INVESTMENT SERVICES

Weekly Relative Value

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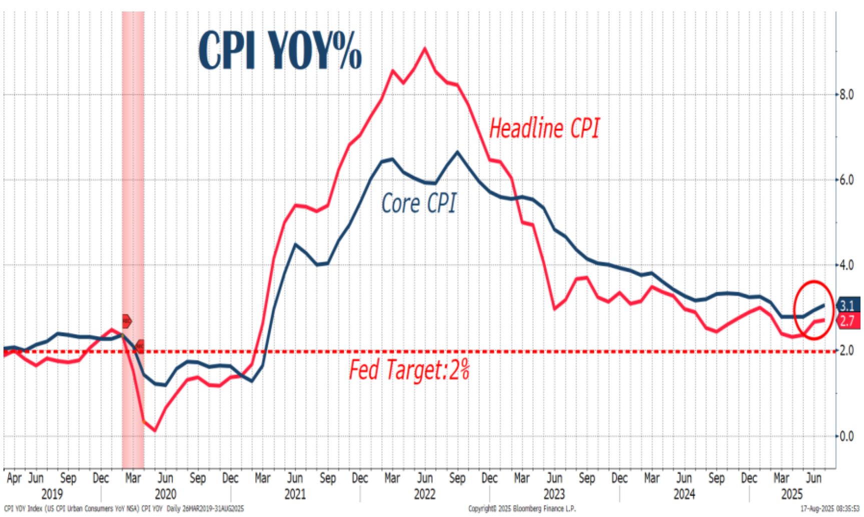
WEEK OF AUGUST 18, 2025

Inflation Is Not a Perfect Number

"Now our inflation is down to a perfect number. Hardly any at all. Yet our country is taking in tens of billions — trillions of dollars actually in tariffs."
— President Donald Trump

This past week's inflation data was less than ideal.

There was no big surprise in the Consumer Price Index (CPI) report for July, with the headline coming in at +0.2% month over month and the core CPI (CPI excluding food and energy) with an as-expected +0.3% increase. The year-over-year headline inflation rate was unchanged at +2.7% while the core rate of inflation broke above +3.0% for the first time since February (from +2.9% in June to +3.1% in July).



For the time being, there was no real thrust from the tariff file as the core goods CPI came in rather tame, at +0.2% month over month, for the second month in a row (though the year-over-year trend did perk up to +1.2% from -1.9% a year ago).

While everyone was busy searching with their magnifying glasses for signs that tariffs are getting pushed into consumer goods prices, there was a mix of price increases and price declines. It was in services where inflation took off again behind their backs, and services are the biggie, representing 60% of the overall CPI.

THIS WEEK

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- WHOPPINGLY BIG!
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- THE CONSUMER CONTINUES TO SPEND
- A DASH OF HOPE
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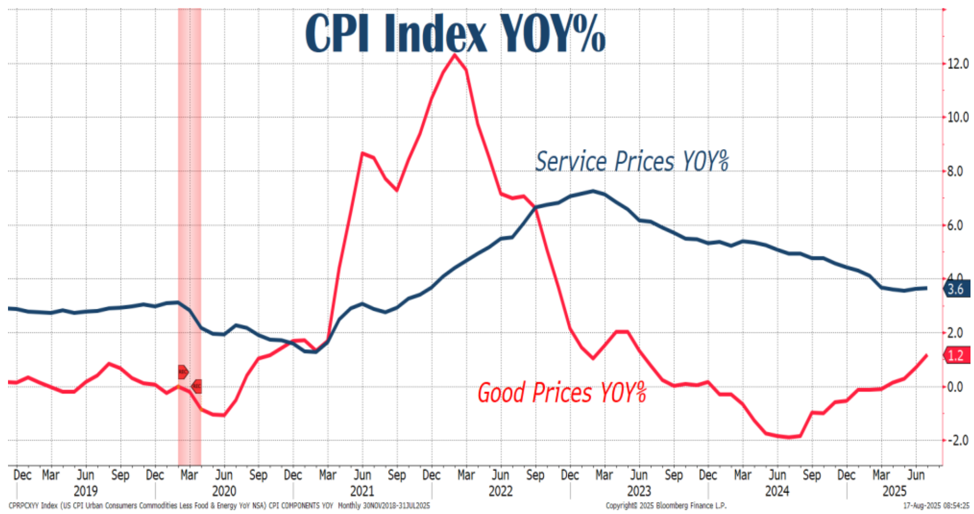
Core services include housing costs, medical care, health insurance, auto insurance, tenants' insurance, subscriptions; telephone, internet and wireless services; lodging, rental cars, airline fares, education, movies, sports events, club memberships, water, sewer, trash collection, motor vehicle maintenance and repair, etc. And that's where inflation re-accelerated sharply.

