US September CPI inflation shows inflation pressures continuing

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The US September inflation data showed inflation continuing to moderate on a year-on-year basis, but there are signals that inflation could be stabilizing at higher levels, which complicates the Fed's decision making process. Year-on-year inflation was 2.4% in September, down from 2.5% in August, but above the consensus estimates of 2.3%. Core CPI (ex. food and energy) actually increased slightly to 3.3% from 3.2% the previous month and is at the highest level since May. On a month-on-month basis, CPI was expected to moderate to 0.1% from 0.2% but remained steady at 0.2%. And Core CPI was expected to moderate to 0.2% from 0.3% but remained steady at 0.3%. This makes two months in a row where Core CPI is at 0.3% and suggests there are plenty of lingering inflation pressures in the economy.

Sticky inflation and strong employment market complicates the Fed's outlook

The stronger than expected CPI inflation, combined with the much stronger than expected employment data for September (unemployment rate dropping to 4.1% from 4.2% and 254k jobs created) shows that the Fed will not be in a hurry to cut rates aggressively, despite starting off its rate cutting cycle with a 0.50% cut at its September meeting. Indeed, the sticky inflation and strong jobs market, despite Fed rates still at high levels (4.75%-5.0%) calls into question the Fed's outlook for 0.50% in further rate cuts this year and then a further 1.0% in cuts in 2025. While we expect the Fed to cut rates by 0.25% at both its November and December meetings, bringing the Fed rate to 4.25%-4.5% by the end of this year, we would not be surprised if the Fed were to slow down or even pause its rate cuts at some point in 2025 if inflation remained at elevated levels.

Treasury yields could rise further on higher inflation

After the Fed meeting on September 18, market implied pricing was calling for more aggressive rate cuts than the Fed's own outlook. But after the strong jobs and CPI data for September, market pricing is now inline with Fed expectations. During this time, the 2-year Treasury yield increased from 3.6% to 3.95% and the 10-year Treasury yield increased from 3.65% to near 4.1%. We believe Treasury yields, especially the longer-term ones may rise somewhat further as financial markets start to incorporate higher inflation risks.

Economic data for next Fed meeting will be impacted by the 2 hurricanes

The next Fed meeting is on November 7, which is just after the US elections. Before then, there will be PCE inflation data released for September as well as another employment report for October (released November 1). However, the October employment data is likely to be highly skewed due to the impact of both Hurricane Helene and Hurricane Milton. We have already seen indications of this as the Weekly Initial Jobless Claims data released at the same time as the CPI data showed a sharp jump in unemployment claims to 258k from 225k the previous week. However, we believe most, if not all of this was due to the impact of Hurricane Helene as there were sharp jumps in claims from states hit by the hurricane including Florida, Georgia, Tennessee, South Carolina, Kentucky, and especially North Carolina.

Some highlights from the CPI inflation report:

- Overall inflation was 2.4% YoY and 0.2% MoM vs expectations of 2.3% and 0.1%. Core CPI was 3.3% YoY and 0.3% MoM vs expectations of 3.2% and 0.2%.

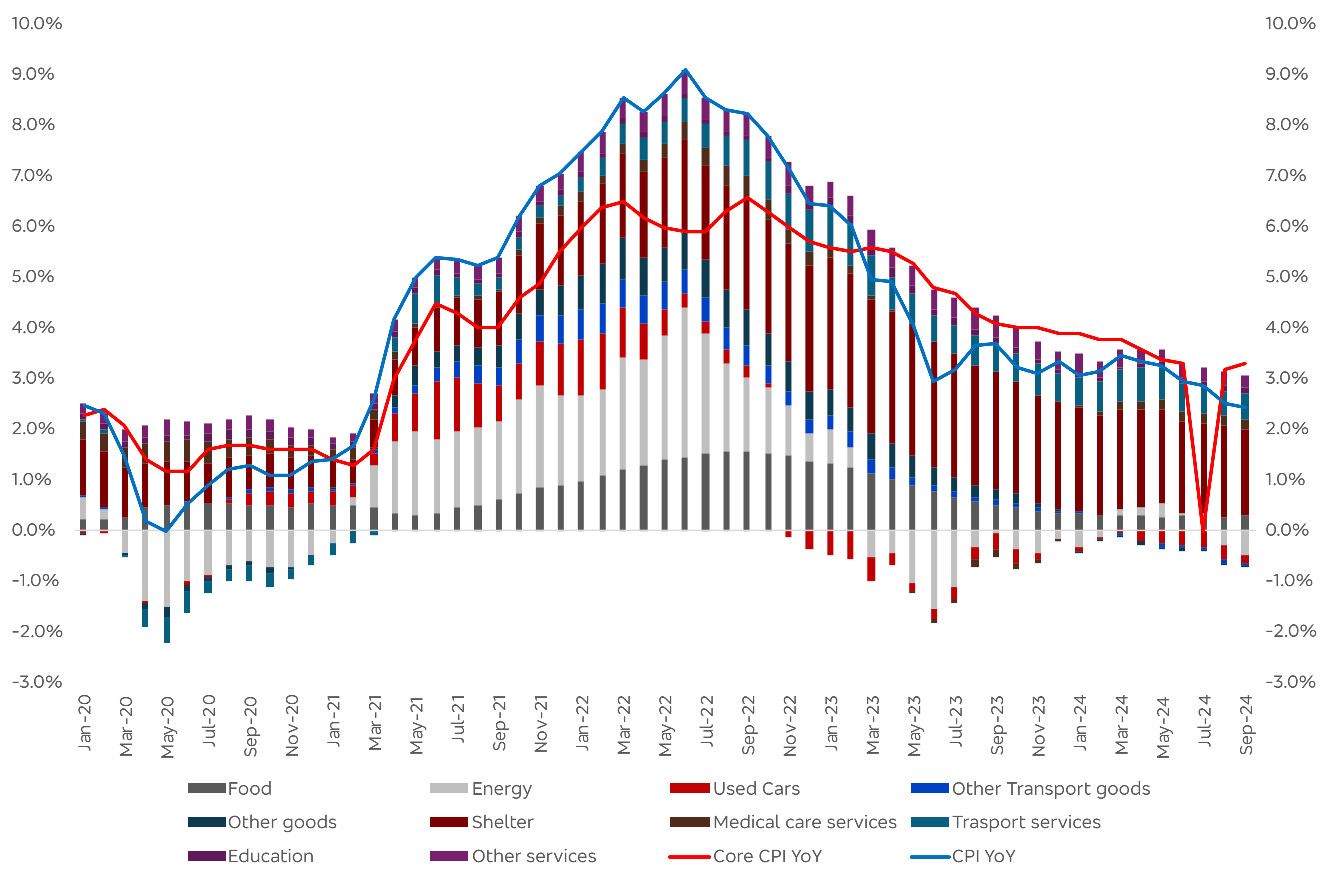
- Food inflation increased slightly to 2.3% YoY from 2.1% as the monthly inflation accelerated to 0.4% MoM. The prices for eggs have been rising sharply in the past few months as they were up 8.4% MoM and 40% YoY.

