

Rising Energy Prices Set to Boost Late Summer Inflation

Energy prices were the main reason for the sharp rise in overall inflation last summer as well as the decline over the subsequent 12 months. With WTI crude oil topping \$84/barrel for the first time since last August and the average U.S. gasoline price (AAA) climbing to a nine-month high of \$3.82, headline inflation is on the verge of an unwelcome upturn.

The sharp rise in oil prices are largely attributed to production cuts by Saudi Arabia and Russia, the world's second and third-largest oil producers, as well as persistent global growth. Higher pump prices are the result of rising crude prices and elevated summer fuel demand, as well as the extreme national heat wave which limits refinery production.

The Cleveland Fed's *Inflation Nowcasting* model (updated through this morning) indicates a +0.4% increase in the July overall CPI number and a larger +0.8% rise for August. On an annual basis, the Nowcast model shows overall consumer inflation climbing to +3.4% in July and +4.1% in August. Fed policy-makers focus more on core inflation (which excludes energy) and consider PCE to be the more appropriate indicator of price pressure, but the media and the masses equate inflation with CPI. As a result, inflation *expectations* are likely to rise, which can often be a self-fulfilling prophecy.

Tomorrow morning, the July CPI report will be released. Economists expect just a moderate +0.2% rise in both the overall and core monthly rate. The median forecast also indicates the year-over-year rate of inflation will increase from +3.0% to +3.3%. The expected rise in the annual rate is primarily due to a reversal of the base effect, which has been widely anticipated. August CPI, scheduled for release a week before the September Fed meeting, will see upward pressure from both a lower base and higher energy prices.

Fed officials recognize the long-term trend for prices is still down, although the recent energy increase will complicate how that message is delivered. As of this morning, the futures market is indicating just a 12% chance of a quarter point increase at the September meeting, but warmer inflation in the late summer months could nudge expectations higher. *It's not over yet.*

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Market Indications as of 11:11 A.M. Central Time

DOW	Down -195 to 35,119 (HIGH: 36,800)
NASDAQ	Down -158 to 13,726 (HIGH: 16,057)
S&P 500	Down -37 to 4,462 (HIGH: 4,797)
1-Yr T-bill	current yield 5.34%; opening yield 5.32%
2-Yr T-note	current yield 4.77%; opening yield 4.74%
3-Yr T-note	current yield 4.39%; opening yield 4.38%
5-Yr T-note	current yield 4.10%; opening yield 4.10%
10-Yr T-note	current yield 4.00%; opening yield 4.01%
30-Yr T-bond	current yield 4.17%; opening yield 4.19%

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