

PORTFOLIO ANALYSIS & CONSULTING

# Inflation Tracker: August 29, 2024

**Jack Janasiewicz, CFA<sup>®</sup>**

Portfolio Manager and  
Portfolio Strategist

**Garrett Melson, CFA<sup>®</sup>**

Portfolio Strategist



# Highlights

***Inflation is yesterday's problem. Downside risks to growth are now greater than the upside risks to inflation.***

The July Consumer Price Inflation print was soft with both headline and core printing +0.2% on a month-on-month basis, in line with consensus. Headline advanced 0.155% while core rose 0.165% - both rounding up to the printed 0.2% reading. In year-on-year terms, headline fell to 2.9% from 3.0% in June while core dropped from 3.3% to 3.2%.

- There are simply no signs of broad inflationary pressure.
- Core CPI has risen just 1.6% annualized over the past three months – the slowest pace since February of 2021.
- Core CPI ex shelter has been in outright deflation for the past 3 months and in year-on-year terms has printed below 2.4% in each of the past 12 months.
- Stripping out the only two mechanically or methodologically lagged components still experiencing inflation - motor vehicle insurance and housing – core CPI has been running below target for 13 months now, sitting at just 0.36% in July.

***The Fed remains on track to commence its easing cycle in September.***

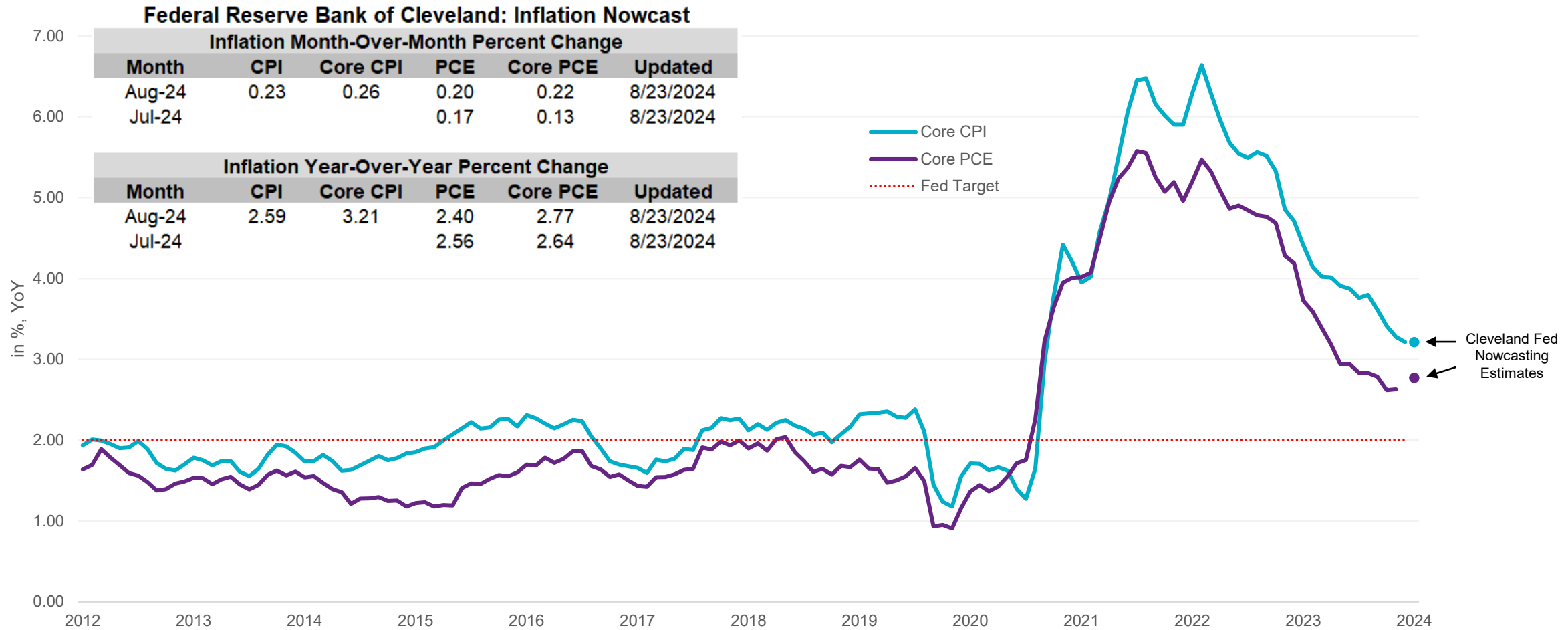
- The dual mandate has swung back into balance but given recent labor market data, that balance is begging to move back out of equilibrium.
- This time, risks are shifting to the growth and labor side of the mandate.
- Inflation risks remain clearly skewed to the downside while unemployment risk are skewed to the upside.
- The time has come for the Fed to focus on risk management and recalibrate policy back towards neutral.
- The only question now is what the size of the first rate cut will be.
- And that will be a function of the labor market data and growth outlook between now and September 18<sup>th</sup>.
- Should July's softer payrolls print mark the beginning of a more material cooling in labor market momentum and a further rise in the unemployment rate, the need for a more aggressive pace of easing increases.



# Inflation: The Big Picture

# Actual vs Target

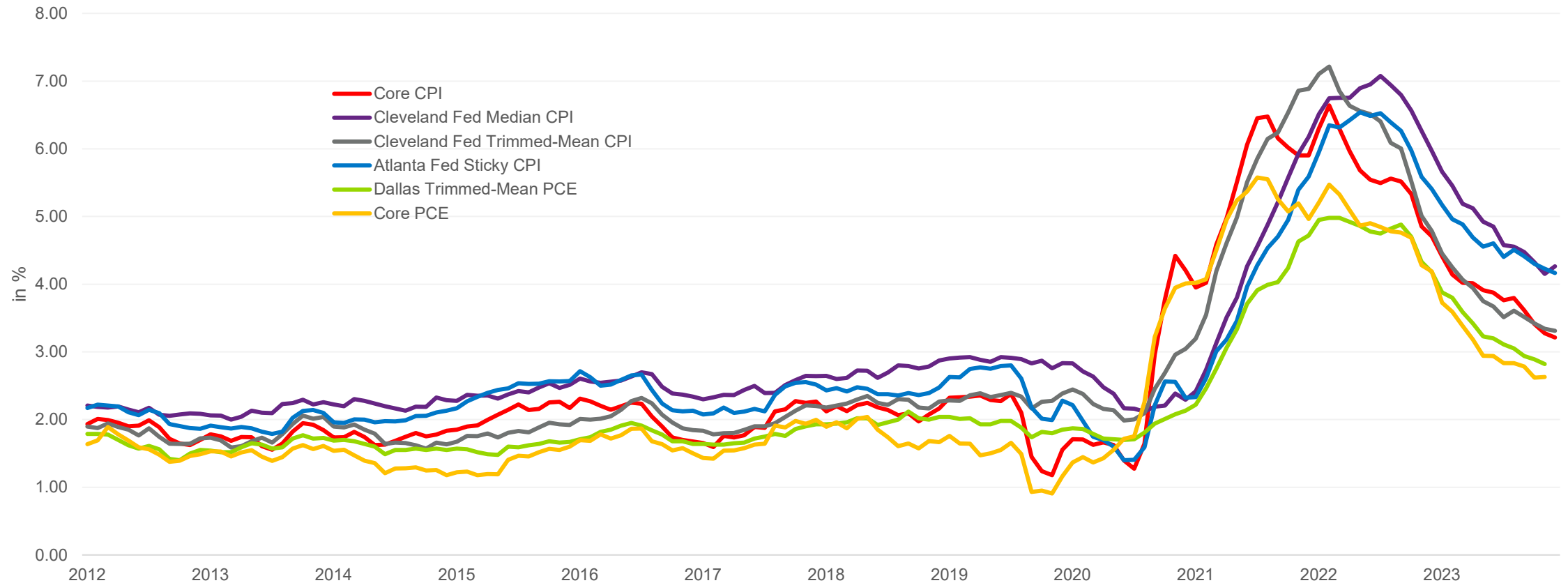
## US Personal Consumption Expenditures vs Consumer Price Inflation (8/31/12–7/31/24)



Source: Portfolio Analysis & Consulting. FactSet. Federal Reserve Bank of Cleveland.

# Inflation Monitor

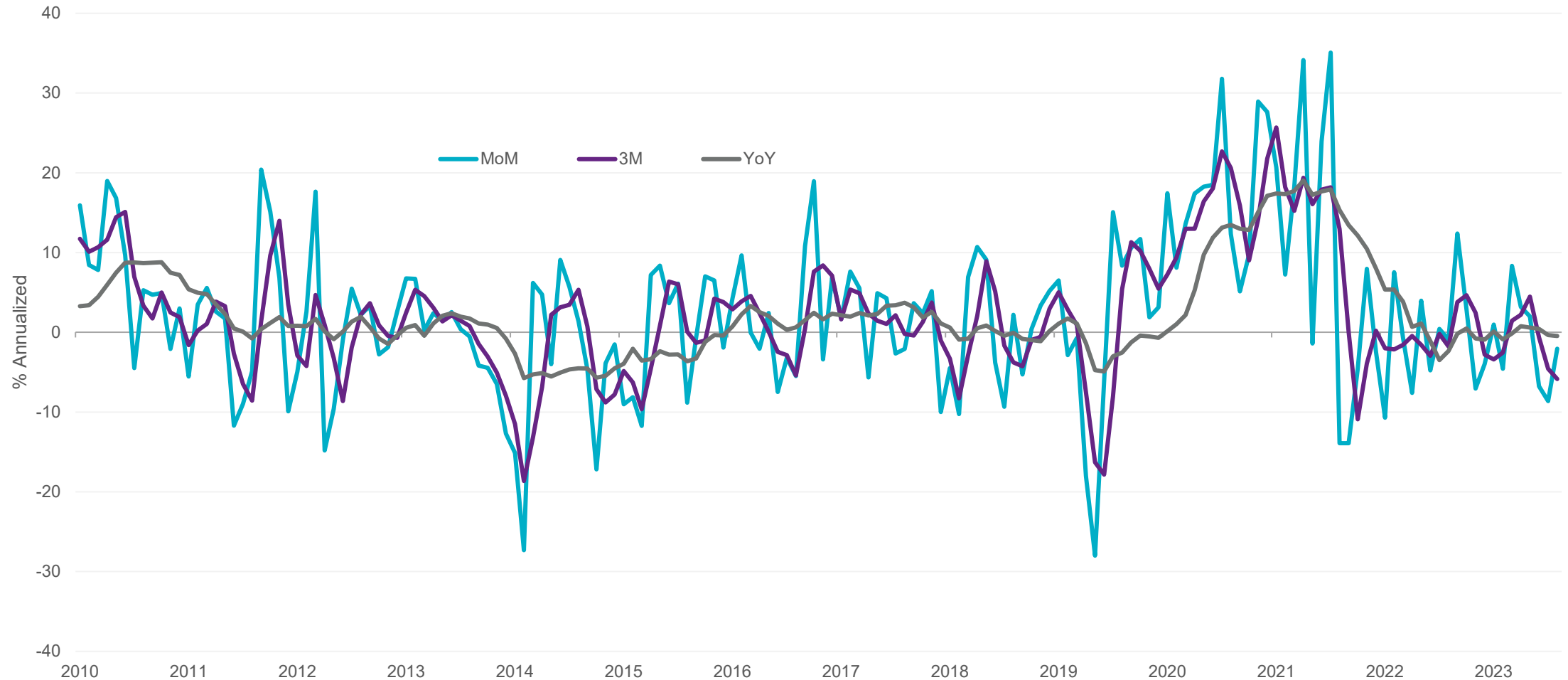
## Trends in Inflation (8/31/12–7/31/24)



Source: Portfolio Analysis & Consulting. FactSet. Median CPI is the Federal Reserve Bank of Cleveland's Median Consumer Price Index that looks at the median price change of the CPI prices. Trimmed Mean CPI is the Federal Reserve Bank of Cleveland's 16% Trimmed Mean Consumer Price Index which excludes 8% of the CPI components with the highest and lowest one month price changes. The Trimmed Mean PCE inflation rate produced by the Federal Reserve Bank of Dallas is an alternative measure of core inflation in the price index for personal consumption expenditures (PCE). The individual price changes are sorted in ascending order from "fell the most" to "rose the most," and a certain fraction of the most extreme observations at both ends of the spectrum are thrown out or trimmed. The inflation rate is then calculated as a weighted average of the remaining components. Sticky Price CPI is the Federal Reserve Bank of Atlanta's Sticky-Price Consumer Price Index which sorts the components of the CPI into either flexible sticky (slow to change) categories based on the frequency of their price adjustments. Core CPI is the Bureau of Labor Statistics Core Consumer Price Index which measures the CPI excluding energy and food prices. Core PCE is the Bureau of Economic Analysis Personal Consumption Expenditures Index which excludes energy and food prices.

# Flexible Prices Are Back to Pre-COVID Levels

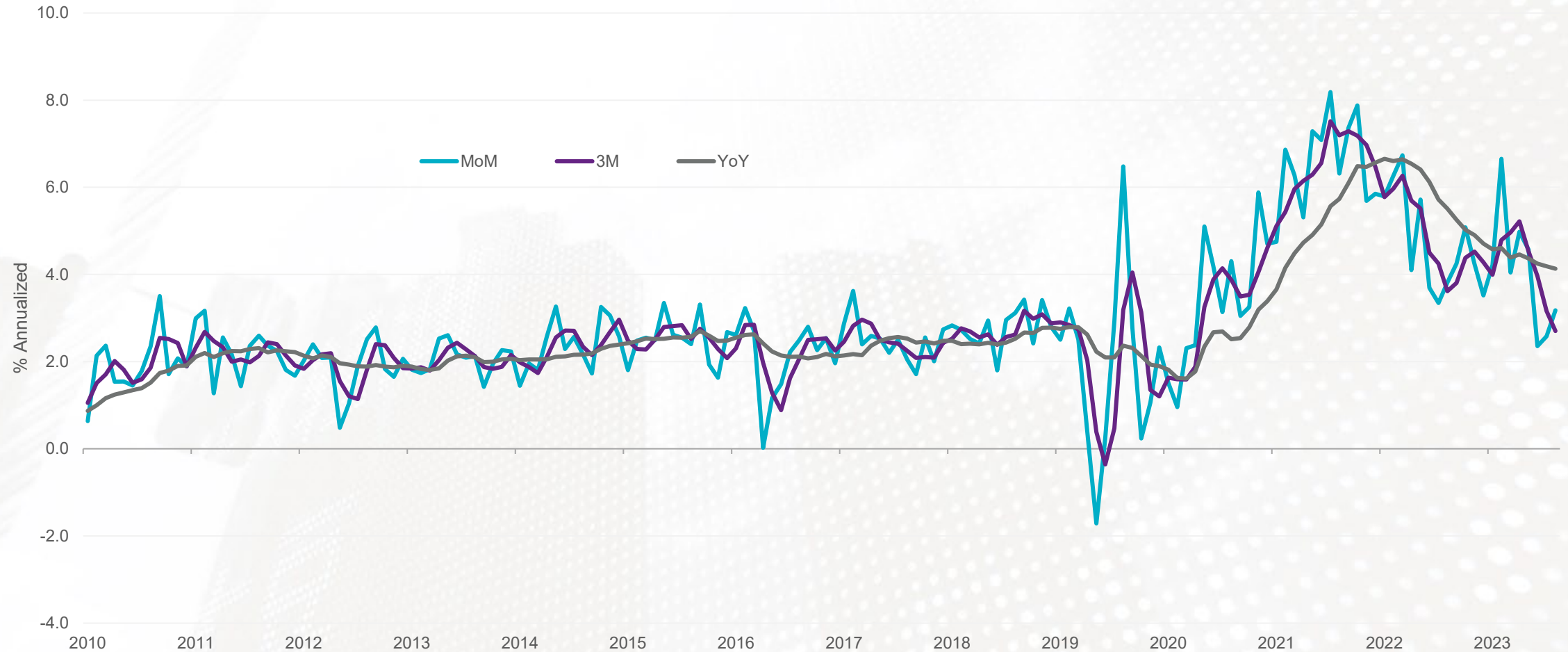
## Atlanta Fed's Flexible Consumer Price Index (12/31/10–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg. Goods that change prices more frequently than, on average, every 4.3 months are considered flexible-price goods. Roughly half of the items defined as flexible-price goods comprise food and energy goods with the remainder being largely autos, apparel, and lodging away from home.

