



Economics Group

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

Surge in July Core CPI Is Mere Catch Up

Inflation surged 0.6% in July, underpinned by the largest gain in the core index in more than 50 years. Yet the jump reflects unwinding of the pandemic-induced price cuts this spring. Weak demand will keep the trend tepid.

In Reverse

Inflation staged quite a comeback in July. Consumer prices jumped 0.6%, with an equally large and significantly rarer gain in the core index. Yet July's increase does not mark the start of sustained pickup in inflation. Instead it is merely catching up from declines this spring.

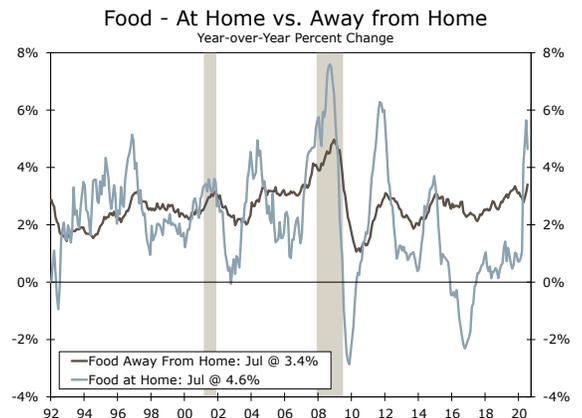
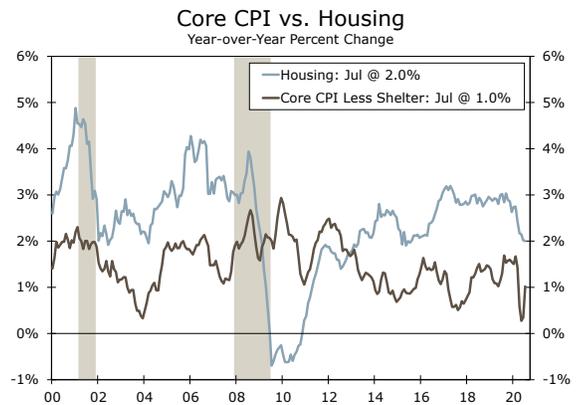
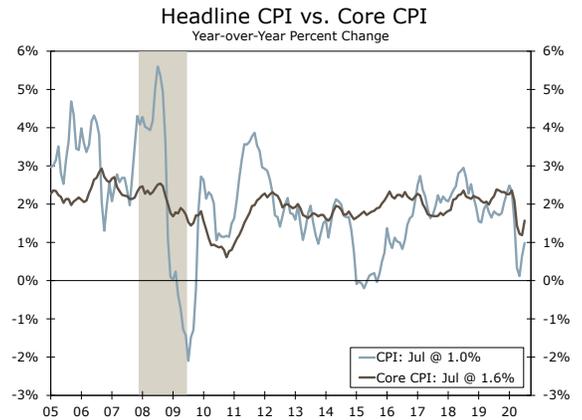
Core inflation is typically the focus of policymakers since it strips out the highly volatile energy and food components. But parts of the core index are also quite volatile, especially in today's age when technology enables businesses to alter prices inexpensively. Many of those categories have also been at the epicenter of the COVID crisis, and after steep cuts this spring were able to gain back some pricing power in July. For example, airfares jumped 5.4%, lodging away from home rose 1.2%, car rentals increased 4.0% and apparel rebounded 1.1%. Other pandemic-induced price declines also unwound, including a 9.3% leap in motor vehicle insurance and 1.3% increase in new and used vehicles now that households are driving more. With a good bit of ground recovered but consumer buying patterns still altered as the virus circulates, gains in the coming months are likely to be more modest.

Support from one key component of the CPI—housing—is also beginning to weaken. Rent of primary residences rose 0.2% in July, as did the owner-owned component. That marks a slightly stronger gain than last month, but trails behind the pre-pandemic trend. With only one-in-six of housing units in the sample surveyed each month, changes in housing market conditions take longer to show up than categories purchased more frequently. We expect shelter inflation to remain weak as job losses have skewed toward renters. Working from home has allowed some white-collar workers to consider less expensive markets and home price appreciation slows.

