

US Watch

September CPI Inflation: Choppy waters

A reminder that there is still more wood to chop

The September Consumer Price Index (CPI) was firmer than we expected and a reminder that there is still more work to do to get inflation under control. Headline CPI rose by 0.4% m/m (0.40% unrounded). Consensus expectations were for a 0.3% m/m print. As a result, the y/y held steady at 3.7% m/m. Core inflation, meanwhile, rose by 0.3% m/m (0.32% unrounded). Though this resulted in the y/y rate ticking down two tenths to 4.1%, the three-month annualized rate accelerated from 2.4% to 3.1%. In short, the report reminded us that the path to 2% inflation is unlikely to be smooth sailing and the Fed must continue to err on the side of doing too much rather than too little.

Pain at the pump

Headline inflation was again boosted by energy prices (+1.5% m/m). This reflected a 2.3% increase in energy goods due to higher gasoline prices and a 0.6% increase in energy services owing to higher electricity prices. The good news for consumers is that gasoline prices have eased in October. Therefore, we may see some relief in the next report. Meanwhile, food prices rose at a trend like 0.2% m/m, roughly in line with our expectations. Food away from home rose by 0.4% m/m likely reflecting the cost of labor, and food at home rose 0.1% m/m.

Core goods deflation continues

Core goods prices fell by 0.4% m/m, its fourth consecutive decline. The drop was largely due to used car prices, which fell 2.5% m/m. That said, we did see more broad-based deflation this month as core goods ex used cars fell by 0.1% m/m and is down 0.8% annualized over the last three months. We think that we are now seeing clearer signs of goods price deflation owing to the unclogging of supply chains and softer demand due in part to higher interest rates.

Sticky Core services

Core services meanwhile rose by 0.6% m/m, well above our expectations for a 0.4% m/m increase. The big surprise, in our view, was shelter and owners' equivalent rent (OER). Both advanced by 0.6 % m/m, an acceleration from the prior month. Rent inflation also picked up to 0.5% from 0.4% m/m. This acceleration in rent is worth noting since asking rent inflation, which leads the CPI measures, has moderated significantly. Therefore, we must wait for more data to see if this is just a blip or if there is something more fundamental driving the increase such as higher rent increases in larger cities offsetting softer increases in smaller cities. Given the declines seen in asking rent inflation and the increase in multifamily supply, we do think that CPI rent and OER will moderate towards its pre-pandemic trend over time. But today's report is a reminder that we do not have good historic examples to lean on in determining the path for rent inflation. *(continued on next page)*

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Glossary

CPI = Consumer Price Index

PPI = Producer Price Index

PCE = Personal Consumption
Expenditures (Price Index)

OER = Owners' Equivalent Rent

NSA = Not Seasonally Adjusted

OIS- Overnight Indexed Swap

Core services ex rent and OER also stickier

Core services ex rent and OER, or core services ex housing services, also accelerated from 0.4% m/m in August to 0.4% m/m in September. Much of the acceleration can be attributed to a 3.7% increase in lodging away from home after a 3% decline in the prior month. Still other components of the core services ex housing services basket remain sticky high. On a three month-annualized basis, the index is up 4.8% and 3.1% on a six-month annualized basis. While we have seen some cooling in the labor market and wage inflation, we think that more cooling is needed for core services ex housing services to return to its pre-pandemic trend.

Fed implications: maintain the hike but it's a toss up

We retain our call for a 25bp hike in November. The Fed is still data-dependent and today's CPI release coupled with last week's employment report very much support a hike in November, in our view. That said, recent commentary from Fed speakers has leaned in the direction of a pause. There's still some time before the blackout period, which starts on October 21, for the Fed to give more guidance on the November decision.

Rates and FX Market reaction

The nominal curve bear flattened driven by higher front-end breakevens. The market has shifted the peak in the fed funds path to January from December, with the market now pricing about 50% probability of another 25bps hike—only modestly higher post CPI. The Fed path was most significantly repriced in late 24/ early 25, with contracts implying 85bps of cuts in 2024 vs 90bps before the print. While we continue to favor expressions for a steeper curve, the biggest risks to this trade are : 1-that it is likely crowded and 2-inflation proving more persistent. As we have recommended, this supports steepener expressions in real rates. Real yield steepeners can benefit from more favorable carry in the scenario of more persistent inflation vs market pricing and be more insulated from bear flattening driven by the breakeven curve.

