Atakan Bakiskan, US Economist | atakan.bakiskan@berenberg.com | +44 20 3207 7873

US CPI: IT IS GETTING WARMER

Berenberg Macro View

A little heat on repeat: The August CPI inflation report was slightly hotter than expected. President Donald Trump's inflationary policies – tariffs and restrictive immigration measures – are gradually showing up in the hard data and continue to erode consumers' purchasing power. Although the August CPI pointed to intensifying price pressures (headline CPI up 0.4% mom vs. consensus expectation of 0.3%), the Fed is likely to prioritize signs of labour market weakness for now. Supporting this view, initial jobless claims data – released at the same time as the CPI report – showed first-time applications for unemployment benefits jumping to 263k in the week of 6 September, up from 237k the week prior – the fastest pace of increase since October 2024 and the highest level since October 2021. This reinforces the Fed's view of an increasingly fragile labour market. Markets placed more weight on the weak jobless claims data than on the hot August inflation print – leading to a drop in 2-year and 10-year yields, and traders fully pricing in three rate cuts this year. The headline CPI for August is now up 2.9% from last year – the highest reading since January. Meanwhile, the core CPI rose 0.3% mom (matching the consensus expectation) in August, which kept the year-over-year rate unchanged at 3.1%. Tariff pass-through becomes more visible with each inflation data release. Core goods (which excludes food and energy commodities) prices rose 0.3% mom in August – after a 0.2% mom increase in July – and now up 1.5% yoy, the highest since June 2023. That is nearly 3.5 percentage points above the -1.9% yoy reading from August 2024 that once gave the Fed confidence that disinflation momentum was intact and inflation was returning to the 2% target. One notable increase was airline fares, up 5.9% mom – an indication that consumers may feel pessimistic about the outlook but have not yet pulled back from discretionary activities. Overall, today's CPI report may be hot, but it is certainly not hot enough to stop the Fed from cutting rates by a 25bp next Wednesday (chances for 50bp jumbo cut is slim).

A sneak peek into August PCE inflation: Usually, the Bureau of Labor Statistics releases the Consumer Price Index (CPI) data before the Producer Price Index (PPI) -- but this week marked a rare exception, with PPI released yesterday. Since we now have both CPI and PPI in hand, we can produce a fairly accurate estimate for Personal Consumption Expenditures (PCE) inflation -- the Fed's preferred measure -- which will be published on 26 September, after the Fed meeting next Wednesday. Yesterday's PPI headline reading came in negative (-0.1% mom vs. consensus expectation of 0.3%) -- but the components that feed into the PCE deflator showed no signs of deflation in August. Month-over-month, airline passenger services increased by 1%, portfolio management fees by 2%, hospital outpatient care by 0.2%, and physician care by 0.1%, while hospital inpatient care remained flat. The only category that declined was nursing home care (-0.2% mom) – which carries a negligible weight of just over 1%. In line with these figures, and based on today's CPI reading, we estimate that the core PCE deflator rose by more than 0.3% mom in August – pushing the year-over-year rate to well above 3%, from 2.9% in July. A 3+% year-over-year reading for core PCE inflation is concerning – especially considering that tariffs have only partially passed through to consumer prices so far, and that futures/swaps markets price in three cuts this year and another three next year. If financial conditions remain accommodative, fiscal stimulus kicks in early next year, the economy recovers from peak uncertainty, and wage pressures build due to heavy volumes of deportations – then the odds of a higher-for-longer inflationary environment clearly outweigh those of disinflation towards 2%.

Underlying inflation turning up: While tariffs raise the cost of imported goods, consumers may not see price increases in the same tariff-impacted categories. Firms likely attempt to pass on tariff costs in less visible ways -- by raising prices on goods where consumers have few alternatives or little willingness to reduce demand despite higher prices. A sudden spike in selling prices could cause firms to lose market share and prompt consumers to sharply cut back spending. To avoid this, businesses may raise prices gradually -- which creates more persistent inflationary pressure that could unfold over years. Even firms not directly affected by tariffs can lift prices if the overall pricing environment becomes more permissive -- as they did three years ago in response to the negative supply shock from the Russia-Ukraine war. We already see early

signs of this slow and broad price increase in measures of underlying inflation. The Cleveland Federal Reserve's trimmed-mean CPI index rose 3.2% from last year -- up from 3.0% in April. Its median CPI has also risen to nearly 3.7% yoy -- from 3.5% yoy in April. The Atlanta Fed's core sticky CPI excluding shelter is now at 2.8% yoy – after bottoming out at 2.1% in April. Last summer, underlying inflation fell faster than headline inflation, which helped the Fed build confidence in the disinflation trend. Now that this dynamic has reversed, the September Fed meeting should reflect it through a higher inflation projection.

Disclaimer
This document was compiled by the above mentioned authors of the economics department of Joh. Berenberg, Gossler & Co. KG (hereinafter referred to as "the Bank"). The Bank has made any effort to carefully research and process all information. The information has been obtained from sources which we believe to be reliable such as, for example, Thomson Reuters, Bloomberg and the relevant specialised press. However, we do not assume liability for the correctness and completeness of all information given. The provided information has not been checked by a third party, especially an independent auditing firm. We explicitly point to the stated date of preparation. The information given can become incorrect due to passage of time and/or as a result of legal, political, economic or other changes. We do not assume responsibility to indicate such changes and/or to publish an updated document. The forecasts contained in this document or other statements on rates of return, capital gains or other accession are the personal opinion of the author and we do not assume liability for the realisation of these.

This document is only for information purposes. It does not constitute investment advice or recommendation to buy financial instruments. It does not replace consulting regarding legal, tax or financial matters.

Remarks regarding foreign investors
The preparation of this document is subject to regulation in the United Kingdom. The distribution of this document in other jurisdictions may be restricted by law, and persons into whose possession this document comes should inform themselves about, and observe, any such restrictions.

United Kingdom
This document is meant exclusively for institutional investors and market professionals, but not for private customers. It is not for distribution to or the use of private investors or private customers.

United States of America
This document has been prepared exclusively by the Bank. Although Berenberg Capital Markets, LLC ("BCM"), an affiliate of the Bank and registered US broker-dealer, distributes this document to certain investors, BCM does not provide input into its contents, nor does this document constitute research of BCM. In addition, this document is meant exclusively for institutional investors and market professionals, but not for retail investors or private customers. It is not for distribution to or the use of retail investors or private customers. BCM accepts responsibility for this research document's contents and institutional investors receiving this research and wishing to effect any transactions in any security discussed herein should do so through BCM and not the Bank.
Please contact Berenberg Capital Markets, LLC (+1 646 949 9000) if you require additional information.

Copyright
The Bank reserves all the rights in this document. No part of the document or its content may be rewritten, copied, photocopied or duplicated in any form by any means or redistributed without the Bank's prior written consent.

© 2021 Joh. Berenberg, Gossler & Co. KG