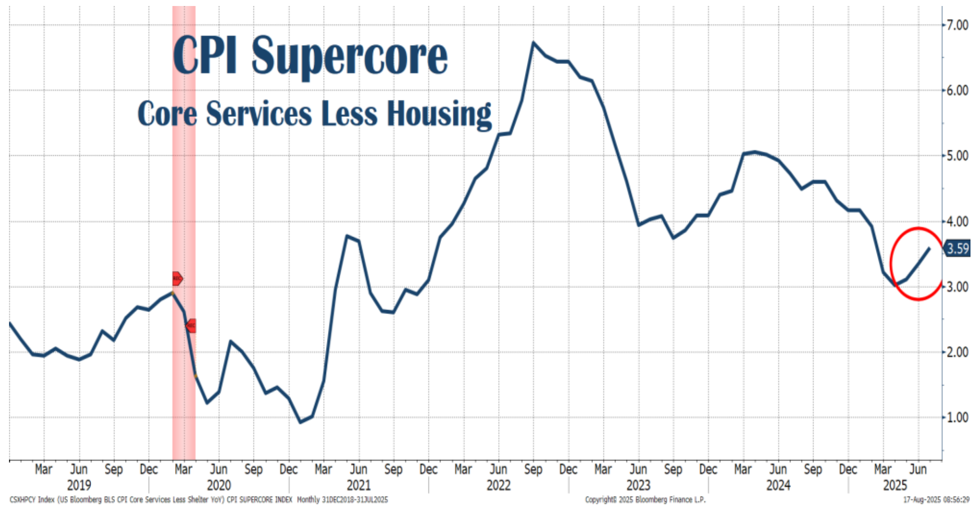
Indeed, the shocker for the second month was the re-acceleration of inflation in core services, accounting for 60% of overall CPI. Year over year, core services accelerated to 3.65%, the second month in a row of acceleration, and the second month in a row of sharp increases, and it wasn't housing costs that did it.



- Owners' Equivalent of Rent (OER) (~ 26% of the CPI) decelerated to +0.28% (+3.4% annualized) in July from June. The three-month average decelerated to +3.5% annualized. In a continuing disinflationary trend, OER rose by 4.1% year over year.
- Rent CPI (~7.5% of overall CPI) accelerated a hair to +0.26% (+3.1% annualized) in July from June. Year over year, Rent CPI rose by 3.5%, continuing the deceleration. It is now back in the range that prevailed before the pandemic.

Rents are no longer the driver of services inflation; the drivers of services inflation are now in other services. To wit: The Powell "super core" index that excludes energy services and rents (including OER) jumped by +0.5% month over month in the steepest increase since the turn of the year. The year-over-year pace hooked up to +3.3% from +3.0% in June — now at a five-month high.

Drilling down, there were too many items with outsized increases that make me a touch uncomfortable: air fares (+4.0%, ending a five-month string of declines and the biggest print since May 2022), tenants' and household insurance (+1%), delivery services (+0.9%), medical care services (+0.8% — driven principally by a record increase in dental costs), motor vehicle maintenance and repair (1%) recreation services (+0.4%) and personal care goods and services (+0.4%).



Bottom line: This was not a horrific report, but all in all, I was less than impressed. The far bigger concern is in service inflation, which is NOT tariffed and is a much bigger part of U.S. economic activity, and where roughly two-thirds of consumer spending goes.

If the Fed decides to cut rates, it is not because of disinflation but because it has shifted its attention to the weakening labor market.

THE PRESIDENT RAGES

After the CPI release, President Trump rageposted about the lack of inflation amid all the tariff fearmongering:

"Trillions of Dollars are being taken in on Tariffs, which has been incredible for our Country, its Stock Market, its General Wealth, and just about everything else. It has been proven, that even at this late stage, Tariffs have not caused Inflation, or any other problems for [the] Country, other than massive amounts of CASH pouring into our Treasury's coffers. Also, it has been shown that, for the most part, Consumers aren't even paying these Tariffs, it is mostly Companies and Governments, many of them Foreign, picking up the tabs."

Then he took direct aim at Goldman Sachs:

"But David Solomon and Goldman Sachs refuse to give credit where credit is due. They made a bad prediction a long time ago on both the Market repercussion and the Tariffs themselves, and they were wrong, just like they are wrong about so much else. I think that David should go out and get himself a new Economist or, maybe, he ought to just focus on being a DJ, and not bother running a major Financial Institution."

Just brutal!