# Sticky Prices: Details Matter

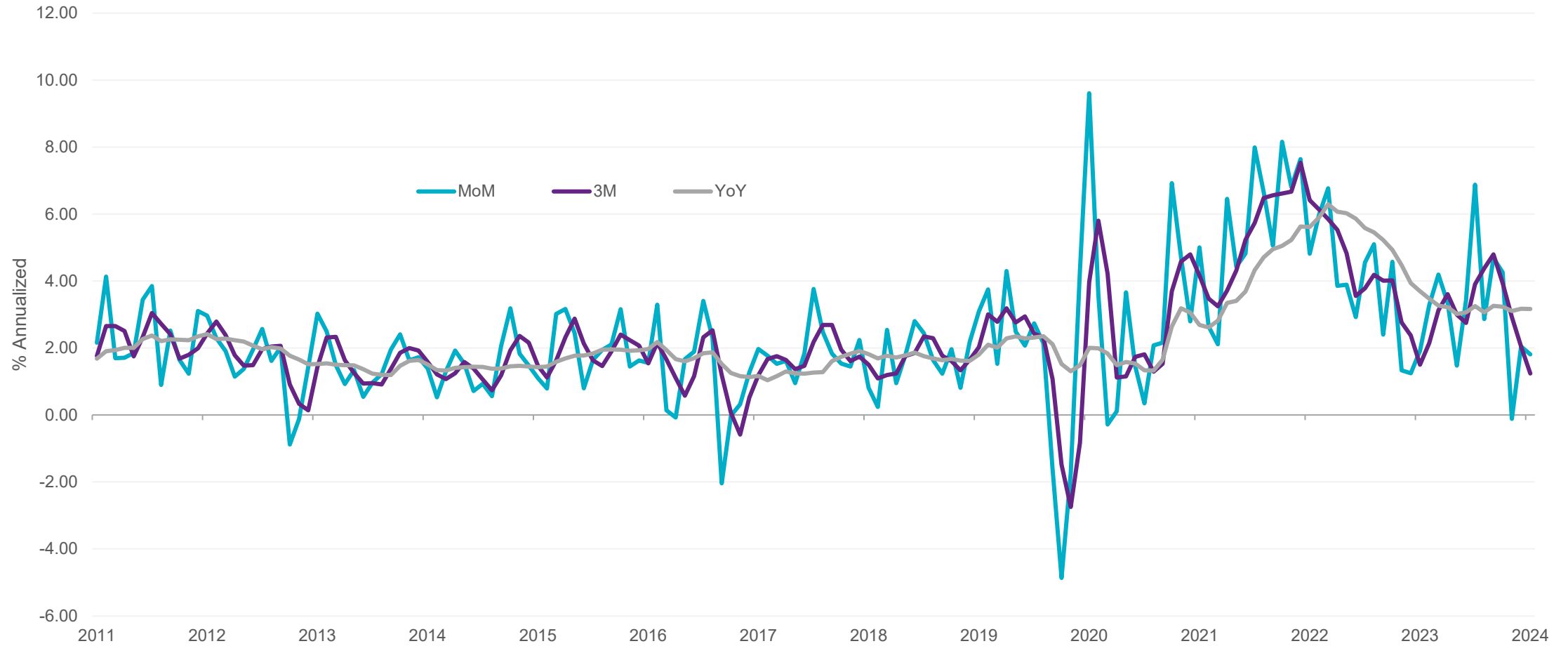
## Atlanta Fed's Sticky Consumer Price Index (12/31/10–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg. Sticky-prices are defined as those line items that exhibit price changes that occur less often, on average, than every 4.3 months. Sticky-price CPI includes many service-based categories such as medical services, education, and personal care services, as well as most of the housing categories.

# Sticky Prices ex-Shelter: a Bump in the Road?

Atlanta Fed's Sticky ex-Shelter Consumer Price Index (12/31/10–7/31/24)

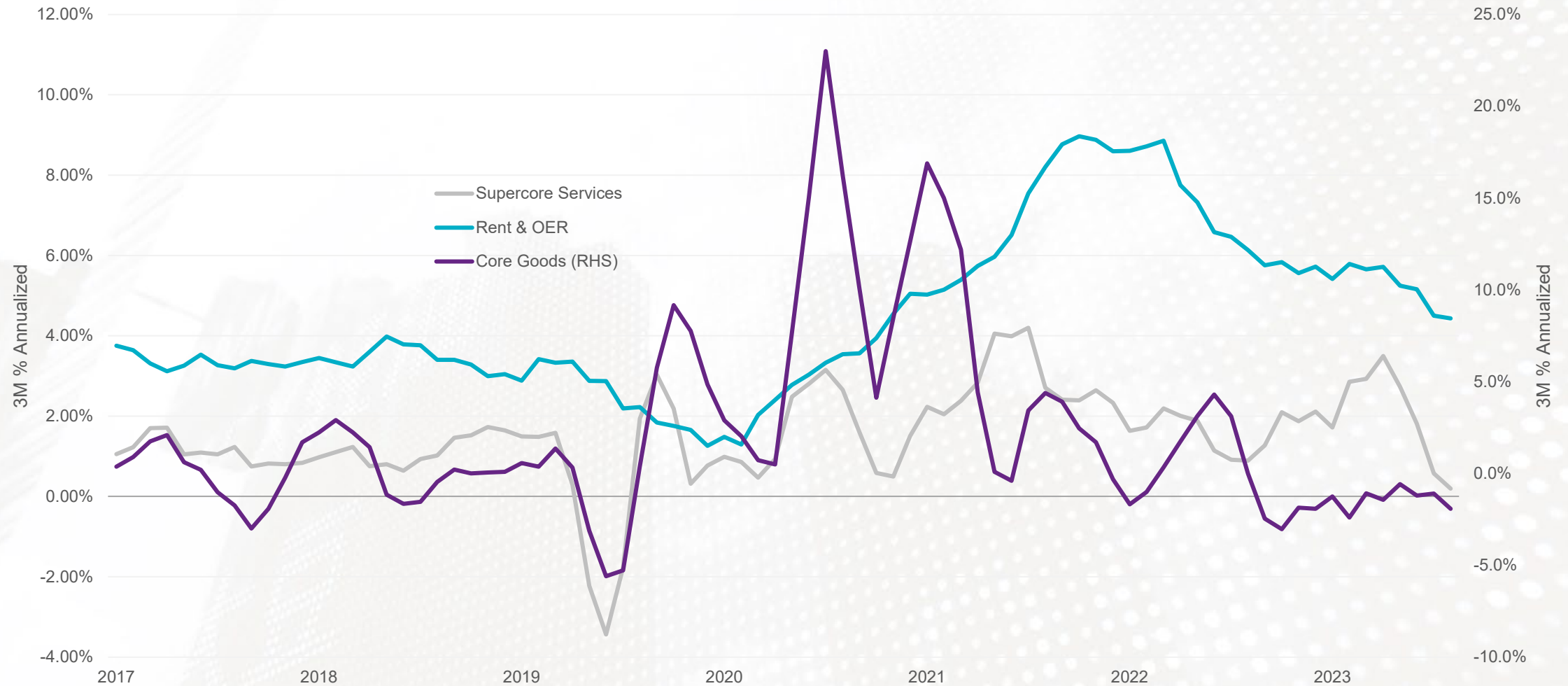


Source: Portfolio Analysis & Consulting. Bloomberg. Sticky-prices are defined as those line items that exhibit price changes that occur less often, on average, than every 4.3 months. Sticky-price CPI includes many service-based categories such as medical services, education, and personal care services, as well as most of the housing categories.



# Powell's Checklist: Moving in the Right Direction

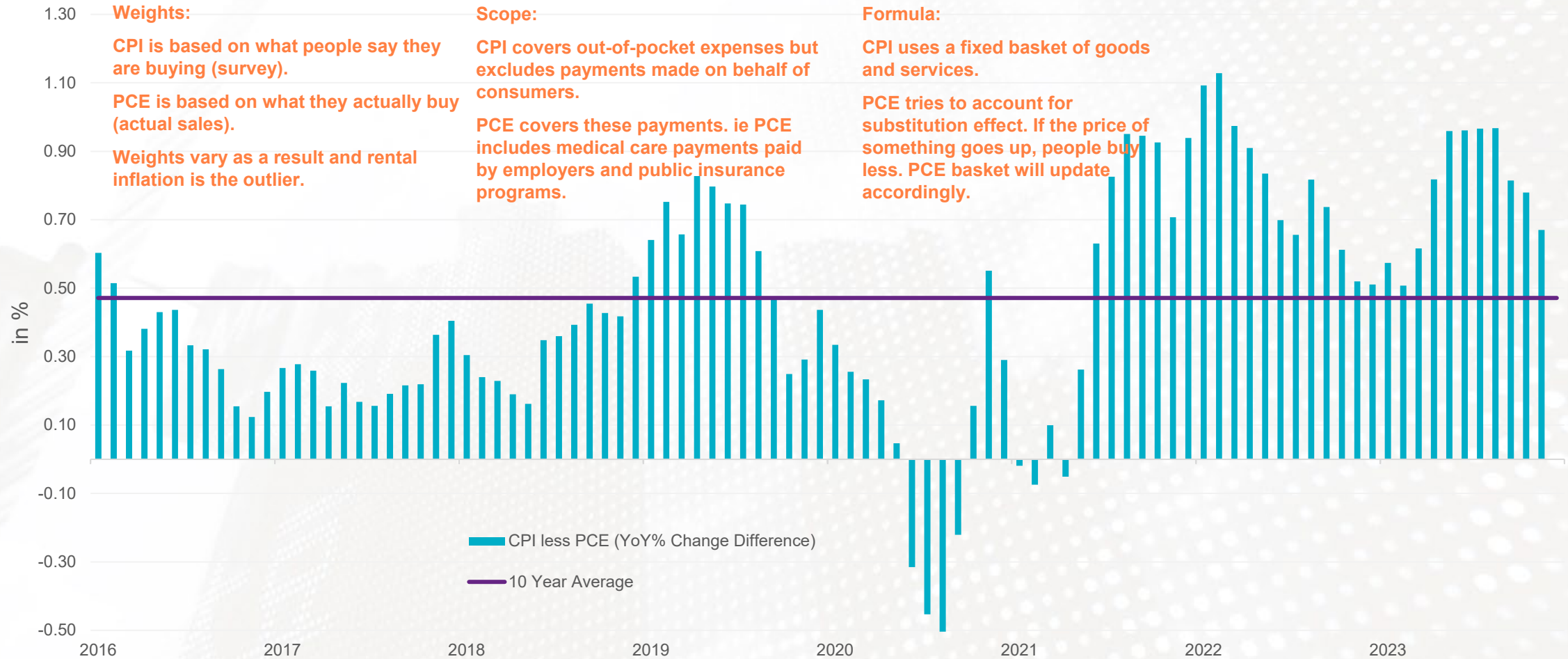
## Supercore Services Consumer Price Inflation vs Core Goods (12/31/17–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg. Supercore Services is Consumer Service Inflation less Energy Services less Rent of Primary Residence less Owners' Equivalent Rent.

# CPI Inflation Tends To Run Higher Than PCE Inflation

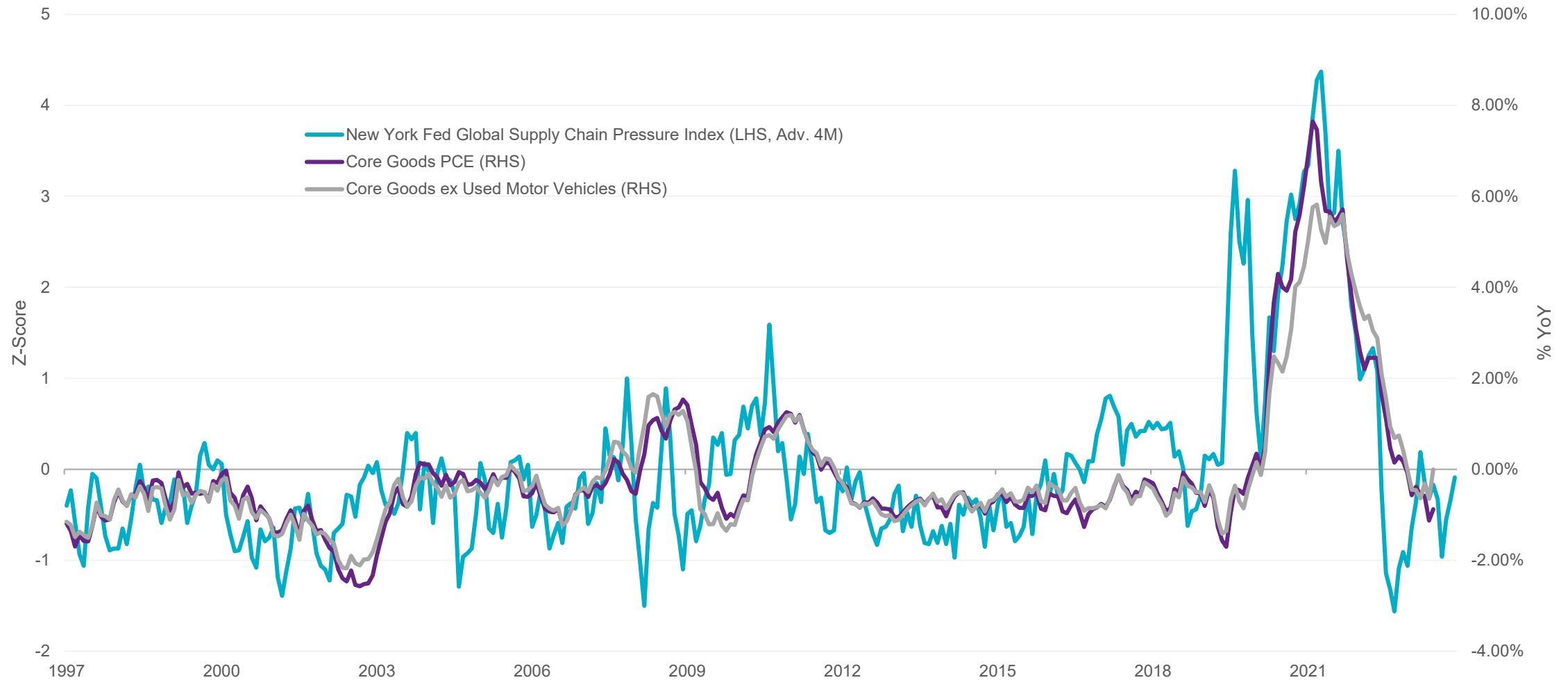
## Core Inflation: CPI vs PCE (7/31/15–6/30/24)



Source: Natixis IM Solutions. Bloomberg.

# Easing Supply Chain Pressures Means More Goods Disinflation

## Supply Chain Pressures vs Core Goods Inflation (9/30/97–7/31/24)

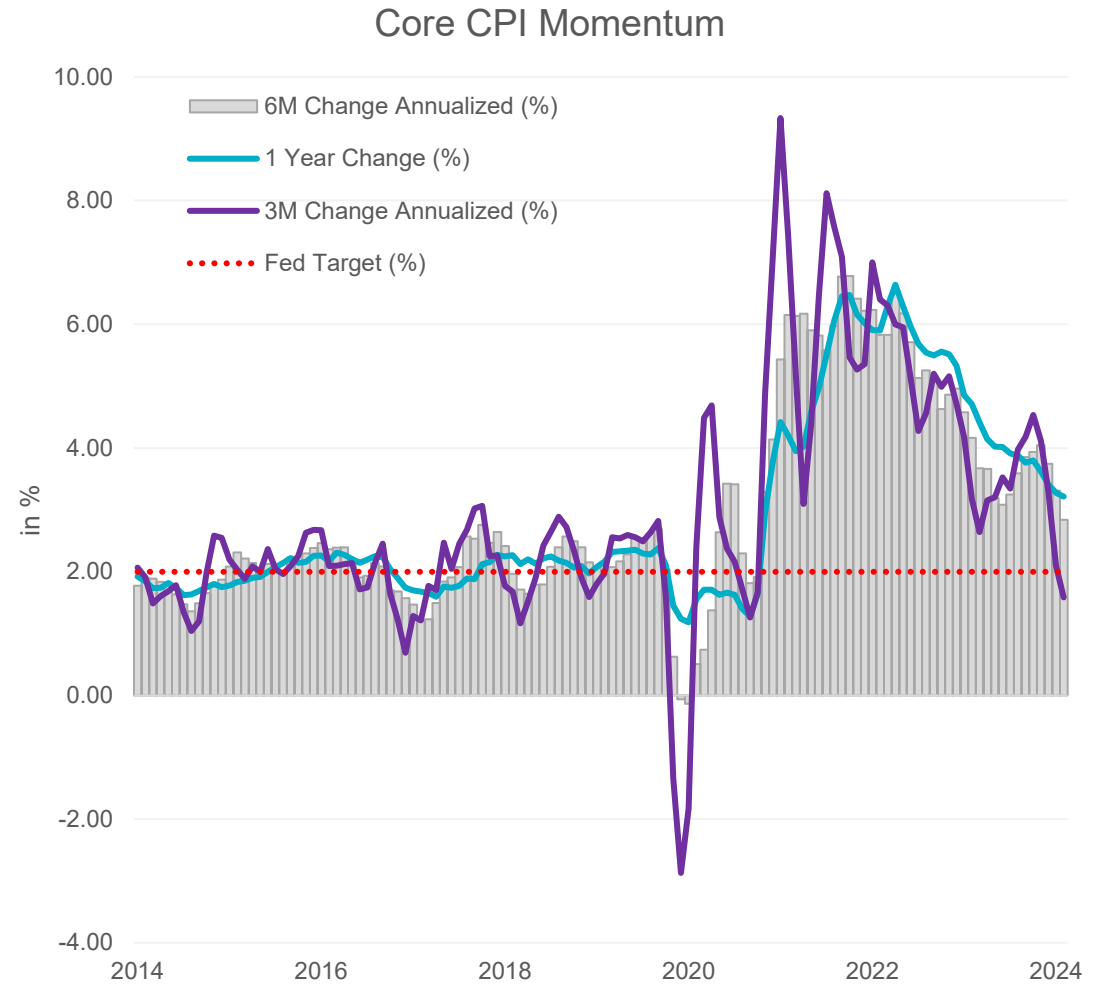
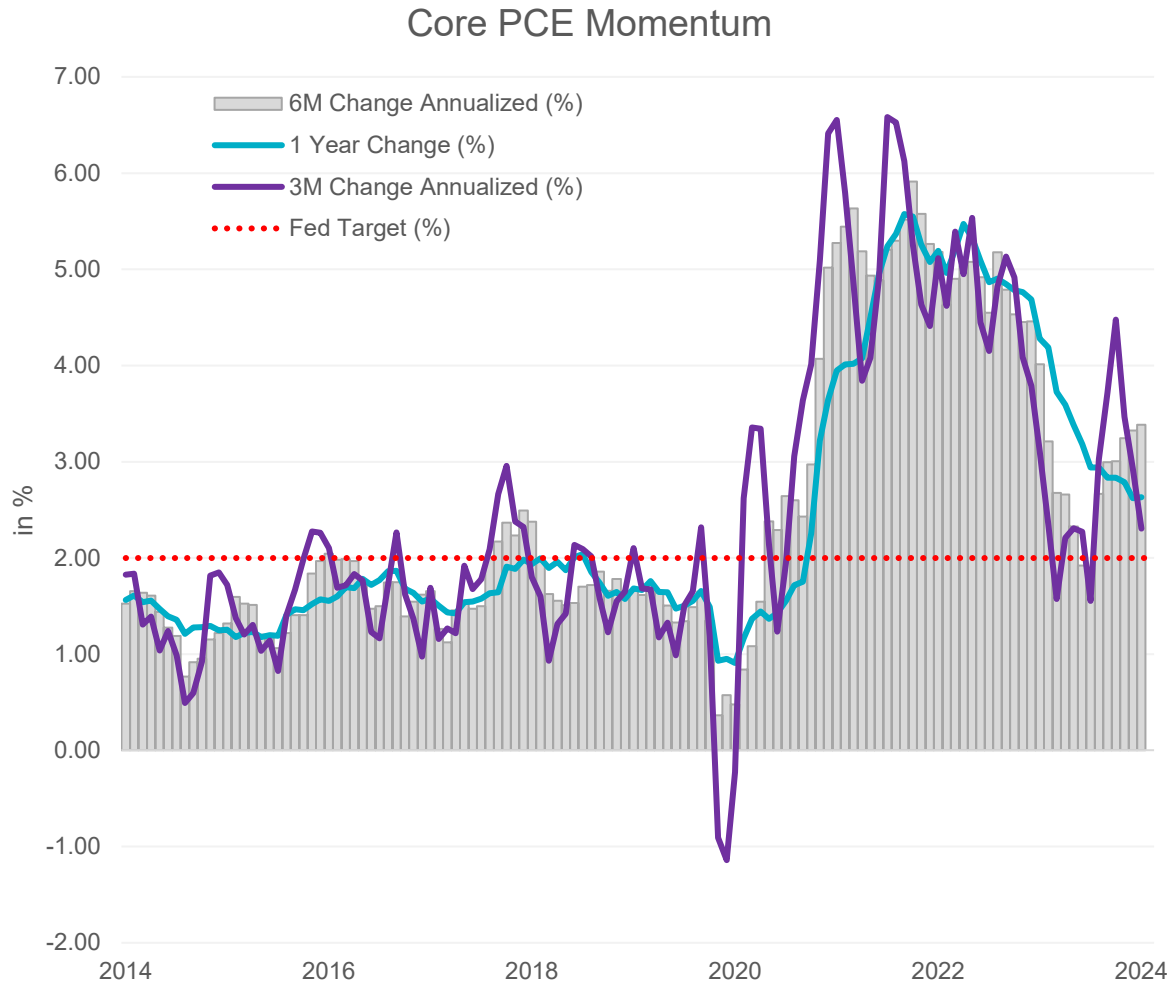


Source: Portfolio Analysis & Consulting. Bloomberg.

