ECONOMIC UPDATE

REGIONS

November 17, 2016

October Consumer Price Index: Rents, Gasoline Push Headline Inflation Higher

- The total CPI was up 0.4 percent (up 0.357 percent unrounded) in October; the core CPI was up 0.1 percent (0.149 percent unrounded).
- On a year-over-year basis, the total CPI was up 1.6 percent and the core CPI was up 2.1 percent in October.

The total CPI rose 0.4 percent in October, in line with expectations, while the core CPI was up 0.1 percent, below the consensus forecast of a 0.2 percent increase. Year-on-year, the total CPI is up 1.6 percent with the core CPI up 2.1 percent, which marks the second consecutive month in which core inflation has gently decelerated. Gasoline and rents were the main drivers of headline inflation in October, with an assist from higher apparel prices. On the whole, however, the October CPI report suggests that there are few sources of meaningful inflation pressure in the U.S. economy. In other words, for all the recent talk of letting the economy "run hot" the reality is we're not quite even at lukewarm yet when it comes to the degree of inflation pressures.

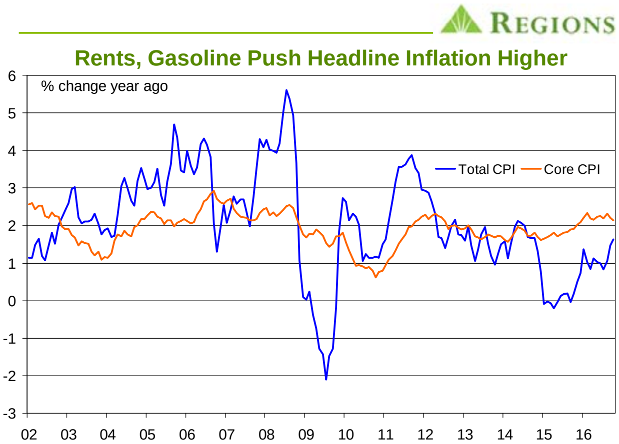
As reported in the CPI data, retail gasoline prices were up 7 percent in October, though this still leaves pump prices down 0.9 percent year-on-year. It should be noted, however, there is a considerable degree of seasonal noise in the increase reported in the CPI data. October is a month in which retail prices typically decline, and the seasonal adjustment factors are therefore geared to falling, not rising, prices. This year, however, unadjusted pump prices rose by 1.8 percent, per the CPI data, so that when the seasonal adjustment factor was applied this turned into the 7 percent increase on a seasonally adjusted basis. Over recent weeks, retail gasoline prices have begun to ease, so it is unlikely that gas prices will have the outsized impact on the headline CPI as was the case in both September and October.

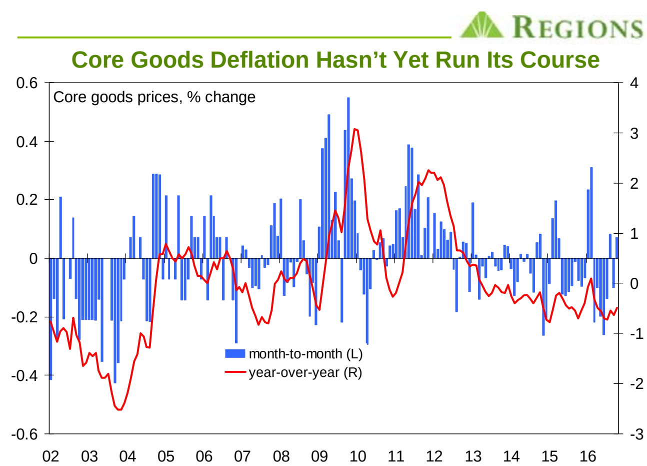
Market rents were up 0.393 percent in October, the largest monthly increase since June 2008, which translates into a 3.8 percent increase on a year-over-year basis. Those who have read our commentary on the housing market data may find this at odds with our stating rent growth on multi-family rental apartments has eased, but keep in mind the CPI data include rents on single family homes, which continue to rise at a rapid rate. Moreover, as single family homes have accounted for a higher proportion of occupied rental housing units over recent years, their representation in the CPI sample has also increased, and we believe this is a key component of continued rapid growth in market rents. At the same time, owners' occupied rents posted a trend-like 0.3 percent increase in October, leaving them up 3.4 percent year-over-year, the fastest since May 2007. Our hunch is that the robust pace of house price appreciation seen over recent quarters is leading to faster growth in owners' equivalent rents. It will be interesting to see whether rising mortgage rates take some of the steam out of this metric over coming months.

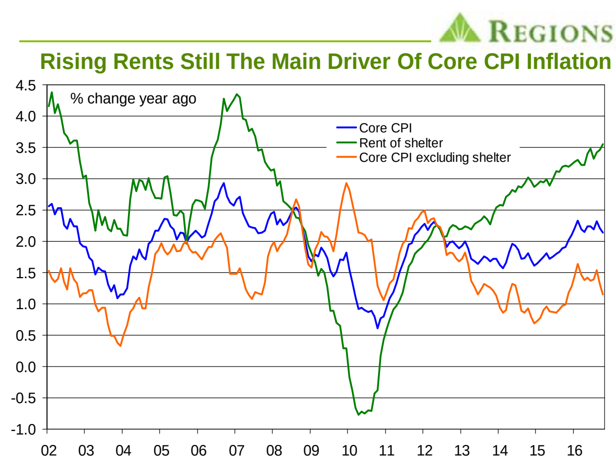
Rents account for roughly 40 percent of the core CPI, and as we show in our bottom chart aside from rents there is little support for core inflation. Excluding shelter costs, core CPI inflation was running at just 1.2 percent in October and has slowed over recent months. After August saw the largest monthly increase in medical costs since November 1990, the past two months have seen a sharp deceleration, with an increase of just 0.016 percent in October, though this yields a year-over-year increase of 4.3 percent. Apparel prices rose by 0.3 percent in October, but this recaptures less than half of September's decline and leaves them up just 0.7 percent year-on-year. Airline fares fell 2.2 percent in October and are now 5.2 percent below their year-ago level.

Elsewhere in the data, food prices were flat, with further declines in prices for foods consumed at home and only a modest increase in prices for food consumed away from home. This ongoing trend figures to continue over coming months. Despite rising in October, core goods prices logged their 42nd year-on-year decline in the past 43 months. To the extent the U.S. dollar strengthens over coming months, goods price deflation will remain a boon to U.S. consumers but a thorn in the side of retailers.

The 0.4 percent increase in the headline CPI stands out, but it is thinly based. We see little reason to expect a material acceleration in core inflation any time soon.







Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203
Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com