Here is the real story. Jan Hatzius, the chief economist at Goldman, did claim that U.S. businesses have so far carried around 64 % of the costs and foreign exporters about 14%. **American consumers have absorbed 22% of the costs from tariffs through June, but that is expected to swell to 67% by year-end** if the pattern of past levies holds. By December, Goldman expects businesses' share to fall below 10% and foreign exporters' share to rise to 25%. **The bank projects the shift will lift core personal consumption expenditures (PCE) inflation to 3.2% in December versus 2.4 % without tariff effects.**

Assuming the data is "honestly" published, U.S. consumer price inflation should reflect a crescendo of tariff effects over the coming months, with the full impact visible next year. However, President Trump's nominee for Bureau of Labor Statistics Commissioner, E. J. Antoni, has suggested that data like the employment report might be suspended.

Bottom line: All that can be truly said is tariffs have not amounted to inflation yet. But most economists never expected an immediate reaction. As for "late stage," Trump delayed tariffs so many times that this is early stage, not late stage. Frontrunning tariffs were massive. Also, the irony is staggering. Trump warned the automakers, Amazon and Walmart against raising prices.

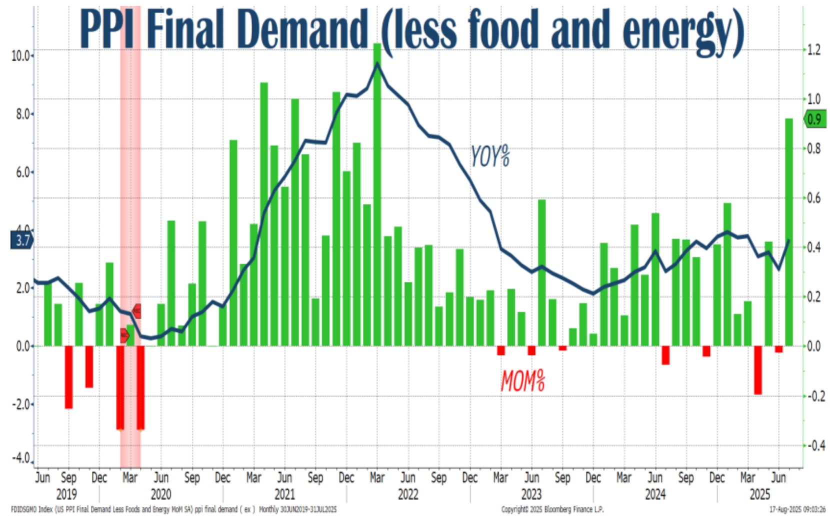
What does it say when you have to do that?

WHOPPINGLY BIG!

"Headline number is — WHOPPINGLY big! …Oh my goodness!"
— Rick Santelli, Editor, CNBC Business News Network

The Bureau of Labor Statistics (BLS) needs the new commissioner to start the job quickly because there is no way President Trump is going to like this Producer Price Index (PPI) data.

PPI reflects what companies charge other companies – not consumers. In the wake of the less than favorable CPI report, the BLS reported that the July PPI final demand (wholesale inflation) spiked by 0.94% (+11.9% annualized), the worst since March 2022, with food prices and energy prices and services surging. This was far more than the +0.2% that had been expected. In fact, it was the biggest jump since June 2022, sending year-over-year PPI up 3.3%. (The consensus was +2.5%.) These are the kinds of pandemic-distorted numbers.



So, based on the data, thus far Goldman Sachs was right after all. Businesses, for now, are bearing the tariff brunt given that the headline CPI spiked by +0.2% month over month in July, which was a fraction of the +0.9% PPI surge.

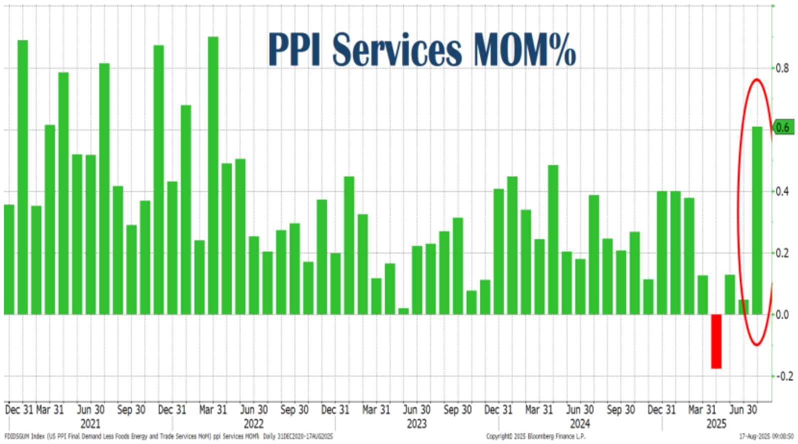
Indeed, companies have eaten the tariffs – $28 billion of them in July alone – and they paid $27 billion in June and $22 billion in May. Tariff increases are hard to pass on. In their earnings warnings and quarterly reports, consumer goods companies, such as automakers across the board and companies such as Nike, have already disclosed how much those tariffs are costing them, as they have trouble passing them on to consumers because additional price increases would cause sales to fall.

