

Peak CPI Theory

The U.S. CPI rose an above-average 0.8% in July, lifting the inflation rate to 5.6% y/y, the highest in 17½ years, pumped by energy and food prices. However, gasoline prices started dropping during the latter half of the month, suggesting that their influence will wane and that current inflation rates could soon mark their peaks. Excluding food and energy, core CPI increased 0.3% (for the second month in a row), reflecting rising import prices. It could also be the case that there was less aggressive seasonal discounting as retailers hoped (obviously too optimistically) for a rebate lift to customer traffic. Sizable price increases were registered for apparel and recreational goods. This lifted the core inflation rate to 2.5% y/y, tapping the top of the range tracked for the past 17 months. The shorter-term metrics were mixed, with the three-month change accelerating to 3.5% annualized from 2.5% (ouch) and the six-month change staying at 2.3% annualized. However, these too could soon be marking peaks. With retail sales volumes already dropping despite the rebates (reflecting the triple-whammy of falling jobs, home prices and credit availability), and with most cheques already disbursed, retailers are likely to pick up the degree of discounting in the months ahead.

(seasonally adjusted)	(month/month % change)			(% change : a.r.)	
	Jul	Jun	May	6-month	12-month
All Items	0.8	1.1	0.6	6.4	5.6
Ex. Food & Energy	0.3	0.3	0.2	2.3	2.5
Food	0.9	0.8	0.3	7.4	6.0
Energy	4.0	6.6	4.4	37.7	29.3
Food & Beverages	0.9	0.7	0.3	7.0	5.8
Clothing	1.2	0.1	-0.3	-0.3	0.8
Transportation	1.7	3.8	2.0	14.4	13.4
New Vehicles	0.2	0.2	-0.1	-0.4	-0.8
Gasoline	4.1	10.1	5.7	38.9	37.9
Medical Care	0.1	0.2	0.2	1.7	3.5
Recreation	0.4	0.1	0.1	1.8	1.7
Education	0.5	0.4	0.4	5.4	5.7
Owners' Equiv. Rent	0.1	0.3	0.1	2.1	2.6

The Bottom Line: Despite the acceleration in core inflation during the past couple of months, the Fed's inflation alarm bells probably aren't ringing any louder. Energy prices are already rolling over and real consumer spending is positioning to register its first quarterly contraction in 17 years. Retail prices appear poised to drop more frequently than swimming records at the Beijing Olympics.

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