TD Economics

October 18, 2016

Data Release: Higher energy prices push inflation upwards in September

- Inflation picked up in September, with prices rising 0.3% on the month, helped by an 2.9% jump in energy costs. The strong September increase lifted the annual inflation rate up to 1.5%. That is relatively modest, but still marks the fastest pace in nearly two years.

- Core inflation was softer-than-expected, with prices excluding food and energy rising only 0.1% in September. On an annual basis core inflation sat at 2.2% in September, continuing its oscillating pattern between 2-2.3% that has been in place for nearly a year.

- Underneath the benign core reading, shelter costs rose 0.4% on the month, and in addition to higher gasoline prices (+5.8%), were a key factor lifting inflation in September. Prices for medical care, motor vehicle insurance, personal care, education, alcohol, airline fares and tobacco also rose. Largely offsetting this were lower prices for apparel, communication, recreation and vehicles.

- Services have been a key source of inflation so far this year, and that trend continued in September as annual services inflation ticked up to 3.0%. Meanwhile, core goods prices (which exclude food and energy) fell 0.1% in September, and remain in deflationary territory on an annual basis (-0.6%).

Key Implications

- While core inflation was a tad weaker than expected in September, it comes after a very strong 0.3% increase in August. Core inflation seems to be stuck around the 2.2-2.3% mark, as the strong U.S. dollar has kept core goods prices in deflationary territory, helping to offset increasing price pressures emanating from services like housing and medical care. We don't expect core prices to get too much stronger over the coming months, but the increase in headline inflation in September is just the beginning. Headline inflation will continue to march higher in the months ahead as the downward pressure from the past drop in energy prices falls out of the year-on-year calculation. Inflation is expected to rise above 2 ½% in the latter half of 2017.

- Market-based measures of inflation expectations have also moved up notably over the past month alongside the move higher in oil prices. This will further reassure the Fed that inflation expectations are moving higher, giving them greater confidence on their price stability mandate and paving the way for an interest rate hike by the end of the year.

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