Progress on inflation stalled in July, as prices nudged up

After more than a year of steady declines, inflation is likely to tick up again. But economists say this is just a temporary blip.

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Inflation pressures continue to ebb through most of the U.S. economy last month, although a rebound in airline, hotel and energy costs led to the first rise in overall consumer prices in over a year.

Prices rose 3.2 percent in July from a year ago — outpacing June's inflation rate of 3 percent and marking the first increase after 12 months of steady declines, according to data released Thursday by the Bureau of Labor Statistics. On a monthly basis, prices ticked up 0.2 percent between June and July.

But economists say the bump is linked to temporary factors — including rebounding airline, hotel and energy prices — that are not likely to erode longer-term progress. The overall number was also higher because prices are being compared to the rates of increase last July, the first month when inflation began to fall after a long climb. Overall inflation has come down sharply from last summer's peak of 9.1 percent.

"In the grand scheme, we're still seeing disinflation and things are moving in the right direction," said Pooja Sriram, U.S. economist at Barclays. "If you look past the volatile categories, underlying momentum hasn't changed."

The Federal Reserve has been aggressively cranking up interest rates in hopes of slowing the economy enough to control inflation. It has raised borrowing costs 11 times since last year, pushing rates to their highest level in decades, which has tempered the housing market and helped cool hiring. Even so, the economy has remained surprisingly resilient: Unemployment is low, wages are rising, and families and businesses continue to spend.

As a result, many economists have scrapped their recession forecasts for the year in favor of a rosier outlook, including the possibility that the Fed can bring down inflation without widespread job losses or a broader economic downturn.

"The easy work in bringing inflation rates down is complete," Tom Garretson, senior portfolio strategist for RBC Wealth Management, wrote in a note this week. "Further progress will continue, but at a slower pace."

Still, the fight against rising prices isn't a done deal. "Core" inflation — a closely watched measure that excludes housing and energy costs, which tend to fluctuate more than other sectors — remains stubbornly elevated.

And although the Fed appears to be approaching the end of its rate-hiking effort, economists say higher inflation could complicate the picture. The central bank won't set new interest rates until its September meeting, by which point another month's worth of inflation figures will have been released.

"Given the weakness we've seen in some economic data of late, I think any re-acceleration in inflation would change the narrative around what the Fed is going to do," said Liz Ann Sonders, chief investment strategist at Charles Schwab. "The market is basically betting that the Fed has paused. But if you start to develop hotter inflation or something that's not a continuation of the disinflationary trend, that's not a great recipe."

What's important, economists say, is not just whether inflation is coming down, but exactly how it is doing so. They are keeping a close watch on whether recent declines in rental costs — which are used as a stand-in for housing prices, and operate on a delay — will begin to push down official inflation readings.

Policymakers also paying particular attention to hikes in the costs of services outside of energy and housing, a measure that Fed Chair Jerome H. Powell has highlighted as closely linked to the path of wages and the labor market.

For now, economists say the summer's biggest swings have come from travel-related spending — including on flights and lodging — and energy costs. Brent crude oil prices, for example, are up 17 percent since June, while average gas prices have risen 7 percent to $3.83 per gallon, AAA data shows.

But some of those costs are likely to stabilize in coming months, as demand tapers off. Americans have recently begun pulling back on dining out, flying and sporting events as they work through extra pandemic-era savings. Delinquencies on mortgages and car loans are edging up, and consumers are sitting on a record $1 trillion in credit card debt, according to data released this week by the New York Fed.

Hotels in particular are likely to feel the pinch in coming months, especially as the busy summer season winds down, said Christopher Henry, chief executive of Majestic Hospitality, a Los Angeles-based consulting firm. Many are considering lowering their nightly prices after realizing "they got way too unrealistic in revving up their rates," he said.

Hotels have been "driving up rates because they can — and certainly during July, they were trying to capitalize on summer vacations," Henry said. "But people are reining in their spending. There isn't never-ending demand anymore. Hotels and airlines are going to have to be more realistic, and that means you're going to start seeing prices cool off."

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