

Flash Macro Update

U.S. CPI | August 2025



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What You Need to Know

1 How are we thinking about the July 2025 U.S. CPI report?

Core CPI for July came in at +0.3% m/m, up from +0.2% m/m in June and in-line with consensus. Beneath the surface, we see more settled housing inflation, sustained inflation in non-shelter services categories, but moderate upward pressures on goods prices. Importantly, however, we do not see tariff-related inflation leading to a 'spiral' higher for inflation expectations. A key anchor, we believe, is that shelter (>40% of Core CPI) has now settled below its 2018-2019 run-rate. At the same time, mid-/high-income consumers are still spending on discretionary items, which makes us think that consumer finances are in okay shape despite a drag from higher tariffs.

Looking at the bigger picture, we continue to view the market as a glass half full: The technical bid remains strong, and fundamentals are solid enough to push markets slightly higher. The big stories, however, remain the productivity enhancements we are seeing as well as the coordinated global easing cycle (despite the global economy having an asynchronous economic recovery). Against this backdrop, our key themes remain the Security of Everything, Productivity/Worker Retraining, Collateral-Based Cash Flows, and Capital Heavy to Capital Light.

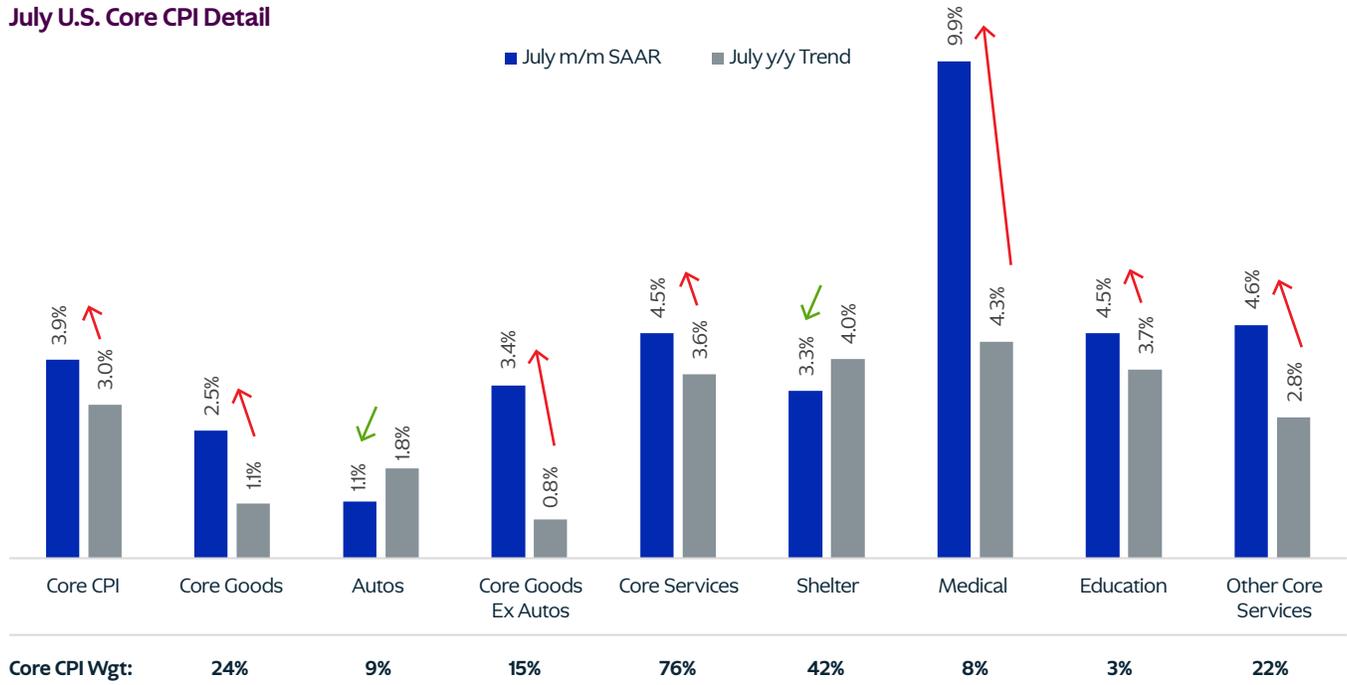
See below for details, but we are largely maintaining our pre-existing forecasts. 2025e CPI holds at 2.7% and remains below-consensus of 2.8%. For 2026e, we lower our headline CPI forecast to 2.8% from 2.9% but remain above-consensus of 2.7%. We persist in our call for two fed cuts this year and three cuts next year (now in-line with market pricing, which has adjusted lower), but are now seeing a distinct skew in balance of risks towards lower rates, and will be on watch to add further cuts to our forecast if job growth remains as subdued as we expect in coming months.

This report is market friendly. In our view, were the labor supply acting normally, unemployment would be closer to 4.9% today, not 4.2%. So, employment is now the swing variable, as long as we are not seeing signs of broad-based inflation in the system. To be sure, we would like to see Supercore inflation ex-housing coming down, but there are enough pockets of inflation weakness we are seeing to justify our view that the Fed should start cutting in September.

DETAILS

- **Core goods inflation remained firm at +0.2% month-over-month for the second month in a row.** Beneath the surface, we see some signs of stabilization in smaller-ticket items, which experienced the fastest pass-through from tariffs (e.g., apparel prices rose +0.1% month-over-month, the slowest increase since tariffs were introduced in May and the third lowest reading of the year). On the other hand, as we had predicted, big-ticket items like autos are starting to see firmer prices (new vehicle prices were flat month-over-month after declining -0.3% in May and June, while used auto prices rose +0.5% after falling around -0.6% month-over-month for the last three months).
- **Core services inflation rose +0.4% month-over-month, above its last 12 months run-rate and on the firmer side given softening in the labor market.** Notably, OER rental inflation has settled near our long-run expectation of +0.35% month-over-month (OER inflation has been around +0.3% month-over-month for the last three months). Meanwhile, Supercore inflation remains bumpy but still above its 2018-2019 run-rate, boosted in part by discretionary categories (airline fares jumped +4.0% month-over-month after declining for six months in a row). Overall, we think services inflation will continue to cool in the coming months, particularly given a weaker labor backdrop.
- **On net, inflation is slightly on the warm side, but today's report suggests that policymakers still need to lower rates.** Weaker shelter inflation aligns with our view that the housing economy is running near stall-speed and needs the Fed to ease policy.
- **We stick to our call for two cuts this year and three cuts next year, but think the balance of risks skews towards lower rates vs. our base case.** The latest jobs report suggests the Fed is starting to fall behind the curve, and nothing in today's report suggests the Fed needs to wait to start cutting. We expect the inflation backdrop to remain mixed but tolerable for the Fed this fall, which means policymakers will be more responsive to continued weakness in the labor market in considering an extra cut.

So, employment is now the swing variable, as long as we are not seeing signs of broad-based inflation in the system. To be sure, we would like to see Supercore inflation ex-housing coming down, but there are enough pockets of inflation weakness we are seeing to justify our view that the Fed should start cutting in September.

Exhibit 1: July Inflation Shows Still-Elevated Goods Inflation, and Slightly Firmer Services Inflation ex-Housing**July U.S. Core CPI Detail**

Data as at July 31, 2025. Source: Bloomberg.

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