Indeed, someone must pay the tariff bill, and it is NOT the foreign exporter. The claims from the Trump Administration that foreign producers are footing the bill are blatantly false. Foreign exporters have not been cutting their prices (as U.S. import prices have not been falling and import volumes in America are declining and are down -3.1% from levels a year ago). You can have your own opinions, but you can't have your own facts.

It is also imperative to realize that most of that beloved tariff revenue filling Uncle Sam's pockets is just a huge tax on the private sector as one hand washes the other. In other words, this report is bad news for corporate margin.

Looking at the components, unlike the CPI, goods prices in the producer price report jumped by +0.7% month over month after a +0.3% increase in June — tied for the biggest increase since February 2024. Food was a big culprit (+1.4% month over month), but there was also upward movement in core durable consumer goods (+0.3% for the second month running).

Consistent with the CPI data, services were also problematic — spiking +1.1% on a month-over-month basis (+13.8% annualized!) which is the worst since March 2022 when inflation was peaking and the Fed embarked on hiking rates.



Indeed, there were aspects of the core CPI and PPI numbers that could be troubling for the Fed. It's one thing to be able to look through the tariff effect on goods prices. But it's this recent re-acceleration in service sector inflation that is a worry because this has nothing to do with trade policy.

And it was broad based: Prices for services less trade, transportation and warehousing spiked by 0.69% (8.6% annualized), while prices for transportation and warehousing services spiked by 1.01% (12.8% annualized).

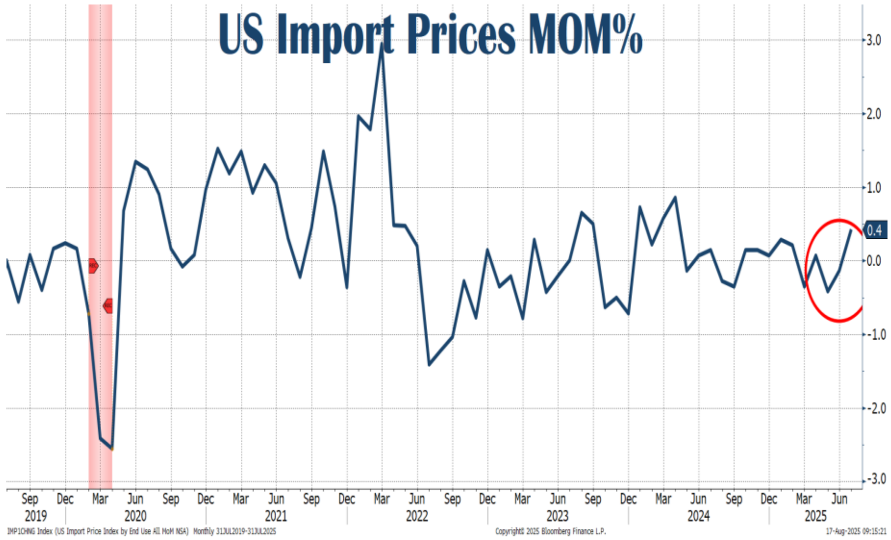
And one more thing. The PCE price index, a measure of consumer price inflation that the Fed uses for its 2% target, includes some parts of the core services PPI such as "portfolio management, securities brokerage, dealing, investment advice and related services" that also surged.

Combined with the CPI components, the PPI data suggests that the core PCE deflator is going to come in at +0.35% month over month, when the data are released on August 29. **That is equivalent to a +4.3% annual rate**. And that is not good news. That would take the year-over-year trend up to +3.0% from +2.8% in May and June. The last time we had a "three-handle" on the core PCE inflation rate was back in January 2024. The trend is not our friend.

Bottom line: It is doubtful that the bond market or the Fed hawks (the ones who are left) will like the PPI too much. Was it a blip? Or was it a lagged reaction to the tariffs which themselves are in their infancy stage since the reciprocals have only just begun?

U.S. IMPORT PRICES RISE

This final inflation report for the week should help settle the debate as to who is bearing the brunt of the tariff hikes to date, because if it were the foreign exporter, we would be seeing these numbers with negative signs in front of them, not plus signs. Hate to break that news to the president, Scott Bessent and Stephen Miran.



