Rising core inflation supports a December hike

A pick-up in core inflation and solid retail sales suggest investors may still be too cautious about the rate hike outlook for the next year

Source: iStockphoto

1.8% Core CPI (YoY%)

Better than expected

Falling core inflation has seen markets remain fairly cautious on the outlook for interest rates through much of this year. However, the latest data for October saw core CPI expectedly rise to 1.8% year-on-year, providing some tentative evidence that inflation may be finally starting to turn a corner. Headline CPI dipped back slightly to 2% as gasoline prices re-adjust following the hurricanes a couple of months ago.

This rise in core CPI tallies with the latest above-consensus producer-price inflation data released yesterday, which saw core PPI hit a five-year high of 2.4%. Given the weaker dollar and higher energy prices, we are optimistic that inflationary pressures will continue to build as we head into next year. Likewise, we also expect wage growth to continue gradually picking up in 2018.

There was some equally good news from today's retail sales data. The headline rate of growth was held back somewhat by falling gasoline prices. But 0.3% month-on-month growth in the control group, which excludes volatile items suggest that consumers started the fourth quarter on a solid footing. This is one reason why we are looking for another near - 3% GDP growth reading this quarter.

All of this argues in favour of a December rate hike, but markets are still sceptical that we will get much more than one hike during next year. However, with the Fed broadening out the reasons for tightening policy - with references to loose financial conditions and rich asset valuations - we suspect investors are too cautious. There is also the annual rotation of regional Federal Reserve voters, which will see two hawks (Williams and Mester) take over the votes of two doves (Kashkari and Evans) in 2018. We still expect two hikes next year.

Author

James Smith
Developed Markets Economist, UK
james.smith@ing.com