Z-Score is a measurement of how many standard deviations above or below the mean a data point is.

# Inflation Momentum

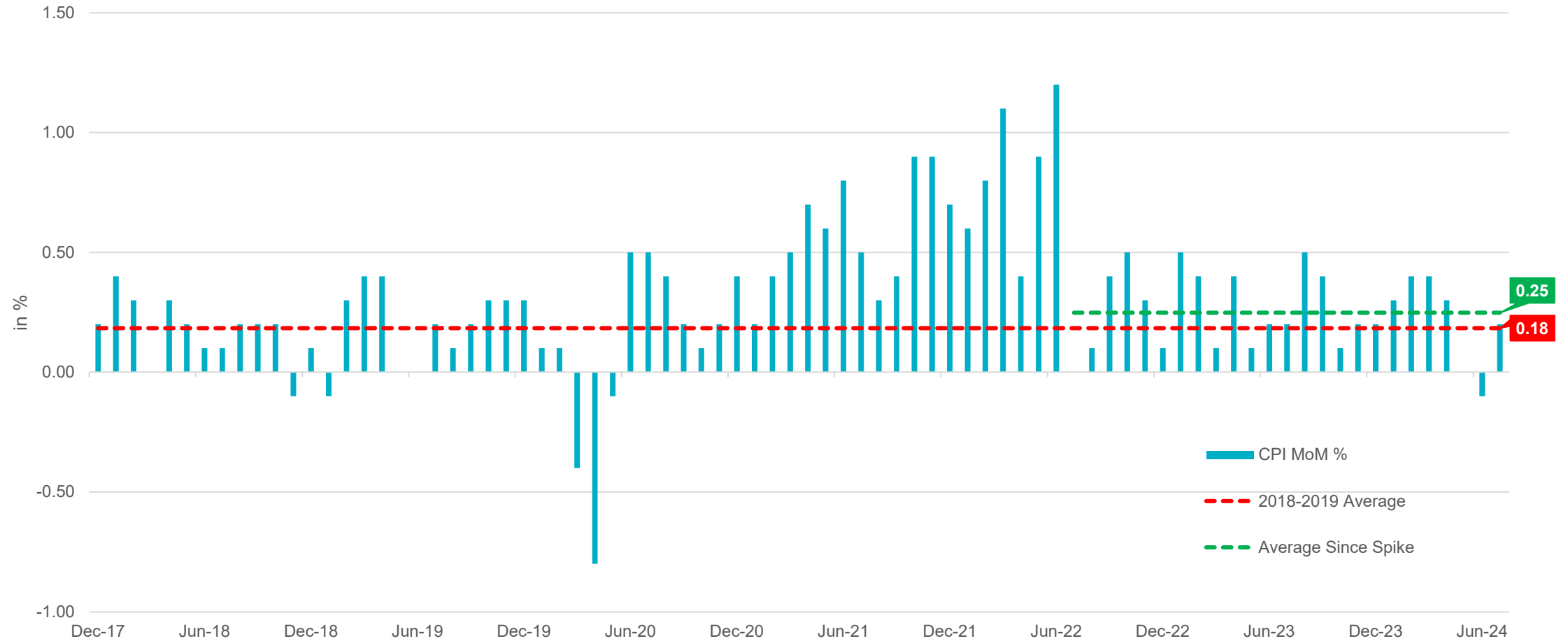
## Core Consumer Prices Momentum vs Core Personal Consumption Expenditures (6/30/14–7/31/24)



Source: Portfolio Analysis & Consulting. FactSet.

# Monthly Changes in Headline Consumer Price Inflation

Headline CPI: Month on Month Change (12/31/17–7/31/24)



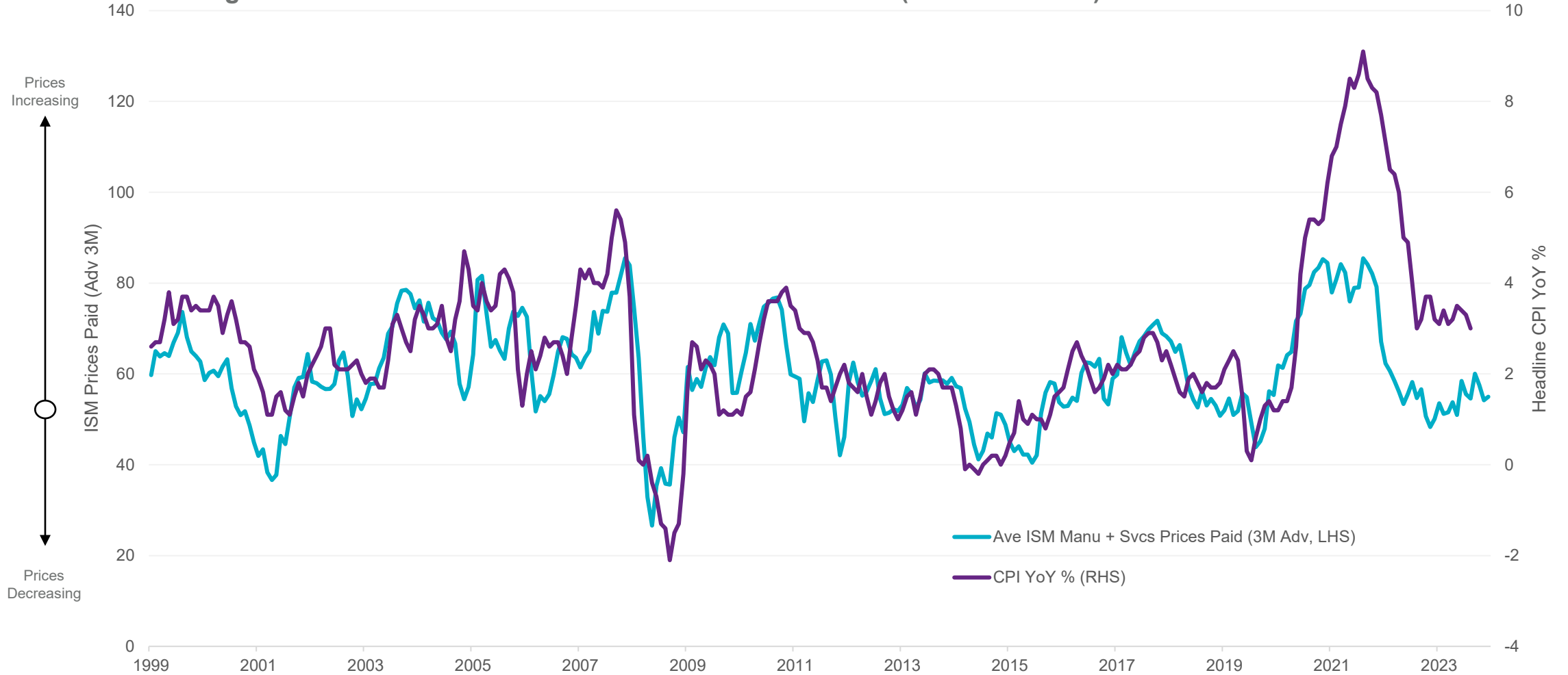
Source: Portfolio Analysis & Consulting. Bloomberg.



# Leading Indicators For Inflation

# Prices Paid Leads Headline CPI

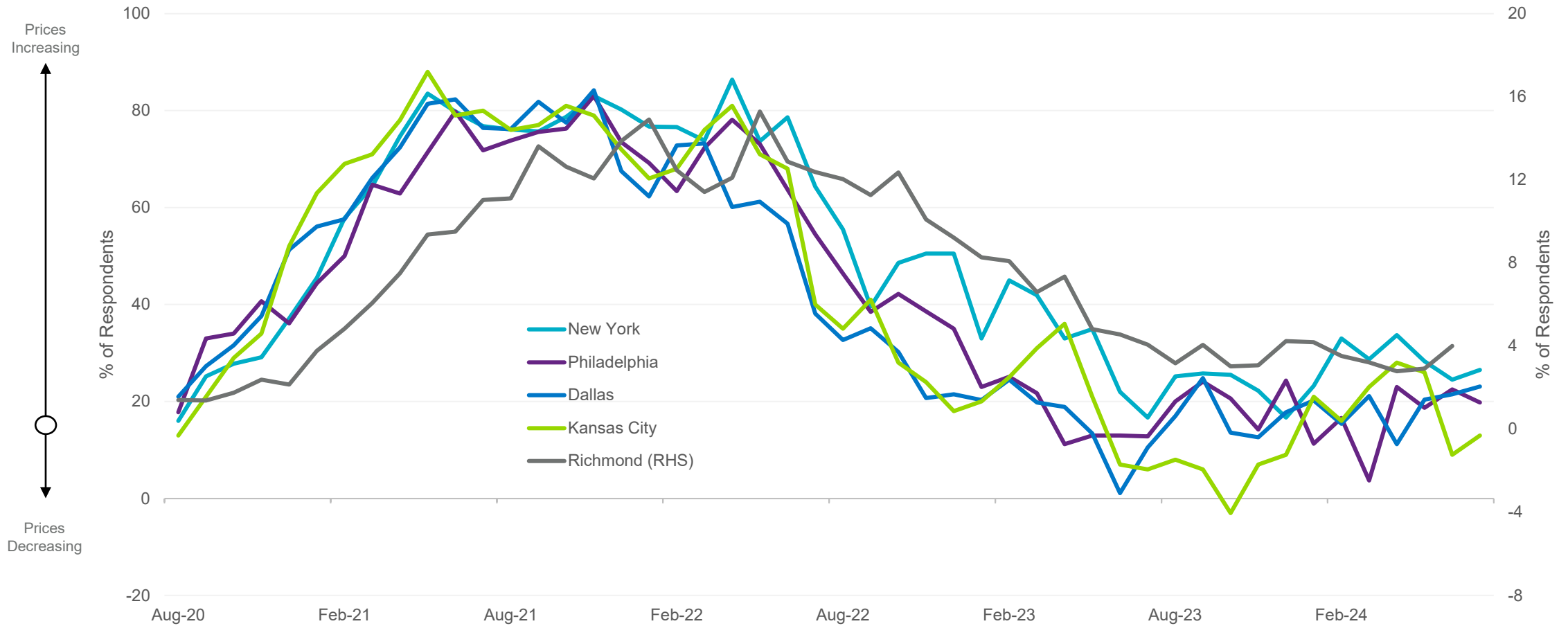
## ISM Manufacturing and Services Prices Paid vs Consumer Price Inflation (8/31/99–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Prices Paid Leads Headline CPI

## Regional ISM Manufacturing Surveys: Prices Paid Component (7/31/20–7/31/24)

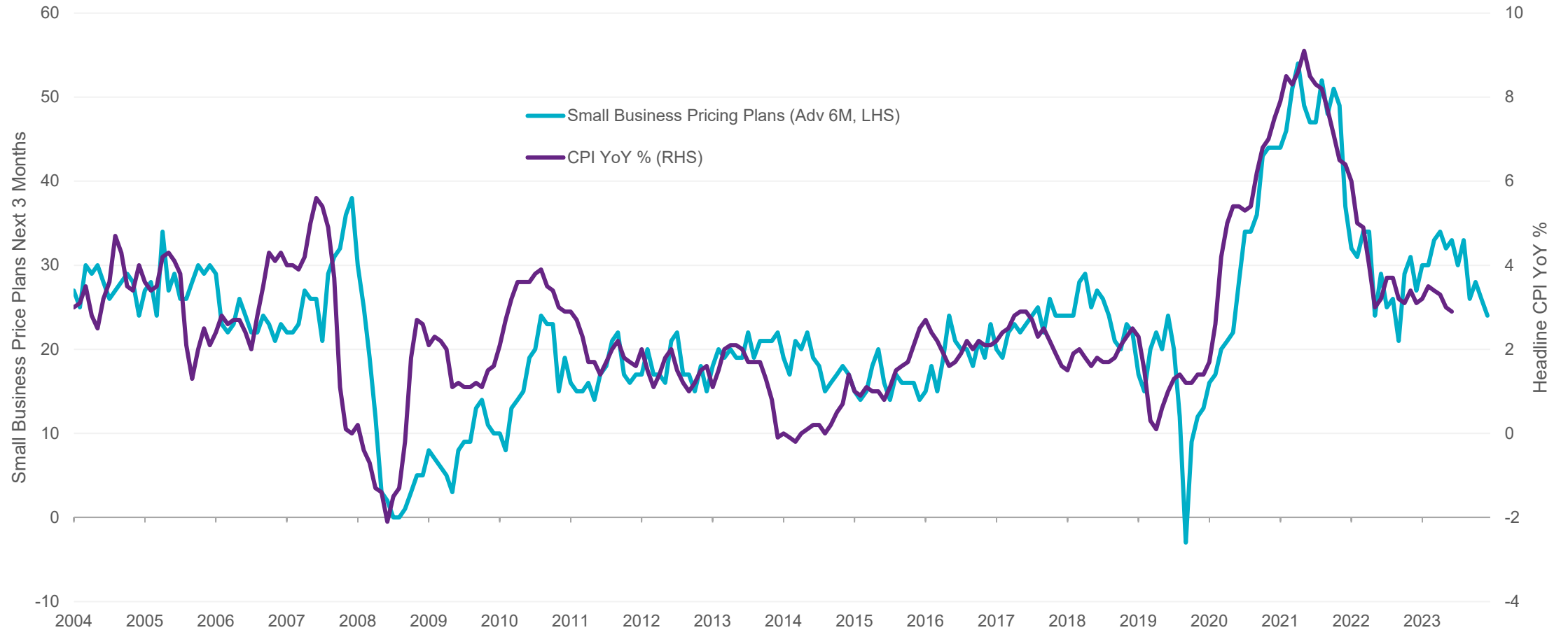


Source: Portfolio Analysis & Consulting. Bloomberg.