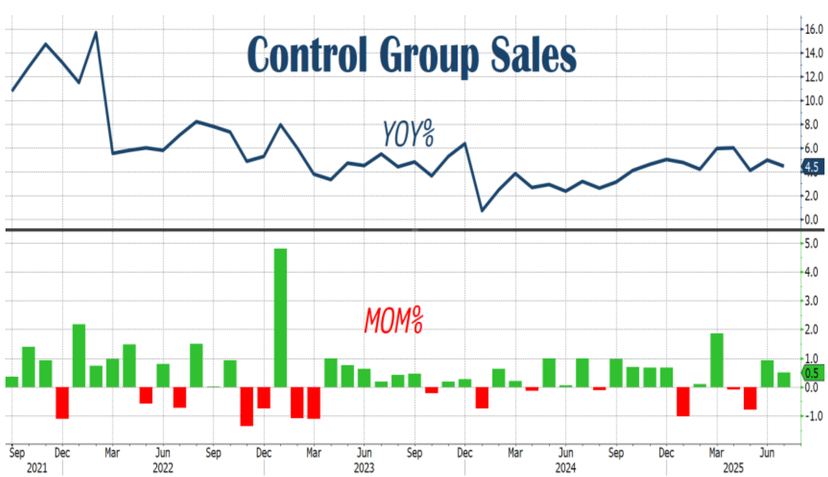
U.S. import prices leapt by +0.4% month over month sequentially in July (consensus was +0.1%), and the segment excluding oil also firmed higher by +0.3% (again, beating the +0.1% consensus estimate). The big surprise was the +0.4% reading for consumer goods excluding autos (up in three of the past four months) and tied for the highest reading since February 2024.

Bottom line: To repeat: This data point is key because it confirms that the tariff burden is being shared by businesses and consumers (up until now, it was more the former) and not exporters.

THE CONSUMER CONTINUES TO SPEND

Last Friday, the July retail sales modestly undercut expectations with a +0.5% month-over-month gain (consensus was +0.6%), and the component excluding auto/gas was also light at +0.2% (consensus was +0.3%).

But what matters the most in this release was the “retail control group” (headline excluding gas, autos, and building materials). It was solid at +0.5% (consensus was +0.4%), and there was a hefty upward revision for June to +0.8% from +0.5% initially. Dare I say a revision that won’t cost anyone at the BLS his or her job.



Not surprisingly, autos got a big boost from electric vehicle (EV) sales. The reason being that the $7,500 Biden EV subsidies expire at the end of September, so there has naturally been a wave of buying that will only trigger a deep hole in Q4 (total vehicle/parts sales jumped by +1.6% month over month after a +1.4% June run-up).

But there were solid increases in other areas.

- Furniture was up +1.4%.
- Grocery chains logged a +0.5% gain.
- Drug store sales were up +0.4%.
- Apparel retailers rose by +0.7% and have expanded now for five months in a row. (That hasn't happened since coming off the pandemic/lockdown shock in the summer of 2020.)
- Online sales posted a +0.8% month-over-month increase, close to matching May and June.
- Big Box retailers as rang up a +0.4% rebound.
- Sporting goods stores showed a pulse, via a +0.8% recovery last month.

The losers were few, but they tell a story nonetheless: Appliances/home electronics went the other way from furniture and sagged by -0.6% month over month, faltering in each of the past three months.

At the same time, building materials slumped by -1.0% and are down sharply in two of the past three months. This speaks to the lingering softness in the housing market.

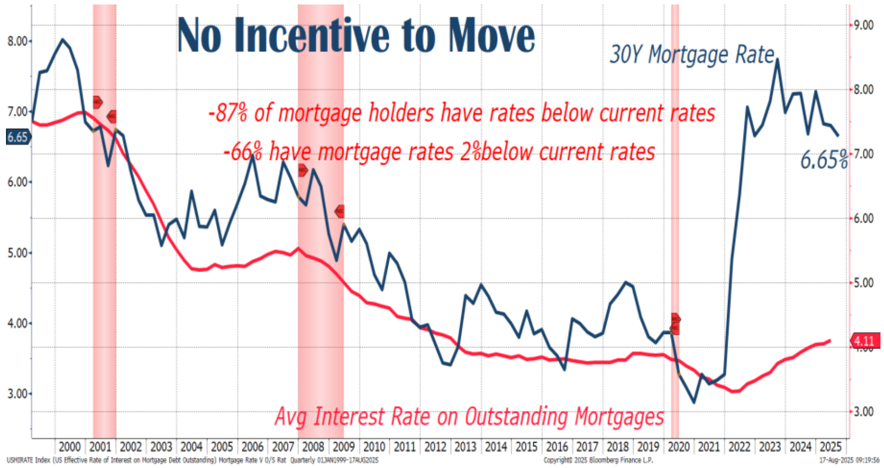
And while the food stores posted solid gains, restaurants saw a -0.4% decline and are slipping now in two of the past three months as well. So, the headline in this report looked decent, but let's face it: When "dining in is in while dining out is out" emerges as a theme, you know, beneath the veneer, that consumer frugality is rearing its head.

