US inflation won’t sway the Fed

Inflation is above the Federal Reserve's 2% target, and with growth looking strong and a robust jobs market there is a very strong case for a December interest rate rise

2.5%

US consumer price inflation

Annual rate

Core US inflation likely to start grinding higher

US consumer price inflation for October has come in broadly within expectations. Headline prices rose 0.3%MoM, which leaves the annual rate of inflation at 2.5% versus 2.3% in September. The core rate, which excludes volatile food and energy components posted a 0.2%MoM increase, leaving the annual rate at 2.1% - down slightly from 2.2% in September.

The main stories in the report were that energy (+2.4%MoM) was the biggest contributor, but this should reverse next month given steep falls in the price of oil and gasoline. Transportation prices rose on the back of higher fuel costs too while housing rose 0.3%MoM and tobacco prices were up 1.3%. However, food was soft, falling 0.1% and there were falls in recreation and education &

communication as well.

We see headline inflation being depressed in the near term by energy price developments, but core inflation is likely to continue grinding higher in coming months – we expect it to peak at around 2.5%YoY in the early part of next year. Price pressures will continue to strengthen thanks to strong growth and a lack of spare capacity. Additionally, wages are rising and this is a huge cost input given the US is largely service sector economy while the probability of higher trade tariffs next year will add further upside pressure.

Fed hikes to slow in 2019

This inflation release will not alter the outlook for the December FOMC meeting where we expect another 25bp rate rise. After all, the economy continues to grow strongly for now and all the key inflation measures the Federal Reserve focus on are at or above the 2% target. We expect the one hike per quarter pace to continue next year through to 3Q19, but expect this to likely mark the peak.

The economy is facing a growing number of headwinds including the lagged effects of previous interest rate rises and dollar strength, the uncertainty of trade protectionism at a time when external demand is slowing and a sense that the support from the fiscal stimulus will gradually fade. The main risk to the upside likely stems from the tight jobs market and whether wages can continue rising, but on balance we look for economic growth to slow through 2019 and this should see inflation pressures gradually recede late next year.

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