# Small Businesses Have A Great Track Record Predicting Inflation

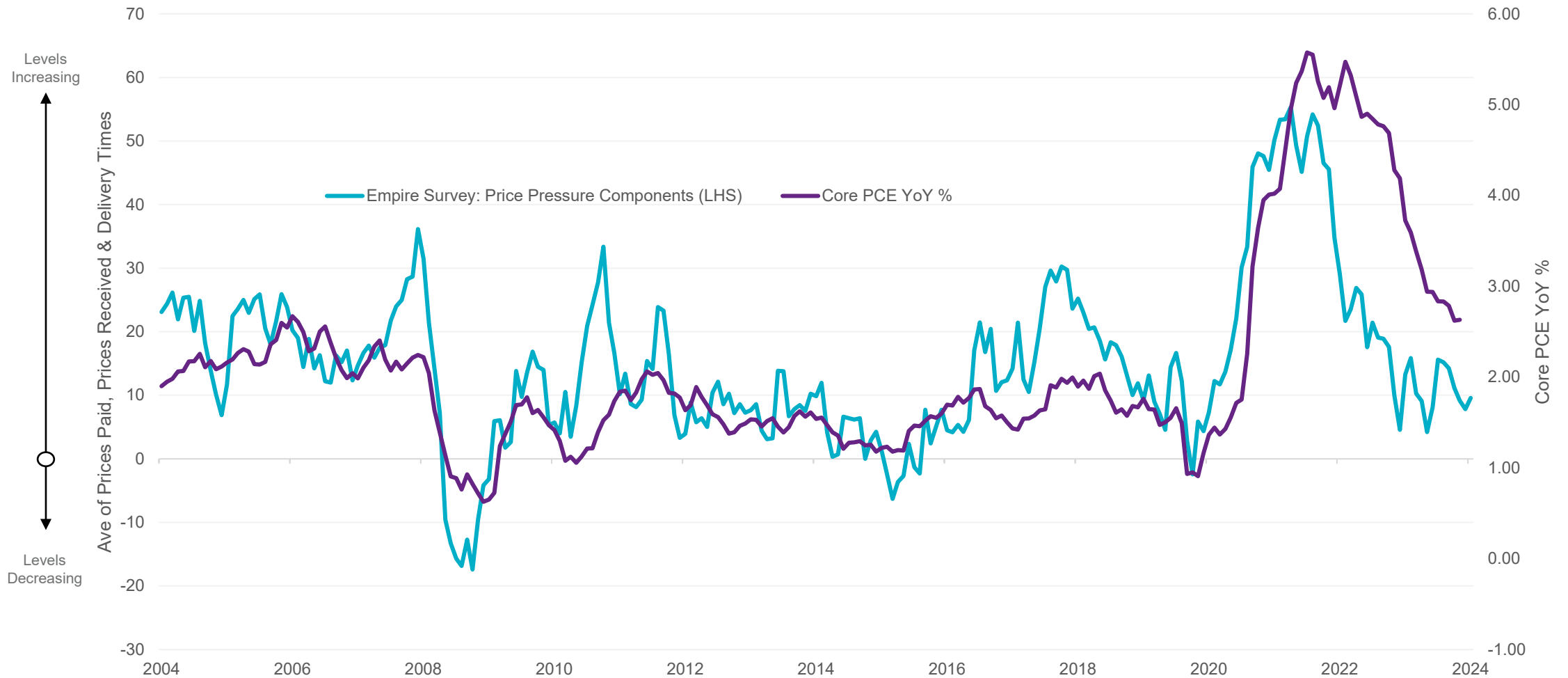
Small Business Price Plans Next 3 Months vs Consumer Price Inflation (8/31/04–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# US Inflationary Pressures

## Empire Survey Subcomponents vs Core PCE Inflation (8/31/04–7/31/24)



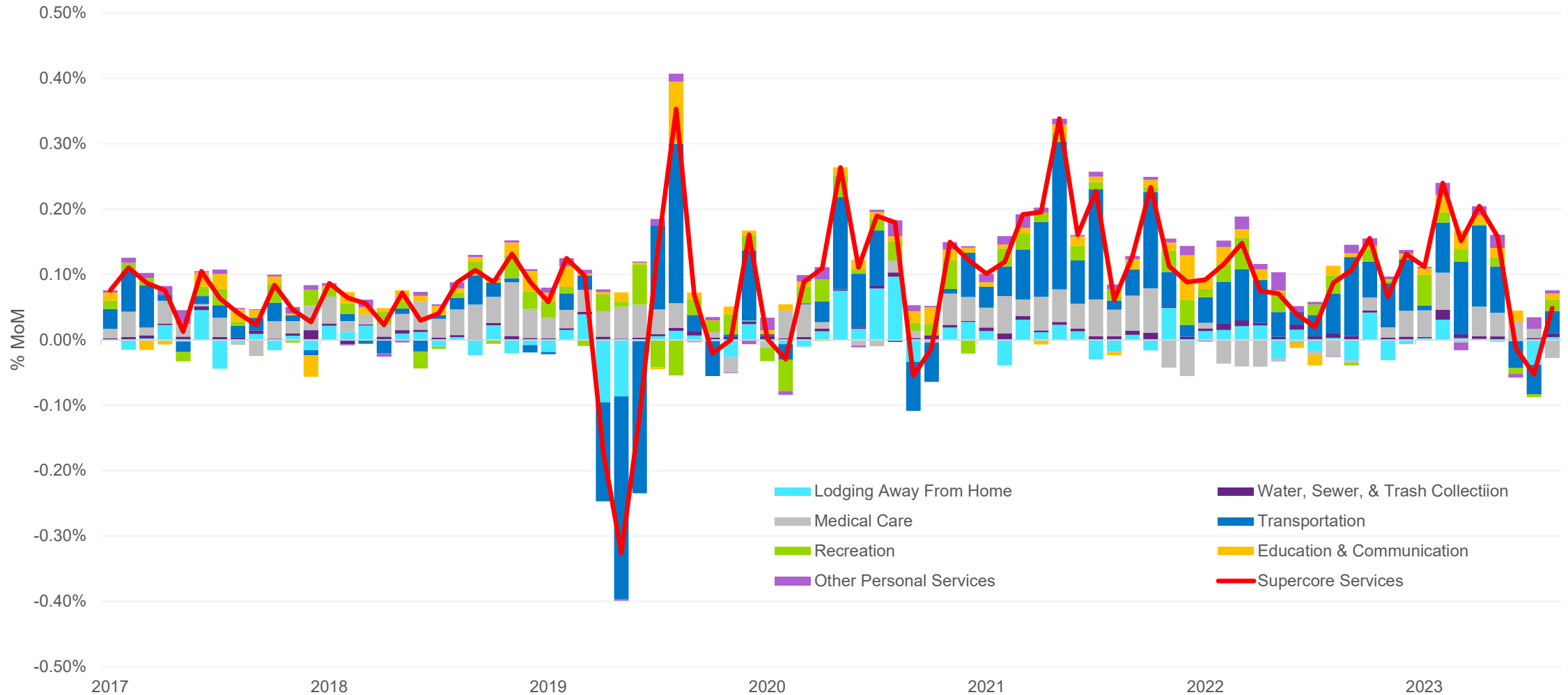
Source: Portfolio Analysis & Consulting. FactSet.



# Culprits: Motor Vehicle Insurance

# Transportation Services: The Driver of Supercore Services

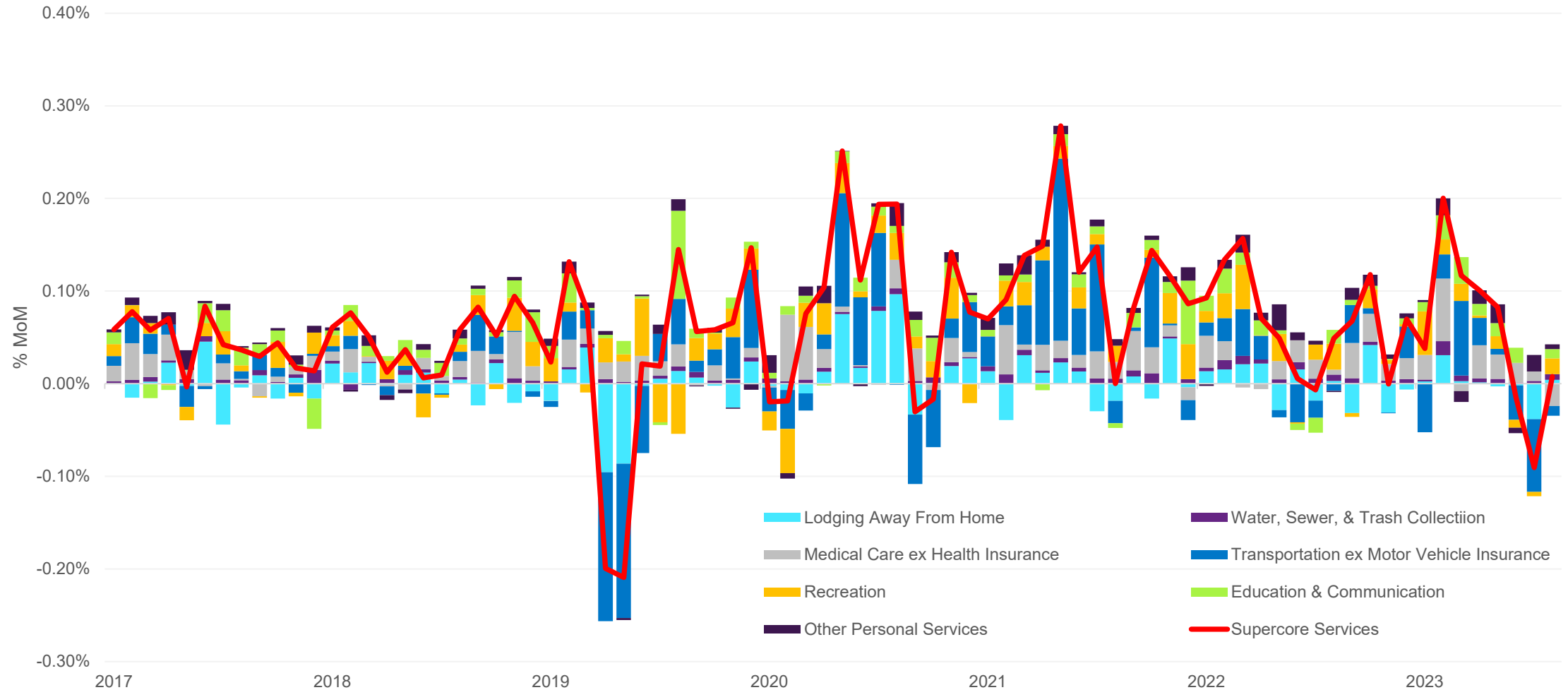
Supercore Services Contribution to Core CPI (12/31/17–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Supercore Services ex Health and Auto Insurance In-Line with Pre-Pandemic Trend

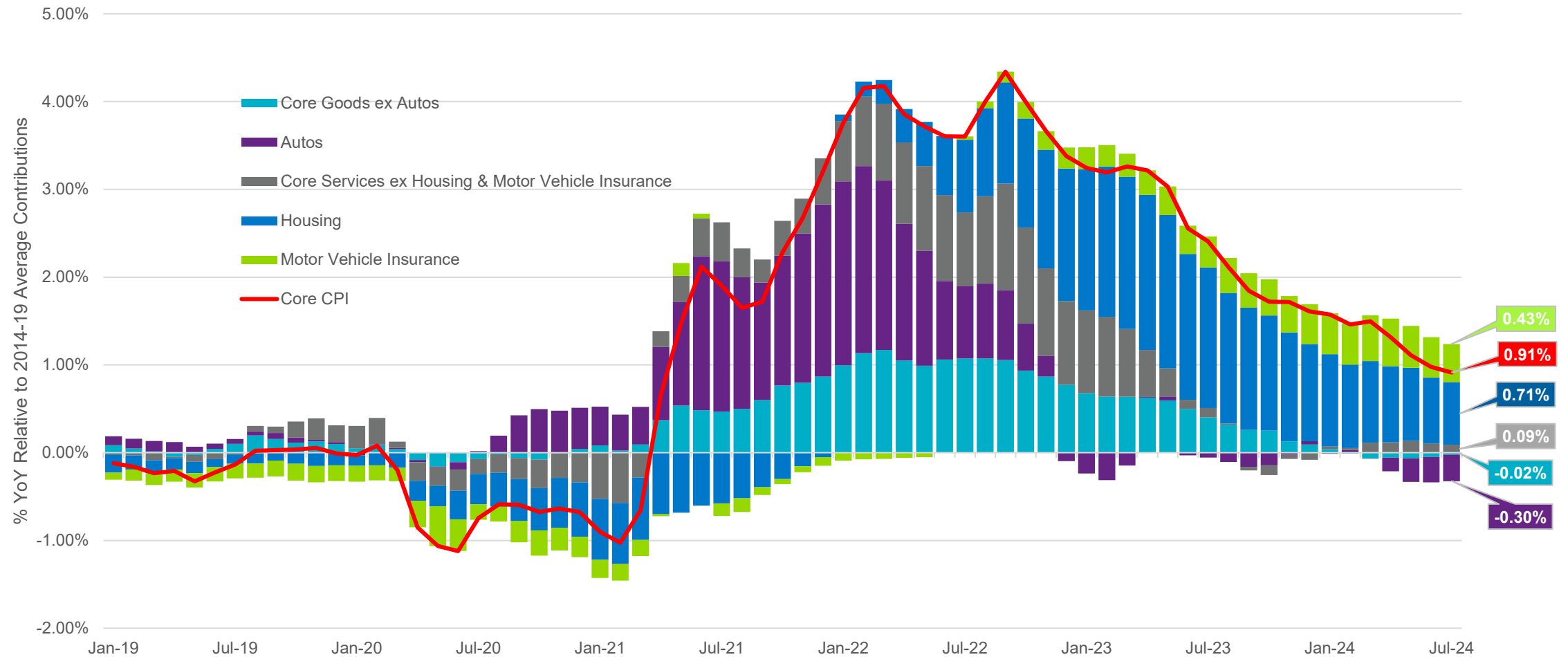
Supercore Services ex Health And Motor Vehicle Insurance Contribution to Core CPI (12/31/17–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Inflation Contributions ex Housing & Auto Insurance Consistent with 2.3% Core CPI

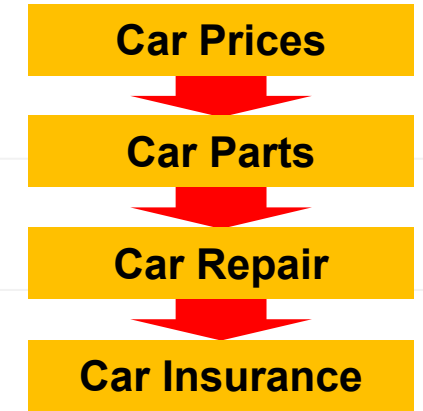
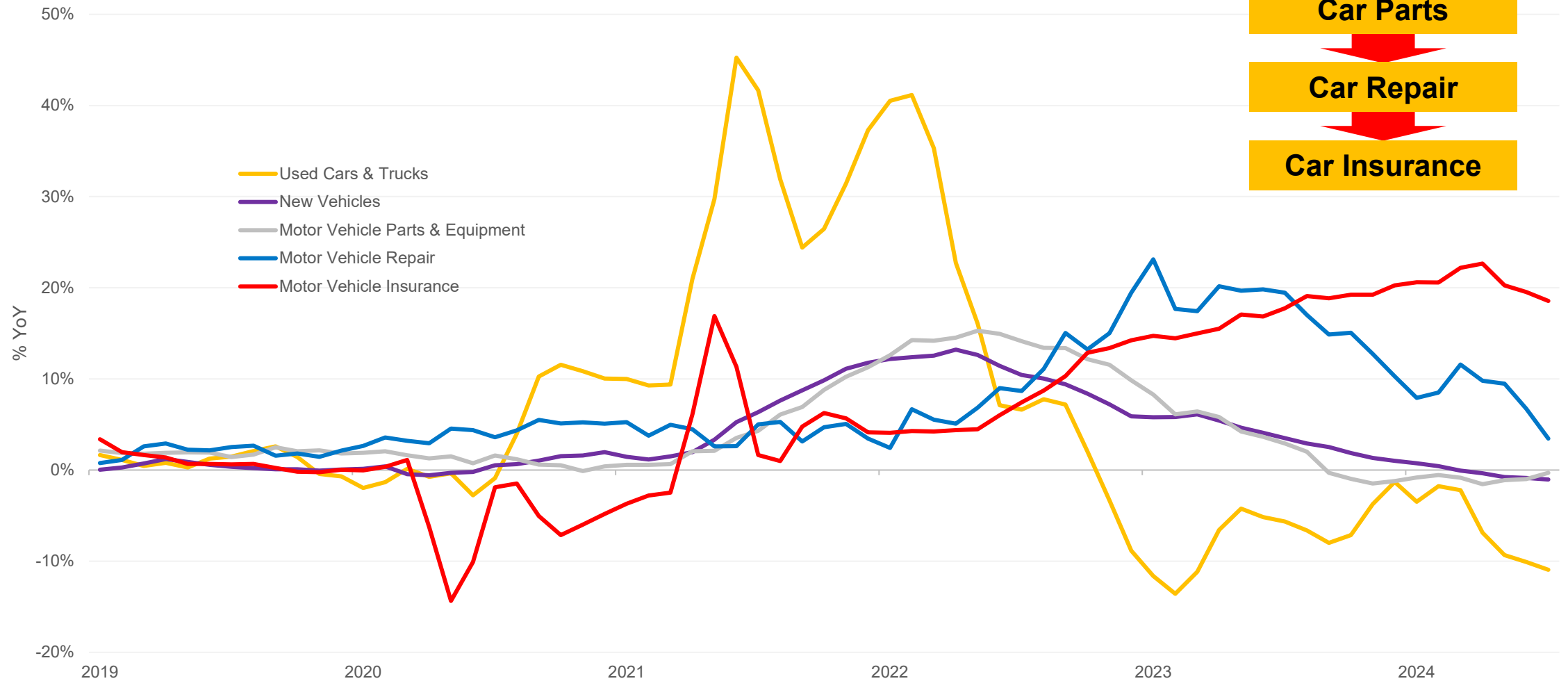
Contribution to Excess Core Consumer Price Inflation (12/31/18–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg. Contributions are relative to their 2014-2019 averages.

