

## Odds of a September Rate Hike Slip Further as CPI Matches Forecasts

The overall and core consumer price index (CPI) rose by +0.2% in July, both *equaling the median forecast* while continuing to indicate a long-term downtrend in price pressures. On a year-over-year basis, headline CPI actually climbed from +3.0% to +3.2%, the first increase in more than a year. However, an uptick was widely expected due to a slightly lower base last July.

The annual pace of core CPI declined from +4.8% to +4.7%, matching the median forecast and down from a peak of +6.6% last September. On a quarter-over-quarter/annualized basis, core CPI clocks in at +3.0%, still above the Fed's +2.0% target but moving in the right direction ...and at an agreeable pace.

Service prices, which make up nearly 62% of the overall index, climbed +0.3% in July and have now risen *no more than +0.3% over the past five months*.

The vast majority of the overall July increase was in shelter costs. Primary rent rose +0.42%, down slightly from the previous month, while owner's equivalent rent climbed +0.49% in July, a fractional increase from June. However, there are signs that notoriously sticky housing costs are on the decline. Yesterday, a report from the San Francisco Fed showed shelter inflation is expected to *slow significantly* over the next 18 months. This is due to substantial and ongoing moderation in the housing market, as well as a significant increase in the supply of apartments and rental units.

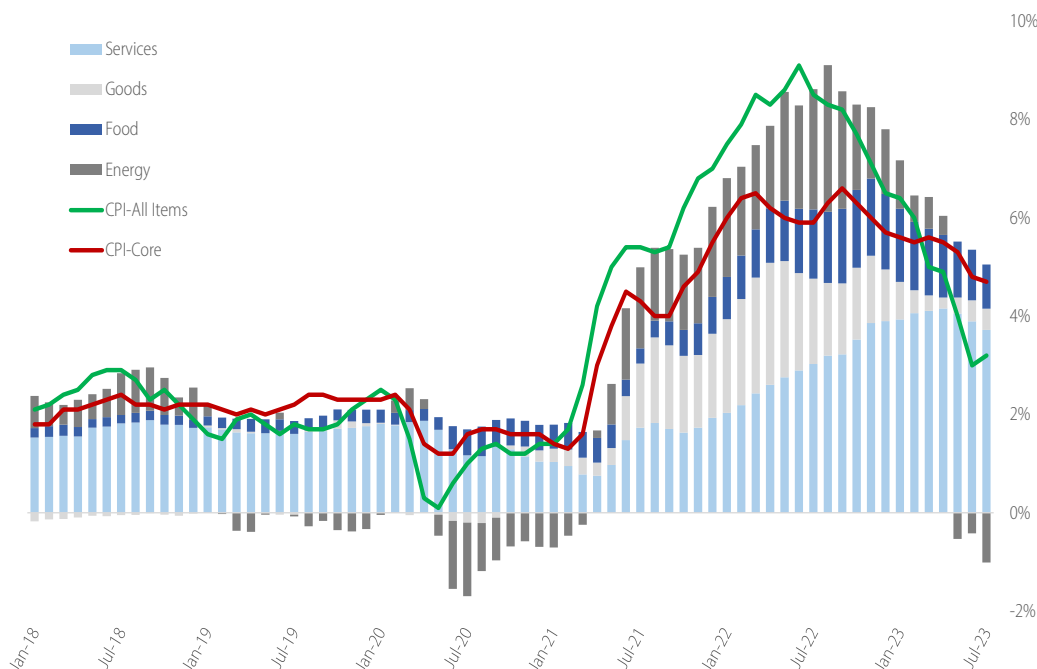
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### Consumer Price Index (Year-over-Year Percent Change)



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Source: Bureau of Labor Statistics

Energy prices, which make up roughly 7% of overall CPI, were up +0.1% in July, but -12.5% lower on an annual basis. Energy prices, which are extremely volatile, are expected to rise more significantly in August.

Food prices were +0.2% higher in July and up +4.9% year-over-year. Food away from home (restaurants) rose +0.2% in July and +7.1% year-over-year, while food at home (grocery stores) rose +0.3% for the month, but just +3.6% for the year.

New car (-0.1%) and used car (-1.3%) prices both fell in July, while airfares dropped -8.1% for the second straight month and are down -18.6% from 12 months earlier.

On the whole, there were few surprises in the report. With shelter costs expected to decline over the remainder of this year and next, Fed officials should breathe a bit easier.

Stocks and bonds are both rallying in early trading, and the futures market continues to reduce the odds of a September rate hike, *now at just 10%*.

The August CPI report, which Fed officials will see before the September FOMC meeting, is expected to show an even bigger rise in the annual inflation rate due to an increase in oil and gas prices, but the longer term price outlook is lower.

The Fed may have completed its rate hikes at this point, but with annual core inflation at +4.7%, the FOMC is still expected to hold the overnight target at 5.25% to 5.5% well into next year.

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## Market Indications as of 9:49 A.M. Central Time

DOW	Up 274 to 35,397 (HIGH: 36,800)
NASDAQ	Up 127 to 13,849 (HIGH: 16,057)
S&P 500	Up 54 to 4,522 (HIGH: 4,797)
1-Yr T-bill	current yield 5.33%; opening yield 5.32%
2-Yr T-note	current yield 4.77%; opening yield 4.81%
3-Yr T-note	current yield 4.41%; opening yield 4.44%
5-Yr T-note	current yield 4.12%; opening yield 4.14%
10-Yr T-note	current yield 4.01%; opening yield 4.01%
30-Yr T-bond	current yield 4.19%; opening yield 4.17%

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