Inflation on Downward Path

The 'higher for longer' outlook for interest rates has been the key factor behind the big movements in financial markets in recent weeks. Both bond and equity markets have come under considerable downward pressure in volatile trading. With the markets preoccupied about interest rates, it would seem that little attention is being paid to recent economic releases that impact the prospects for interest rates, in particular inflation data.

The latest figures show that core inflation is now on a downward path virtually everywhere, with headline inflation rates well below last year's peak levels. In the case of Ireland, September was the third month in a row that saw very weak readings for the core HICP index, which excludes energy and unprocessed food. As a result, the annual core rate fell to 4.5%, which compares to levels of 5.7% in June and a peak of 6.2% in March.

In the US, the Fed's preferred inflation measure is the core PCE (personal consumption expenditures) price index. The annual rate had been stuck in a narrow 4.7-4.9% range between December and May, before falling over the summer. It declined to 3.9% in August, its lowest level since May 2021. Meantime, the headline PCE rate stood at 3.5% in August, down from a peak of over 7% hit in mid-2022.

In the UK, core CPI inflation is at last starting to move down, with the annual rate declining to 6.2% in August from 6.8% in July. Meanwhile, the Eurozone saw very sharp falls in both the headline and core HICP inflation rates in September. The headline rate fell from 5.2% to 4.3% and is now well below its peak of 10.6% reached in October last year. The core HICP rate, which had been stuck in a 5.3-5.7% range since January, fell to 4.5% in September.

There have been concerns that the sharp rise in oil prices over the summer will see renewed upward pressure on inflation. Brent oil climbed from $75 a barrel at mid-year to $96 by the end of September. Oil prices, though, fell back sharply last week to below $85, close to their level in the first half of the year.

Indeed, energy inflation will benefit from favourable base effects over the next couple of months in many countries, including Ireland and the UK, as sharp rises in utility bills last autumn drop out of annual rates. Furthermore, lower wholesale energy prices are starting to feed through into reductions in retail electricity and gas prices.

Meanwhile, food price inflation is on a clear downward path. The FAO Food Commodity Price index fell again in August and is now 24% below its peak in March 2022. Core inflationary pressures are also

now starting to ease and annual rates should be significantly lower by mid-2024. In this regard, recent PMI data point to some moderation in services sector inflation, which has been proving quite sticky.

The continuing volatility in oil prices, though, highlights the potential upside risks to inflation from energy prices. Labour markets also remain tight which is putting upward pressures on wages. There is also still a long way to go to get inflation back down to the 2% target level, but at least price indicators are moving in the right direction.

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