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Services will be the sticking point for an inflation-sensitive Fed

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Next week marks a packed calendar, with the most consequential data release being the July CPI print which lands on Wednesday. We expect core CPI rose +0.2% m/m, knocking the y/y pace down to 2.4%. We look for headline inflation to come in at a more subdued +0.1% m/m (+3.3% y/y), helped by a continued retracement in gasoline prices.

Core goods have consistently helped headline inflation as of late – registering flat to negative for three consecutive months. Core services inflation is expected to continue to retreat from April and highs – but as the final ingredient to return core inflation to target, we expect it will remain stickier than the FOMC would like. Still, shelter price growth will likely register cooler in July, providing some relief to core services. The Zillow Observed Rent Index has decelerated since Q1 2025 (aside from a recent one-month blip) and tends to flow through to OER with a sizeable lag. New and existing home sales have largely moderated over the past year and a half, and with a nearly two-year lag to OER, that should continue pulling shelter lower through year-end — though more meaningful relief will come later on. And airfares will add a further tailwind on cheaper jet fuel. But the longer-term limitation for core services is still elevated wage growth, which continues to put a floor under core services disinflation, while Baby Boomers – a cohort that is relatively less sensitive to wage income – will also be demand supportive for services.

Core PPI is unlikely to register the same relief that we expect to see in core CPI. Our forecast calls for core PPI to rise +0.3% m/m, with pressures stemming from services including transportation and warehousing. Headline PPI will be helped by the energy reprieve (+0.1% m/m). Trade services is the wildcard, and after the ISM Services prices paid index unexpectedly shot up in July, we will be watching to see how wholesale and retail margins are faring via trade services PPI.

The week culminates with retail sales data. We expect that a retracement in gasoline prices will translate to negative nominal retail sales (-0.3% m/m), and declines in light motor vehicle sales will also be a drag. Most importantly, excluding autos and gas, spending is expected to remain in positive territory suggesting a resilient consumer picture. We are forecasting a +0.3% m/m increase in the retail sales control group (which excludes autos, gasoline, building materials, and restaurant spending) in July. This should reassure the Fed that demand is still healthy. Still, we expect next week’s inflation print will preserve Fed optionality as the FOMC awaits one additional inflation print before the September meeting.

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