Economic Analysis

CPI Continues Modest Upward Trend in July

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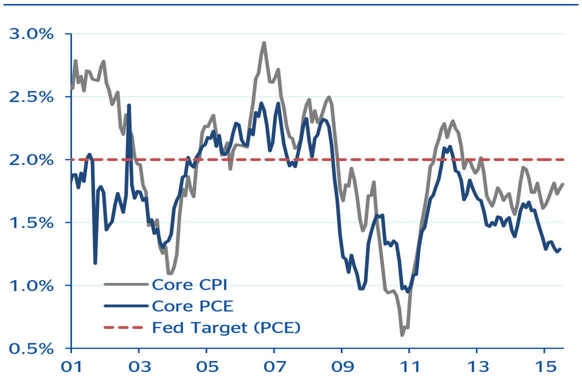
- **Headline and core CPI both increased 0.1% MoM in July, in line with Fed expectations**
- **Core commodities declined for the 3rd straight month, mostly due to a drop in auto prices**
- **With core CPI at 1.8% YoY, July's data provide reasonable support for a September hike**

The consumer price index for July just barely held in line with Fed expectations, with both headline and core inflation up 0.1% for the month. While this certainly isn't a strong report, the fact that inflation did not decline should be enough support for the Fed to move forward with a September rate hike. Headline CPI increased 0.2% on a YoY basis, marking the third consecutive month in positive territory. Core CPI, which is much more relevant to the Fed, increased to 1.8% YoY in July. FOMC doves may be concerned that inflationary pressures are too low, but this may be the best they're going to get in order to support their data dependent strategy.

Despite the increase in core CPI, the core commodities index declined 0.1% for the third straight month. On a YoY basis, core commodities have been in decline since April 2013. Much of this can be attributed to deflationary pressures for household furnishings and supplies, where demand is low given the weakness in housing activity relative to the pre-crisis period. Apparel prices have also declined throughout the past year, most likely reflecting the strength of the USD in importing such products and materials. Prices for new and used autos were also down for July as dealers attempt to clear out inventory for the summer months. As usual, the core services index offset these declines, with shelter prices up nearly 0.4% for the month, followed by a 0.15% increase in medical care services.

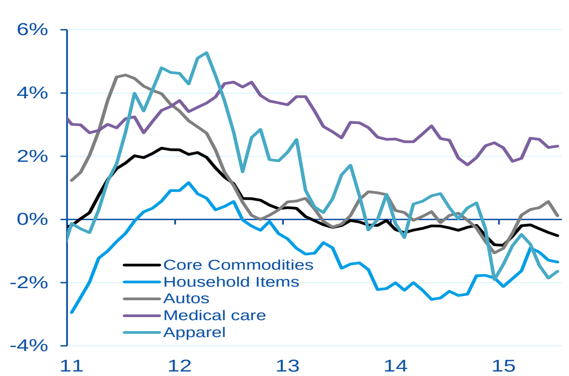
If anything, July's CPI report should help push the FOMC doves towards a September liftoff given that the data are at least moving in the right direction. Language from the last FOMC statement suggests that most members are ready to get over this first rate hike, and therefore they are willing to accept any data to support this move. August's CPI report will be released on the first day of the September FOMC meeting, and as long as it is on par with July's report, we should see serious discussion about increasing the federal funds rate in September.

Chart 1
Core Inflation (YoY % change)



Source: BLS, BEA, & BBVA Research

Chart 2
Core Commodities (YoY% change)



Source: BLS & BBVA Research

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