

Consumer Inflation Moderates Before Next Week's Fed Meeting

The August consumer price index indicated price pressures may be heading lower, allowing Fed officials additional time to assess the recent economic slowdown before announcing a tapering of asset purchases. Headline CPI rose by +0.3% last month, cooler than the +0.5% July reading and the smallest increase since January. Core CPI was up just +0.1%, matching a 6-month low.

Pressure in several of the pandemic bounce-back categories eased in August, notably used car prices, which dropped by -1.2%. On a year-over-year basis, prices of used vehicles were still up +32%. New car prices rose +1.2% last month and are up +7.6% year-over-year. With the global microchip shortage continuing to stall auto production, prices of new vehicles are likely to remain elevated.

Overall energy prices rose +2.0% last month as gasoline prices climbed +2.8%. Pump prices for all grades of gas are up nearly +43% from a year-ago.

Airfares dropped -9.1% in August, reflecting a winding down of summer travel and mounting concerns over the Delta variant. In a related note, hotel/motel prices fell by -3.3% after gains of +6.8% and +7.9% in the previous two months.

Owner's equivalent rent, the flawed measure of housing costs, was up a relatively mild +0.3% for the fourth straight month. Rental prices are just beginning to climb and could add a dose of pressure to future CPI reports.

On a year-over-year-basis, headline CPI was up +5.3% in August, down from +5.4% the previous month. Core CPI climbed +4.0% on a year-over-year basis following a +4.3% annual increase in July. During the 20-year period before the pandemic began, core CPI had averaged just under +2.0% per year.

Fed officials have long asserted that elevated prices will be temporary. Supply chain shortages, exacerbated by the latest covid wave, have stretched this temporary period well beyond a few months. Normally when the Fed reins-in inflation, they hike rates to cool *demand*. This time is different as lean *supply* is mostly to blame for recent price pressures. Nevertheless, the economic emergency has passed, along with the need for hyper-accommodative monetary policy. The Fed will eventually announce a tapering of QE purchases, but the slight easing of price pressure in today's CPI report along with the weak August payroll gains should postpone the announcement until later this year. All QE purchases will have ended before the first rate hike, which isn't expected until sometime in 2023.

Bonds have rallied in response to the slightly weaker CPI, pushing yields lower. Bond investors seem to believe Fed officials will signal *no change in policy* at next week's FOMC meeting. Although a taper timing announcement isn't likely, a fresh dot plot will be revealed providing a glimpse into committee member expectations for eventual tightening of the overnight funds target.

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Market Indications as of 10:07 A.M. Central Time

DOW	Down 199 to 34,670 (HIGH: 35,625)
NASDAQ	Down 13 to 15,092 (HIGH: 15,374)
S&P 500	Down 18 to 4,450 (HIGH: 4,537)
1-Yr T-bill	current yield 0.07%; opening yield 0.06%
2-Yr T-note	current yield 0.21%; opening yield 0.21%
3-Yr T-note	current yield 0.43%; opening yield 0.44%
5-Yr T-note	current yield 0.78%; opening yield 0.81%
10-Yr T-note	current yield 1.28%; opening yield 1.32%
30-Yr T-bond	current yield 1.84%; opening yield 1.90%

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