INFLATION WATCH

...A mid-month focus on inflation via Traditional Indexes, Commodity Prices, and Labor Costs.

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Modest Disinflation

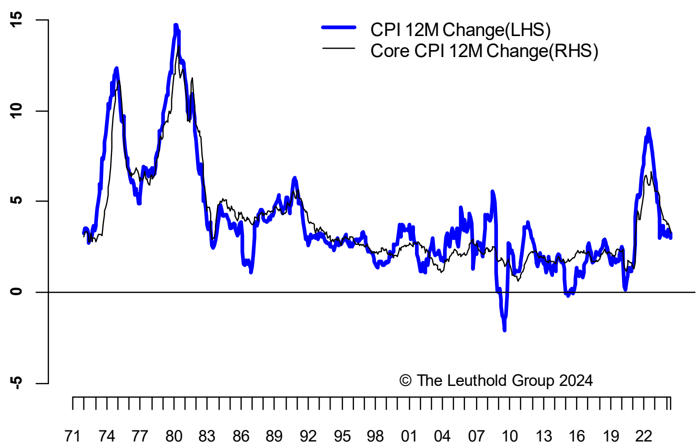
- The latest CPI report was a tad cooler than consensus.
- Our scorecard suggests the modest disinflationary regime is likely to persist.

June CPI: 3% (Y/Y); Core CPI: 3.3% (Y/Y)

With the first monthly drop since July 2022, the negative m/m headline CPI number (-0.1%) triggered another round of dovish reactions. Bonds and small caps were bid, and the dollar was offered. The Fed rate cut expectations jumped from 2 to 3 for the rest of the year. By now, we should all be very familiar with the overreaction that comes with every 0.1% beat/miss. What's new this time is the rotation from large AI-related growth stocks to small caps. One day does not make a trend but this is clearly worth monitoring.

Chart 1

US CPI & Core CPI 12-Month Change



Consistent with the overall dovish tone, the non-seasonally adjusted headline CPI for June edged lower to 3% from 3.3% in May. The Core CPI increased by 3.3% YOY, also a tad cooler than the 3.4% recorded in May (Chart 1).

The key components that drive the overall inflation remain the same. Gasoline and Energy were a big contributor to the cool-down in the headline index (Chart 2). The pace of shelter and rent inflation continues to ease, but the overall levels are still solidly positive (Chart 3). Slower increase on top of an already elevated level is unlikely to provide real relief. It's a step in the right direction, nonetheless.

