US data casts more doubt over Fed hike strategy

Softer inflation and retail sales data means markets will remain sceptical about Fed's plans to hike four times before 2018 ends

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The annual rate of headline inflation is now at its lowest since October last year and will add to market doubts about the Fed's rate hiking strategy. Energy prices were largely to blame, with a 1.6% month-on-month fall reflecting lower gasoline prices resulting from oil prices falls. There was also a fourth consecutive monthly fall in apparel prices, and tobacco, transportation and recreation also declined.

Janet Yellen had been suggesting that inflation was subdued because of "transitory" factors. However, this week's testimony added the caveat that given inflation has been consistently below target for much of this year, "there could be more going on there". Financial markets took this as a signal that the Fed may be wavering on their forecast that interest rates will be hiked by 25bp on four occasions over the next 18 months and today's figures are likely to intensify this debate.

1.6%

Headline CPI (YoY%)

Previously 1.9%

Worse than expected

This came alongside disappointing retail sales data, albeit offset somewhat by a two-tenths percentage point upward revision to May. This will put a small dent in 2Q GDP forecasts, although we still expect growth to come in around the 3% region.

-0.2%

Retail sales (MoM%)

Previously -0.1%

Worse than expected

> The market is pricing in just one and a half hikes (40bp or so). We still look for three – one more this year along with a formal start to balance sheet reduction with two more hikes in 2018. Our reasoning is that inflation is likely be back above 2% in Q4 while GDP, while GDP has rebounded. With the Fed also citing "easier" financial conditions as a factor that could facilitate higher interest rates and "somewhat rich" asset prices they seem to be broadening out the factors that will help them justify action.

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