Weekly Economic Review & Outlook

September 18, 2023

Service inflation is still too hot

The core CPI was stronger than expected in August, underscoring the sticky nature of inflation in the service sector. The Fed is highly unlikely to pursue another rate hike this week, but an increase is still on the table for November or December. In consumer news, the August retail sales report showed that some wind has been taken out of consumers' sails as still-high inflation and slowing earnings growth cut into disposable income.

Energy causes an inflation surge

Headline inflation in the August CPI report rose a strong 0.6 percent. Energy prices overall accounted for half of the increase as gasoline prices jumped 10.6 percent during the month. This lifted the year-on-year rate to 3.7 percent from 3.3 percent in July. But more worrisome, the core CPI surprised to the upside, rising 0.3 percent versus expectations for a softer 0.2 percent rise. Within the details, total rents climbed by 0.4 percent in August as rising home prices and rent for primary residences pushed up shelter costs.

Reflecting the continued upward push from services, super core CPI (core services ex rents) climbed 0.4 percent, its fastest increase since March. The three-month annualized rate ticked up to 2.3 percent from 1.8 percent in July, while the year-on-year rate slipped to 3.9 percent from 4 percent. Transportation service costs continue to account for the largest share of pressure on the super core measure. Motor vehicle repair costs increased another 1.4 percent (NSA) in August and are up 17.2 percent from a year ago; similarly, motor vehicle insurance rose 2.4 percent and is up nearly 20 percent year-over-year.

Given how strongly Fed officials have signaled no change in rates at this week's FOMC meeting, the higher August core CPI reading shouldn't trigger a surprise rate hike. But overall consumer activity hasn't softened enough to put inflation on track to hit the Fed's 2.0 percent target anytime soon. This leaves open the possibility of another rate increase in November or December if the incoming data is still buoyant. Our base case remains that the Fed is done hiking for this cycle with a hiking bias maintained through year end.

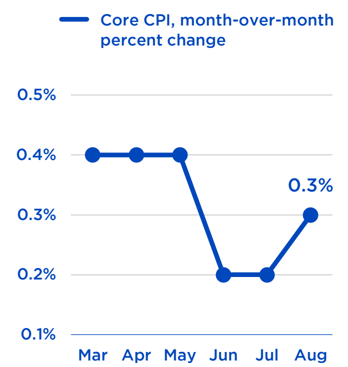
Consumer activity begins to slow

August retail sales showed that consumers took a needed breather after splurging in July. The headline gain was buoyant at 0.6 percent, but it was fueled by a 5.2 percent surge in gasoline sales owing to the abovementioned climb in gasoline prices. Core retail sales, which excludes auto, building supplies, and gasoline sales, rose a much more modest 0.1 percent — suggesting that more consumers are being stretched thin by still-high inflation and slowing income gains.

The retail sales data contain only a small snapshot of spending on services, but the sales at food services and drinking places was softer on the month, up 0.3 percent — considerably lower than the average monthly gain of one percent in the prior three months. This suggests some pullback on dining out, though we expect spending on travel services to end the summer on a strong note.

While real consumer spending should be robust in the third quarter (powering an expected 4.0 percent annualized gain real GDP), slower August retail sales likely represents the beginning of a downtrend in consumer activity. When combined with fading pandemic savings and the resumption of student loan payments, consumer expenditures should slow substantially in the fourth quarter — likely a forerunner of modest recessionary trends in early 2024.

Cost pressures increase for services



The August gain of 0.3 percent in core CPI was higher than expected as service inflation continued to drive up consumer costs.

Consumers pull back in August

Growth in core retail sales was significantly lower in August than the last few months. Is this the beginning of a weaker consumer trend?

