Core inflation hotter than expected, October hike back in play

Headlines

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- Headline CPI increased 0.6% m/m in September, the fastest pace of inflation since last April, driven by a 10% increase in fuel costs. **Core CPI came in above expectations, increasing 0.33% against an expectation of 0.2%.** Year-over-year core inflation increased to 2.6%.

- **The strength in core inflation was broad-based**, with accelerations in shelter and core goods inflation, as well as a third month in a row of elevated "supercore" inflation. **Shelter** added 0.17 percentage points to the 0.33% increase in core inflation in September, driven by stronger rent inflation and a 2% increase in hotel prices.

- **The acceleration we are seeing in core goods inflation in recent months is concerning.** Core goods prices increased 0.25% in September, which translates to a 3.1% annualized pace of growth, and is the fastest pace since January 2025. There was some optimism that the impact of tariffs was waning in the data and that core goods inflation would moderate in 2H26, but that isn't happening. The impact of higher diesel costs is taking the baton from tariffs as the primary driver of goods inflation.

- Supercore, or core services inflation excluding shelter, increased 0.34% in September, still significantly above the ~0.2% m/m increase that was common prior to the pandemic. **Over the past three months, supercore has increased at a 4.5% annualized pace, nowhere close to where the Fed needs it to be to return inflation to target**. We continue to think the Fed's inflation problem is fundamentally a demand problem, and this is where that shows up most cleanly.

- **What does this mean for the Fed?** October rate hike odds jumped to just over 50% on the news, which feels appropriate. In our view, any core CPI reading that rounded close to 0.4% would likely bring an October rate hike back into the conversation, and this morning's reading was close to that. Tomorrow's PPI reading will help us pin down what core PCE inflation looks like in September, which should help bring clarity to whether the Fed hikes at the end of the month or not.

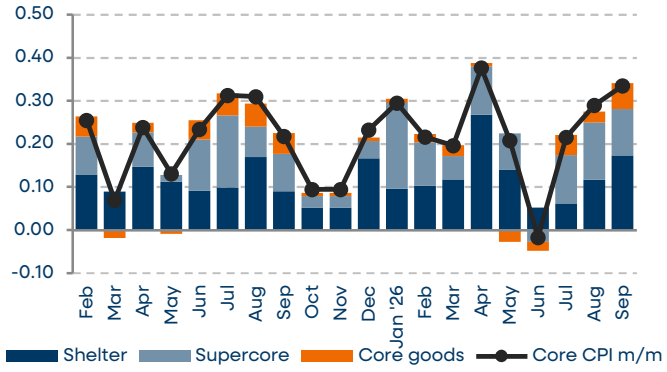
Table 1: CPI and components (% chg., m/m)

Indicator	Avg. 2025	Avg. YTD	May '26	Jun '26	Jul '26	Aug '26	**Sep '26**
Headline	0.22%	0.35%	0.47%	-0.42%	0.07%	0.40%	**0.65%**
Core	0.22%	0.23%	0.21%	-0.02%	0.22%	0.29%	**0.33%**
Shelter	0.26%	0.28%	0.32%	0.12%	0.14%	0.26%	**0.39%**
Core Services ex. Shelter	0.24%	0.30%	0.26%	-0.09%	0.35%	0.42%	**0.34%**
Core Goods	0.12%	0.07%	-0.11%	-0.09%	0.20%	0.11%	**0.25%**

Hotter than expected print across the board

Headline CPI increased 0.6% in September, the most rapid pace of inflation since last April, driven by a nearly 10% increase in fuel costs. Core CPI was also hot, coming in well above expectations, increasing 0.33% on the month. That is still well above the Fed's target, translating to a very hot 4.1% annualized pace of growth. Over the past three months, core CPI inflation has increased at a 3.4% annualized pace.

