ECONOMIC UPDATE

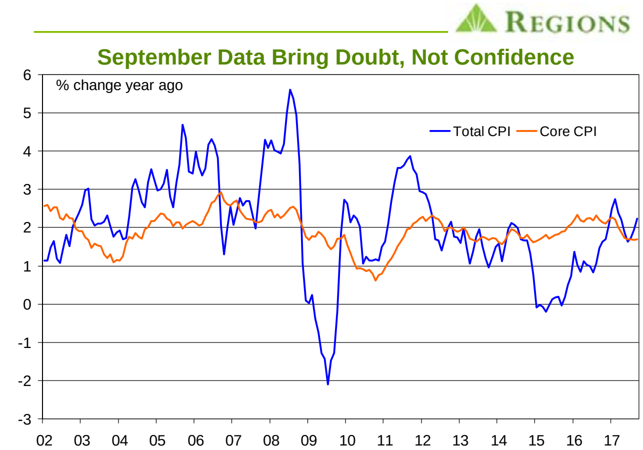
REGIONS

October 13, 2017

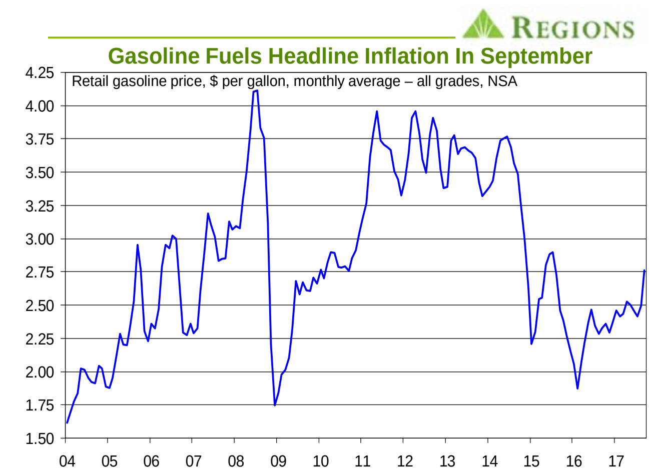
September Consumer Price Index: September Data Bring More Doubt Than Confidence

- The total CPI rose 0.5 percent (0.548 percent unrounded) in September; the core CPI was up 0.1 percent (0.127 percent unrounded).
- On a year-over-year basis, the total CPI was up 2.2 percent and the core CPI was up 1.7 percent in September.

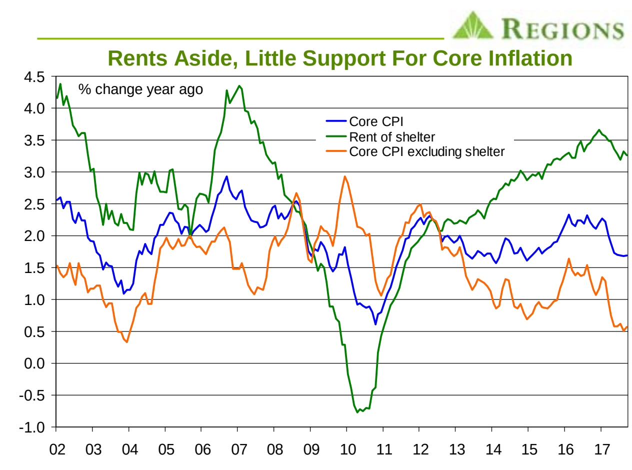
The total CPI rose by 0.5 percent in September, below our forecast of 0.7 percent, while the core CPI was up 0.1 percent, below the anticipated 0.2 percent increase. As expected, some of the components, such as gasoline and lodging, show the effects of Hurricanes Harvey and Irma, but other components we had expected to be impacted, such as food prices and vehicle prices, came in surprisingly soft, while the deceleration in rent growth was more pronounced than our forecast had anticipated. Prior to the release of the September data, the thinking was that once the hurricane related noise was filtered out of the data, there would be enough evidence of building inflation pressures to make the FOMC more confident in their (collective) view that inflation was moving towards their target. Instead, the September data are likely to instill more doubt, particularly in those FOMC members wavering in their assessment of underlying inflation trends.



As we had anticipated, retail gasoline prices were up 13.1 percent on a seasonally adjusted basis – that is the month/month increase, not the year/year increase. Unadjusted pump prices were up 10.6 percent in September, reflecting the impact of Hurricane Harvey taking down over 20 percent of the nation's refining capacity. With unadjusted gasoline prices falling by roughly 1.5 percent in a typical September, this year's increase was magnified by seasonal adjustment. The overall index for energy was up 6.1 percent in September (up 10.1 percent year-on-year). Prices for lodging away from home were up 1.5 percent in September, a bit below our expectations but still reflecting effects of the hurricanes, as increased demand by some who had evacuated before the storms or who were displaced by the storms put upward pressure on prices.



Food prices were up just 0.1 percent, with prices for food consumed at home flat and prices for food consumed away from home up 0.3 percent. We had anticipated higher prices for food consumed at home in the wake of Irma's effects on Florida's agricultural sector, so this is one source of our miss on our forecast for the total CPI. It is possible that coming months will show some of these effects, so this will bear watching. Another element of our forecast that was off was motor vehicle prices – we had expected the post-hurricane spike in sales to have put upward pressure on prices for both new and used motor vehicles. Instead, new vehicle prices were down by 0.4 percent, with prices for both automobiles and SUVs/light trucks down, while prices for used vehicles fell by 0.2 percent. Year-on-year, new vehicle prices are down by 1.0 percent and used vehicle prices are down 3.7 percent.



There are some notable elements of the September data that have nothing to do with the hurricanes. First, the 0.2 percent increase in primary rents was the smallest monthly increase since December 2014, and owners' equivalent rents also rose by 0.2 percent, both softer than our forecast anticipated. As rents account for over 40 percent of the core CPI, this is the primary factor behind the core CPI coming in lighter than expected. Also, medical costs as measured in the CPI were down 0.1 percent, largely reflecting lower prices for prescription and nonprescription drugs while prices for physicians services and hospital stays were higher. Apparel prices were down 0.1 percent in September, leaving them down year-on-year for a fifth consecutive month. Core goods prices fell by 0.2 percent, leaving them down 1.0 percent year-on-year, the largest such decline since September 2004 and the 53rd such decline in the past 54 months. As seen in our bottom chart, take away rents and there is very little support for core inflation. If rent growth continues to decelerate, as we anticipate, and core goods prices do not begin to firm up, there is little to sustain faster core inflation in the months ahead.

The FOMC will see two more CPI reports before making a decision on interest rates at their December meeting. How much clarity those reports will bring, however, is an open question, even with the focus on core inflation. Still, those who have argued the recent deceleration in inflation is transitory may have a tough time making their case.

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