Bottom line: One thing is for sure, the American consumer is not exactly rolling over despite the slowing economy and sharp cooling in the pace of job creation.

A DASH OF HOPE

I have detected at least one encouraging development emerging for the U.S. economy — a potential bottoming, or possibly even a revival in the beleaguered U.S. housing market — and all courtesy of bond yields having fallen from their nearby highs (though it has not exactly been a straight-line down).

Mortgage rates have tumbled to a ten-month low of 6.65% for the 30-year fixed-rate and down -5 basis points over the past week — a dash of hope for a positive tone to the fall selling season, all the more so with a supply thaw having taken hold and home prices cooling off.



While everyone gazes at the Big Tech space, the homebuilding stocks have soared by +33% from the April lows to their highs for the year.

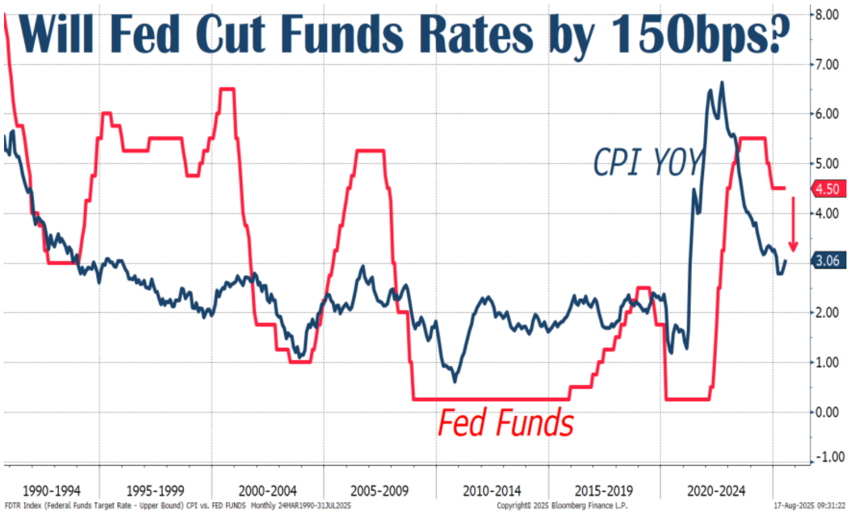
BESSENT AND TRUMP WANT LOWER RATES (STAT)

*"I think we could go into a series of rate cuts here, starting with a 50-basis point rate cut in September… "**If you look at any model…we should probably be 150, 175 basis points lower**."*
– Scott Bessent, U.S. Treasury Secretary

Despite the unsettling inflation readings in July and the high uncertainty of tariff impact going forward, Scott Bessent, the U.S. Treasury secretary, told Bloomberg news that "***if you look at any model"*** for the fed funds rate, it suggests that ***"we should probably be 150, 175 basis points lower."***

We also know that President Trump is now calling for a 300-basis point interest rate cut, immediately. This would be three TIMES larger than the 100-basis point cut on March 15, 2020, the largest in history.

This is mind blowing. With the current fed funds rate at 4.50%, Bessent and Trump want rates to be somewhere around 1.5-2.5%. Over the last 70 years, the rate has never been that low with inflation as high as it is currently (with the core reading above 3%). So apparently "any" model now shows that U.S. monetary policy has been misguided throughout that entire period and needs to be changed.

