



Economics Group

Sarah House, Senior Economist
sarah.house@wellsfargo.com • (704) 410-3282

Tariffs Becoming Evident in Consumer Price Inflation

Core consumer prices rose 0.3% for a second straight month. While a few details suggest that the pace overstates the trend, it is clear tariffs are beginning to drive goods prices higher.

Goods Inflation Set to Stay a While

Consumer prices heated up in July, rising 0.3%. As expected, energy prices gave a pump to the headline, while food prices were flat. More striking was another strong gain in core prices, which pushed the year-over-year rate back up to 2.2%.

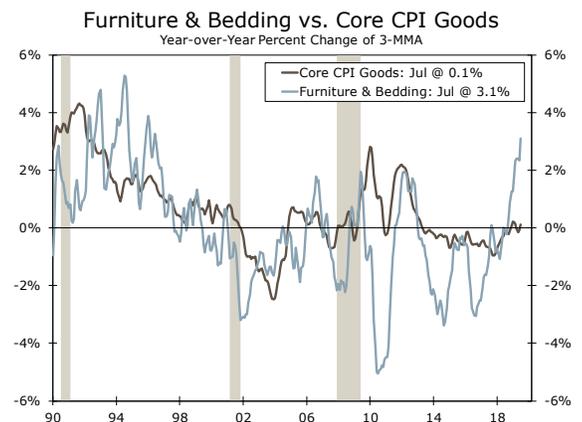
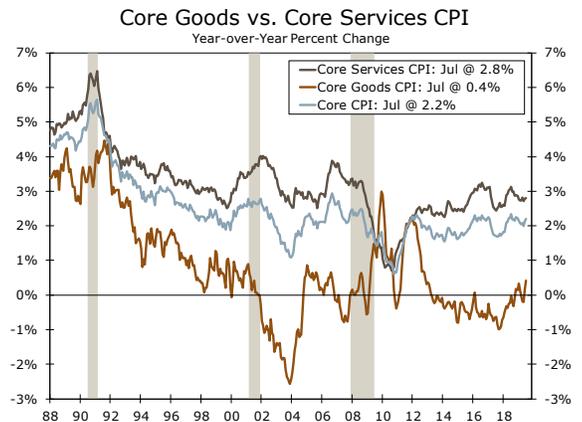
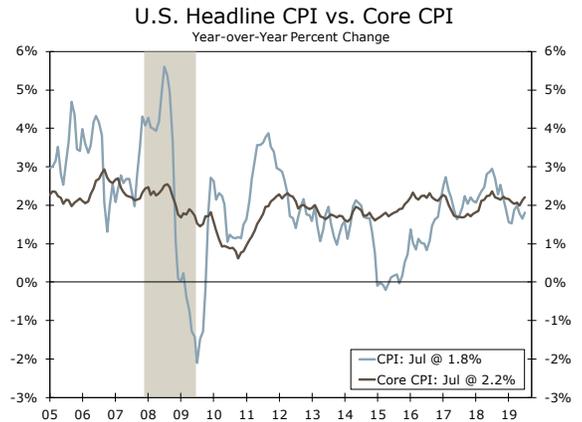
As we noted last month, the 0.3% increase in core CPI in June was payback for undue softness in prior months. Yet this month, core prices rose 0.3% again. So is this the start of a significant pickup in core inflation?

We suspect that two months in a row of 0.3% gains in core prices overstate the general trend. Shelter costs rose a solid 0.3%, but that was lifted in part by a 0.9% jump in the volatile lodging away from home category. Owners' equivalent rent, which makes up most of the shelter component, increased more slowly in July. Airfare, and other volatile categories of core services, jumped 2.3%. We would expect to see some reversal in the hotel and airfare components the next few months given the inherent noise in these categories. As for core goods prices, which rose 0.2% in July, some of the strength looks to be further catchup from aberrant weakness in apparel (+0.4%) and used vehicles (+0.9%) in early spring.

That said, there were a number of signs that the upping of tariffs on about \$250B of imports from China to 25% from 10% this summer is beginning to feed through to core goods and drive consumer prices higher. For example, computer and peripheral prices (including tablets, notebooks and related accessories) rose 2.8% in July, its largest one-month increase on record, after some electronic goods were included in the \$250B tranche of tariffs. Similarly, furniture and bedding prices rose 0.7% in July and have now increased 3.9% over the past year—the largest gain in 23 years.

We expect the most recently announced round of tariffs, which places a 10% import tax on the remaining \$300 billion of goods imported from China, to go into effect in the coming months. That should drive goods inflation up further. The overall impact to inflation, however, should be fairly small. We estimate that the upcoming round of tariffs will add about 0.1% to CPI inflation. The categories of consumer goods most directly exposed to tariffs account for only about 8.5% of items in the CPI basket.

While the FOMC has been seeking higher inflation, tariffs were not how it wanted to get it. Assuming inflation expectations are not altered, tariffs provide only a temporary boost to inflation after the initial lift to the price base, while weighing on broader growth prospects. Although inflation has firmed, we expect the Fed to continue to focus on the downside risks to growth amid the tumultuous global backdrop, and cut the fed funds rate again at its September meeting.



Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	Acting Chief Economist	(704) 410-3274	jay.bryson@wellsfargo.com
Mark Vitner	Senior Economist	(704) 410-3277	mark.vitner@wellsfargo.com
Sam Bullard	Senior Economist	(704) 410-3280	sam.bullard@wellsfargo.com
Nick Bennenbroek	Macro Strategist	(212) 214-5636	nicholas.bennenbroek@wellsfargo.com
Tim Quinlan	Senior Economist	(704) 410-3283	tim.quinlan@wellsfargo.com
Azhar Iqbal	Econometrician	(212) 214-2029	azhar.iqbal@wellsfargo.com
Sarah House	Senior Economist	(704) 410-3282	sarah.house@wellsfargo.com
Charlie Dougherty	Economist	(704) 410-6542	charles.dougherty@wellsfargo.com
Erik Nelson	Macro Strategist	(212) 214-5652	erik.f.nelson@wellsfargo.com
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	Macro Strategist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economic Analyst	(704) 410-1681	shannon.seery@wellsfargo.com
Matthew Honnold	Economic Analyst	(704) 410-3059	matthew.honnold@wellsfargo.com
Jen Licis	Economic Analyst	(704) 410-1309	jennifer.licis@wellsfargo.com
Hop Mathews	Economic Analyst	(704) 383-5312	hop.mathews@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

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