September 11, 2020

Economics Group

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

CPI: Inflation Rebound Continues, but Don't Extrapolate Pace

Consumer price inflation increased 0.4% in August, further reversing price declines this spring. Core inflation also rose 0.4%, driven by a surge in used auto prices. Despite recent volatility, the trend remains subdued.

Rebound in Inflation Continued, but Less Widespread

Many of the initial price shocks from the coronavirus pandemic continued to unwind August. The consumer price index rose 0.4%, bringing the year-over-year rate up to 1.3% from 1.0% in July.

Prices at the grocery store, which jumped at the start of the crisis, fell for a second straight month (down 0.1%). The drop was led largely by a decline in meat prices as supply disruptions have eased. Nevertheless, prices for food at home are still up 4.6% year-over-year as households are eating more meals at home in an effort to save money and avoid exposure to COVID. However, less interest in eating out/getting take out has not resulted in much of a price break for households, as prices for food away from home rose 0.3% in August and are up 3.5% over the past year—still faster than the overall pace of inflation. At the same time, the windfall from lower gasoline prices is fading, albeit slowing, with the sub-index up another 2.0% in August.

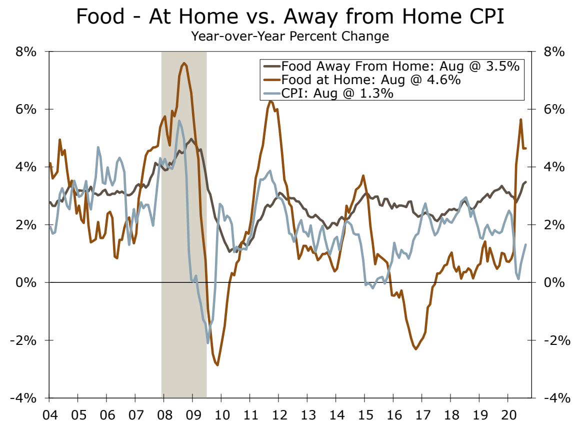
Meanwhile, core inflation is bouncing back. Excluding food and energy, prices rose 0.4% and have increased at a 5.1% annualized pace the past three months. The strength in core inflation in August, however, was less widespread than in July. The desire to avoid public transport drove a 5.4% surge in used vehicle prices, which alone added 0.14 points to the headline's gain. That brings consumer prices for used cars more in line with the recent boom in auction prices, but there still may be scope for further gains the next couple of months. Apparel, hotel and airlines fares also continue to rebound.

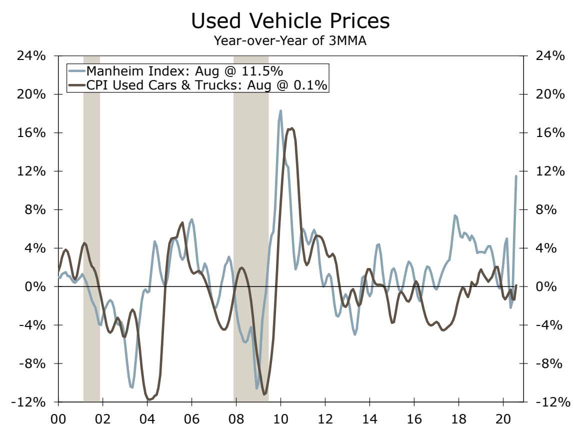
The overall disinflationary impulse of the pandemic, however, was evident elsewhere. Shelter prices rose just 0.1% with weakness in rental and owner-owned properties. Medical care and transportation services costs also eased.

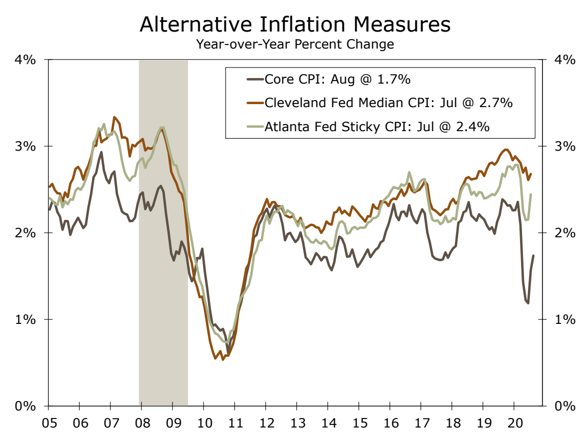
A Long Way Off From Testing the Fed's New Comfort Level

Any fears of pandemic triggering deflation should be calmed by the definitive rebound in prices the past few months. But inflation is not about to take off either. The pickup in core inflation is more mean reversion than the start of a trend. Measures like the Median CPI and Sticky CPI that present an alternative way of gauging the underlying trend in inflation besides excluding food and energy suggest the overall trend is more stable than the traditional core has indicated recently.

While not as weak as at the nadir of the crisis, we expect core CPI to remain subdued, and barring favorable base effects in the second quarter of next year, struggle to reach and maintain a 2% over the next couple of years. The core CPI runs a few tenths above the core PCE deflator, the inflation measures to which the FOMC benchmarks policy. Therefore, we expect inflation will struggle to meet the Fed's 2% target over the next two years, let alone run higher for a time in order to bring inflation to 2% on average. In other words, it is a long time before inflation becomes an issue for the Fed.







Source: U.S. Department of Labor, Bloomberg LP, Atlanta Federal Reserve, Cleveland Federal Reserve and Wells Fargo Securities

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
Nicole Cervi	Economic Analyst	(704) 410-3059	nicole.cervi@wellsfargo.com
Sara Cotsakis	Economic Analyst	(704) 410-1437	sara.cotsakis@wellsfargo.com
Coren Burton	Administrative Assistant	(704) 410-6010	coren.burton@wellsfargo.com

WELLS FARGO SECURITIES