

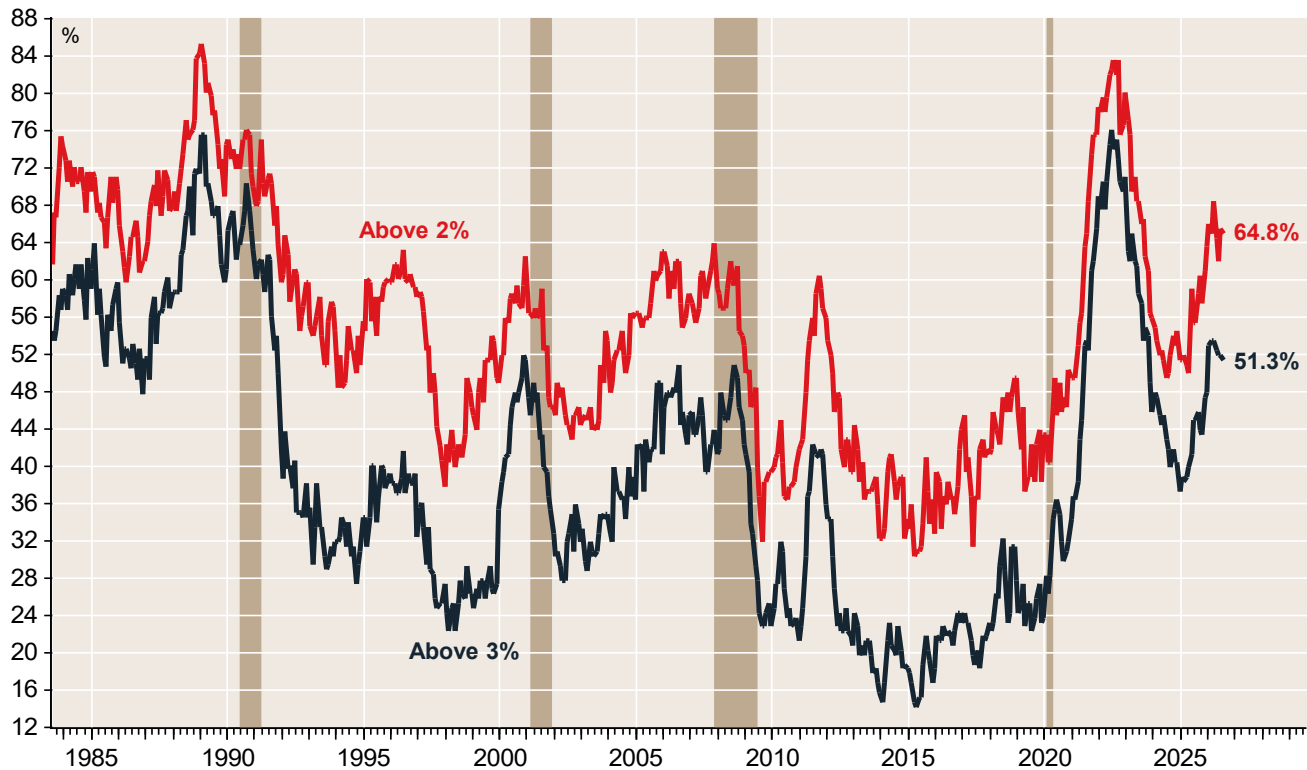
U.S. Watch

By Jocelyn Paquet

Several observers certainly breathed a sigh of relief when the U.S. inflation data were released yesterday, as methodological revisions resulted in figures that were much lower than expected, both for the headline PCE and the core PCE. Changes in how prices for computer software and accessories, portfolio-management fees, and legal services are compiled indeed lowered annual core inflation by no less than 36 basis points—significantly more than economists had anticipated—leaving this measure three-tenths of a percentage point below consensus expectations (3.0% vs. 3.3%). The revision also helped narrow the gap that had recently widened between core inflation as calculated by the PCE and the CPI, bringing it down from 0.9% in July to 0.6% in August. Although welcome, this revision has not fundamentally altered our view of the inflation outlook in the United States. With domestic demand still being fueled by the AI investment boom, we believe it will be difficult to bring inflation back to target without multiple rate hikes by the Fed. Labour market tightness is another factor to consider, as any acceleration in wage growth would threaten to intensify price pressures in the services sector. But more fundamentally, it is the highly widespread nature of current inflation that leads us to believe further rate hikes are likely. As shown in today's Hot Chart, the proportion of PCE components with an annual growth rate exceeding 3%—an indicator frequently cited by Fed Chairman Kevin Warsh—remains well above its long-term average (51.3% versus 35.3%). The same is true for components rising at a rate above the central bank's 2% target (64.8% vs. 50.3%). These two measures suggest that price pressures are currently not limited to the components most directly affected by the crisis in the Middle East. In an economy that continues to grow at a rate above its potential, demand-driven inflation is also a factor and will be more difficult to curb, especially after five years of inflation above the 2% target.

U.S.: Inflation too broad-based, even after methodological revisions

Share of PCE components (out of 199) that are rising at an annual rate of more than 2% and 3%



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