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UNITED STATES

Sticky US inflation justifies a Fed rate hike

US headline and core inflation came in well above the 0.17% month-on-month trend rate required to bring the annual rate down to the Federal Reserve s 2% target. Given Fed Chair Kevin Warsh s hawkish spin at Jackson Hole, he will be pushing for a rate hike next week and a majority on the FOMC will likely agree

US inflation is too high and we expect a one-off rate hike

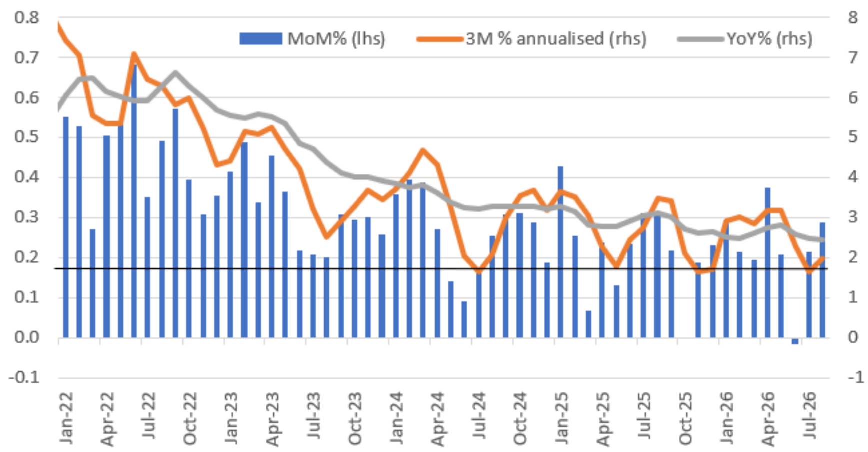
Inflation continues to trend too hot for comfort

US August CPI has come in to match the 0.4% month-on-month and 3.4% year-on-year consensus expectation. However, the core inflation index (ex-food and energy) rose 0.3%/2.4%, which is hotter than the 0.2% MoM expected. To three decimal places, it came in at 0.290% MoM. Remember, we need to average 0.17% MoM over time to bring the YoY inflation rate trending towards the Fed's 2% target. This outcome has reinforced market expectations of Fed policy tightening next week, with Fed funds futures contracts implying an 85% chance of a 25bp rate hike – an outcome that we fully expect.

The chart below shows the MoM, 3M annualised and YoY rates of core inflation. The black line marks 0.17% MoM, which is what the blue bars need to trend at to bring annual inflation down to 2%. The details show energy prices rose 2.1% MoM, led by a 3.9% jump in gasoline prices.

Higher fuel costs pushed airline fares 2.7% higher while education and communication prices jumped 1.6%. On the opposite end, apparel, recreation, food and housing were all benign. We should also remember that the Fed's favoured inflation measure, the core personal consumption expenditure deflator, is running even hotter at 3.3% YoY.

Core US inflation metrics (MoM%, 3M annualised, YoY%)



Source: Macrobond, ING

We expect a one-off hike

With Kevin Warsh warning that inflation has been above target for too long in an environment where the economy is at full employment and financial conditions aren't restrictive, there should be a decent majority of FOMC members backing a hike. Markets don't expect them to stop there, with Fed funds futures looking at potentially three further rate hikes over the next 12 months. We are not in that camp. If we see an improvement in energy flows from the Strait of Hormuz in coming months, fears of a renewed upswing in inflation will likely be proved wrong. Weak wage growth and tariff refunds provide relief on corporate costs and the cooling housing market will continue to dampen the shelter component of inflation. We, instead, think this is merely a recalibration of Fed policy, similar to the hike implemented by Alan Greenspan's Fed in 1997.

Author

James Knightley
Chief International Economist, US
james.knightley@ing.com

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