

Uncomfortably Hot August CPI Report Increases Pressure on Fed

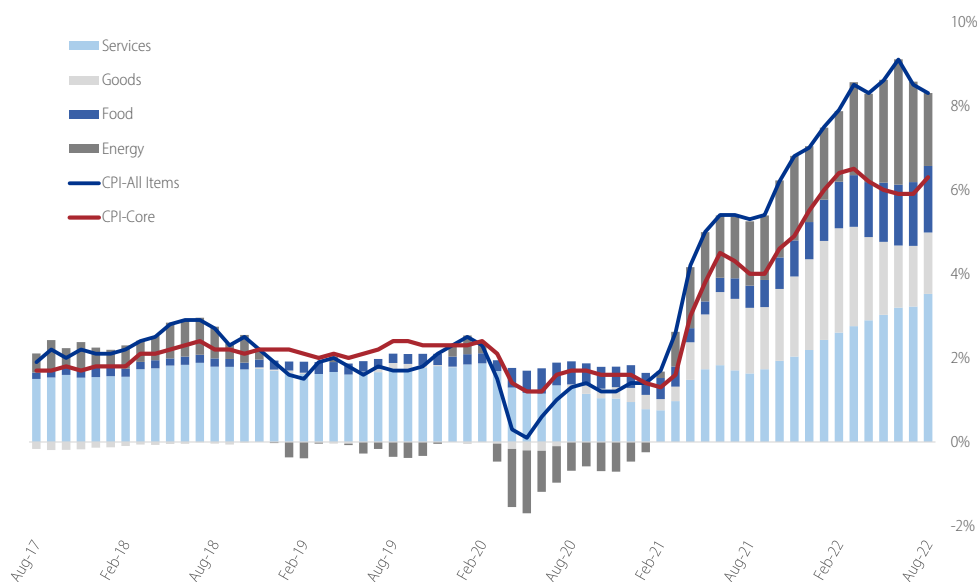
The headline consumer price index rose +0.1% in August, above the expected -0.1% decline and following an *unchanged* reading in July. On a year-over-year basis, CPI increased at a +8.3% pace, down from +8.5%, but above the +8.0% forecast. Unfortunately, it was much worse when food and energy prices were excluded. Core CPI was up +0.6% in August, doubling both the median forecast and the July increase. On an annual basis, the rate of core consumer inflation rose from +5.9% to +6.3%. *This is what the market will focus on.*

Any lingering possibility of a 50 basis point rate increase at next week's FOMC meeting was completely dashed this morning. A third straight 75 bp hike is now fully priced-in. Although a full percent point would be a stretch, the September "dot plot" is likely to indicate a 4.0% yearend target rate. The shocking thing to realize is that just a year earlier, the FOMC was evenly split on whether the first 25 bp move would occur at the end of 2022 or the beginning of 2023. *Then, inflation happened.*

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Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

The largest contributors to CPI in August were food, shelter costs, and medical care. This was expected; the magnitude of the increases were not. The food index rose +0.8% in August, and +11.4% on annual basis. The monthly increase was actually the smallest since December, but the annual pace was the fastest since 1979. The cost of eating out was up "just" +8.0% over the past year, while the cost of eating at home rose +13.5%, making it particularly challenging to rein-in spending.

The shelter index increased by +0.7% following a +0.5% rise in July, and is now rising at a +6.2% annual pace. The medical care index climbed +0.7% after a +0.4% rise in the previous month, and is now up +5.6% year-over-year.

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The overall energy index fell by -0.5%. Within the index, gasoline prices tumbled -10.6%, but both natural gas and electricity prices rose. On a year-over-year basis, overall energy prices were up +23.8%, down from a +32.9% pace in July.

Price increases were wide-spread last month, although there were a few notable declines. In addition to the drop in gasoline prices, airfare and used vehicle prices were both lower.

Despite the few positives, *this was a terrible report*. Falling gas prices were a given, but the fact so many other prices were stubbornly sticky suggest that inflation expectations aren't easing. The only remedy for the Fed is to continue chopping away at demand with additional rate increases.

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Equity market futures were up before the number along with bond prices, but the unexpectedly much-too-hot report abruptly reversed the direction of both stocks and bonds. *The bears have the wheel at this point*. The Fed is in the midst of its 10-day blackout period, so committee members will be silenced until after next Wednesday's meeting. This void promises plenty of volatility.

Market Indications as of 9:07 A.M. Central Time

DOW	Down -703 to 31,678 (HIGH: 36,800)
NASDAQ	Down -396 to 11,870 (HIGH: 16,057)
S&P 500	Down -88 to 4,023 (HIGH: 4,797)
1-Yr T-bill	current yield 3.86%; opening yield 3.63%
2-Yr T-note	current yield 3.73%; opening yield 3.56%
3-Yr T-note	current yield 3.74%; opening yield 3.59%
5-Yr T-note	current yield 3.58%; opening yield 3.43%
10-Yr T-note	current yield 3.44%; opening yield 3.34%
30-Yr T-bond	current yield 3.55%; opening yield 3.50%

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