US: Inflation gives the Fed room to act

US consumer price inflation undershot expectations in September. With the growth outlook deteriorating the Fed has the flexibility to offer more "insurance" rate cuts

The Great Mall, San Francisco

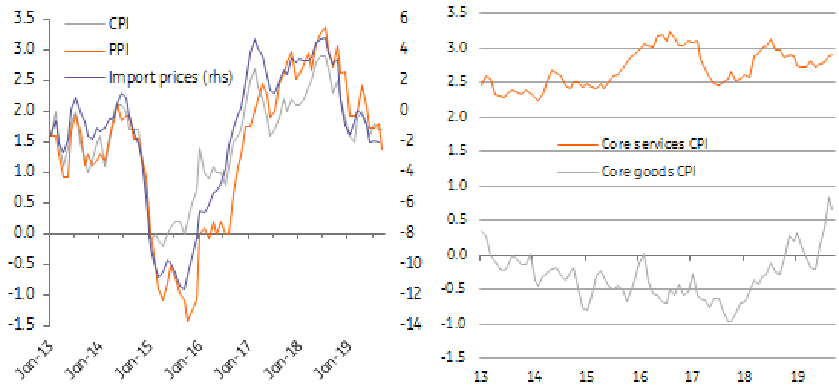
Inflation concerns ease

US headline inflation was flat on the month versus expectations of a 0.1% month on month gain, which leaves the annual rate of inflation at 1.7%.

Meanwhile core inflation, which strips out volatile food and energy products and services, also undershot. It rose 0.1%MoM - the weakest rise for four months, leaving the annual rate of core CPI at 2.4%. This is important because there had been some concern that inflation pressures were starting to build following three consecutive 0.3%MoM increases. If the pick-up had continued it could have been perceived as a constraint on potential future Fed stimulus.

Looking at the details energy was a drag given the declines in gasoline prices, but there was also a big fall in used car prices (-1.6%MoM) and apparel prices fell 0.4% - the first decline since April. Medical care costs also showed a slower rate of inflation, but the shelter component remains firm, rising 0.3%.

Tariff hikes felt in goods prices, but pipeline price pressures look to be easing

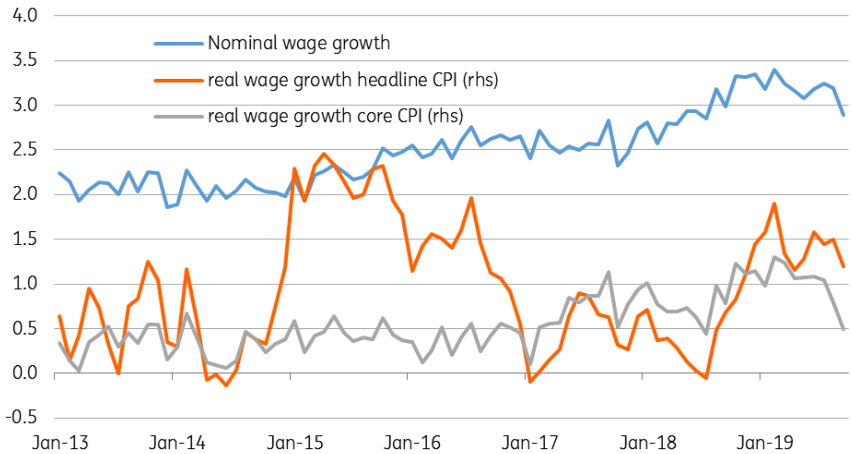


Source: Macrobond, ING

A focus on growth

There continues to be evidence to suggest that tariff hikes are putting upward pressure on consumer prices, given the marked pick-up in goods price inflation in recent months. However, inflation is a lagging indicator and service sector inflation doesn't show a broader threat. With PPI and wage growth slowing we may already be seeing a moderation in pipeline price pressures that results in the Fed retaining a relaxed attitude to inflation, especially given the weakness in forward-looking activity survey such as NFIB and ISM. Moreover, with real wage growth softening the outlook for consumer spending may also be a little less rosy.

Real wage growth no longer accelerating



Source: Macrobond, ING

Between now and October 30

Looking at the data flow between now and the October 30 FOMC meeting, we have to say the odds of a third rate cut from the Fed are likely to increase.

Next week's retail sales will have positives from autos, but gasoline will be a drag and chain store sales have been softer. Industrial production will fall, led by manufacturing, given employment in the sector fell and the ISM production component is firmly in the contraction territory. Housing data may be supported by falling mortgage rates, but the declines in consumer confidence suggest this may not last.

Other than that it is durable goods orders, which is already pointing to a contraction in investment spending in Q4 and then we have 3Q GDP the day of the Fed meeting – we are forecasting 2% growth with the Atlanta Fed Nowcast currently at 1.8%. The last Fed official scheduled to speak are Charles Evans and John Williams on October 17th, but by that point, we suspect a 25bp cut will be virtually certain in the market's mind versus the 76% (19bp) currently priced.

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