US inflation in July

United States

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Edgar González
edgar.gonzalez@hrratings.com
Economic Analysis and Sovereign Debt Senior Associate

Ricardo Gallegos
ricardo.gallegos@hrratings.com
Deputy Chief Economic Analysis Officer

Felix Boni
felix.boni@hrratings.com
Chief Credit and Economic Analysis Officer

July CPI comes in line, reinforcing case for a September Fed hold

Largely in line with expectations, U.S. consumer inflation was weak in July rising a mere 0.1% vs. June which comes after a sharp 0.42% drop in June. Annual headline inflation fell to 3.30% from 3.46% in July. For its part, core inflation fell to 2.47% from 2.57% in June. This, combined with the weak employment report, significantly reduces the pressure on the Fed to raise rates, at least through the next meeting in September. In contrast, there appears to have been less progress in the costs related to food and apparel. Given the overall good news HR Ratings anticipates that the modest inflation recorded in July, aligning with the consensus, alongside a weaker employment report, will lead the Federal Reserve to maintain its reference rates at 3.5%-3.75% during the forthcoming September meeting. Nevertheless, a hike in rates late this year is still possible as inflation continues to exceed the objective.

According to the Bureau of Labor Statistics, the seasonally adjusted Consumer Price Index (CPI) had a 3.3% rise over the previous twelve months, ending in July, after a 3.46% increase in June, as shown in Figure 1.

Figure 1. CPI Inflation Evolution

Inflation During:	June-26		July-26		Annualized 3MMA		
	Monthly	Annual	Monthly	Annual	May-26	Jun-26	Jul-26
Headline	**-0.42%**	**3.46%**	**0.07%**	**3.30%**	**6.95%**	**6.07%**	**3.77%**
Core	**-0.02%**	**2.57%**	**0.22%**	**2.47%**	**3.08%**	**2.88%**	**2.36%**
Services less Energy	-0.03%	3.16%	0.08%	3.01%	5.20%	4.75%	3.62%
Services less Rent	-0.18%	3.15%	0.19%	2.99%	4.40%	4.11%	3.50%
Rent of Shelter	0.13%	3.24%	0.14%	3.15%	4.15%	4.71%	3.99%
Non Durable Goods	-1.53%	5.96%	-0.29%	5.61%	17.87%	15.16%	7.55%
Durable Goods	-0.02%	-0.18%	0.31%	-0.17%	-2.25%	-1.25%	-0.29%
Food	0.21%	2.99%	0.08%	2.94%	2.85%	3.26%	2.64%
Energy	-5.71%	15.45%	-1.48%	14.45%	75.48%	57.22%	23.11%
Gasoline	-9.69%	26.72%	-2.86%	24.64%	167.66%	115.44%	41.12%

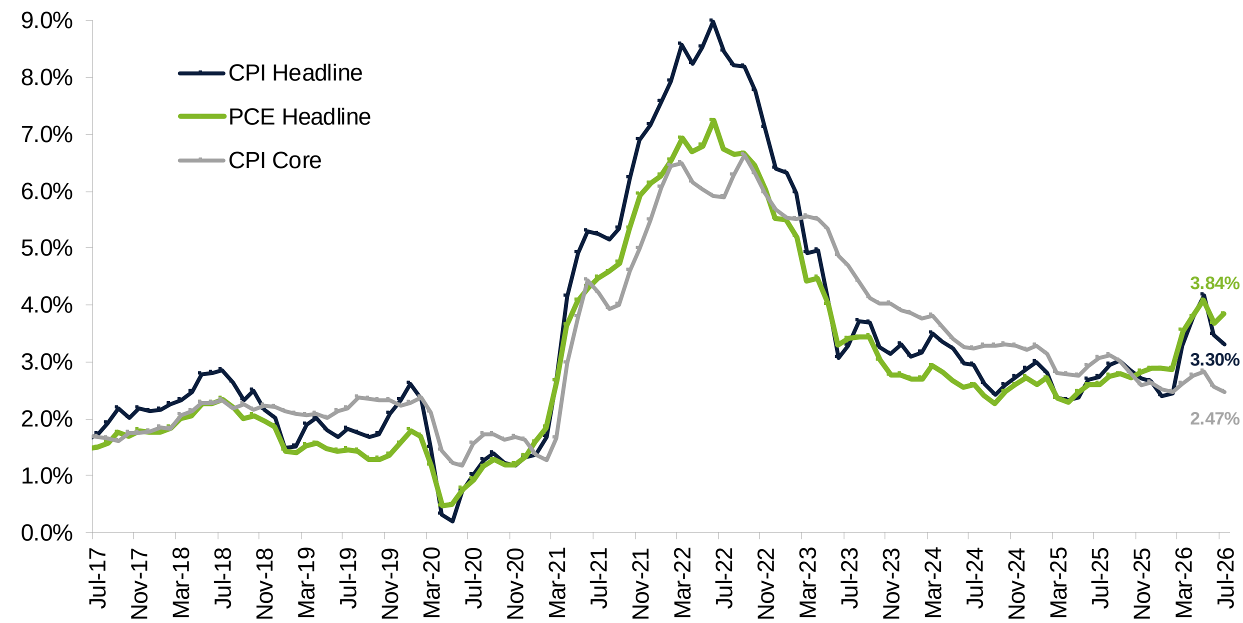
Source: HR Ratings with seasonally adjusted information from the U.S. Bureau of Labor Statistics, retreived from FRED.