# The Cycle of Auto Related Inflation

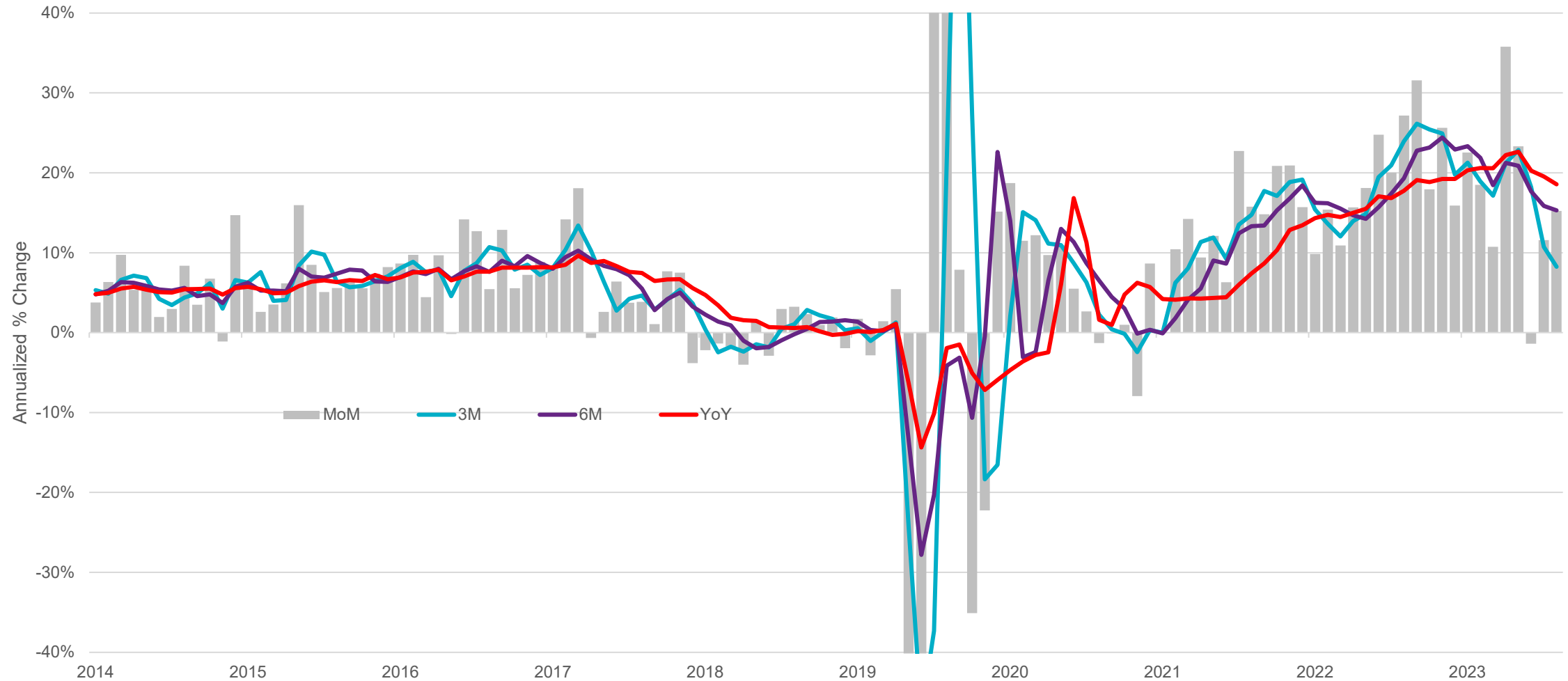
Motor Vehicle Related Consumer Price Inflation (1/31/19–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Motor Vehicle Insurance: Finally Rolling Over

## Motor Vehicle Insurance Consumer Price Inflation (12/31/14–7/31/24)

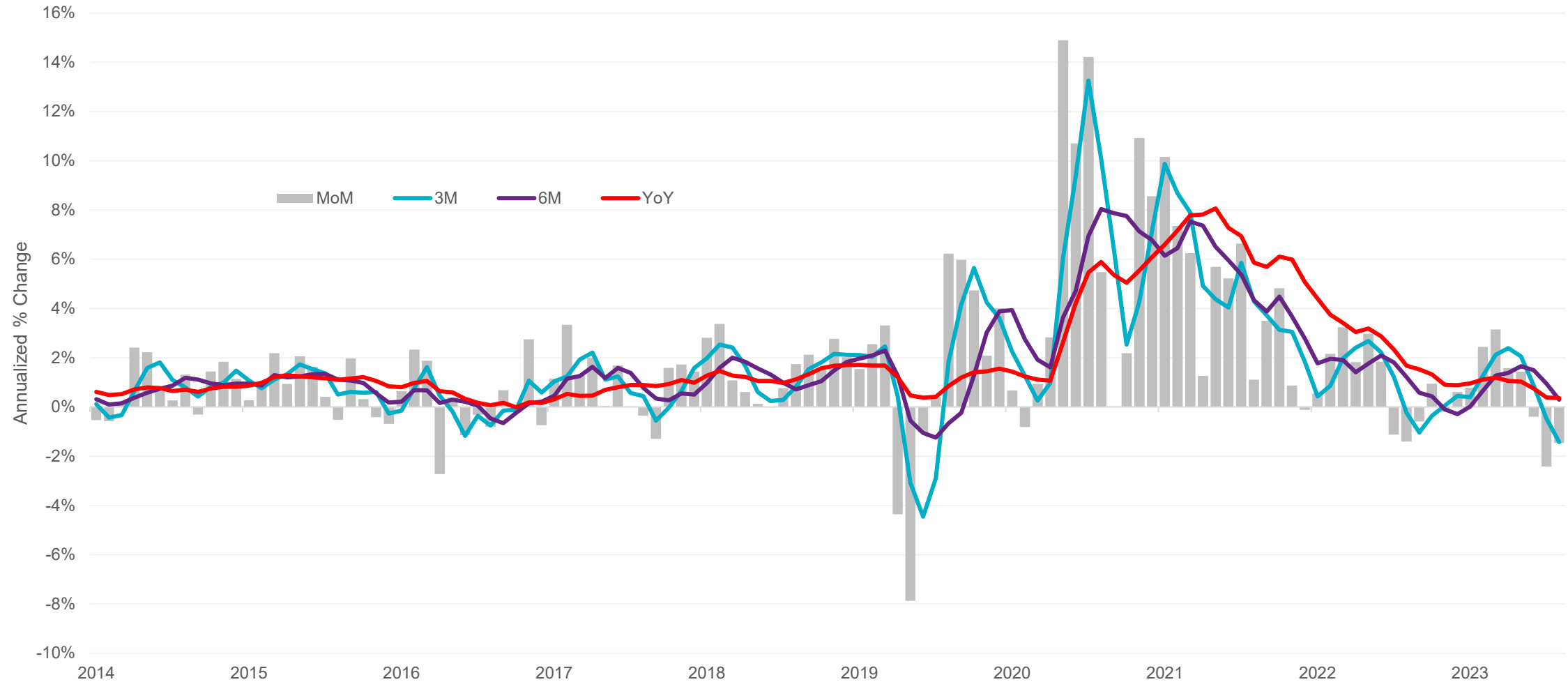


Source: Portfolio Analysis & Consulting. Bloomberg.



# The Rest of the Inflation Basket Is Running Below 2%

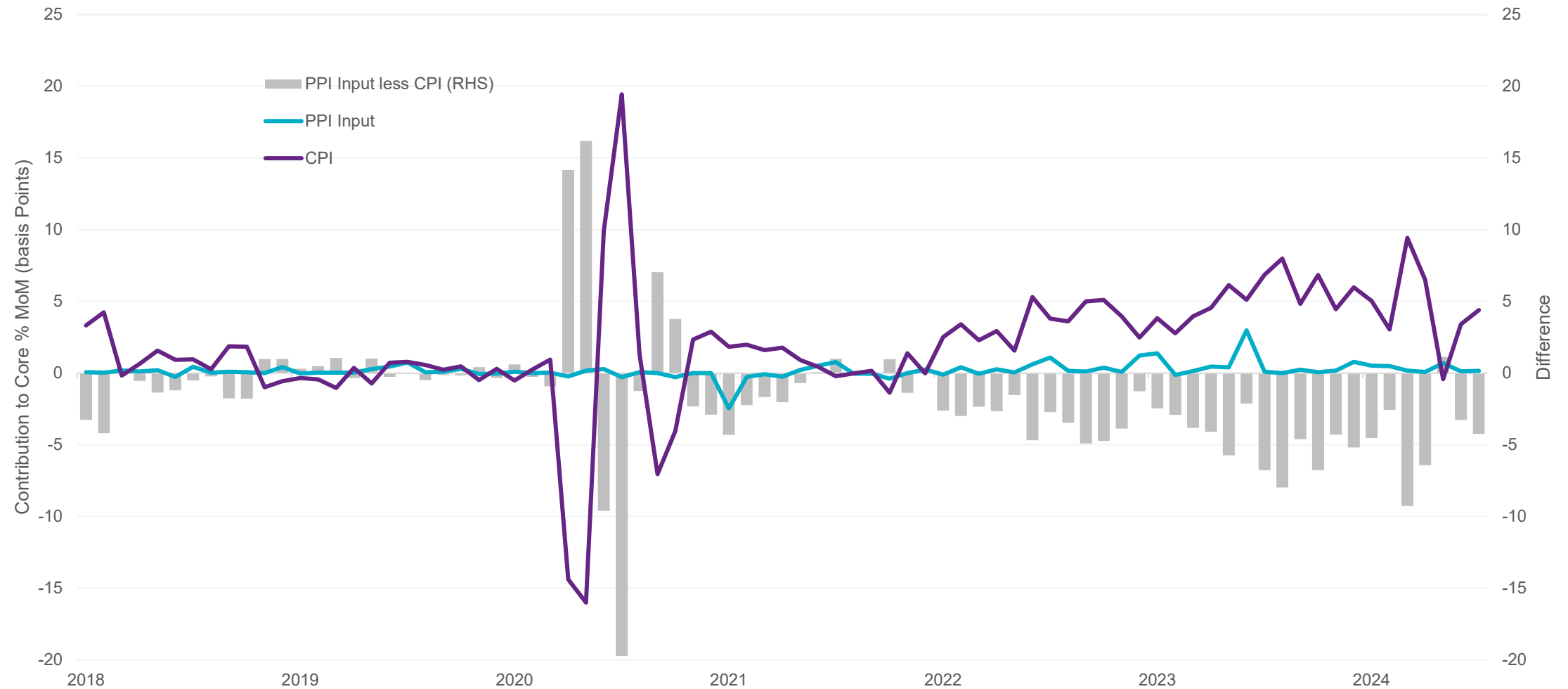
Core Consumer Price Inflation ex Housing and Motor Vehicle Insurance (12/31/14–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Vehicle Insurance Costs: A Huge Divergence in PCE and CPI

## CPI vs. PPI Inflation Input to PCE: Motor Vehicle Insurance (1/31/18–7/31/24)



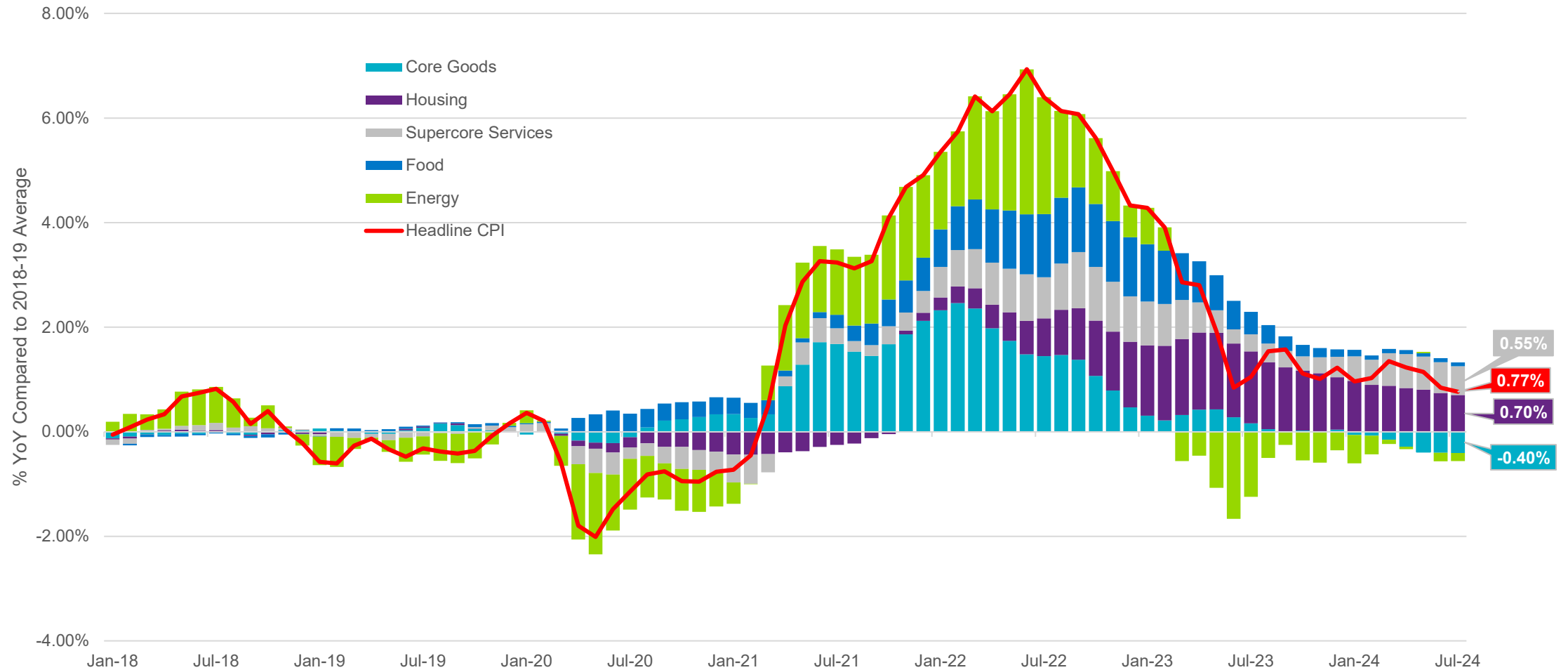
Source: Portfolio Analysis & Consulting. Bloomberg.



## Culprits: Shelter

# It's All About Housing

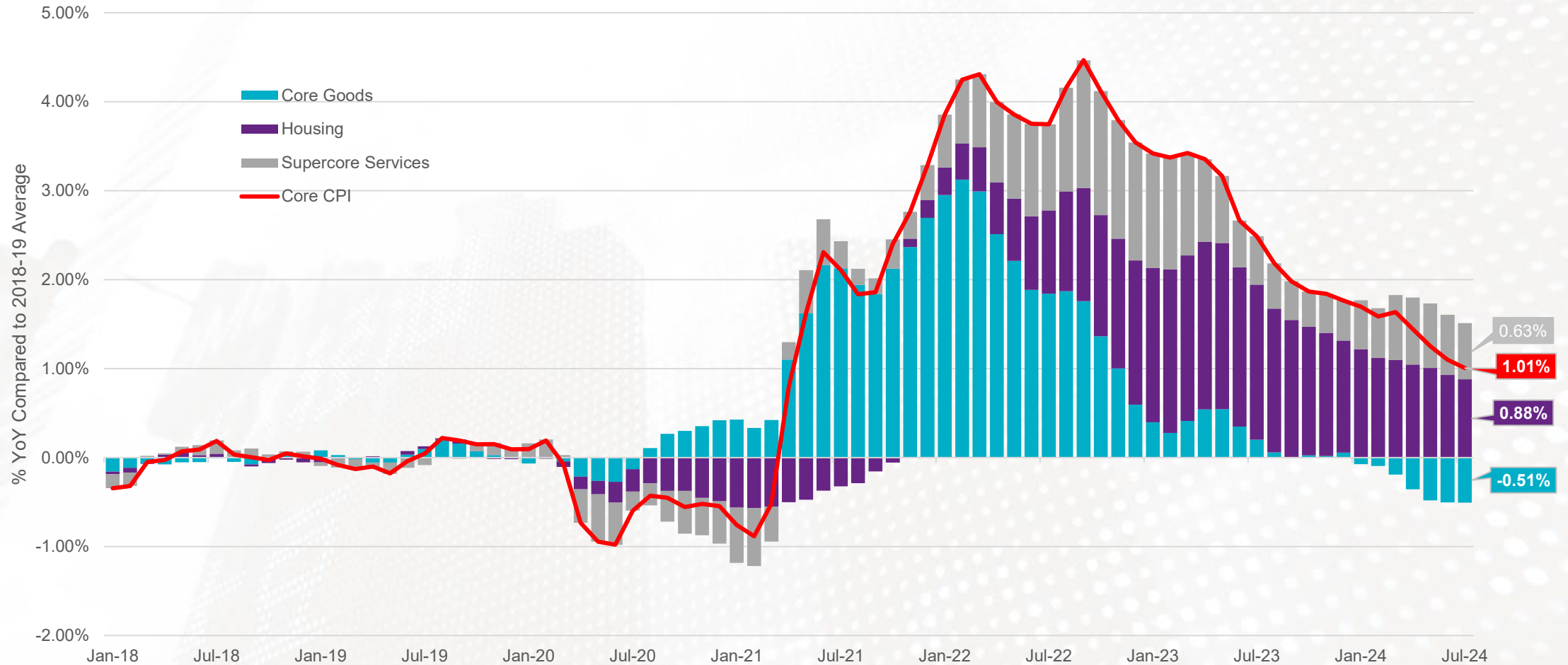
## Contribution to Excess Headline Consumer Price Inflation (1/31/18-7/31/24)



Source: Natixis IM Solutions. Bloomberg. Excess compares current levels to the 2018-2019 average.

