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CENTRAL BANKS COMMENTARY

Pro Take: Pieces Come Together in Fed's Inflation Fight, but Big Ifs Remain

Curbing housing-price growth is key in the central bank's effort to achieve 2% inflation

Fed policy makers will meet to determine the next interest-rate step in September.

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By Bob Fernandez

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The U.S. economy has two months to show that inflation has cooled enough for the central bank to be able to avoid raising interest rates in September after 11 increases since early last year. On Friday, Federal Reserve policy makers got a bit of good news.

The government's personal-consumption expenditures price index, the Fed's preferred inflation measure, rose 3% in June from a year earlier, down from 3.8% the prior month. The Fed's inflation target is 2%.

This is the sort of headline report that Fed Chair Jerome Powell is looking for. "We see the pieces coming together," he said Wednesday when announcing the Fed was raising interest rates by a quarter of a percentage point, to a range between 5.25% and 5.5%.

Powell pointed to a decline in the consumer-price index and a mildly softening labor market. The nation's job gains have moderated in recent months. In May, the number of job openings decreased in 15 states and was little changed in the other 35, also an indication of softening. The largest drops in job openings occurred in Florida (-63,000), Pennsylvania (-54,000) and Colorado (-47,000), according to the latest government data. The number of job openings nationally decreased by almost a half million.

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Fed policy makers aren't scheduled to meet in August and will reconvene to determine the next interest-rate step Sept. 19-20. During the break, they will have a torrent of new economic data to consider. The Fed has said it is strongly committed to bringing inflation down to its 2% target.

Rajeev Dhawan, the director of economic forecasting at Georgia State University, said it is too early to tell if the inflation fight is really being won. The saying among economists, he said, is that one month of data could be an aberration, two months could be a coincidence and three months would be a trend.

Two more CPI reports are due before the September Fed meeting, and headline readings of 3% or lower could indicate a lasting trend. The most recent CPI number, for June, came in at 3%.

Meanwhile, economists and Fed policy makers are looking at what could go wrong.

Powell said he didn't believe Russia's bombing of Ukraine's ports would lead to higher food inflation in the U.S.

Healthcare inflation, as measured in the CPI, has moderated, though J.P. Morgan economists warned it could kick up later this summer or fall.

Housing and shelter costs still have to come down and they are expected to do so, though perhaps not by September. Shelter, a big component of the CPI, registered at 7.8% in June on a seasonally adjusted basis, far above the Fed's 2% inflation target.

"The shelter inflation component of CPI should continue a gradual decline as rent growth slows," said Robert Dietz, chief economist at the National Association of Home Builders. A historically large number of new apartments is in the pipeline—about one million. When those apartments become available, it "will result in more competition in the rental market," and thus, Dietz and other analysts believe, lower rents. Experts have noted a lag in moderating rents appearing in the government data.

"Some of the discussion about housing heating up as an inflation risk have cause and effect reversed," Dietz said. "The additional activity in housing is home construction rallying off cycle lows. And more housing supply is anti-inflationary."

But a booming stock market could trigger higher consumer spending and push inflation higher.

Finishing the job can be the hardest part of a project. The same could be said for the Fed. It may be facing the last mile to reach the 2% finish line, but it could be a long last mile.

"Inflation is sticky on the way down," Dhawan said.

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