

Economic Analysis

Cheap Fuel Drags Down September Headline CPI

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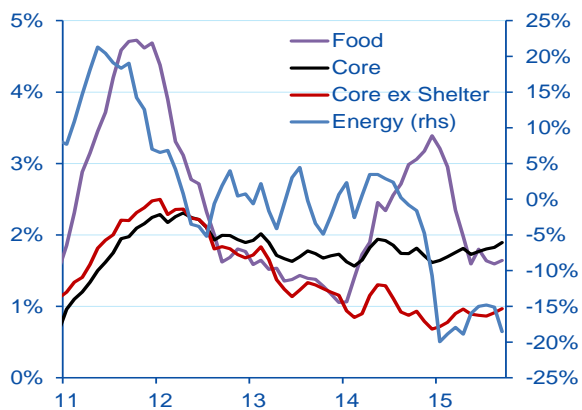
- **Headline CPI declined 0.2% MoM, driven by a 4.7% MoM decline in energy**
- **Core CPI rose 0.2% MoM and hit 1.9% YoY, its highest since June 2014**
- **No cost-of-living adjustment in 2016 for just the third time in 40 years**

The CPI release for September does little to assuage the Fed's concerns on inflation, even if they still believe that these downward pressures remain transitory. Headline CPI fell 0.2% MoM, its second consecutive decline this year, and remained unchanged on a YoY basis. However, core CPI is gaining on a YoY basis, up 1.9% in September to its highest level since June 2014. The difference between the core and headline CPI figures can be attributed to energy costs. Energy prices were down 4.7% MoM and 18.4% YoY, with gasoline prices representing the biggest downward factor, falling 9.0% MoM and 29.6% YoY. However, there were several gains last month as well: food prices rose 0.4% MoM—the biggest increase since May 2014; shelter was up 0.3% MoM, and medical care was up 0.3% MoM.

Although core CPI continues to move upward gradually, it is important to note that a majority of this is coming from shelter prices. Excluding shelter, core inflation remains low, hovering near 1.0% YoY. This is likely a factor playing into the Fed's inflationary concerns, alluding to some pass-through from headline. Also, if shelter prices are on the road to stabilizing and/or slowing in the coming months, we could see an impact on the core figure.

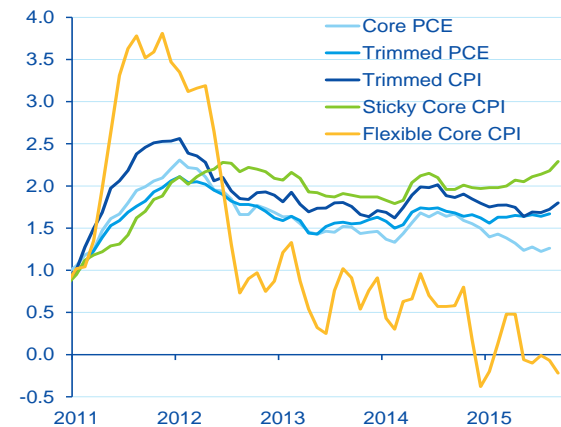
Notably, today's inflation report led to the Social Security Administration's announcement that there would be no cost-of-living adjustment (COLA) made in 2016, marking just the third time in 40 years with no adjustment. In order for social security recipients to receive a COLA, the CPI-W, or the price index for Urban Wage Earners and Clerical Workers, must be higher during the base period (September 2014-15) than the previous year. However, the CPI-W actually decreased 0.6% YoY last month.

Chart 1
CPI Inflation (YoY % Change)



Source: BLS & BBVA Research

Chart 2
Alternative Measures of Inflation (YoY % Change)



Source: BLS, BEA, FRB, & BBVA Research

September's CPI release leads to some mixed concerns, with energy acting as the main drag to headline CPI. However, the annual gain in core CPI helps keep alive the possibility of a rate hike later this year. Upcoming inflation figures will continue to receive close scrutiny as the Fed convenes in October and December. However, the Fed also looks closely at the PCE index, which rose only 0.3% YoY in August reflecting low oil and import prices. At this point, with last month's core CPI data and the September FOMC meeting officially behind us, our expectations are for a liftoff in December.

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