TD Economics

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Data Release: Rising energy prices take inflation steadily higher in October

- Inflation continued to grind higher in October, with prices rising 0.4% on the month, helped by a 3.5% increase in energy costs. The strong October gain lifted the annual (year-on-year) inflation rate up to 1.6%, from 1.5% in September.

- Core price growth was slightly weaker than expected, up 0.1% on the month. On an annual basis core inflation was 2.1% in October, down one tick from September's pace. Core inflation has maintained a remarkably steady pace, in the 2.1-2.3% range, throughout 2016.

- Various categories contributed to the benign core inflation reading, including medical care (0.0% m/m), recreation (-0.1% m/m), education (-0.1% m/m) and personal computers(-0.1% m/m). Housing remains a key driver of inflation in the core, as the shelter component rose 0.4% in October.

- Core inflationary pressures have been limited to service prices so far this year, but this took a step backward to 3.0% (year-on-year) in October. Meanwhile, core goods prices (which exclude food and energy) rose a modest 0.1% in October, and remain in deflationary territory on an annual basis (-0.5%).

Key Implications

- In the here and now, inflation remains relatively benign, but financial markets have ratcheted up their expectations for future inflation in the wake of Trump's election victory. Anticipation that Trump will pursue expansionary fiscal policy, and potentially raise import tariffs, have been behind rising inflation expectations. It remains to be seen how the President-elect's policies will play out, but there is little doubt that the direction for inflation is higher.

- Even without major fiscal changes, higher energy prices will continue to push headline inflation up. As of October, energy prices are now in positive territory on a year-on-year basis, and are expected to be a key driver taking headline inflation to 2.5-3.0% range over the next year.

- This is the last CPI report before the Fed's December 14th meeting, and October's report was not enough to forestall a widely-expected rate increase. Other economic data continue to point to an economy that is rapidly absorbing economic slack, and price pressures are likely to follow. In her prepared remarks for her testimony later this morning, Fed Chair Yellen supported this notion, saying that it will be appropriate to raise rates "relatively soon."

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