

MARKET SIGHT LINES



No Cooling Trend for Inflation

By Michael O'Keeffe, *Chief Investment Officer*



In [Inflation May Be Cooling](#), we reviewed the July inflation reports showing improving inflation. When the report was released, market pundits and the media were quick to point out that one month of improving inflation was not yet a trend. We agree. Last week in [Navigating the Rest of 2022: Get Ready for More Volatility](#), we shared key dates when we will be monitoring important inflation and other data through the balance of the year. And this week was important, so in this SightLines we'll share an update on inflation and other key data points.

AUGUST INFLATION REPORTS

The consumer price index (CPI) rose 0.1% in August, with inflation dampened by lower energy prices, which fell 5% over the month. Core CPI, which excludes food and energy, rose 0.6% in August, well above expectations of a 0.3% rise. This monthly rate translates to an annualized level of 7.4%, still well above the Federal Reserve (Fed)'s 2% target. And as Figure 1 illustrates, the modest improvement in July was not sustained, with core CPI rising higher than the elevated levels of the first half of this year. Many categories experienced price increases. For example, shelter rose 0.7%, medical care services jumped 0.8%, household furnishings rose 1.0%, new vehicles increased 0.8%, and motor vehicle insurance was up 1.3%. We did see a decline in airline fares, which fell 4.6%.

FIGURE 1: Consumer Price Index

	CPI		Core CPI	
	Monthly	Annualized	Monthly	Annualized
2020	0.11%	1.29%	0.13%	1.60%
2021	0.57%	7.10%	0.45%	5.48%
1H22	0.89%	11.16%	0.55%	6.85%
July '22	0.00%	0.00%	0.30%	3.66%
August '22	0.10%	1.21%	0.60%	7.44%

Source: Stifel CIO Office, U.S. Bureau of Labor Statistics

We saw a slightly more muted producer price index (PPI), which fell 0.1% in August, driven by lower gasoline prices and falling prices on other goods like chicken eggs and primary basic organic chemicals. The core PPI, which excludes food and energy, rose 0.4%. Producer prices are important as they represent input prices that influence prices for the consumer.

All in all, the August inflation reports were negative. The Fed has been watching these reports and is expected to maintain its hawkish policy shift given the reports of sustained, higher inflation. At present, markets are pricing in a 70% chance of a 0.75% rate increase at next week's Fed meeting, with a 30% chance of a 1% hike. Next week's Fed announcement, and its Summary of Economic Projections (SEP), will be important to understand further the market dynamics for the balance of the year and beyond. But staying focused on this week, we learned more about the consumer with reports on retail sales and consumer sentiment.

RETAIL SALES

Consumption makes up about two-thirds of U.S. GDP, so monitoring retail sales helps gauge the economy's health. This week we learned that August retail sales rose 0.3%, well ahead of expectations, after declining a month earlier. Consumers paid less at the pump with lower gasoline prices, allowing them to spend elsewhere. Motor vehicle sales increased 2.8%, food services and drinking places were up 1.1%, and building materials and garden equipment also rose 1.1%. A measure called control group sales, which is used to calculate gross domestic product and excludes auto dealers, food services, building materials stores, and gasoline changes, was flat (0.0%) in August after rising 0.4% in July. These readings tell us the consumer remains engaged some, a modest tailwind for the economy.

CONSUMER SENTIMENT

The University of Michigan produces a monthly report on consumer sentiment, and this week we learned the preliminary report for their September result, which rose modestly to 59.5, but was still 18% below the September 2021 level. This report includes an assessment of consumer year-ahead inflation expectations, which improved from 4.8% last month to 4.6% this month. And the long-run expectations fell to 2.8%, the best result in the past year.

CONCLUSION

In [Navigating the Rest of 2022: Get Ready for More Volatility](#), we shared key dates (Figure 2 below) to monitor and help us understand market dynamics for the balance of this year. This week we saw a report indicating worsening inflation, a retail sales report signaling a modest positive tailwind for the economy, and consumer sentiment survey showing modest improvement in recent months. Fed policy will remain important, and we will learn about the next Fed meeting decision next week.

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MARKET PULSE

This past week's inflation report solidified the Fed's case for a 75-basis-point increase at the next meeting and reignited the debate about the outlook for the global economy and the possibility of a Fed-induced recession. The S&P 500 is down over 16% this year, and we expect volatility to remain, as a number of uncertainties continue to weigh on markets. We still believe that the S&P 500 will be higher from current levels 12 months from now as we get clarity or resolution on the path of inflation, Fed policy, and geopolitical tensions. Read more in our latest [Market Pulse](#).

FIGURE 2:
Key Dates for Remainder of 2022

SEPTEMBER		OCTOBER		OTHER IMPORTANT TOPICS
2	Employment	7	Employment	
13/14	Inflation	12	FOMC Minutes	
15	Retail Sales	13/14	Inflation	
16	Consumer Sentiment	14	Retail Sales	
20/21	Housing	14	Consumer Sentiment	
21	Fed Policy Decision	19/20	Housing	
21	FOMC Economic Projections	27	3rd Quarter GDP (Adv Est.)	
NOVEMBER		DECEMBER		<ul style="list-style-type: none"> ▪ Russia-Ukraine War ▪ China-Taiwan Tensions ▪ Progression of Earnings Forecasts ▪ 3rd Quarter Earnings Season ▪ Progression of PMI measures ▪ Business and consumer sentiment ▪ Global Inflation ▪ Global Central Bank Policy
2	Fed Policy Decision	2	Employment	
4	Employment	9	Consumer Sentiment	
8	Mid Term Elections	9/13	Inflation	
10	CPI/Core CPI	14	Fed Policy Decision	
11	Consumer Sentiment	14	FOMC Economic Projections	
15	PPI/Core PPI	15	Retail Sales	
16	Retail Sales	20/21	Housing	
17/18	Housing			
23	FOMC Minutes			

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