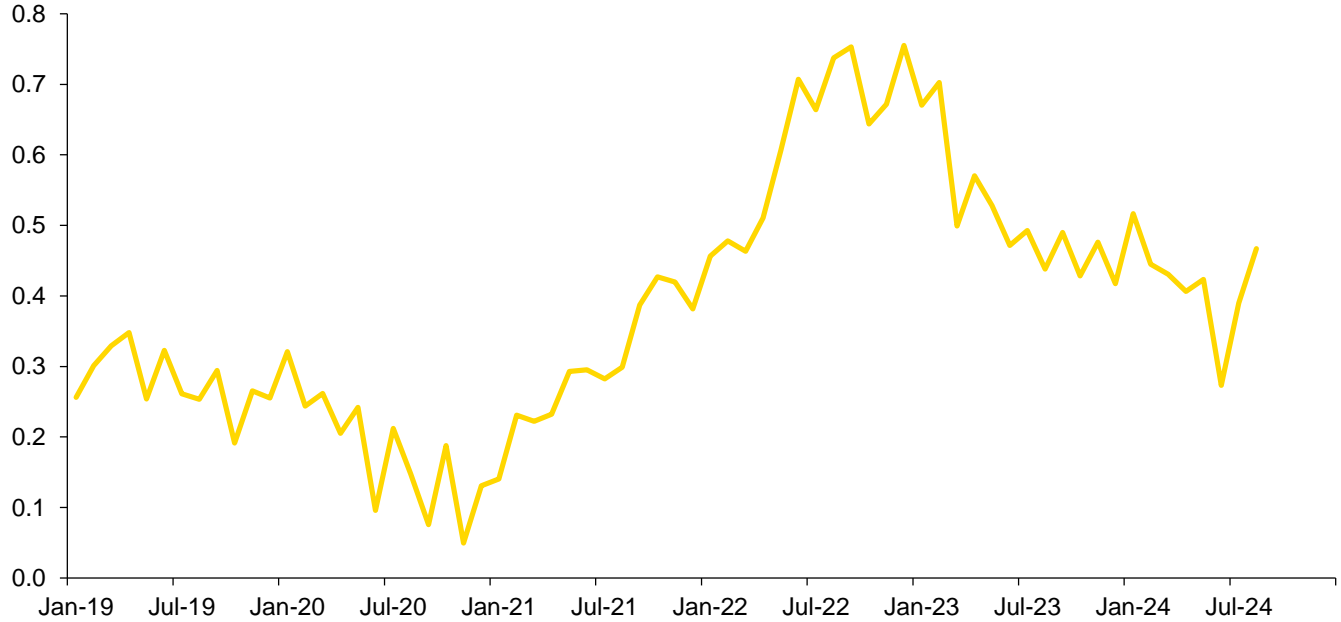
The more important core rate, which excludes energy and food, amounted to 0.3%. Only the figures for core goods were favorable here at -0.2%, which was roughly in line with the trend of recent months. In contrast, core service prices rose by 0.4%, which was a stronger increase. Firstly, some highly volatile (and therefore less informative) prices such as those for airline tickets and hotel accommodation were for the acceleration. Secondly, rents/imputed rents for owner-occupiers, which are actually quite stable, also rose more strongly again (Chart 1). However, industry data on rents for new contracts indicate that prices here should tend to rise more slowly in the future. Overall, we therefore believe that inflation remains on a downward trend. However, this trend is more bumpy than some might have expected after the last three favorable inflation reports.

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Chart 1 - No all clear as regards rental inflation?

Consumer prices, rents and owners' equivalent rents combined, month-on-month change in %.



Source: BLS, S&P Global, Commerzbank Research

The Fed will probably cut its key interest rate by 25 bp next week

The Federal Reserve has already widely communicated the imminent turnaround in interest rates and made it very clear that it will take action at next week's FOMC meeting. Today's inflation figures, which exceeded market expectations, reinforce our view that the Fed will probably initiate the interest rate cut process with a small move of 25 basis points.

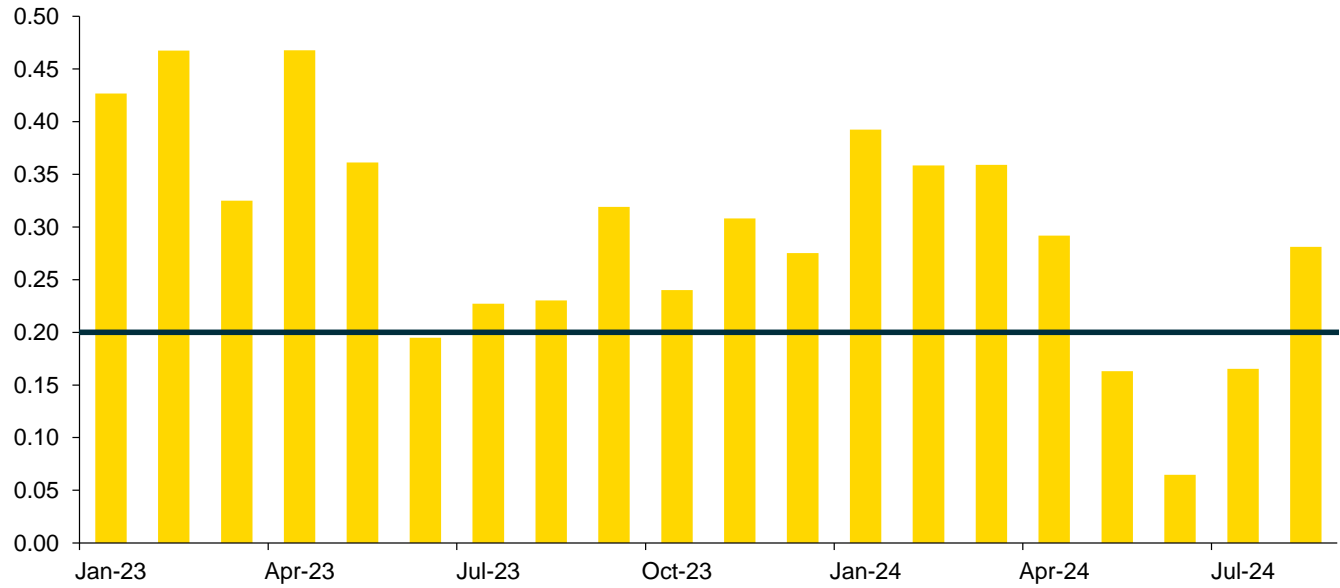
The Fed's inflation target refers to the consumer spending deflator, which normally rises somewhat more slowly than the consumer price index. Thus, a 0.2% monthly increase in the consumer price index (2.4% annualized) is roughly consistent with the Fed's 2% inflation target. In August, the underlying price increase was above this mark (see chart 2).



According to today's inflation figures, the Fed is under no pressure to cut rates by 50 basis points immediately. The fact that economic growth in the third quarter is likely to be around 2% according to today's data also speaks in favor of a small move. Although the labor market has weakened, it is not yet showing any signs of a crisis.

Chart 2 - Underlying inflation increased again

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



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