

Unexpected Warming of Core Inflation Reduces Possibility of Larger Cut

Lower energy prices restrained the overall consumer price index (CPI) in August, but the more important core CPI came in *warmer than expected*, further reducing the slim possibility of a 50 basis point cut at next week’s Fed meeting. Headline consumer prices rose by +0.2% for the second straight month, according to BLS data, exactly matching expectations. Energy prices were -0.8% lower in August and -4.0% over the past year. Overall food prices rose by just +0.1%, with the food at home (groceries) component *unchanged* and food away from home (restaurants) up +0.3%.

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

When food and energy prices are excluded, the core rate climbs +0.3%, uncomfortably above both the +0.2% forecast and the +0.2% July gain. Shelter costs were the big surprise in August, rising +0.5%, *the most since the beginning of the year*. The unexpected increase in the cost of housing contributed roughly 70% of the core gain last month.

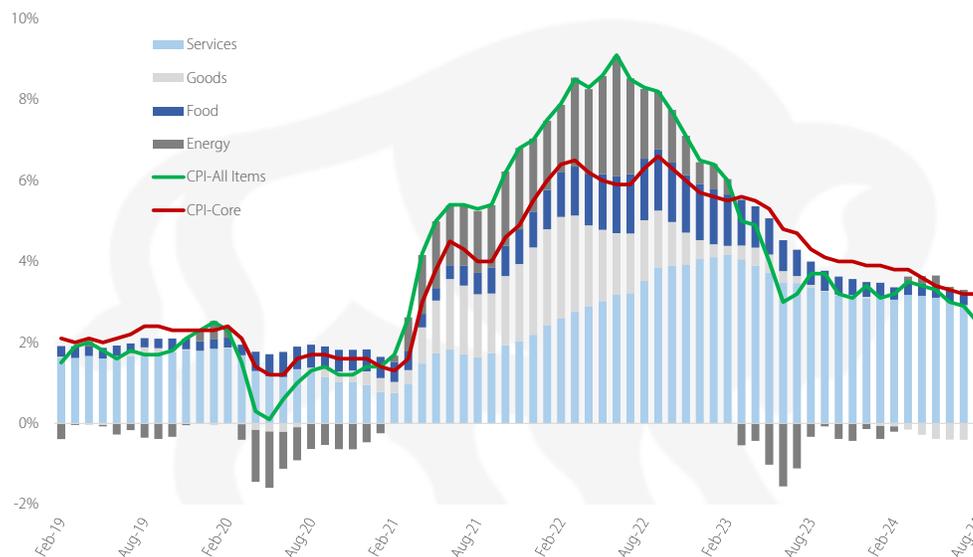
Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2012
greg.warner@hilltopsecurities.com

New vehicle prices were unchanged in August, while prices on used vehicles continued a deflationary trend, down -1.0% for the month and -10.4% over the past year. Airfares reversed a five-month period of falling prices with a +3.9% August rise, although still down -1.3% from a year ago.

On an annual basis, overall CPI held steady at +2.5% (SAAR), the lowest since February 2021, while core CPI was stubbornly unchanged at +3.2%. The so-called “supercore rate,” which strips out food, energy and housing, took an unexpected step forward, increasing by +0.33% in August following a +0.21% rise in July. Fed officials had been focused on the supercore for well over a year but have more recently shifted attentions away as labor concerns dominate.

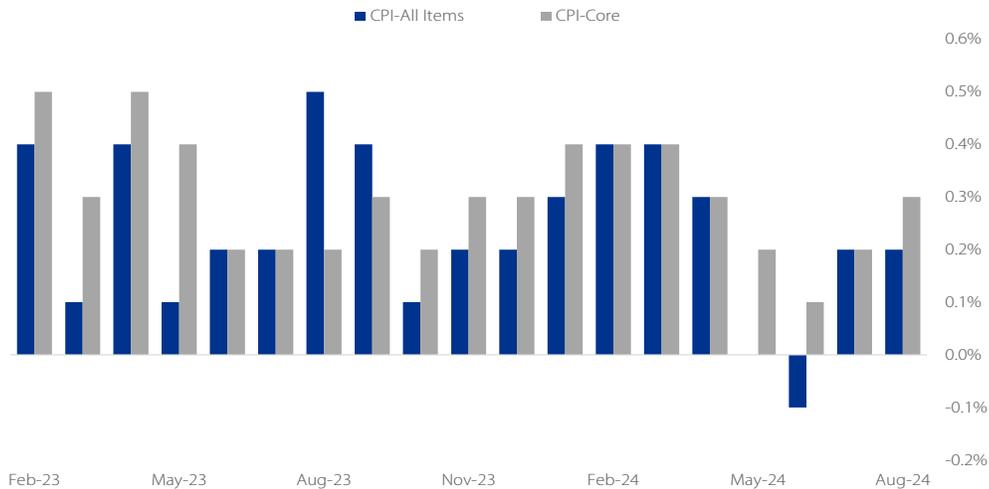
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Consumer Price Index (Year-over-Year Percent Change)



Source: Bureau of Labor Statistics

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



The three-month, annualized core rate rose from +1.6% to +2.1% last month. Although still very close to the Fed's target, the increase halts a string of decline.

Source: Bureau of Labor Statistics

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The bond market is mixed in early trading, with yields slightly higher on the short end and lower on the long end. This reaction is consistent with the Fed's recent shift from a primary focus on inflation to the weakening labor market. The futures market is now indicating just a 15% possibility of a half point cut at next week's FOMC meeting, although it remains a near certainty that Fed officials will announce the first rate cut since March 2020, and will likely accelerate the easing process in the coming months.

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Market Indications as of 9:00 A.M. Central Time

DOW	Down -541 to 40,196 (HIGH: 41,563)
NASDAQ	Down -61 to 16,965 (HIGH: 18,647)
S&P 500	Down -28 to 5,467 (HIGH: 5,667)
1-Yr T-bill	current yield 4.10%; opening yield 4.05%
2-Yr T-note	current yield 3.63%; opening yield 3.58%
3-Yr T-note	current yield 3.45%; opening yield 3.42%
5-Yr T-note	current yield 3.44%; opening yield 3.42%
10-Yr T-note	current yield 3.65%; opening yield 3.64%
30-Yr T-bond	current yield 3.95%; opening yield 3.95%

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