

## Softer US inflation just a blip

US inflation ticked modestly higher in April to 2.5%YoY. Service sector inflation could be a growing issue...



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**2.5%** Headline inflation has only been higher once in the past six years

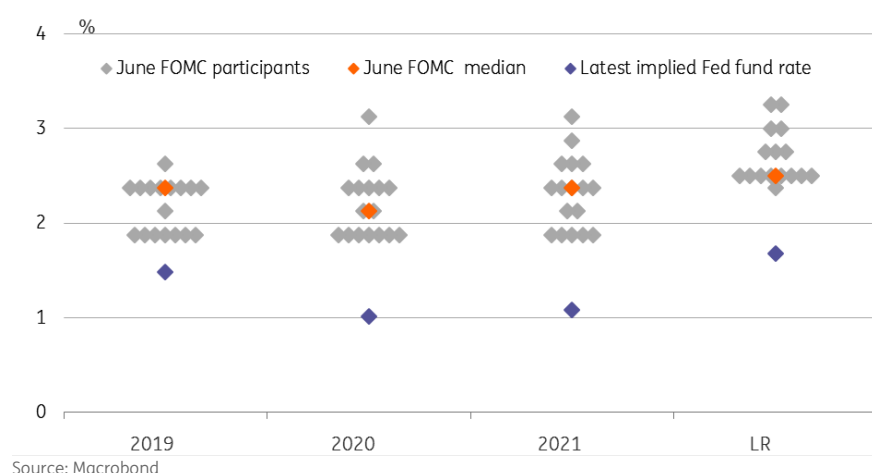
Headline US inflation rose 0.2% and core was up 0.1% month-on-month in April, both a tenth of a percentage point below market expectations. The main reason for the "miss" was autos, with new car prices down 0.5% and used prices down 1.6%MoM. Airfare prices were also weaker, falling 2.7%MoM. We would expect all three to recover next month given the healthy state of the economy with flight prices possibly impacted by holiday timings.

Nonetheless, the annual inflation rate ticked higher to stand at 2.5% - it has only been higher once in the past six years - while excluding food and energy, the core rate remained 2.1% YoY. Both are above the Federal Reserve's 2% target. Out of all the main inflation measures, only the core PCE deflator is below 2% right now (1.9%), but is almost certain to imminently break above 2%YoY.

We see further upward price pressures developing and predict CPI approaching 3%YoY and core CPI rising to 2.5% by summer as energy prices, unwinding of mobile cell phone data plan charge effects and rising import prices feed through. We also see rising price pressures from services, driven by higher employment costs. For sure, average earnings are not particularly worrying at 2.6%YoY, but the broader ECI series is accelerating and the NFIB's worker compensation series has only been higher once in its 34-year history.

As such, we think the market consensus forecast for CPI this year is too low and that in an environment of robust economic activity fuelled by tax cuts and a tight jobs market there is the risk of a market re-appraisal. We look for three further interest rate rises from the Fed this year, running at one every quarter, with US 10Y Treasury yields moving up to a 3.25-3.50% range in 2H18.

## US inflation measures



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