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TD Economics

Data Release: Inflation hotter-than-expected in August

- Inflation was hotter than expected in August (0.2% m/m), as unchanged prices for food and energy partially offset a 0.3% increase in core inflation. The year-on-year pace of inflation moved up to 1.1%.

- The big surprise was a 0.3% m/m jump up in core inflation, the biggest increase since February. Price pressures came largely from shelter (+0.3% m/m) and medical care (+1.0% m/m). Prices for motor vehicle insurance, apparel, communication and tobacco also increased. In contrast, prices for used cars and trucks, household furnishings and operations, recreation and airline fares all declined in August.

- The annual pace of core inflation ticked up to 2.3% y/y in August. That matches previous highs seen at a couple of points earlier in 2016.

- Services have been a key source of inflation so far this year, and annual core services inflation was 3.2% y/y in August. Meanwhile, goods prices remain in negative territory on an annual basis (-2.2%) as the stronger dollar has led to price declines. However, core goods prices were up 0.1% in August, the first monthly increase since February, reflecting higher prices for things like apparel.

Key Implications

- A slightly hotter-than-expected reading on core inflation is consistent with the FOMC taking rates higher this year. While the Fed's preferred inflation gauge is the core personal consumption expenditure deflator, the CPI is the first price gauge released for August, and the last data point before next week's rate decision when the FOMC will likely have a serious discussion about taking rates higher.

- In light of recent weakness in several indicators of real economic activity, we expect the Fed will wait until later in the year before taking rates higher. Nonetheless, the continued upward movement in inflation should give the Fed the confidence it needs that it is moving closer to target on both its full employment and price-stability mandates.

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