Following the release, the DXY index rose by about 0.5%, in-line with the move higher in the US rates complex. While the report offered some mixed signals on the inflation picture, the highest MoM jump in core services-ex housing since last year was a key factor supporting the USD. However, today's move thus far represents just a partial reversal of the dollar's broader consolidation observed over the past over the past 7 sessions. The USD had briefly reached year-to-date highs following the September employment report last week, but had been steadily depreciating since as the market reassessed the Fed's stance. Recent commentary by several FOMC members coalescing around the theme of tightening financial conditions potentially being a substitute for further policy tightening caused the market to pare back pricing of an additional rate hike this year, as well as adding back in some of the cuts priced for next year. Today's print reinforces the sticky nature of inflation, which should keep the "higher for longer" mantra alive. This along with relative US growth outperformance has underpinned the dollar's broad appreciation over the past several months.

Exhibit 2: CPI Forecast vs. Actual (SA % m/m unless specified otherwise)

Below is a table that compares our bottoms-up CPI forecasts to actuals

	September Forecast		
	Actual	Forecast	Error
NSA Index (level)	307.389	307.342	0.047
Headline CPI (All Items)	0.40%	0.25%	0.14%
Food	0.2%	0.2%	0.0%
Energy	1.5%	0.4%	1.2%
Core CPI	0.32%	0.24%	0.08%
Core goods	-0.39%	-0.29%	-0.10%
Household furnishings and supplies	-0.3%	0.0%	-0.3%
Apparel	-0.8%	0.0%	-0.8%
Transportation commodities less motor fuel	-0.9%	-0.7%	-0.2%
<i>Of which:</i>			
New vehicles	0.3%	0.2%	0.1%
Used cars and trucks	-2.5%	-2.0%	-0.5%
Medical care commodities	-0.3%	0.4%	-0.7%
Recreation commodities	0.3%	-0.4%	0.7%
Other recreational goods	-0.2%	-0.7%	0.5%
Education and communication commodities	0.3%	-0.7%	1.0%
Alcoholic beverages	0.8%	0.0%	0.8%
Other goods	0.5%	0.1%	0.4%
Core Services	0.57%	0.44%	0.14%
Shelter	0.6%	0.4%	0.2%
<i>Of which:</i>			
Rent	0.5%	0.4%	0.1%
Lodging away from home	3.7%	1.5%	2.2%
OER	0.6%	0.4%	0.2%
Water and sewer	0.2%	0.4%	-0.2%
Medical care services	0.3%	0.0%	0.4%
<i>Of which:</i>			
Health insurance	-3.5%	-3.8%	0.3%
Transportation services	0.7%	1.4%	-0.7%
<i>Of which:</i>			
Airfares	0.3%	1.5%	-1.2%
Recreation services	0.5%	0.3%	0.2%
Education and communication	0.1%	0.1%	0.0%
Other personal services	0.6%	0.2%	0.4%

Source: BofA Global Research, Bureau of Labor Statistics, Bloomberg

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Exhibit 3: CPI heatmap (%m/m)