- Energy was -1.9% MoM and -6.8% YoY, helping to keep overall inflation down (and which is why Core inflation is higher). However, after reaching lows for the year in September, crude oil prices have jumped higher in October due to the continuing conflicts in the Middle East and this could mean somewhat higher inflation going forward.

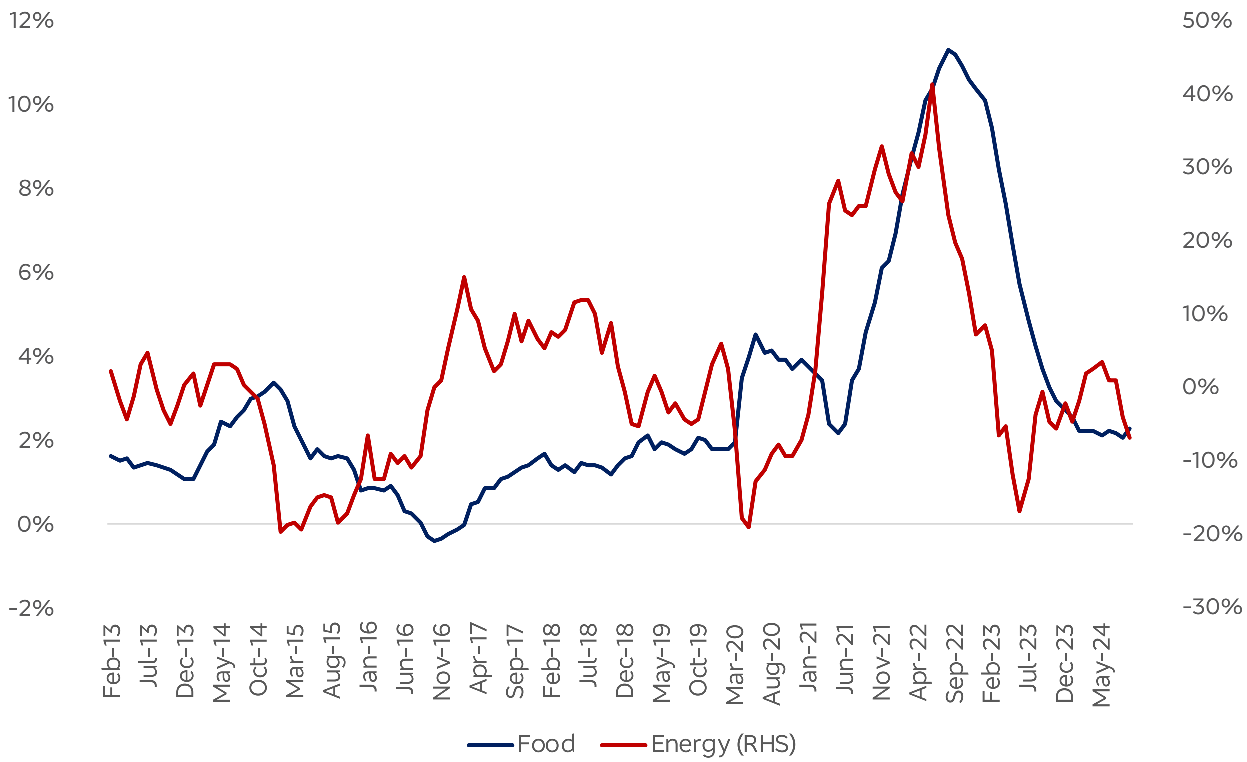
- Shelter has been one of the main components holding overall inflation higher but this is slowly moderating. Annual Shelter inflation fell to 4.9%, the lowest level since early 2022. On a monthly basis, Shelter fell to 0.2% from 0.5% the previous month.

- Used Car deflation was one area that was helping bring inflation down over much of the past 2 years. However, used car pricing may be nearing a bottom as prices actually increased by 0.3% month-on-month in September. As well, auto insurance is still a strong driver of inflation as it increased 1.2% MoM and 16% Yoy.

CPI inflation reached 2.4% while Core CPI increased to 3.3%



Food inflation increased slightly to 2.3% while Energy at -6.8%



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