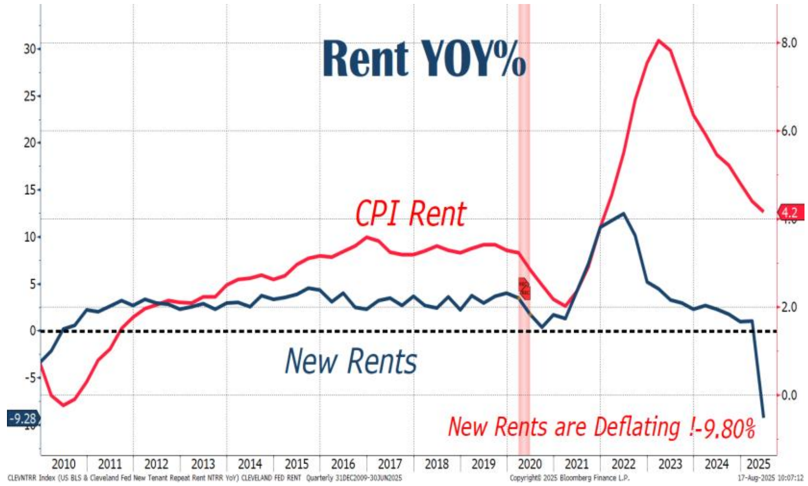


That said, I too argue that the Fed is too restrictive and the longer-term trend for inflation is lower due to shelter costs, which have been disinflating. The disinflation in shelter costs should over time offset any inflation caused by tariffs.

Side bar: Either something is really going wrong with another BLS database in the form of CPI rental rates, which are running at nearly a +4% year-over-year pace, or there is something wonky with the St. Cleveland Federal Reserve Bank because their New Tenant Rent Index just collapsed in epic form in Q2. It swung massively to a deflationary -9.8% year-over-year trend from +1% in the first quarter and +2.3% a year ago.

I'll tell you how strange this is: If the Cleveland Fed were to input their data into the CPI, the headline and the core index would be deflating outright (and by -2.3% for the core!).

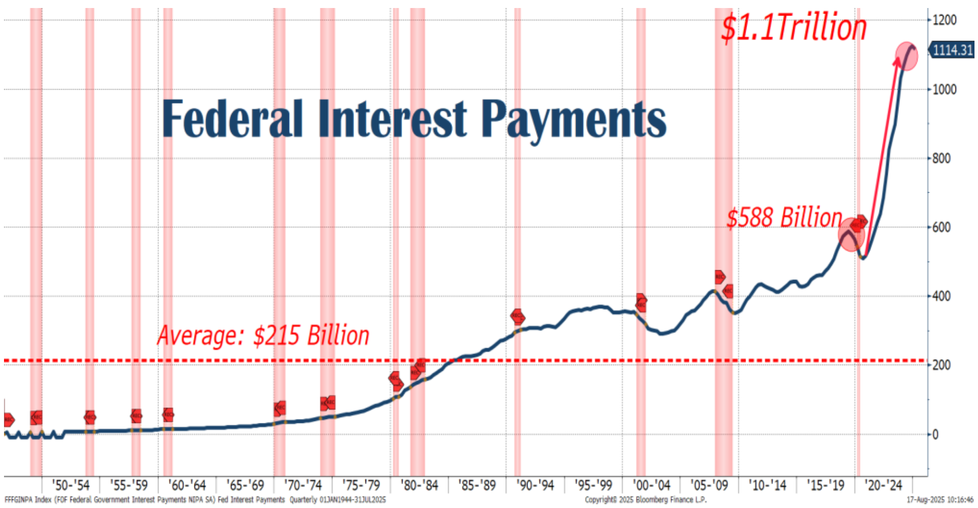
Never mind 50 basis points on September 17 – maybe Powell should go 150 (sarcasm).



That said, the core CPI and PPI numbers may end up being disturbing for the Fed. It's one thing to be able to look through the tariff effect on goods prices, but it's this recent re-acceleration in service sector inflation that is a worry, because this has nothing to do with trade policy. Meanwhile, the odds are 50-50 that we see a +0.4% print on the core PCE deflator, which would take the year-over-year trend back to 3%. Not good.

In other words, what's the rush to cut rates aggressively with so much uncertainty surrounding inflation? The most obvious answer is to bring down longer Treasury yields, which determines the cost of servicing the government's debt. Moreover, the U.S. Treasury posted a $291 billion budget deficit in July, the second-largest deficit for any July on record.

U.S. interest expense is set to exceed $3 billion PER DAY. Without rate cuts, interest will skyrocket, adding more pressure. Trump's new Fed chair will clearly be cutting rates. But tariffs are adding to inflation, and the Fed would be cutting into hot inflation data.



Here's the thing: All else equal, lower overnight rates from the Fed mean lower longer-term yields. But the Fed doesn't control the long end. There have been many other incidents when Treasuries refused to follow the lead that the Fed set for them.

To wit: When the Fed cut rates by 50 basis points in September 2024, the 10-year Treasury yield bottomed that year. Concern over inflation and the probability of Donald Trump winning the election, the 10-year Treasury note yield rose from 3.6% to 4.4% between September and early November 2024.