# It's All About Housing

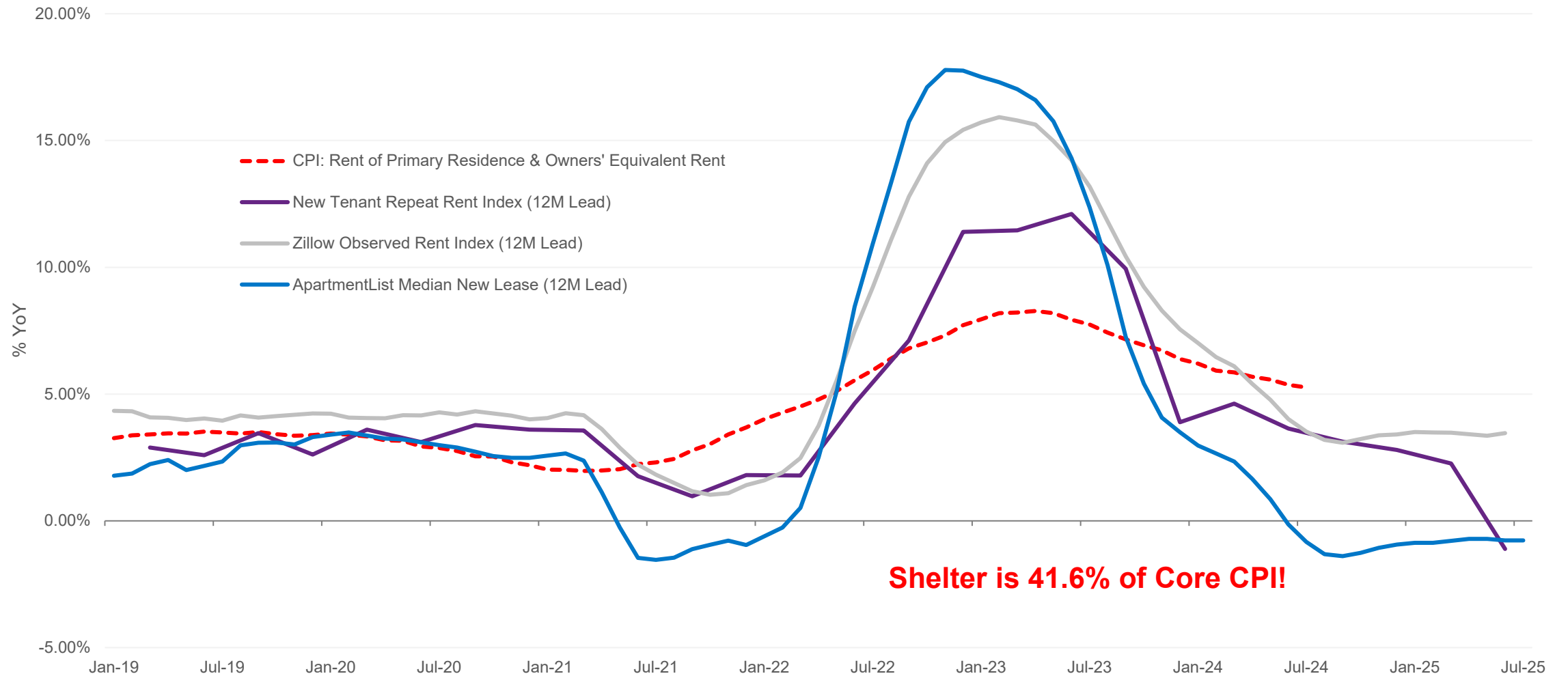
## Contribution to Excess Core Consumer Price Inflation (1/31/18-7/31/24)



Source: Natixis IM Solutions. Bloomberg. Excess compares current levels to the 2018-2019 average.

# Shelter Prices Will Drop – Not if But When

Consumer Price Rent vs Market Rents (1/31/19–7/31/24)

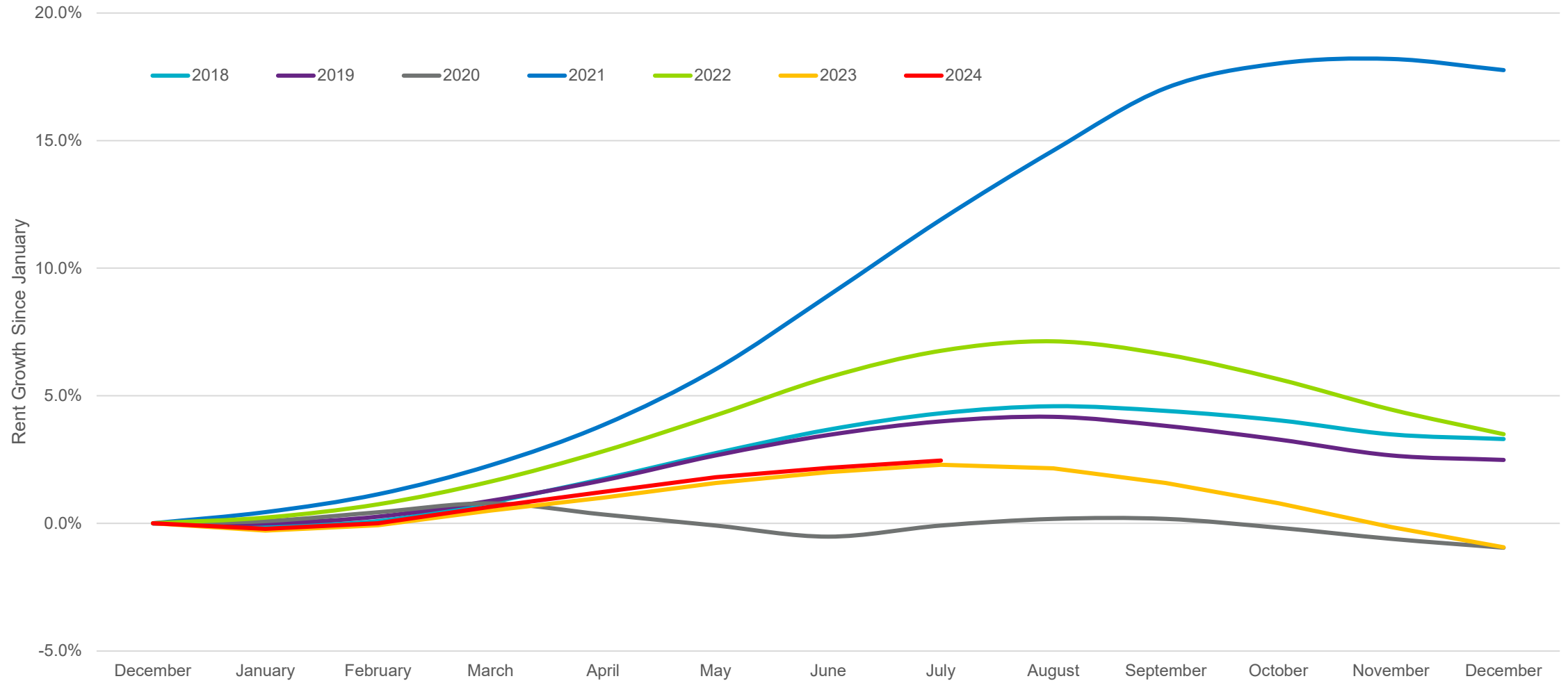


**Shelter is 41.6% of Core CPI!**

Source: Portfolio Analysis & Consulting, Bloomberg, Apartment List, Federal Reserve Bank of Cleveland.

# Apartment Rents Are Cooling

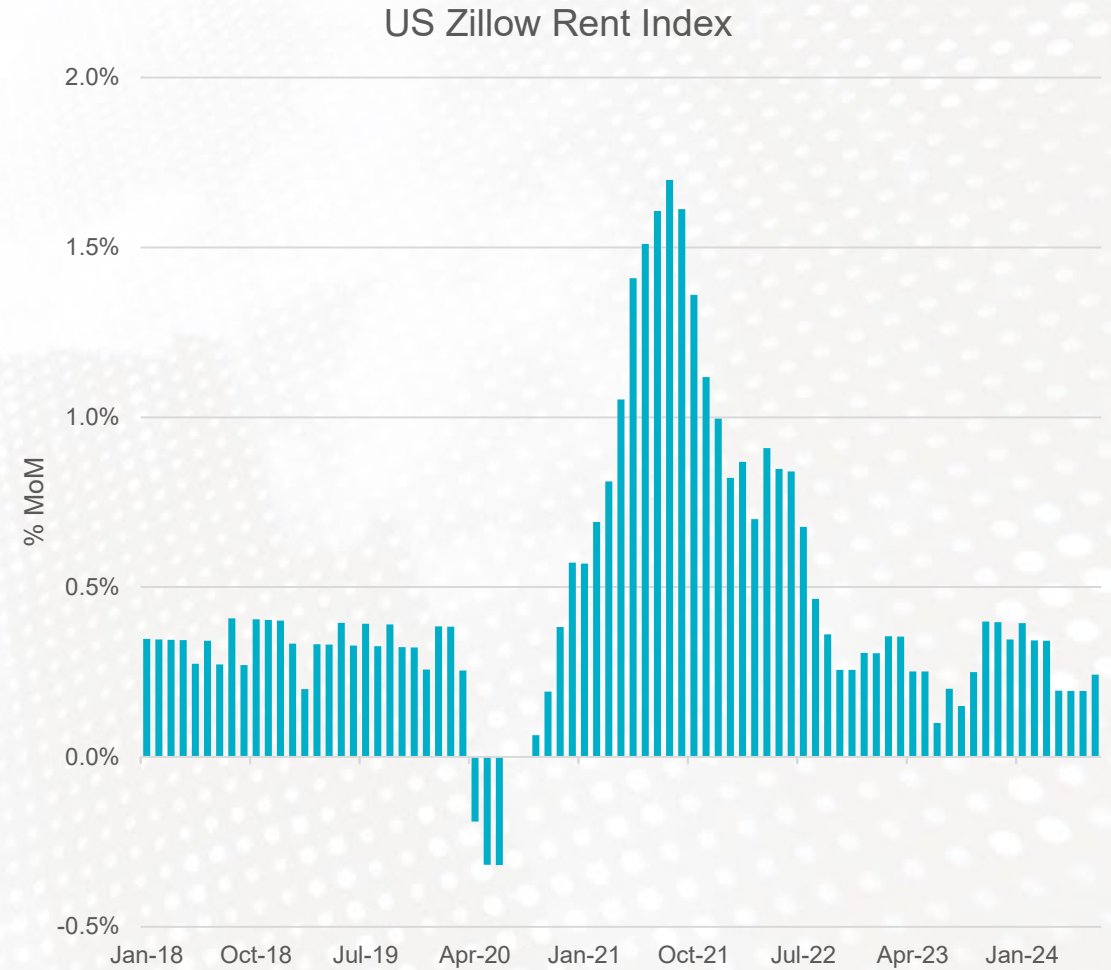
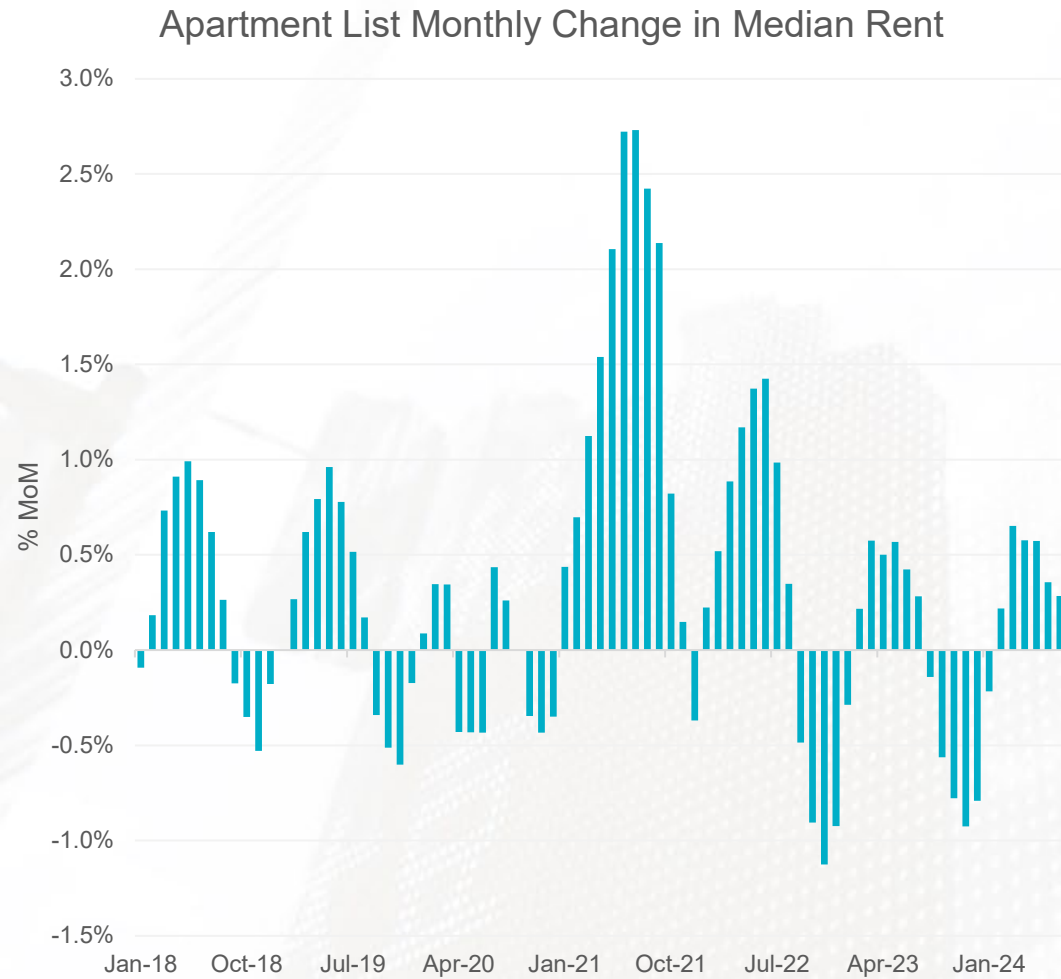
## Annual Change in Median Rent (As of 7/31/24)



Source: Natixis IM Solutions. Apartment List.

# Rental Prices: Slowing From a Blistering Pace

## Monthly Change in Rents (1/31/18-7/31/24)

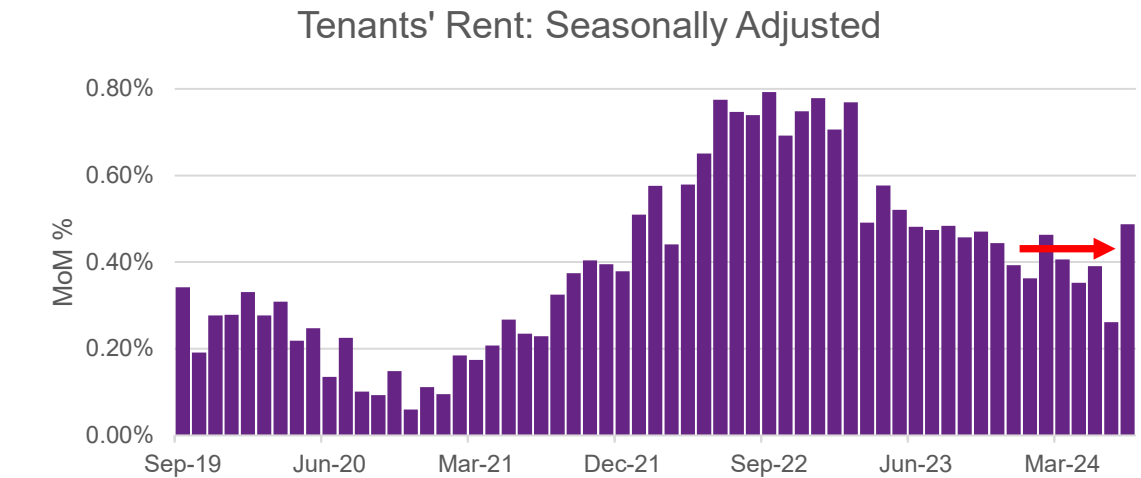
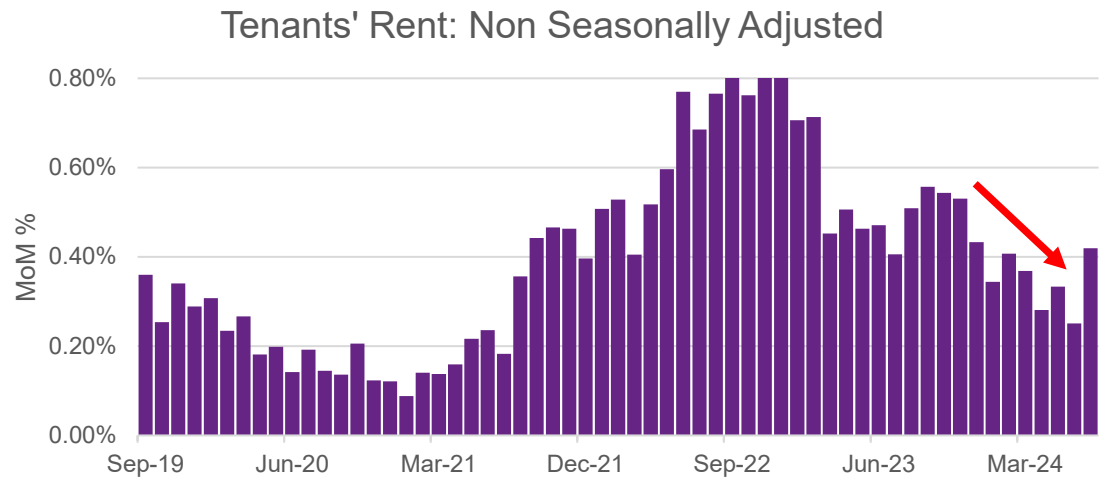
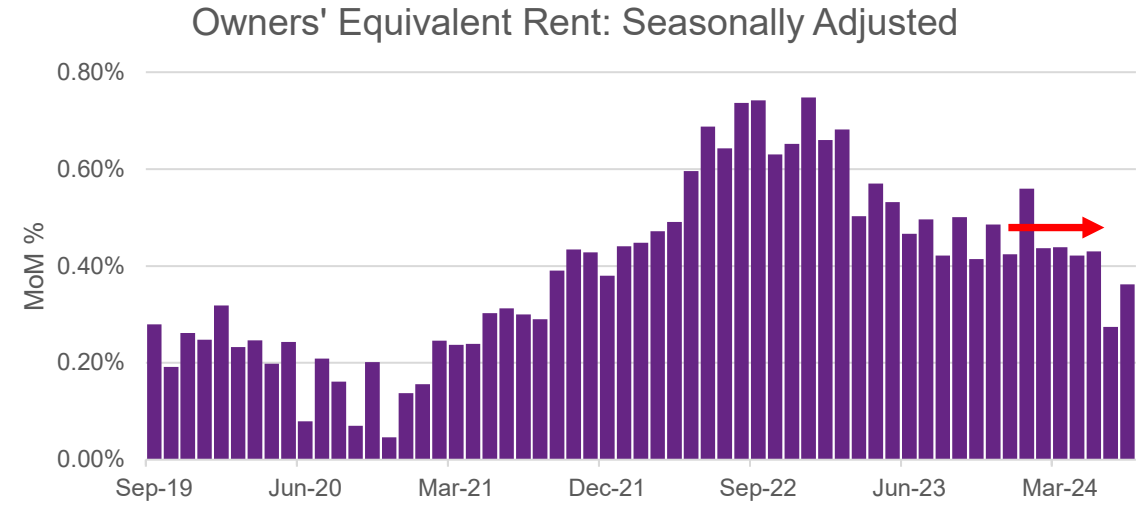
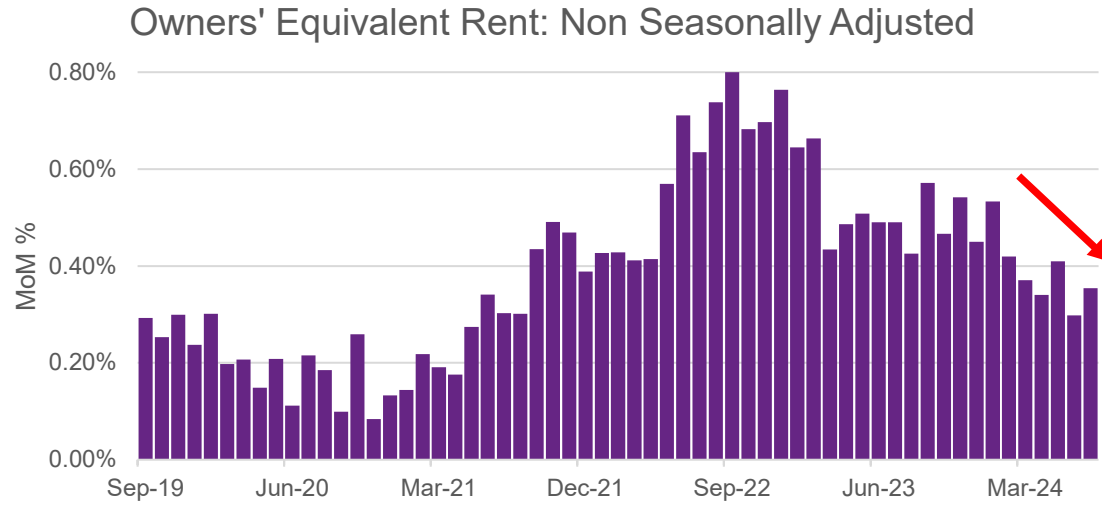


Source: Natixis IM Solutions. Apartment List. Bloomberg. Zillow.



