Expect three more Fed hikes this year as core inflation hits target

Having warned for some time that lower inflation will prove a temporary phenomenon, the Fed will breathe a small sigh of relief as core CPI moves back above target.

Source: iStockphoto

The big news from today's CPI data is that core inflation is now back above target at 2.1%. As has been telegraphed for quite some time, this is largely because a distortion related to cell phone data pricing has now dropped out the annual comparison.

Odd as it may sound, a quality adjustment conducted in March last year, to reflect the rise of unlimited mobile data contracts, resulted in a sharp one-off fall in communication costs. This quirk has been knocking 0.2-0.3ppt off most core inflation measures ever since.

Headline inflation picked up to 2.4% for the same reason, although was held back partly by an unseasonal fall in energy costs. And having skyrocketed since the start of the year, apparel costs fell slightly in March, helping to keep a lid on overall CPI.

> With the weaker dollar likely to drive prices higher over coming months (particularly as

firms have the pricing power to pass these costs on in this strong economic environment), we think core inflation will continue edging higher this year. And with skill shortages intensifying in the jobs market, we'd expect wage growth to gradually rise too.

We think this makes it all the more likely that the Fed will hike three more times this year, although policymakers will also be watching closely to see how the recent trade escalations play out over the next few weeks.

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