US data backs the case for December hike

Inflation pressures are grinding higher and domestic activity is strong, suggesting the main barrier to a higher Fed funds rate is political rather than economic

Source: iStockphoto

2.3% US annual headline inflation rate

The US CPI report shows inflation pressures are rising, but this is primarily an energy story reflecting higher oil prices and refinery shutdowns relating to Hurricane Harvey. At the headline level, it rose 0.5% month on month/2.2% year on year (a tenth of a percentage point below what was expected). Energy prices rose 6.1%MoM, but excluding food and energy inflationary pressures were more muted, rising just 0.1%MoM/1.7%YoY (again a tenth of a percentage point below expectations).

In terms of core inflationary pressures, we are starting to see a bit more upward movement in the housing component, but medical care, apparel and education prices are very soft. Nonetheless, with the economy growing quite strongly, the jobs market looking tight with wage growth starting to show some signs of life we would expect inflation rates to creep higher. Certainly, PPI is pushing upwards, and the lagged effects of the weaker dollar may also add some upside impetus.

> *We expect the positive story to continue into next week with industrial production rebounding following storm disruption.*

September retail sales have also been released and are strong, rising 1.6%MoM with small upward revisions to August's data. Hurricane effects are visible – higher gasoline prices boosted gasoline station sales 5.8%MoM while the fact unit car sales rose to a 12 year high helped boost the value of sales with a 3.6%MoM rise.

Strength can also be seen in other components, and it is likely that there was some uplift as households start to replace lost items following the recent hurricanes. This has come on top of what is already a strong story for the consumer with employment, wages and confidence all looking healthy.

We expect the positive story to continue into next week with industrial production rebounding following storm disruption. After all, the ISM manufacturing index is at a 13-year-high, the dollar is making exports more competitive, and we see stronger global growth.

With overall economic growth looking good, inflation pressures gradually increasing and the Fed's worries about asset valuations and financial stability becoming more prominent in speeches a December rate hike is looking likely. The main risk remains the potential for an economically market destabilising government shutdown.

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