Headline CPI rose by 0.4% m/m in September. Core rose by 0.3% m/m

Aug-23 weight	Component	Sep-23	Aug-23	Jul-23	Jun-23	May-23	Apr-23	Mar-23	Feb-23	Jan-23	Dec-22	Nov-22	Oct-22
100.0	Headline CPI	0.396%	0.63%	0.17%	0.18%	0.12%	0.37%	0.05%	0.37%	0.52%	0.13%	0.21%	0.49%
13.4	Food	0.23%	0.24%	0.24%	0.11%	0.20%	0.02%	0.01%	0.39%	0.51%	0.45%	0.55%	0.68%
7.2	Energy	1.52%	5.58%	0.11%	0.60%	-3.59%	0.56%	-3.52%	-0.56%	1.97%	-3.06%	-1.41%	1.68%
79.5	Core CPI	0.323%	0.28%	0.16%	0.16%	0.44%	0.41%	0.38%	0.45%	0.41%	0.40%	0.31%	0.33%
4.3	Household Furnishings and Supplies	-0.28%	0.32%	-0.35%	-0.27%	-0.41%	-0.40%	0.37%	0.76%	0.51%	0.25%	0.36%	0.04%
2.5	Apparel	-0.76%	0.20%	-0.03%	0.31%	0.29%	0.27%	0.26%	0.81%	0.83%	0.21%	0.10%	-0.25%
7.7	Motor Vehicles & parts	-0.88%	-0.29%	-0.54%	-0.17%	1.49%	1.45%	-0.04%	-0.90%	-0.71%	-0.62%	-0.66%	-0.50%
4.2	New Vehicles	0.30%	0.27%	-0.08%	-0.03%	-0.12%	-0.22%	0.38%	0.18%	0.23%	0.58%	0.47%	0.56%
2.7	Used Cars and Trucks	-2.53%	-1.23%	-1.34%	-0.45%	4.42%	4.45%	-0.88%	-2.77%	-1.94%	-1.99%	-1.99%	-1.71%
1.5	Medical Care Commodities	-0.29%	0.56%	0.51%	0.19%	0.65%	0.46%	0.59%	0.15%	1.06%	0.11%	0.19%	-0.02%
2.2	Recreation Commodities	0.29%	-0.44%	-0.78%	-0.36%	-0.05%	0.29%	0.24%	0.44%	0.12%	0.09%	-0.34%	0.78%
0.9	Education and Communication Commodities	0.33%	-0.70%	-1.25%	-0.07%	-0.20%	-0.18%	-0.50%	-0.77%	-0.09%	-0.92%	-1.69%	-1.53%
0.8	Alcoholic Beverages	0.81%	-0.01%	0.12%	0.01%	0.51%	0.47%	0.14%	-0.28%	0.41%	0.65%	0.64%	0.69%
1.2	Other Goods	0.48%	0.12%	0.30%	0.08%	0.59%	0.24%	0.53%	0.74%	0.77%	-0.07%	0.62%	0.58%
34.7	Shelter	0.65%	0.29%	0.44%	0.37%	0.56%	0.42%	0.56%	0.76%	0.74%	0.79%	0.64%	0.72%
25.6	Owners' Equivalent Rent of Residences	0.56%	0.38%	0.49%	0.45%	0.52%	0.54%	0.48%	0.70%	0.67%	0.79%	0.65%	0.62%
7.6	Rent of Primary Residence	0.49%	0.48%	0.42%	0.46%	0.49%	0.56%	0.49%	0.76%	0.74%	0.79%	0.77%	0.72%
1.2	Lodging Away From Home	3.65%	-2.97%	-0.34%	-2.01%	1.80%	-2.96%	2.70%	2.26%	1.20%	1.10%	-0.52%	3.49%
1.1	Water & Sewer & Trash Collection Services	0.24%	0.48%	0.46%	0.40%	0.58%	0.33%	0.27%	0.79%	0.85%	0.25%	0.31%	0.17%
0.9	Household Operations	0.00%	-1.14%	1.79%	0.78%	-1.19%	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A	#N/A
6.3	Medical Care Services	0.32%	0.06%	-0.40%	-0.02%	-0.05%	-0.14%	-0.50%	-0.70%	-0.68%	0.30%	-0.49%	-0.38%
6.0	Transportation Services	0.69%	1.96%	0.34%	0.13%	0.84%	-0.18%	1.38%	1.14%	0.85%	0.63%	0.33%	0.60%
0.5	Airline Fares	0.28%	4.89%	-8.09%	-8.11%	-2.95%	-2.55%	3.96%	6.38%	-2.15%	-2.05%	-1.63%	-1.16%
3.1	Recreation Services	0.50%	-0.07%	0.77%	0.46%	-0.09%	0.74%	0.01%	1.19%	0.73%	0.29%	0.94%	0.78%
4.8	Education and Communication Services	0.07%	0.08%	0.29%	-0.27%	-0.15%	0.07%	0.29%	0.21%	0.45%	0.26%	0.98%	0.17%
1.5	Other Personal Services	0.64%	0.70%	-0.07%	0.23%	0.47%	1.52%	0.47%	1.06%	0.54%	-0.15%	0.82%	0.36%

Source: BofA Global Research, Bureau of Labor Statistics

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Exhibit 4: CPI heatmap (%y/y)

