



Higher 'core' inflation reading unlikely to knock Fed off course for rate cut in September

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A fresh reading on the Federal Reserve's inflation gauge inched up again, but it isn't likely to knock the central bank off course to cut rates in September.

"Today's in-line PCE Price Index will keep the focus on the jobs market. For now, the odds still favor a September cut," said Ellen Zentner, chief economic strategist for Morgan Stanley Wealth Management. "But the size of that opening is going to depend on whether labor-market weakness continues to look like a bigger risk than rising inflation."

The Personal Consumption Expenditures index on a "core" basis, which excludes volatile food and energy prices, rose 2.9% from a year earlier, up from 2.8% in the previous month and the highest since February. On a monthly basis, core prices increased 0.3% for the second month in a row.

On a headline basis, prices rose 2.6% in July compared with a year ago, matching the increase in June. Month over month, prices rose 0.2% from June to July, down from 0.3% the previous month.

(The S&P 500 stock index has been trading down about 0.70% since the morning release of the inflation data.)

At the same time, the report showed that consumer spending picked up last month.

While Fed officials are keenly watching how much tariffs push up inflation, the rise in "core" prices in July was due to a rise in services prices. "That's further evidence that tariffs are having minimal impact on goods prices," said Harry Chambers, assistant economist for Capital Economics.

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Chambers noted that the breakdown showed that core goods prices were unchanged on the month. Instead, the rise was driven solely by a 0.36% month-over-month rise in core services prices, which was expected given the strength of services CPI.

While inflation is not moving in the direction the Fed wants to see, Fed Chair Jerome Powell said in a speech in Jackson Hole, Wyo., last week that a reasonable base case is that inflation from tariffs will likely result in a one-time increase in prices — and that the balance of risks appears to be shifting.

Powell indicated there is concern about the direction of the strength of the job market given the lower payroll report for July and large downward revisions to job growth in previous months. He also noted that there's been a marked slowing in both the supply of and demand for workers, suggesting that downside risks to employment are rising.

“If those risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment,” said Powell.

It may very well be that the next jobs report, due out on Sept. 5, for the month of August could be the determining factor for lowering rates at the September policy meeting.



A rate cut soon? Federal Reserve Chairman Jerome Powell. Powell recently spoke at the annual Jackson Hole Economic Symposium. (Photo by Natalie Behring/Getty Images) · Natalie Behring via Getty Images

Fed governor Chris Waller argued again Thursday night for a 25 basis point rate cut at the September policy meeting, saying that downside risks to the labor market have increased further since he last called for a rate cut in July.

“While I believe we should have cut in July, I am still hopeful that easing monetary policy at our next meeting can keep the labor market from deteriorating while returning inflation to the FOMC’s goal of 2%. So, let’s get on with it,” he said in a speech in Miami.

Waller reiterated large downward revisions for May and June and soft payroll growth for July are cause for concern about the strength of the job market. He said he believes that the data is likely to indicate that employment actually shrank over those three months. Waller also said that the softening in demand for labor is occurring at the same time as a decline in labor supply, noting any decrease in supply is masking lower demand for labor.

Waller dissented at the last policy meeting, preferring to cut by 25 basis points instead of holding rates steady. Waller noted in his speech that “was the right call.”

He also noted that he does not believe a larger cut than 25 basis points is needed at this time, but that could change depending on whether the jobs report for August, due out Sept. 5, shows further weakening.

"There are another two important inflation reports before next month's meeting — PPI and CPI on 9/10-9/11 — but as long as those reports don't show a huge spike in inflation, the Fed will be almost guaranteed to cut interest rates by 0.25% on September 17," said Chris Zaccarelli, chief investment officer for Northlight Asset Management.

Jennifer Schonberger is a veteran financial journalist covering markets, the economy, and investing. At Yahoo Finance she covers the Federal Reserve, Congress, the White House, the Treasury, the SEC, the economy, cryptocurrencies, and the intersection of Washington policy with finance.