Chart 2

Gasoline & Energy CPI 12-Month Change

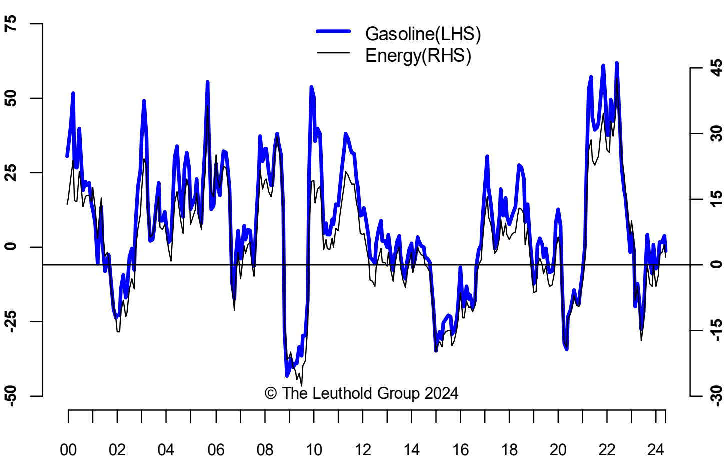


Chart 3

Shelter vs OER Inflation

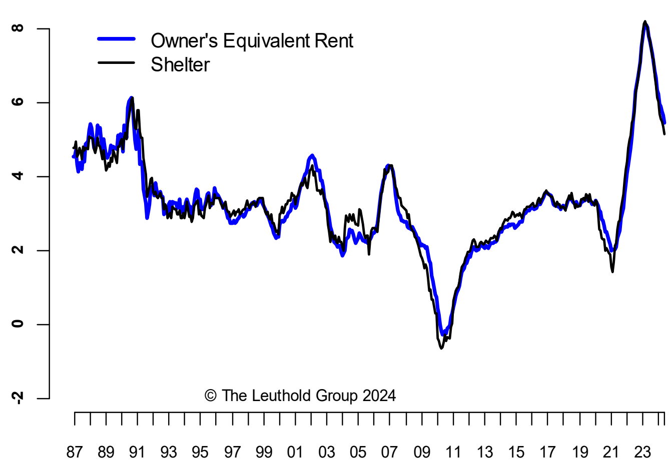


Chart 4

US CPI Inflation: Services vs Goods

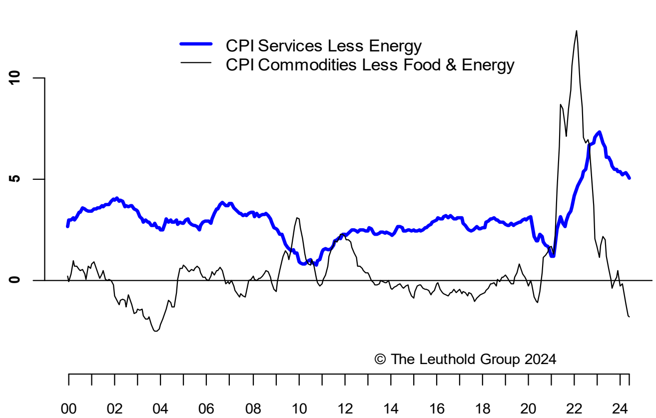
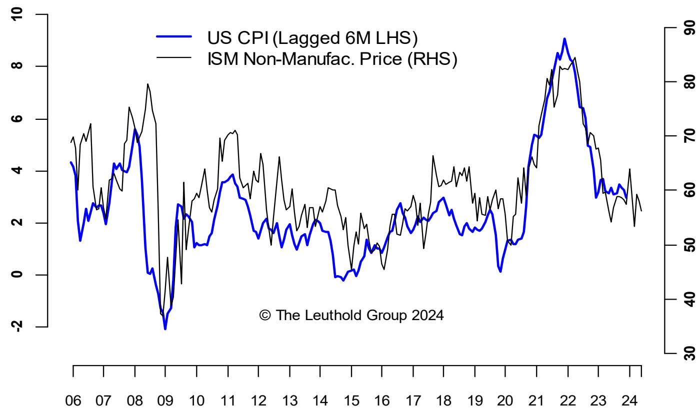


Chart 5

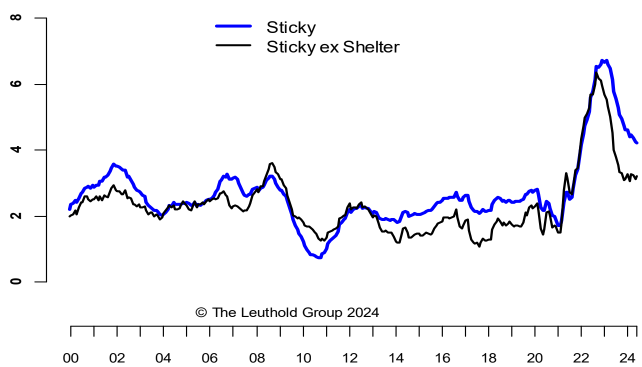
US CPI vs ISM Non-Manufacturing Price Index



We have highlighted the notable divergence between goods and services inflation in our previous reports. Goods inflation has now plunged to a level not seen in the last two decades, but services inflation, while down from its pandemic peak, still lingers at an uncomfortably high level (Chart 4). The trend needs to continue to bring overall inflation back into the Fed's comfort zone. We are not there yet.

Chart 6

Sticky vs Sticky ex Shelter CPI



The good news for the Fed is that economic activities seem to be slowing and that will likely guide inflation lower. The ISM Non-Manufacturing Price index tends to lead the CPI by 6 months and the recent dip in the ISM Price index bodes well for the CPI going forward (Chart 5). While the market is very eager to embrace the dovish CPI report, the small uptick in the Sticky ex-Shelter CPI is conveniently ignored (Chart 6). At the same time, oil prices are back above $80, reversing much of the decline in the 2nd quarter. Higher oil prices also tend to drive Core PCE higher, even though energy is not a component of it (Chart 7).

Additionally, we are plunging head-long into the election season, politics and geopolitics will move to center stage. The Global Supply Chain Pressure index (Chart 8) remains near the recent high. That will likely put a floor under the CPI in the near term.

