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Economics Group

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Core Inflation Eases in October

The CPI rose 0.4% in October, but the boost from gasoline prices masks the underlying easing in core inflation. The October CPI report is unlikely to materially change the Fed's near-term outlook.

Headline Masks Cooling in Underlying Inflation

Headline inflation was up 0.4% in October, marking the largest one-month gain in eight months. But, the headline was boosted by a 3.7% pop in gasoline prices. Stripping out the volatile food and energy components, however, core CPI was up a more modest 0.2% in October.

Core prices are now up 2.3% over the past year and are rising 2.2% on a three-month annualized basis. This marks a significant slowdown from the 3.4% annualized pace just a couple months ago.

There appear few signs of price pressure stemming from tariffs. Despite the 15% tariff on roughly $111 billion of imports from China that went into effect in September, overall core goods prices fell in October, the first month we might expect to see a boost from tariffs. Prices of apparel and household furnishings, which became exposed to tariffs in September, actually declined over the month. By our calculation, the lift to annual headline inflation coming from tariffed categories was only about 0.04 percentage points.

Overall core goods prices declined 0.1%, despite an uptick in used car prices (+1.3%), which look to have moved back in line with auction prices. Medical care commodities, up 1.2%, also added to core goods inflation.

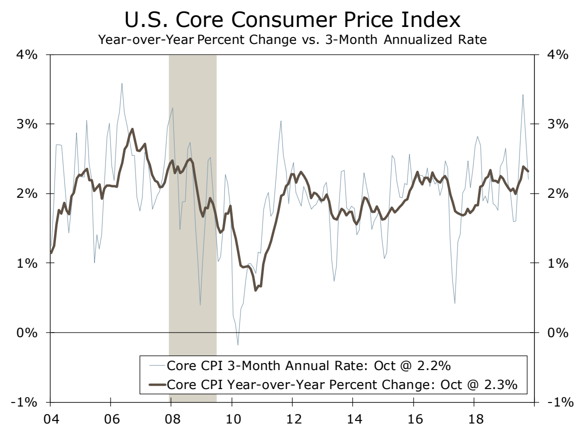
Core services prices therefore continue to underpin overall inflation, though the gains here were also weak in October. Shelter prices rose a modest 0.1%, held back by a weak print for rents. In fact, rent saw the smallest one-month gain since 2013, which is hard to square with the low vacancy data for rental units. Airfare prices also weighed on core services inflation, declining 0.4%. But, given the run-up in airfare prices in recent months a pull-back here is not too surprising.

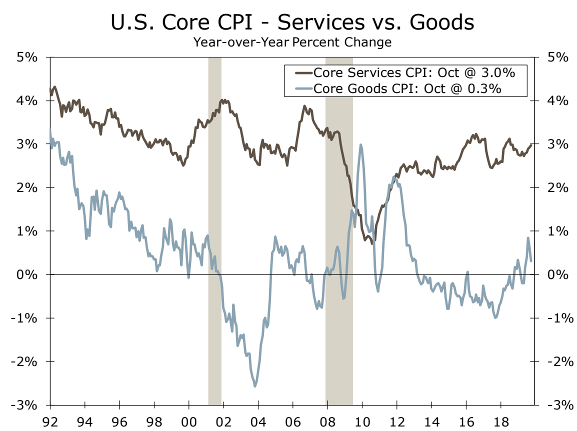
October Inflation Unlikely to Materially Change the Fed's Outlook

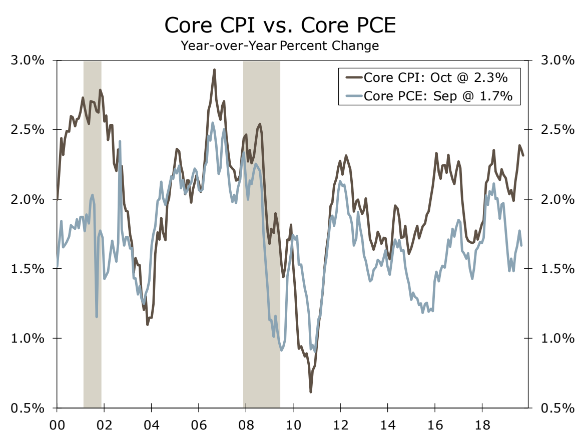
October's ease in core inflation suggests the underlying trend, while running in line with the Fed's target in recent months, is still not running at levels that would materially change its outlook. Powell expressed a "wait-and-see" approach to policy after the FOMC October policy meeting and this report doesn't appear to alter its current views.

The PCE deflator—the Fed's preferred inflation gauge—trended to 2% in 2018, but has fallen back since. In fact, this measure has run below the FOMC's target for all but 11 months of this 10+ year expansion. Given the undershoot in PCE inflation, we suspect policymakers' concerns about inflation still remain skewed toward it running too cool rather than too hot, and, barring a material resolution to trade policy, we expect the Fed will cut rates another 25 bps in the first quarter of next year.

While we expect the trend in inflation to firm, dimmer prospects for U.S. growth amid the ongoing trade war will likely prevent inflation from breaking meaningfully above the Fed's target in the near-term.







Source: U.S. Department of Labor, U.S. Department of Commerce and Wells Fargo Securities

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