At the same time, price changes are settling down in areas that got a boost from stay at home orders—namely grocery stores. Prices for food at home fell 1.1% in July as supply chain issues have alleviated to an extent.

Settle In for a Prolonged Period of Weak Inflation

Despite the sharp rise in July, weak demand will keep a lid on inflation in the coming months. Even as employment has recovered ground since the spring's widespread shutdowns, the labor market remains in tatters. Many households are unable or unwilling to spend amid the more tenuous jobs situation, questions over the amount and duration of unemployment benefits and continuing risk of COVID. Low inflation expectations will also make the Fed's job of 2% inflation harder in this environment. While expectations have perked up a bit recently, they remain depressed by historical standards and are unlikely to have much staying power as the soft inflation environment persists. We expect core CPI, which runs a few tenths hotter than the core PCE deflator, to remain below 2% though 2021.



Wells Fargo Securities Economics Group

Jay H. Bryson, Ph.D.	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	International Economist	(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
Michael Pugliese	Economist	(212) 214-5058	michael.d.pugliese@wellsfargo.com
Brendan McKenna	International Economist	(212) 214-5637	brendan.mckenna@wellsfargo.com
Shannon Seery	Economist	(704) 410-1681	shannon.seery@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

Wells Fargo Securities Economics Group publications are produced by Wells Fargo Securities, LLC, a U.S. broker-dealer registered with the U.S. Securities and Exchange Commission, the Financial Industry Regulatory Authority, and the Securities Investor Protection Corp. Wells Fargo Securities, LLC, distributes these publications directly and through subsidiaries including, but not limited to, Wells Fargo & Company, Wells Fargo Bank N.A., Wells Fargo Clearing Services, LLC, Wells Fargo Securities International Limited, Wells Fargo Securities Canada, Ltd., Wells Fargo Securities Asia Limited and Wells Fargo Securities (Japan) Co. Limited. Wells Fargo Securities, LLC is registered with the Commodities Futures Trading Commission as a futures commission merchant and is a member in good standing of the National Futures Association. Wells Fargo Bank, N.A. is registered with the Commodities Futures Trading Commission as a swap dealer and is a member in good standing of the National Futures Association. Wells Fargo Securities, LLC. And Wells Fargo Bank, N.A. are generally engaged in the trading of futures and derivative products, any of which may be discussed within this publication. Wells Fargo Securities, LLC does not compensate its research analysts based on specific investment banking transactions. Wells Fargo Securities, LLC's research analysts receive compensation that is based upon and impacted by the overall profitability and revenue of the firm which includes, but is not limited to investment banking revenue. The information and opinions herein are for general information use only. Wells Fargo Securities, LLC does not guarantee their accuracy or completeness, nor does Wells Fargo Securities, LLC assume any liability for any loss that may result from the reliance by any person upon any such information or opinions. Such information and opinions are subject to change without notice, are for general information only and are not intended as an offer or solicitation with respect to the purchase or sales of any security or as personalized investment advice. Wells Fargo Securities, LLC is a separate legal entity and distinct from affiliated banks and is a wholly owned subsidiary of Wells Fargo & Company © 2020 Wells Fargo Securities, LLC.

Important Information for Non-U.S. Recipients

For recipients in the EEA, this report is distributed by Wells Fargo Securities International Limited ("WFSIL"). WFSIL is a U.K. incorporated investment firm authorized and regulated by the Financial Conduct Authority. For the purposes of Section 21 of the UK Financial Services and Markets Act 2000 ("the Act"), the content of this report has been approved by WFSIL, an authorized person under the Act. WFSIL does not deal with retail clients as defined in the Directive 2014/65/EU ("MiFID2"). The FCA rules made under the Financial Services and Markets Act 2000 for the protection of retail clients will therefore not apply, nor will the Financial Services Compensation Scheme be available. This report is not intended for, and should not be relied upon by, retail clients.

SECURITIES: NOT FDIC-INSURED/NOT BANK-GUARANTEED/MAY LOSE VALUE