Headline CPI rose by 3.7% y/y in September and core rose by 4.1% y/y

Aug-23 weight	Component	Sep- 23	Aug- 23	Jul-23	Jun-23	May- 23	Apr- 23	Mar- 23	Feb-23	Jan-23	Dec-22	Nov- 22	Oct- 22
100.0	Headline CPI	3.70%	3.67%	3.18%	2.97%	4.05%	4.93%	4.98%	6.04%	6.41%	6.45%	7.11%	7.75%
13.4	Food	3.69%	4.25%	4.86%	5.74%	6.69%	7.65%	8.50%	9.49%	10.13%	10.41%	10.63%	10.95%
7.2	Energy	-0.45%	-3.62%	-12.47%	-16.74%	-11.66%	-5.06%	-6.42%	5.19%	8.70%	7.31%	13.07%	17.63%
79.5	Core CPI	4.15%	4.35%	4.65%	4.83%	5.33%	5.52%	5.59%	5.54%	5.58%	5.71%	5.96%	6.28%
4.3	Household Furnishings and Supplies	0.91%	1.68%	2.24%	3.24%	4.08%	4.77%	5.79%	6.33%	6.37%	7.28%	8.28%	8.81%
2.5	Apparel	2.32%	3.09%	3.18%	3.07%	3.47%	3.65%	3.25%	3.26%	3.06%	2.91%	3.55%	4.09%
7.7	Motor Vehicles & Parts	-2.29%	-1.92%	-1.27%	-0.75%	0.12%	-0.30%	-1.82%	-3.18%	-2.26%	-0.95%	2.37%	5.48%
4.2	New Vehicles	2.53%	2.92%	3.50%	4.07%	4.66%	5.42%	6.12%	5.83%	5.78%	5.89%	7.20%	8.39%
2.7	Used Cars and Trucks	-7.99%	-6.64%	-5.64%	-5.15%	-4.22%	-6.56%	-11.15%	-13.58%	-11.62%	-8.83%	-3.34%	2.03%
1.5	Medical Care Commodities	4.24%	4.45%	4.13%	4.21%	4.42%	4.01%	3.59%	3.19%	3.39%	3.21%	3.13%	3.06%
2.2	Recreation Commodities	0.25%	-0.08%	1.02%	1.96%	2.73%	2.90%	3.16%	2.85%	3.27%	4.11%	3.63%	4.31%
0.9	Education and Communication Commodities	-7.32%	-8.12%	-7.84%	-7.10%	-6.88%	-8.29%	-10.17%	-10.47%	-10.26%	-10.08%	-9.68%	-9.08%
0.8	Alcoholic Beverages	4.24%	3.71%	4.10%	4.42%	4.77%	4.64%	4.53%	4.92%	5.82%	5.78%	5.54%	5.01%
1.2	Other Goods	5.11%	5.01%	6.09%	6.13%	6.58%	6.80%	6.91%	6.96%	7.15%	7.17%	7.51%	7.21%
34.7	Shelter	7.15%	7.27%	7.69%	7.83%	8.04%	8.11%	8.18%	8.10%	7.88%	7.51%	7.12%	6.92%
25.6	Owners' Equivalent Rent of Residences	7.08%	7.32%	7.66%	7.81%	8.05%	8.12%	8.04%	8.01%	7.76%	7.53%	7.13%	6.89%
7.6	Rent of Primary Residence	7.41%	7.76%	8.03%	8.33%	8.66%	8.80%	8.81%	8.76%	8.56%	8.35%	7.91%	7.52%
1.2	Lodging Away From Home	7.33%	2.98%	6.04%	4.54%	3.41%	3.31%	7.26%	6.73%	7.69%	3.18%	3.24%	5.86%
1.1	Water & Sewer & Trash Collection Services	5.25%	5.82%	5.83%	5.71%	5.71%	5.41%	5.39%	5.25%	4.97%	4.94%	5.01%	4.77%
0.9	Household Operations	0.00%	4.79%	#N/A	5.21%	4.55%	8.01%	#N/A	#N/A	#N/A	#N/A	#N/A	6.57%
6.3	Medical Care Services	-2.64%	-2.14%	-1.53%	-0.76%	-0.08%	0.41%	1.03%	2.15%	2.99%	4.12%	4.38%	5.45%
6.0	Transportation Services	9.05%	10.35%	9.03%	8.23%	10.18%	11.03%	13.88%	14.64%	14.63%	14.58%	14.19%	15.19%
0.5	Airline Fares	-13.42%	-13.29%	-18.59%	-18.85%	-13.44%	-0.87%	17.70%	26.54%	25.56%	29.14%	35.90%	43.02%
3.1	Recreation Services	6.44%	6.10%	6.21%	5.92%	5.76%	6.39%	5.94%	6.34%	5.75%	5.71%	5.38%	3.94%
4.8	Education and Communication Services	2.45%	2.57%	2.72%	2.38%	2.79%	3.13%	3.25%	2.86%	2.77%	2.41%	2.24%	1.32%
1.5	Other Personal Services	6.78%	6.38%	5.95%	6.46%	6.67%	6.30%	5.25%	5.21%	5.34%	5.55%	6.49%	5.76%

Source: BofA Global Research, Bureau of Labor Statistics

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