

United States

Inflation drops sharply in August, but core rate picks up

- **Inflation slows to 1.5% (2.0% in July)**
- **Core inflation rises to a five-month high, allaying fears of deflation**
- **Weak headline rate unlikely to dissuade Fed from tapering**

The headline rate of inflation in the US fell sharply in August, but a rise in the core measure will help alleviate concerns that deflationary forces are taking hold. The data therefore add to the likelihood of the Fed starting to trim its asset purchases this week.

Consumer price inflation eased sharply from July's five-month high of 2.0% to 1.5% in August, coming in below market expectations of a decline to 1.6%. However, core inflation, which excludes volatile food and energy prices, picked up slightly from 1.7% to a five-month high of 1.8%, in line with expectations.

The upturn in the core measure has the biggest implication for policy, as it will help the argument that it is appropriate for policy stimulus to be scaled back from the current \$85bn monthly asset purchases programme. Those worrying about the possibility of deflation taking hold will be reassured by the upturn in the core measure and are likely to be more inclined to agree to start tapering this week.

Policymakers will therefore most likely vote to trim the Fed's monthly asset purchases by \$5-10bn as the FOMC meeting concludes tomorrow. Accompanying the reining-in of stimulus may be a dovish statement that suggests that the economy is growing only slowly and that job creation remains disappointingly weak, indicating that policy will need to be withdrawn gradually in order to not jeopardise the recovery. However, the Fed is also likely to note that the outlook continues to brighten, buoyed by an improving international economic environment, as well as improving domestic conditions. This may reinforce expectations in the markets that policy will continue to be tapered gradually as we move into and through 2014.

Inflation



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