# Seasonal Adjustments Wreaking Havoc on the Data

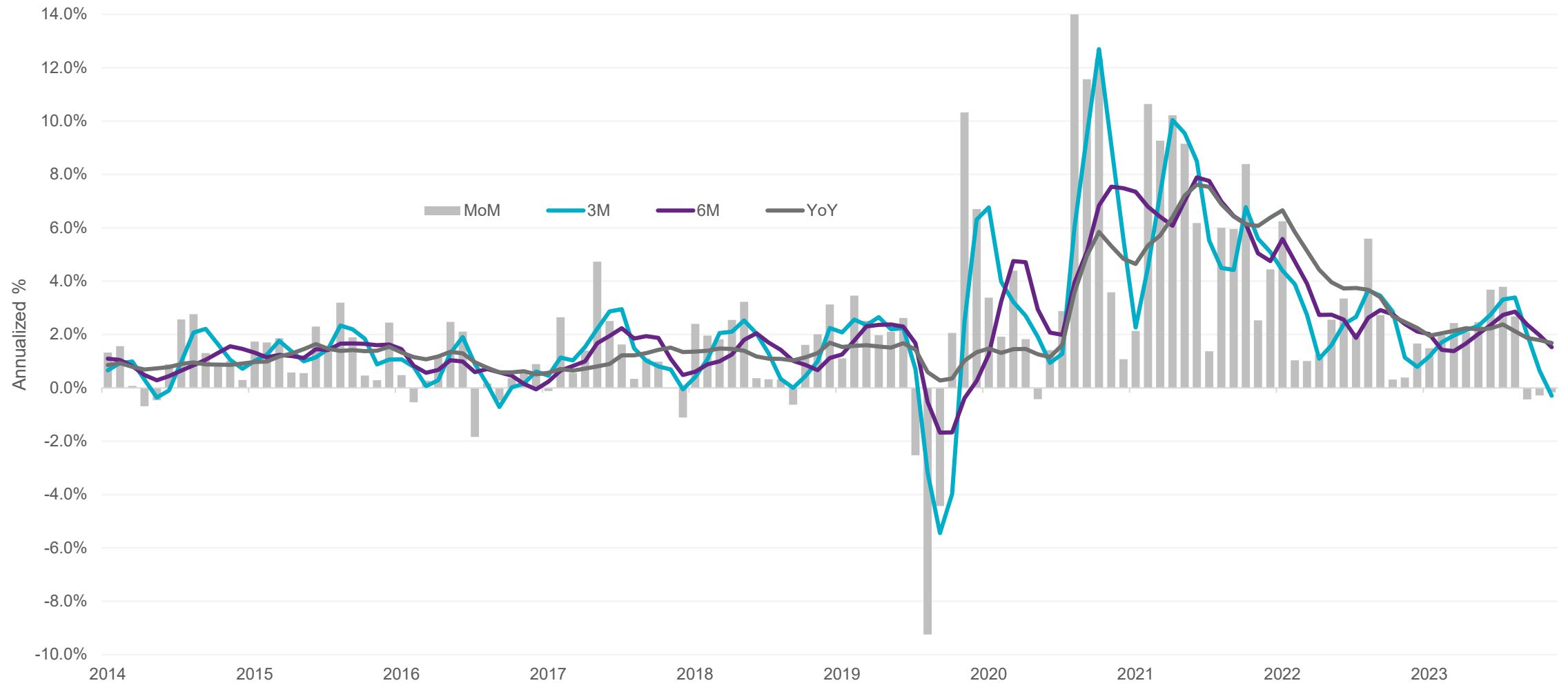
## Shelter Prices: Seasonally vs Non Seasonally Adjusted (9/30/19-7/31/24)



Source: Natixis IM Solutions. Bloomberg.

# Core CPI ex Shelter: Consolidating

## Core Consumer Price Inflation ex Shelter (9/30/14–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.



## Culprits: Wage Pressure

# Service Sector Wage Pressures

Average Hourly Earnings: Service Sector (12/31/19–7/31/2024)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Small Businesses Not Hiking Pay

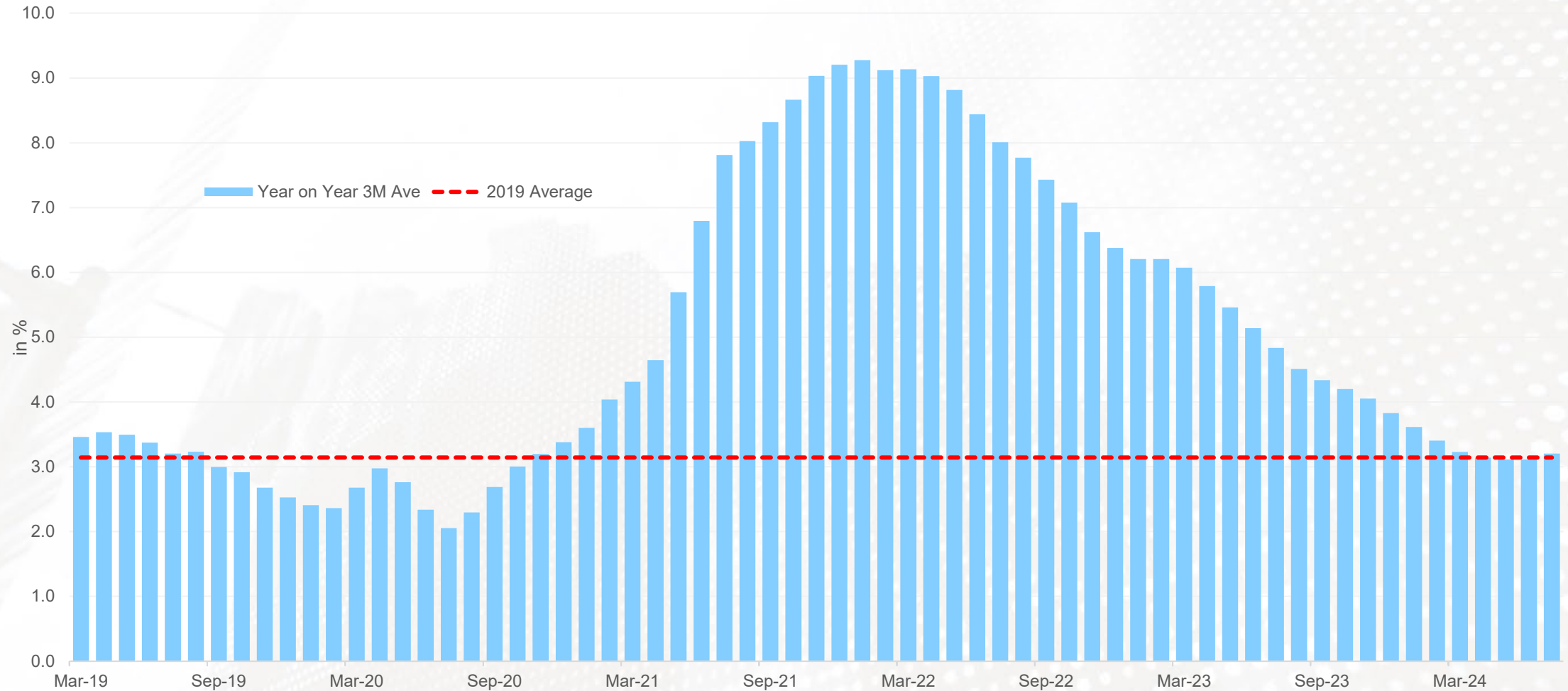
## Small Business Compensation Index: Pay Hikes (7/31/19–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Wage Pressures – Back To Pre-COVID Levels

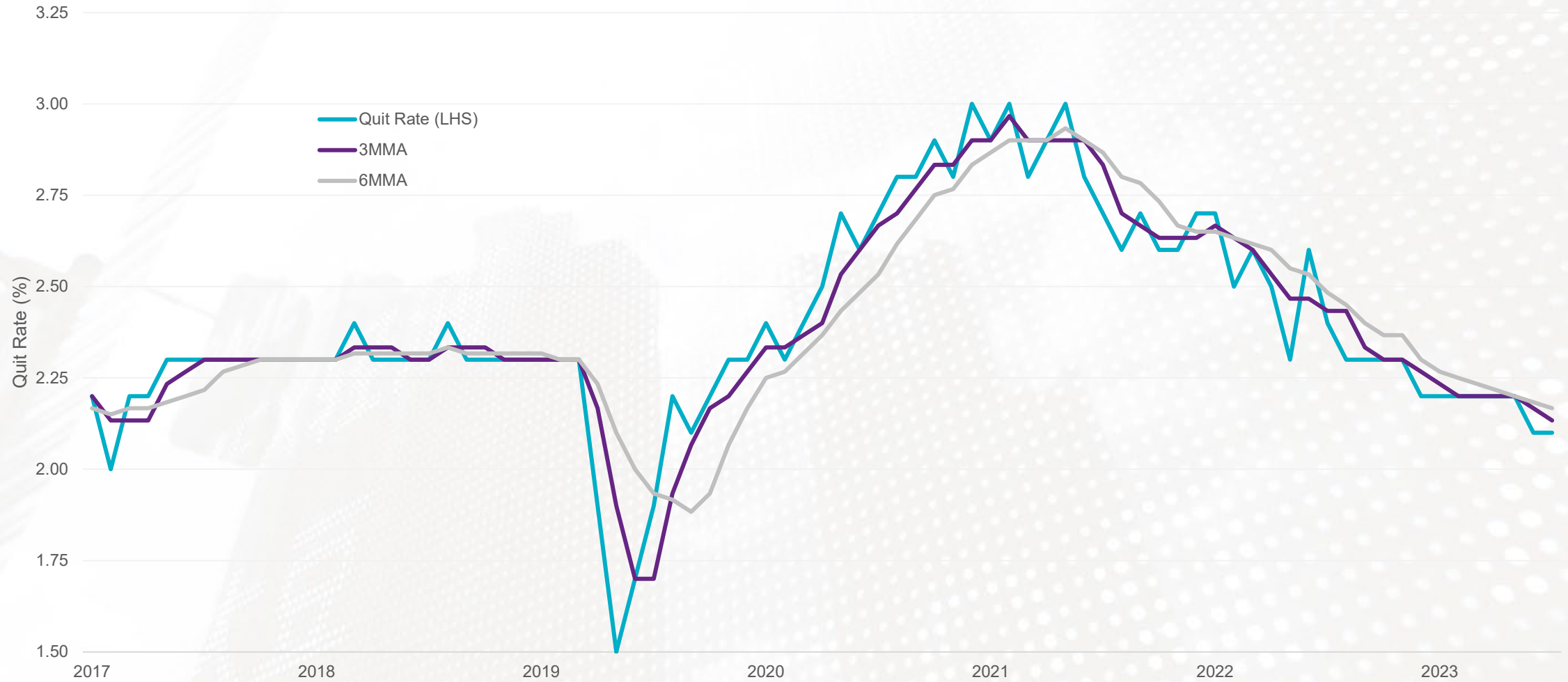
Indeed.com Posted Wage Growth (3/31/19–7/31/24)



Source: Portfolio Analysis & Consulting. Indeed.com.

# Quits Rate Points to Easing Labor Market Tightness

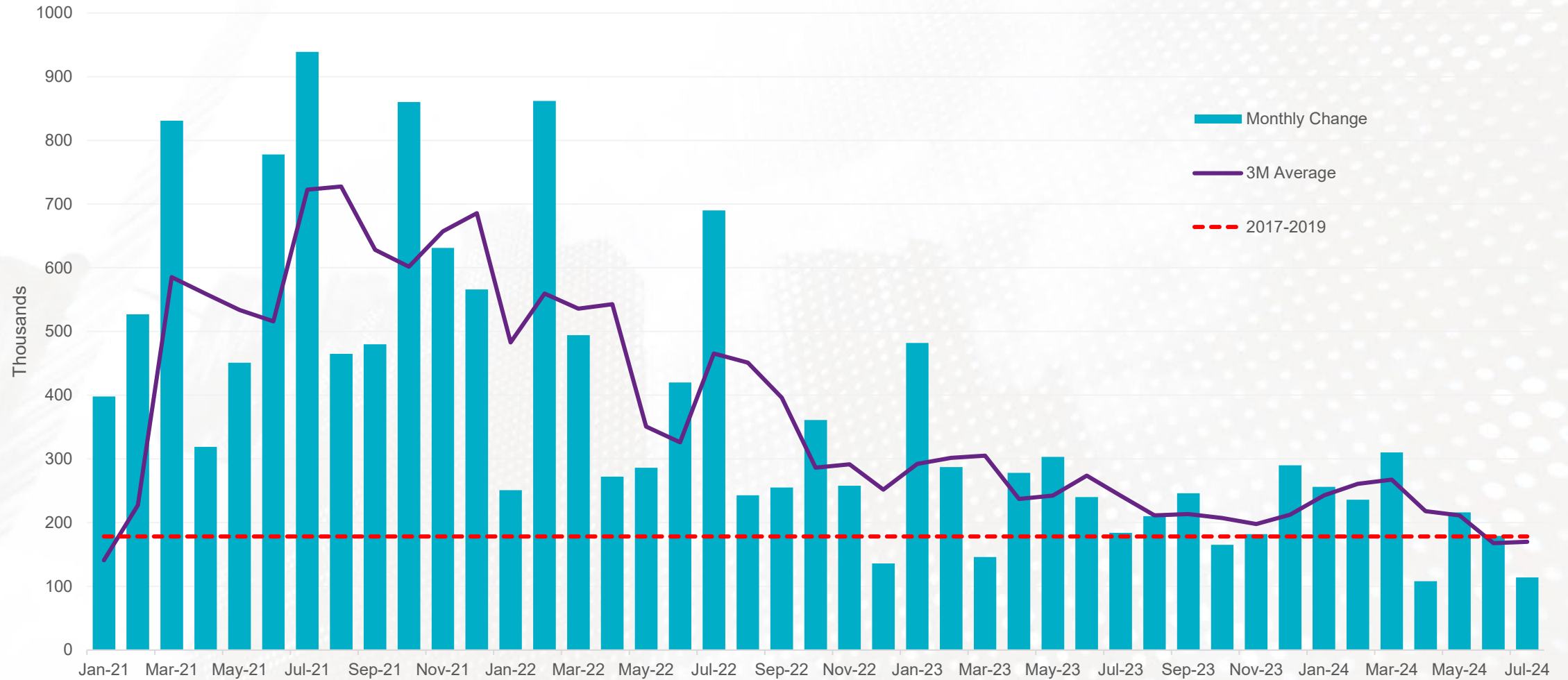
Nonfarm Quit Rate (12/31/17–4/30/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Job Adds Remain Consistent