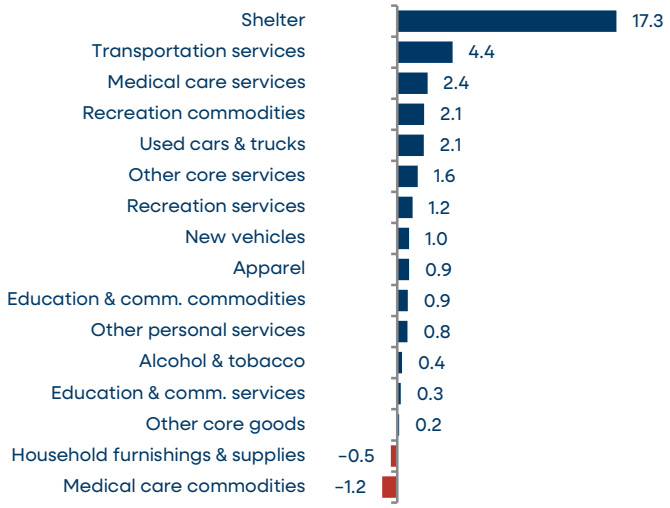
Figure 1: Core CPI and contributions (% chg., m/m)



Sources: BLS, PNC

The strength in core inflation was also very broad-based in September, with clear accelerations in shelter and core goods inflation. This was also the third month in a row of elevated "supercore" inflation, which has been the stickiest and most persistent component of inflation in recent years. Shelter added 0.17 percentage points to the 0.33% increase in core inflation in September, driven by stronger rent inflation and a 2% increase in hotel prices.

Figure 2: Contributions to core CPI in September (basis points, m/m)



Sources: BLS, PNC

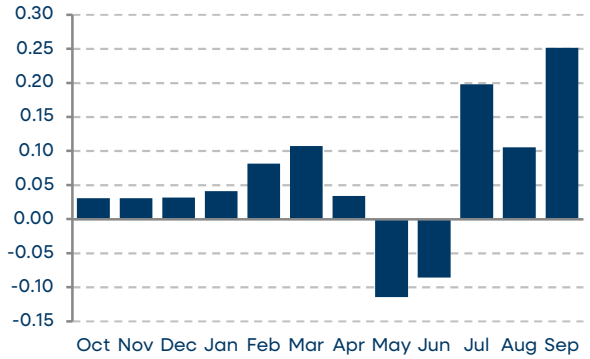
The trend in core goods inflation is concerning

We are also seeing clear evidence that core goods inflation may be re-accelerating, which is concerning. Core goods prices increased 0.25% in September, which translates to a 3.1% annualized pace of growth, and is the fastest pace since January 2025.

There was some optimism that the impact of tariffs was waning in the data and that core goods inflation would moderate in 2H26, but that doesn't appear to be happening. The impact of higher diesel

costs appears to be taking the baton from tariffs as the primary driver of goods inflation.

Figure 3: Core Goods Inflation (m/m %)

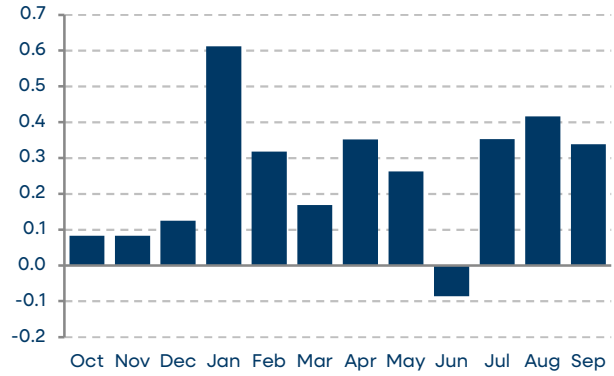


Sources: BLS, PNC

Supercore still too hot

Supercore, or core services inflation ex shelter, increased 0.34% in September. In order for the Fed to durably reduce core inflation toward target, this will need to fall closer to 0.2%, which doesn't appear to be happening anytime soon. Over the past three months, supercore has increased at a 4.5% annualized pace, nowhere close to where the Fed needs it to be.

Figure 4: Core Services ex Shelter Inflation (m/m %)



Sources: BLS, PNC

One thing that has become clearer to us in recent months is that the Fed's remaining inflation problem is really a demand one. There's simply too much demand chasing too little supply in this economy, and supercore is primarily where that demand pressure is most visible. The Fed can, and should, look through one-time supply shocks. What it can't do is look through a demand shock, or a serial string of supply shocks that compound on each other.

What does this mean for the Fed?

The market moved to price October as roughly a coin flip, which feels appropriate. Before this morning, we viewed anything that rounded up to 0.4% m/m on core CPI as bringing October back into play. This was close to that, and we think the Fed will go into the October FOMC meeting with a relatively open mind on whether to hike or not. Tomorrow's PPI reading will help us pin down what core PCE inflation looks like in September, which should help bring clarity to the Fed's decision in October. We continue to believe the Fed will hike in December and again in March of next year.

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