

Renewed Acceleration in Inflation Complicates the US Interest Rate Outlook



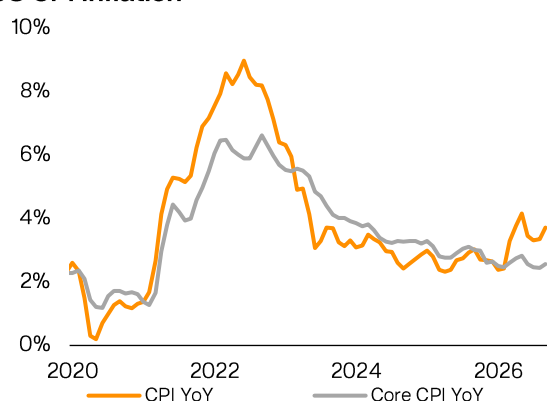
Summary:

- Driven by a surge in gasoline prices, headline CPI rose 0.6% MoM in September, lifting annual inflation to 3.7% YoY from 3.4%.
- Core CPI increased 0.3% MoM (2.6% YoY), a sign that price pressures may have begun to spread beyond energy.
- With labour market conditions softening and inflation re-accelerating, the Fed is set to face an increasingly complex policy backdrop.

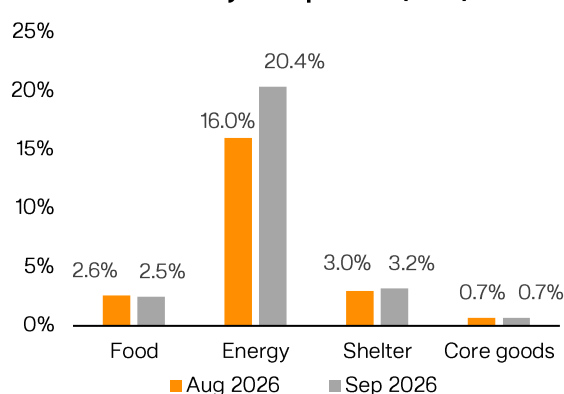
September's CPI report showed a renewed acceleration in inflation. Headline CPI inflation increased by 0.6% month-on-month (MoM) in September, compared with 0.4% in August, lifting the annual rate to 3.7% year-on-year (YoY) from 3.4%. Core CPI inflation (which excludes volatile food and energy prices) increased by 0.3% MoM in September, the same pace as in August, while the annual rate accelerated to 2.6% from 2.4%. The headline figure was broadly in line with expectations, but core inflation was stronger than anticipated, indicating that underlying price pressures remained persistent.

Energy prices were again the main driver of the headline CPI increase. The energy index surged by 5.2% MoM after rising 2.1% in August, representing a 20.4% YoY increase. Gasoline prices surged by 9.1% MoM in September, accounting for more than half of the monthly rise in CPI inflation, while fuel oil prices soared by 15.3% MoM. Meanwhile, energy services prices edged up 0.1% MoM, as a 0.2% rise in electricity prices more than offset a 0.3% MoM drop in natural gas prices. These movements reflected continued supply-side pressures in energy markets associated with geopolitical tensions in the Middle East. In contrast to energy, the food index remained unchanged in September, following a modest 0.1% increase in August. Grocery prices declined by 0.1%, helped by lower prices for beef, dairy products, and eggs, although some categories, including fruits and vegetables, recorded higher price gains.

Within core inflation, price pressures broadened across goods and services. Shelter costs rose 0.4% MoM after a 0.3% gain in August, equating to a 3.2% YoY gain. Airline fares rose by 1.2% MoM, slower than August's 2.7% increase, but were still up 22.4% YoY as higher jet fuel costs were passed on to travellers. Used cars and trucks recorded a 0.7% increase, and prices for medical care services rose by 0.3% after declining by 0.2% in August. Core services prices rose by 0.4%, while core goods prices increased by 0.3% in September, with both accelerating from August. While core CPI inflation is not running particularly hot at 2.6% YoY, these developments are significant because a renewed pickup across a wide range of core items raises the risk that higher inflation could become more entrenched.

US CPI Inflation


Source: Bloomberg

US CPI Inflation by Component (YoY)


Source: Bloomberg

The latest CPI report introduces a difficult policy backdrop for the Federal Reserve (Fed). With headline inflation rising and core inflation exceeding expectations, policymakers may be compelled to consider further interest-rate increases. Following its release, the report triggered a wave of risk-off sentiment across global financial markets. Futures-implied odds of an October hike rose sharply initially, before easing as Fed officials emphasised that further hikes might be needed but not urgently. At present, market pricing suggests that the Fed is more likely to hold rates steady in October, with one more hike still widely anticipated by year-end. Upcoming CPI and PCE releases will help determine whether September's increase represents a temporary shock or the beginning of a more sustained period of renewed inflation. Going forward, the sustainability of energy-price increases, trends in housing and service costs, and developments in the labour market will be key factors shaping the Fed's interest rate outlook.

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