Sources: Bureau of Labor Statistics, Census Bureau

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The Week Ahead

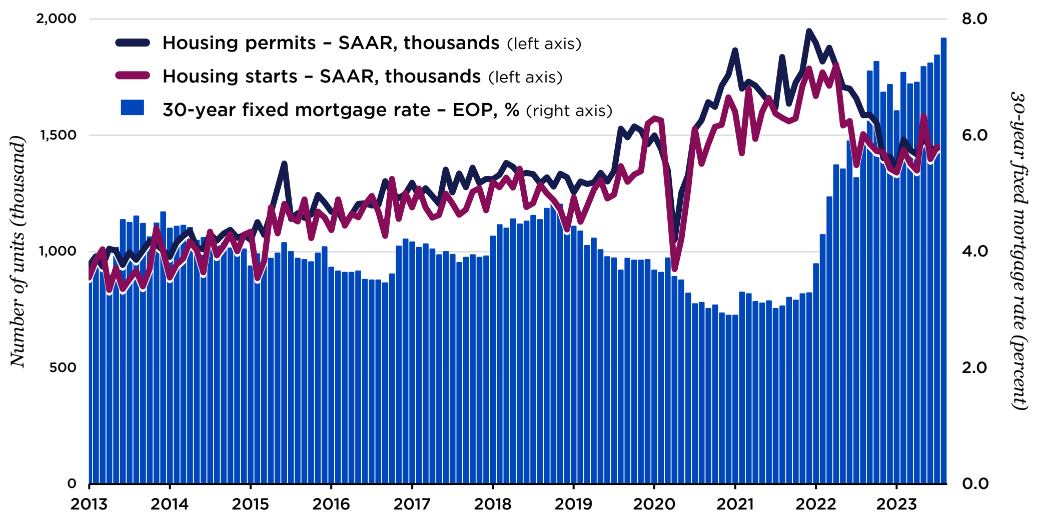
Here's our outlook for the days ahead. Subscribe to [Daily Insight](#) for updates throughout the week.

Housing Starts and Building Permits

Sept 19

Rising mortgage rates should take a toll on housing starts

Building permits were relatively flat in July, which should dampen housing starts in August. But more importantly, mortgage rates moved above seven percent over the month which should slow home construction even with many builders subsidizing rate offerings to reduce financing pressures. We expect to see a draw back in both building permits and housing starts due to the renewed jump in financing costs, with starts falling to an annualized pace of 1.435 million.



Sources: Nationwide Economics, BLS, Haver Analytics

Existing Home Sales

Sept 21

Existing home sales may get a boost from buyers locking in rates

Mortgage rates were tamer in July when most of the closings reported in August went into contract. With some buyers trying to get ahead of the upward spike in financing costs, existing home sales are expected to edge up in August to an annualized pace of 4.1 million units. Even after the slight rise, sales activity would be only marginally above the recent low. Moreover, mortgage applications have plunged over the past month, suggesting a rocky road in coming months for the housing market.

Leading Economic Index

Sept 21

Stock market pull back should drag on LEI reading

The resilience of equity markets has been the lone significantly positive factor within the Leading Economic Index (LEI) for much of the year. However, the market dipped last month which should weaken the August LEI print, with a 0.4 decline expected. Few components that make up the index recorded growth in August, demonstrating the widespread deterioration of economic conditions across multiple sectors and highlighting the strong recession signal from the LEI for the outlook.

Additional Economic Indicators

Previous Week's Indicators

Previous Week's Indicators	Period	Actual	Previous
NFIB Small Business Optimism	August	91.3	91.9
CPI MoM	August	0.6%	0.2%
CPI Ex Food and Energy MoM	August	0.3%	0.2%
Initial Jobless Claims	Week ending Sept 9	220,000	216,000
Retail Sales Advance MoM	August	0.6%	0.7%
Retail Sales Ex Auto and Gas	August	0.2%	1.0%
PPI Final Demand MoM	August	0.7%	0.3%
PPI Ex Food and Energy MoM	August	0.2%	0.3%
Import Price Index MoM	August	0.5%	0.4%
Industrial Production MoM	August	0.4%	1.0%
Capacity Utilization	August	79.7%	79.3%
U. of Mich. Sentiment	September P	67.7	69.5

This Week's Indicators

This Week's Indicators	Release Day	Period	Forecast*	Previous
NAHB Housing Market Index	Monday	September	49	50
Housing Starts	Tuesday	August	1435k	1452k
Housing Starts MoM	Tuesday	August	-1.2%	3.9%
Building Permits	Tuesday	August	1440k	1442k
Building Permits MoM	Tuesday	August	-0.1%	0.1%
FOMC Rate Decision (Lower Bound)	Wednesday	Week ending Sept 20	5.25%	5.25%
Initial Jobless Claims	Thursday	Week ending Sept 16	225,000	220,000
Existing Home Sales	Thursday	August	4.10m	4.07m
Existing Home Sales MoM	Thursday	August	0.7%	-2.2%
Leading Index	Thursday	August	-0.4%	-0.4%

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