The primary catalyst for this year's inflation is the increase in energy costs, since the conflict with Iran appears to be ongoing. The overall energy index decreased by 1.5% month-on-month (m/m) subsequent to a 5.7% reduction in June. Despite this, it has increased by 14.45% during the last twelve months. Gasoline prices experienced a reduction of 2.9% in comparison to June. In

July, the average price of regular gasoline in the U.S. was US$4.06 per gallon, a decrease from US$4.18 in June and a peak of US$4.609 in May.

Excluding volatile food and energy categories, the CPI experienced a 0.22% rise in July, having remained unchanged in the month before. Core CPI had a 2.5% annual increase, in contrast to the 2.6% recorded in June. This includes increases in medical care, airlines fares, transportation, education, and recreation. In Figure 2 we show the 12 month annual evolution of headline CPI along with its core component and to provide more context we also present the evolution of the PCE.

Figure 2. Annual CPI



Source: HR Ratings Retrieved from FRED. Data are seasonally adjusted and calculated on a monthly

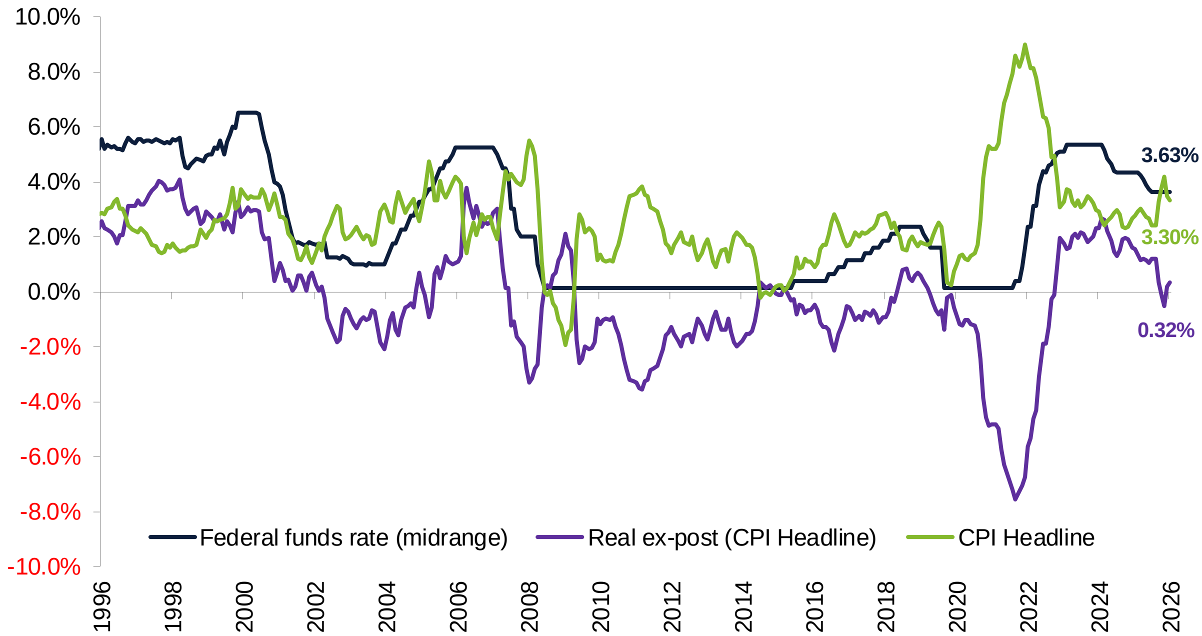
A small 0.1% increase in housing expenses, representing approximately two-thirds of the overall monthly gain in the Consumer Price Index, as reported by the U.S. Bureau of Labor Statistics. Rental prices for primary residences increased by 0.3% month-to-month and by 2.9% over the last year. The equivalent rent for owners increased by 0.3% month-over-month and 3.2% year-over-year. The cost of hotel and motel accommodations in the United States decreased by 3.3% in July on a month-to-month basis, attributed to the conclusion of the FIFA World Cup, which contributed to curbing total housing inflation.

In summary, the data from July indicates that inflationary pressures persist at somewhat elevated levels throughout the U.S. economy. Despite certain sectors like energy costs (gasoline) and non-durable goods showing signs of decline, inflation in services persists, challenging the Federal Reserve's objective of achieving a 2.0% inflation rate. As illustrated in Figure 3, the ex-post real interest rate reached 0.32%, lower than their historical average (1.0%). Data from the Federal Open Market Committee (FOMC) reveals that the Fed estimates an implied neutral real rate of 1.1%, based on long-term expectations for federal funds at 3.1% and a CPI target of 2.0%[1]. Nonetheless, the headline Consumer Price Index is presently elevated due to a temporary energy surge, which the Federal Reserve typically ignores, making core inflation the more pertinent metric. According to the core CPI data, the

[1]Link to the economic projections of Federal Reserve Board https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20260617.pdf

actual rate stands at 1.1%, in line with the historical levels. This is consistent with the Fed's decision to maintain interest rates in September.

Figure 3. Federal Funds Rates in Nominal and Real Terms



Source: HR Ratings and historic information from the Fderal Reseve retrieved from FRED.

Media Contact

comunicaciones@hrratings.com