Chart 7

Oil Futures Prices vs Core PCE Index Y/Y Change

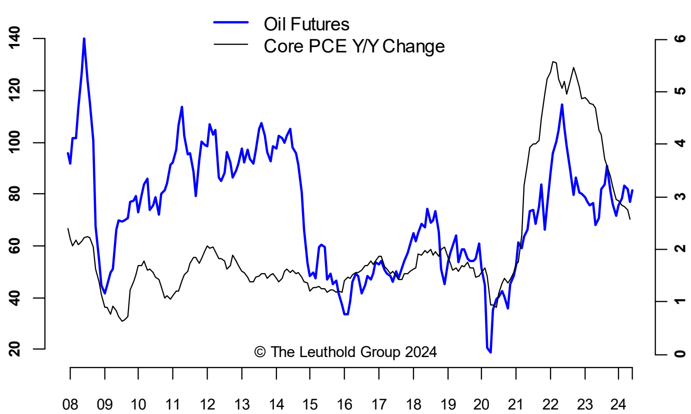


Chart 8

US CPI vs Global Supply Chain Pressure Index

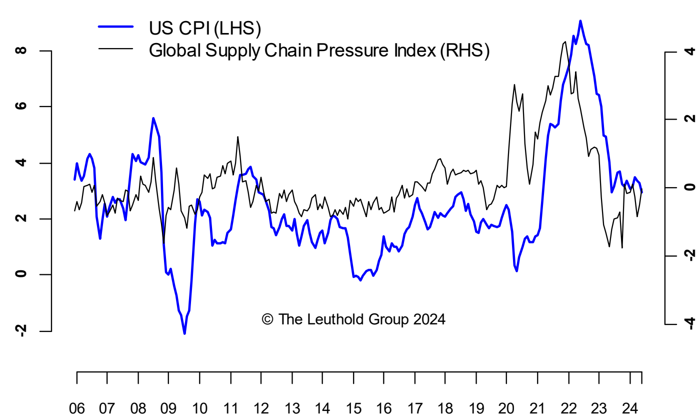


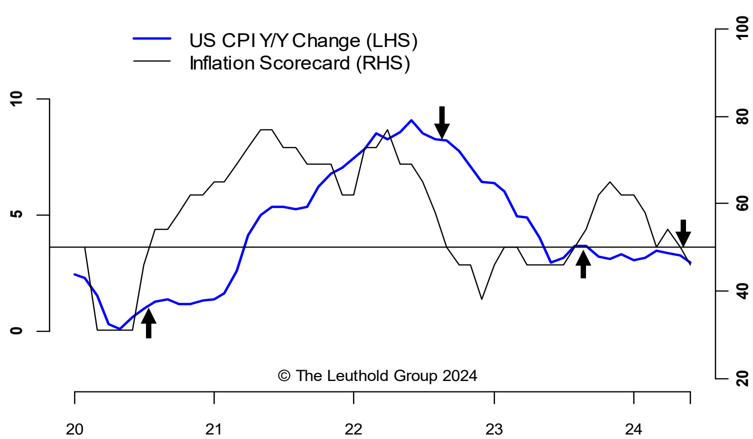
Table 1

Inflation Scorecard

Category	Sub-Category	Indicator	Mec. Signal	Adj. Signal
Demand Pull				
	Consumer	**Disposable Income**	**0**	**50**
		Confidence	**0**	**0**
		Personal Expenditure	**100**	**100**
	Investment	**Private Investment**	**100**	**100**
	Government	**Govt Spending**	**0**	**50**
	Loan Activities	**Business Loan Flows**	**100**	**50**
Cost Push				
	Natural Resource:	**Commodities**	**100**	**50**
	Exchange Rate	**US Dollar (inverted)**	**0**	**0**
	External Shocks	**Oil**	**100**	**100**
		Import Prices	**100**	**100**
	Wages	**Avg Hourly Earnings**	**0**	**0**
		Unit Labor Costs	**0**	**0**
		Employment Costs	**0**	**0**
		Total Score	**46**	**46**

Chart 9

US CPI vs Inflation Scorecard



The latest update of our Inflation Scorecard (Table 1) shows a modest disinflationary reading of 46, unchanged from the previous month.

Chart 9 shows the live record of our Inflation Scorecard readings (Adjusted Signals). A reading above 50 is inflationary, while a reading below 50 is disinflationary. The arrows indicate when the Scorecard signal crossed the neutral line (i.e., signal change). Note that the signals are one-month ahead of the actual CPI numbers. Overall, the signals have been very timely. The inflationary signal from late 2023 to May 2024 was also on target, as the CPI numbers turned out to be persistently higher than market consensus during this period, resulting in a big reduction in Fed rate cut pricing.

The mechanical signals were unchanged, but this month we align some of our adjusted signals with the mechanical ones.

Consumer confidence rolled over again and is now negative Y/Y (Chart 10), so we adopted the mechanical signal of 0. On the cost-push side, oil prices have turned positive for inflation, and we followed suit (Chart 11).

Overall, we believe the modest disinflationary regime is likely to persist for a while. Market overreaction should not be given too much weight.

Chart 10

US CPI vs Consumer Confidence

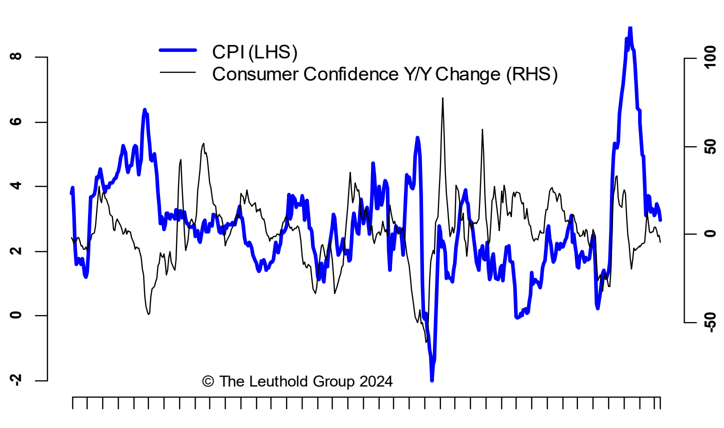


Chart 11

US CPI vs WTI Oil Futures