Bottom line: We already knew that Bessent and Trump want lower interest rates and more control over them. Fed independence has long been contested, and other presidents have kicked against it, but since the end of the gold standard in 1971, an independent Fed has been central to maintaining the dollar as the linchpin of the global economy. This is a dangerous game.

Further, the drawback of allowing the Treasury Department to control both fiscal and monetary policy is that it can then coordinate them to rhyme with the political cycle. Even so, it's mad for a government to behave like this six months into a four-year term. The likely outcome would be a short-term boom, and a serious bust in time for the next election in 2028.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

Our economy is booming."— President Donald Trump, August 12, 2025

Well, from my lens, real gross domestic product growth so far this year has averaged out to ~1.25% at an annual rate, one of the worst first-half economic performances in recorded history. I'm thinking we may have to redefine the definition of a "boom."

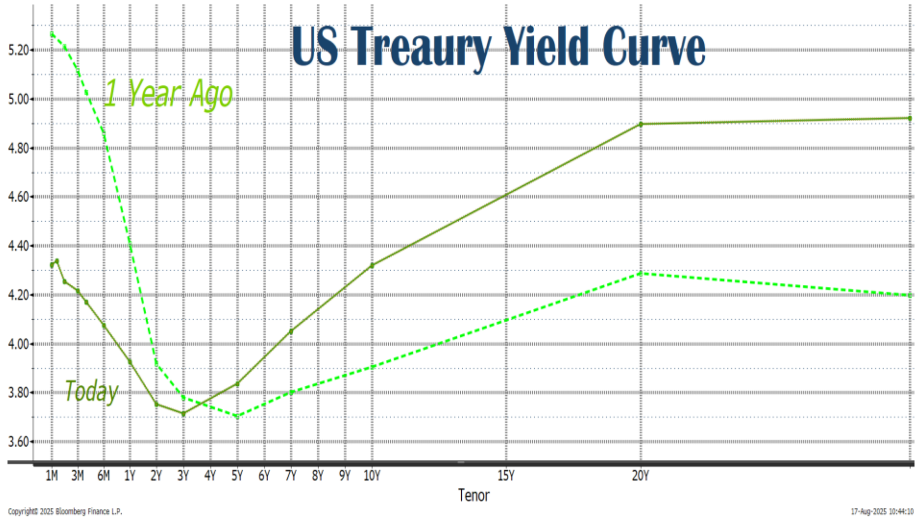
At the same time, the labor markets have clearly weakened. Meanwhile, we haven't even seen the full brunt of the tariff effect on profit margins and real consumer spending power. That is still to come because the "reciprocal" tariffs were largely delayed until August 7.

That all said, the question has shifted from IF the Fed will cut rates. It is now, HOW MANY rate cuts will we get?

Despite the higher inflation readings last week, there is still an 84% chance of a rate cut in September 2025. The odds of three cuts this year have declined, but there is still a 50% probability of this scenario depending on the incoming data.

Moreover, Fed Chair Powell's term will end in May 2026, and the new Fed chair announcement is coming soon. Markets will begin trading off what the new Fed chair guides over Fed Chair Powell. This is clearing a path for Trump to get rate cuts, even as inflation re-accelerates. If so, we are about to witness history.

I should note that the Federal Reserve can drive the bond market action, but a premature easing by the Fed could be "rejected" by the bond market if investors feel it is imprudent, and the longer end of the curve sells off. As shown below, the yield curve has steepened materially over the past. Yields at the front end of the curve (one month to three years) have plunged while longer term yields have risen. The overall policy landscape, coupled with political interference in central bank decision-making, has raised the likelihood of a continuation of a steeper yield curve as we move forward.



From a portfolio perspective, credit unions should be positioned for a reduction in the fed funds rate in September and a steepening of the yield curve. Given the policy landscape the best risk-return tradeoff lies in the intermediate part of the yield curve.

WHY SUBSCRIBE TO THE WRV?

There is a lot of noise in the financial world and social media about the markets and the economy. I do what I always do, block out the noise, rhetoric and bullish biases (that point to the rewards without discussing the risks) that dominate Wall Street research and, most of all, try to keep investors out of trouble. This constant analysis goes through the noise, debunks misleading headlines and makes deep dives into the financial markets and economic reality. Call me a "permabear" if you will, but I see myself more as the car mechanic who fixes your brake lights and makes sure your side-view mirrors are okay. Risks should never be ignored, and I focus on identifying them. It's what makes the *Weekly Relative Value (WRV)* unique in the marketplace. By subscribing, you will always be up to date with the most relevant economic and market trends, and most importantly, you will be aware of the key risks. To receive future issues of WRV in your inbox, subscribe here.

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For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at **tom.slefinger@alloyacorp.org** or (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.