Sticky US inflation increases pressure on the Fed

Cost push and demand pull inflation show little sign of fading as cracks form in the Fed's "transitory" narrative. Housing costs, low inventories and rising energy prices will keep inflation higher for longer and with inflation expectations accelerating the case for earlier and swifter Fed corrective policy is growing

5.4% Annual US headline CPI

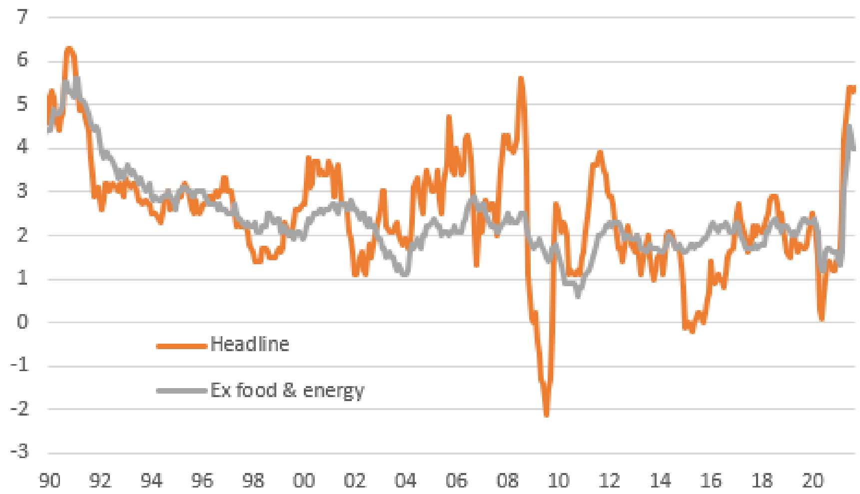
Stubborn inflation not going away

US CPI rose a tenth more than expected to 0.4% month-on-month/5.4% year-on-year while core came in-line with the consensus prediction at 0.2%/4.0%. The larger headline figure was caused by energy prices rising 1.3% MoM and food gaining 0.9% MoM.

Gasoline prices have accelerated through the first half of October, suggesting more upside from this component next month and it will feed through into higher transportations costs too. We also have to be braced for sharply higher wholesale natural gas prices translating into higher utility bills.

Within core apparel prices fell 1.1% and used cars and trucks fell 0.7% while medical care was flat and airline fares fell sharply again. While these are positive developments we don't see them as being sustainable. Used car auction prices are on the rise again given the lack of new vehicles to buy caused by chip shortages while retail inventories are at all-time lows so the need for seasonal discounts ahead of the key shopping season is simply not there.

Annual inflation rates



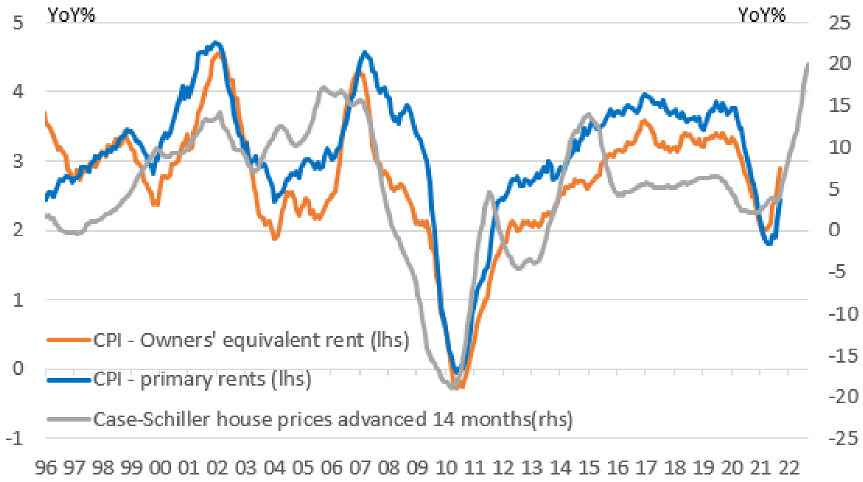
Source: Macrobond, ING

Housing costs intensify inflation risks

Another key reason why we think inflation will stay higher for longer is housing costs. Primary rents and owners' equivalent rent account for a third of the CPI basket with movements in these components tending to lag 12-18 months below house price changes. The chart below suggests that housing components of inflation are now the story to watch year and could add nearly a full percentage point to annual inflation on their own.

Putting this altogether it means we think headline inflation stays above 5% through 1Q 2022 with core inflation above 3.5% through 2Q 2022. This hardly fits the "transitory" narrative put out by many at the Fed.

Housing costs and house prices (YoY%)



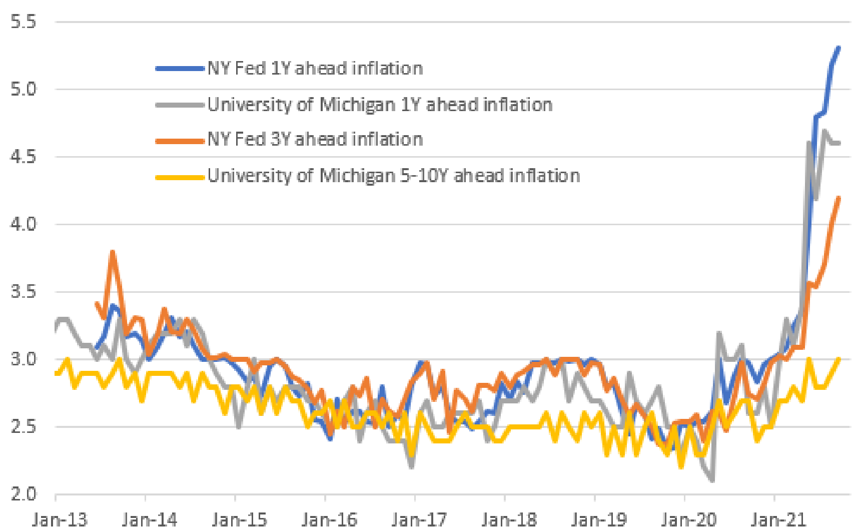
Source: Macrobond, ING

Not so transitory now

The Federal Reserve continues to assert that "longer term inflation expectations remain well anchored at 2 percent", but there is growing discontent with this assessment – most notably from Atlanta Fed President Raphael Bostic. They can just about get away with it when talking about market inflation expectations. Using Treasury Inflation-Protected Securities, the breakeven rate 5 years out is 2.65% and 10Y it is 2.5%.

However, consumer inflation expectations are looking much less anchored. The Federal Reserve's own survey (conducted nationally by the NY Fed), shows 1Y ahead inflation consumer expectations rising to 5.3% – not really surprising as it tends to track actual inflation. However, the 3Y ahead inflation expectations rose to a new all-time high of 4.2%. We wouldn't be surprised to see the University of Michigan 5-10Y ahead expectations break-up toward 3.5% in the next few months.

Inflation expectations are surging



Source: Macrobond, ING

We are already predicting earlier and swifter policy action from the Fed than the market – QE taper to end in 2Q 2022 with rate hikes in September and December next year. An acceleration in these inflation expectations would bring that time-line even further forward.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

Disclaimer