

Economics Group

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Core Inflation Comes Back to Earth, But Trend Still Firm

The CPI was unchanged in September, and core prices, up 0.1%, cooled from their blistering pace the prior three months. While the trend in inflation has firmed recently, it remains sufficiently tame for the Fed.

Core Inflation Settles Down

Inflation eased up in September, with prices unchanged over the month. A 2.4% drop in gasoline prices held down the headline. We expect the drag to dissipate next month, following the jump in gas prices after outages at a major Saudi Arabian facility, and for gasoline to be a more neutral force in October as oil prices have come down more recently.

Almost offsetting the drag from energy prices was a 0.1% increase in the larger food category. Grocery store prices remain under pressure and were flat in September, but prices for food-away-from-home rose 0.3% and costs for eating out continue to underpin food inflation.

After the strongest three-month run in 13 years, core CPI settled down in September. Excluding food and energy, prices rose 0.1% (0.13% before rounding). The more modest reading was to be expected after exaggerated gains the prior few months. Used car prices (down 1.6%) were among the categories due for some payback and now are starting to look more aligned with auction prices. Apparel prices also fell in September after three consecutive months of gains, while prescription drugs and new cars also contributed to the 0.3% drop in core goods prices.

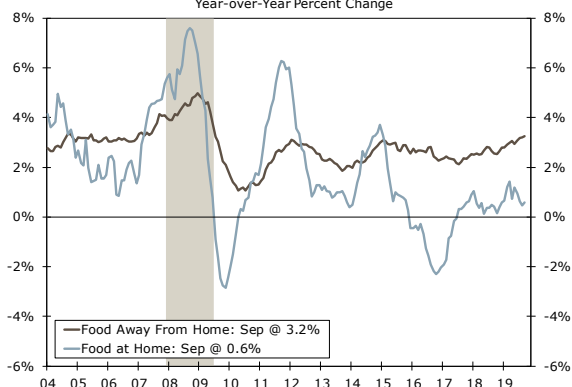
Core services inflation, on the other hand, continues at a steady rate. Ex-food and energy, service prices were up 0.3% on the back of a rebound in shelter prices—both primary residences and lodging away from home. Medical care services prices and airfares also saw sizeable gains, up 0.4% and 0.8% respectively, although that marked a slowdown from the prior two months for each category. On a 12-month basis, core CPI remains up 2.4% versus 2.2% this time last year.

Inflation Trend Still Firm, But Case Now Harder for FOMC Hawks

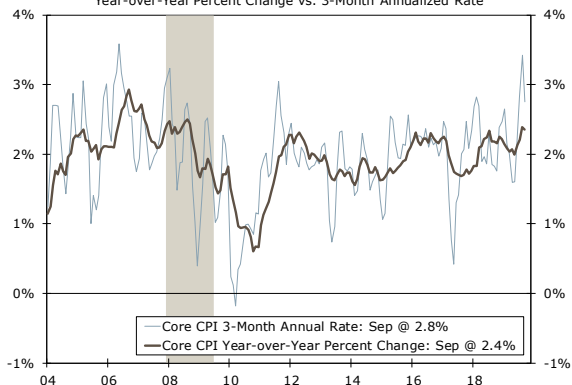
Although the core trend has firmed in recent months, inflation is still running below levels that are likely to threaten the FOMC's easing bias. Committee members have heavily emphasized the symmetric nature of the inflation target. With the core PCE deflator running below the FOMC's 2% target for all but 11 months of the 10+ year expansion and inflation expectations at the low end of historical ranges, concerns about inflation remain skewed toward it running too cool, not too hot. Moreover, the dimmer prospects for U.S. growth under the light of a weak global economy and the trade war are expected to weigh on inflation in the coming months and offset the temporary boost from tariffs.

On balance, the softer September print in core CPI weakens FOMC hawks' case for holding off on further rate cuts as it shows inflation is not about to break meaningfully above the Fed's target. We continue to look for the FOMC to cut rates again in the fourth quarter, most likely as early as this month, as growth slows and significant downside risks to the outlook linger.

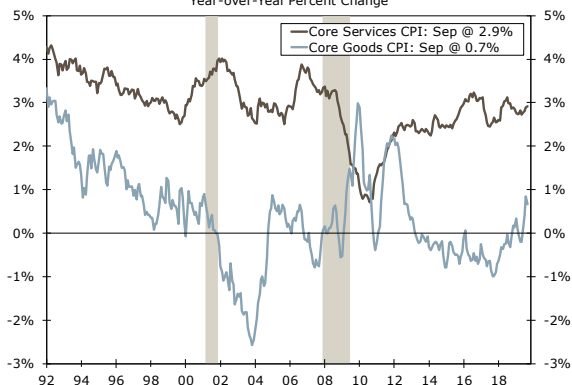
Food - At Home vs. Away from Home
Year-over-Year Percent Change



U.S. Core Consumer Price Index
Year-over-Year Percent Change vs. 3-Month Annualized Rate



U.S. Core CPI - Services vs. Goods
Year-over-Year Percent Change



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