## Nonfarm Payrolls (1/31/21–7/31/24)

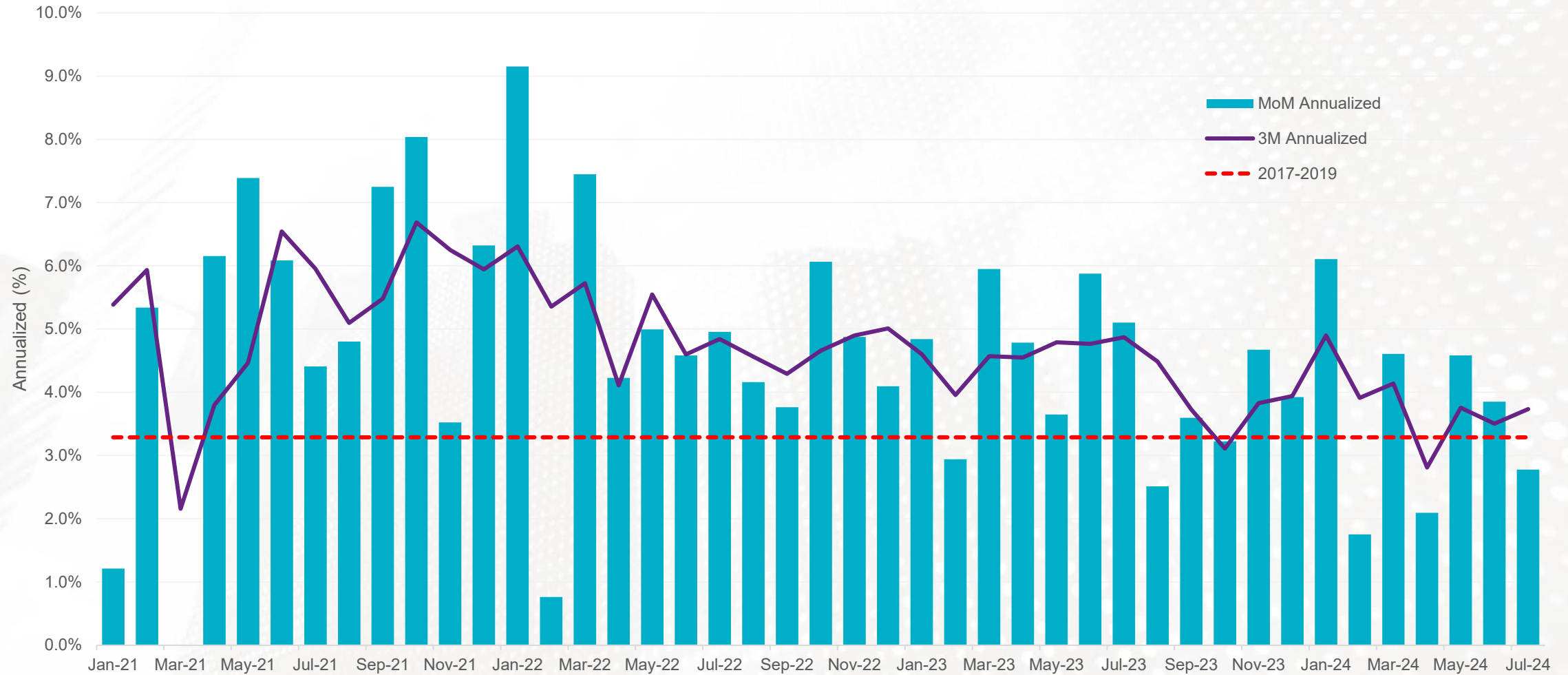


Source: Portfolio Analysis & Consulting. Bloomberg.



# Wage Growth Remaining Consistent

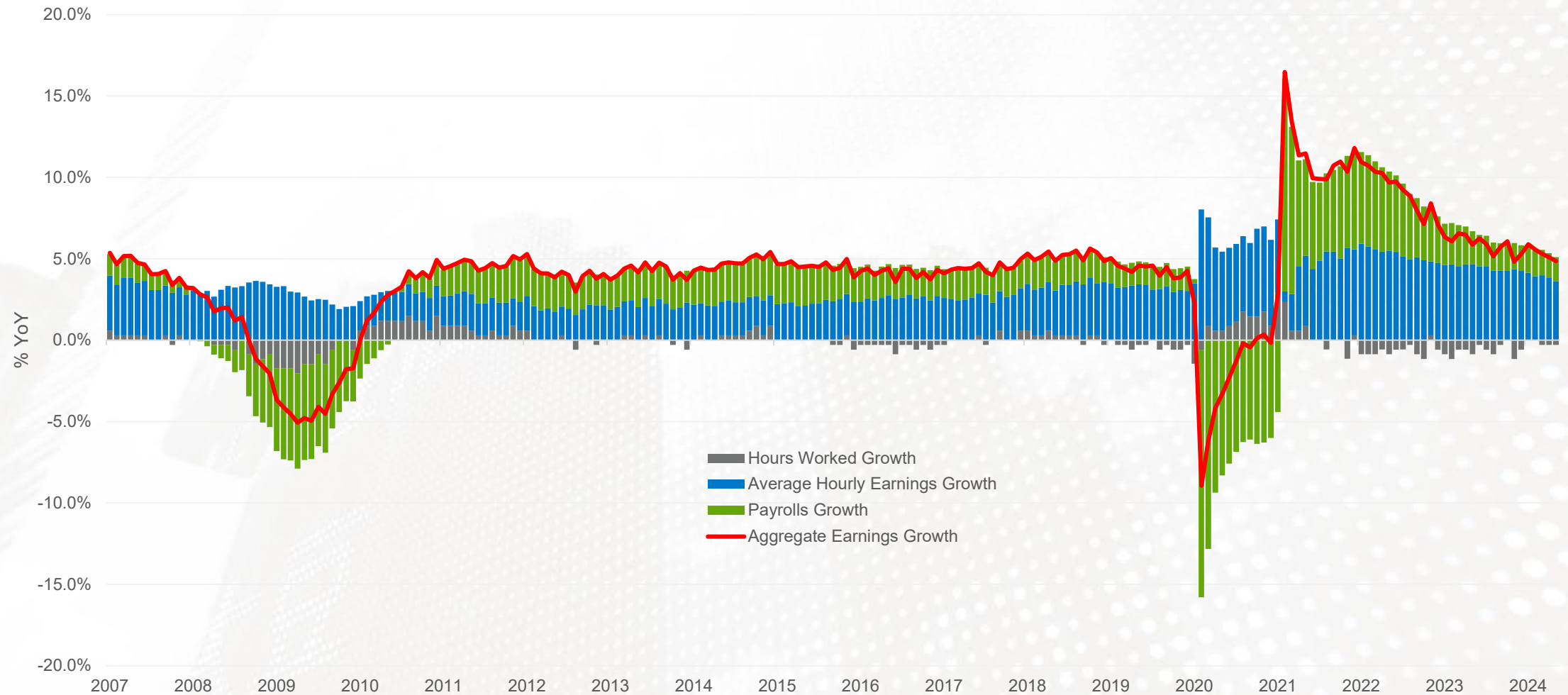
Average Hourly Earnings (1/31/21–7/31/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Household Paycheck Proxy: Consistent With 2% Inflation

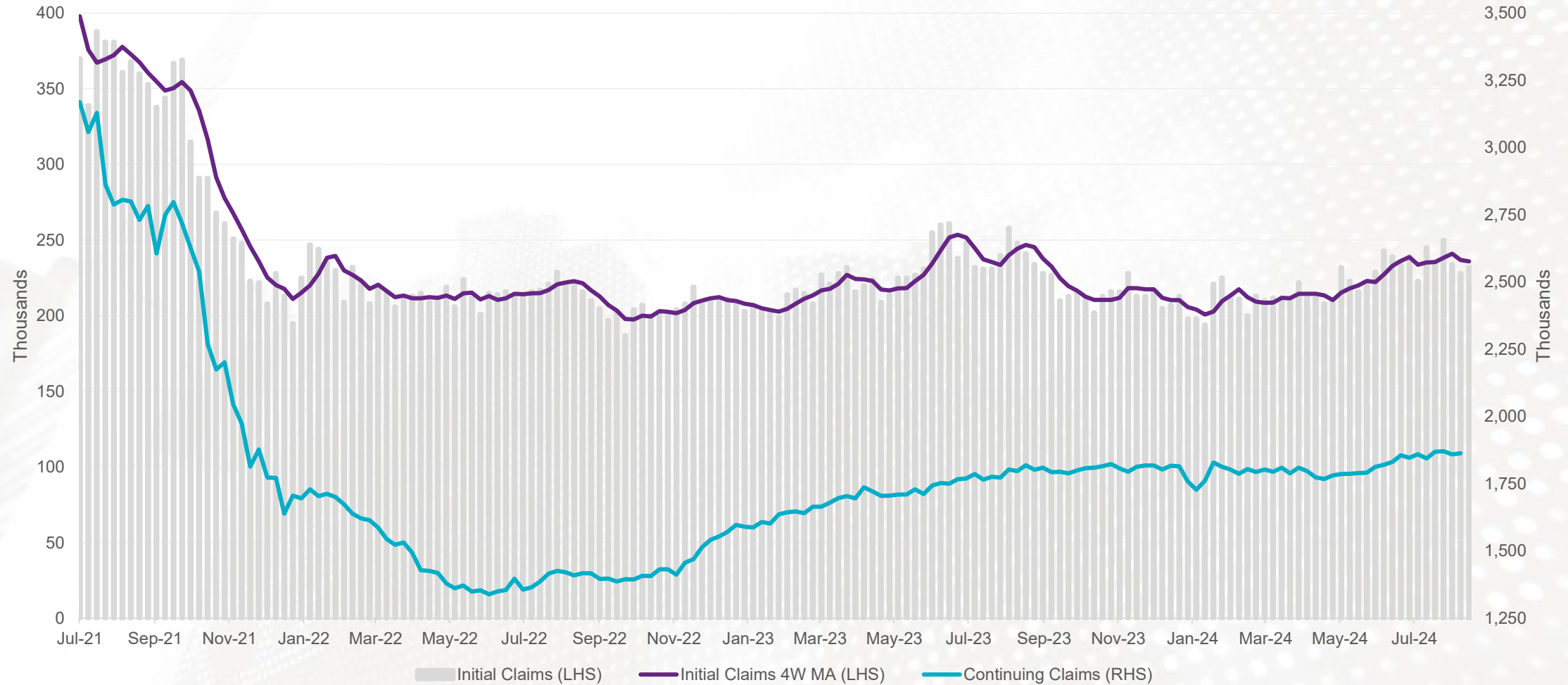
## Contribution to Aggregate Earnings Growth (3/31/07–7/31/24)



Source: Natixis IM Solutions. FactSet.

# Continuing Claims Remain Benign: Laid Off Workers Are Finding Jobs

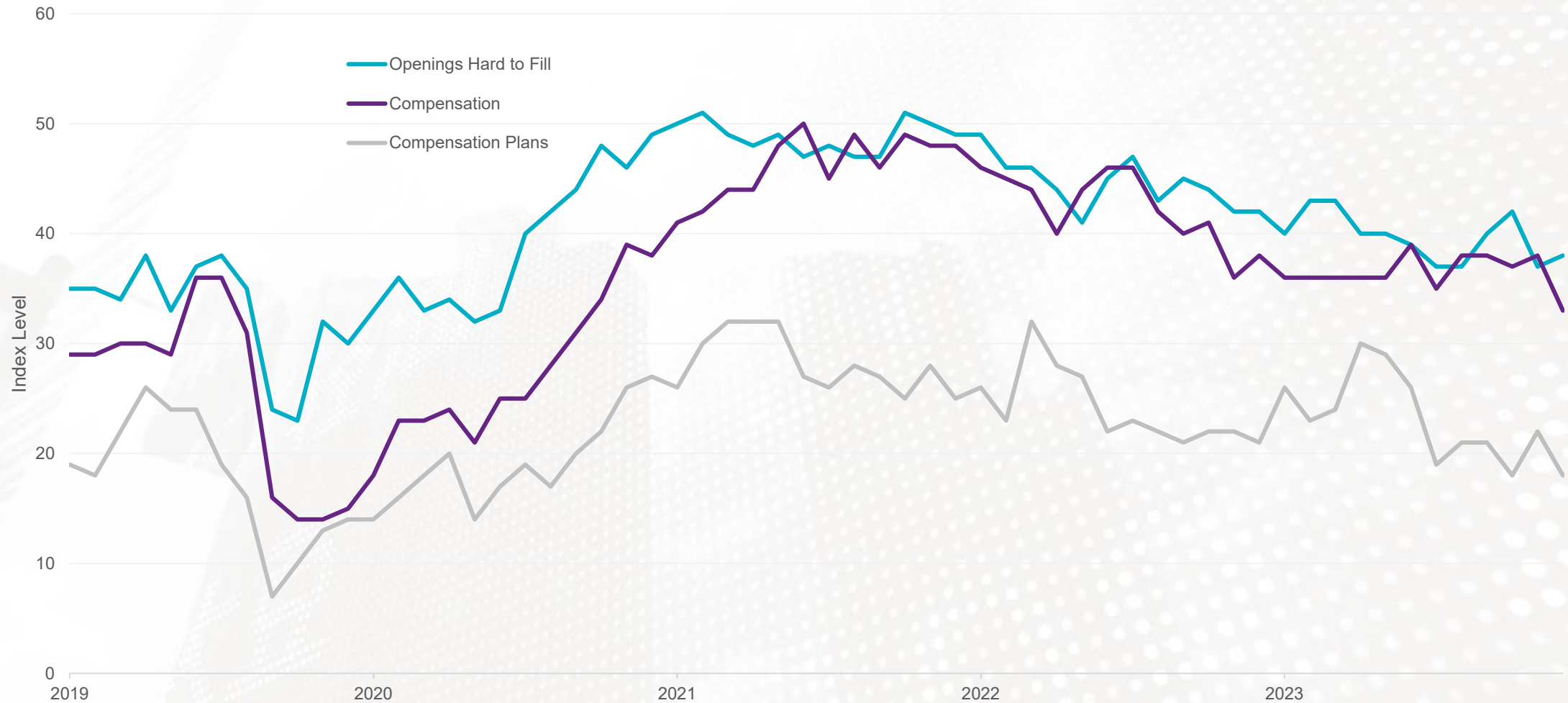
## Initial Claims vs Continuing Claims (7/2/21–8/16/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Compensation Plans Have Peaked

National Federation of Individual Business Compensation Plans (6/30/19–7/31/24)



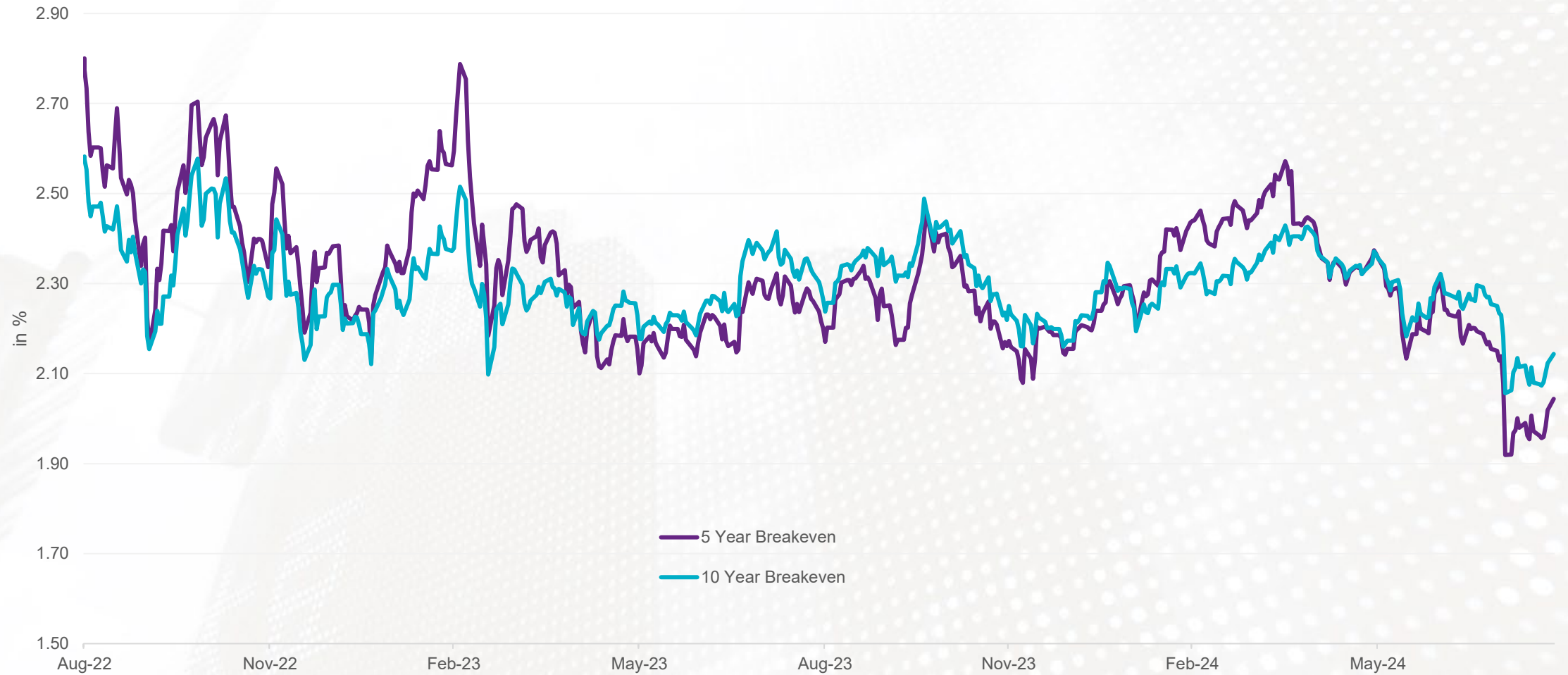
Source: Natixis IM Solutions. Bloomberg.



# Market Based Perception

# Evolution of Market Based Inflation Expectations

## US Inflation Breakevens (8/26/22–8/26/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# Implied Fed Rate Cuts

Implied Probability of Fed Rate Cuts (as of 8/27/24)



Source: Portfolio Analysis & Consulting. Bloomberg.

# The Fed's Implied Terminal Rate

## The Market's Implied Federal Reserve Terminal Rate: SOFR Curve (12/31/21–8/27/24)



Source: Portfolio Analysis & Consulting. Bloomberg.



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Adtrax: 1438702.296.1  
Expiration Date: 12/31/2024