ECONOMIC UPDATE

REGIONS

April 11, 2018

March Consumer Price Index: Inflation Asks, Very Politely, "Can You Hear Me Now?"

- The total CPI fell by 0.1 percent (-0.063 percent unrounded) in March; the core CPI was up 0.2 percent (0.176 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.4 percent and the core CPI was up 2.1 percent in March

After having for been oddly muted for some time, inflation found its voice in March. But, rather than a roar, inflation came back with more of a polite whisper. The total CPI fell by 0.1 percent in March, matching our forecast (consensus was for no change), with the core CPI rising by 0.2 percent, matching the consensus forecast and ahead of our forecast of a 0.1 percent increase. It is the over-the-year comparisons, however, that were the focus ahead of today's release. Thanks to base effects stemming from the precipitous decline in prices for cell phone service plans that began last March, the over-the-year increases in both the headline and the core CPI figured to look much worse in the March data than had been the case over the past several months. While energy prices muted the over-the-year change in the headline CPI, up 2.4 percent, those base effects were more pronounced in the core CPI, which stands 2.1 percent higher year-on-year compared to 1.8 percent higher in February. These over-the-year increases were smaller than many had feared. To which we'll say just wait a month, as those changes will become more pronounced, beginning with the April data. So, even if inflation itself isn't screaming at us a month from now, the headlines atop the stories about inflation surely will be.

As we noted in our weekly *Economic Preview*, retail gasoline prices were basically flat on a monthly average basis in March, contrary to the sizeable increase for which the seasonal adjustment factors were geared. As a result, in the seasonally adjusted data gas prices were down 4.9 percent month-on-month, which knocked two-tenths of a point off of the change in the headline CPI. This effect, however, will be reversed in the April data. As we also expected, March saw a sharp decline in apparel prices after outsized increases in both January and February, which simply repeats the odd seasonal patterns seen in apparel prices over recent years. If this pattern holds, apparel prices will decline over the remainder of the year, at least as measured in the CPI data.

Primary rents were up 0.3 percent in March, but only barely as the unrounded increase was 0.258 percent; our forecast anticipated a 0.3 percent increase, but that was rounded down from 0.334 percent. We note this because the increase in March came off of a notably small 0.2 percent increase in February. Though we have anticipated rent growth would decelerate over the course of 2018, we had expected a more gradual decline as still robust growth in rents on single family homes blunted a pronounced slowdown in rents on apartments. But, while the month-to-month changes have been smaller than anticipated over the past two month, primary rents are still up 3.6 percent year-on-year. Owners' equivalent rents rose by 0.3 percent and are up 3.3 percent year-on-year.

Contrary to our expectations of a modest increase, core goods prices fell by 0.1 percent in March. As seen in our bottom chart, on a month-to-month basis core goods prices have been lacking a clear direction over the past several months. Year-on-year, core goods prices were down 0.3 percent in March, the 58th such decline in the past 60 months, but as seen in our bottom chart the over-the-year declines have been getting progressively smaller, and we expect core goods prices to be higher, even if only modestly, on an over-the-year basis over the second half of 2018. Medical costs, which along with rents and core goods prices is one of our "big three" drivers of core inflation in 2018, were up 0.4 percent in March, leaving them up just 2.0 percent year-on-year. If core goods prices have been lacking clear direction over the past several months, then medical costs have been all over the map, and we have yet to get a sense of where they will head next.

The reaction in the financial markets to the March inflation data has leaned more towards indifference than to fear, and we suspect the reaction within the FOMC will be much the same. The base effects in the inflation data are no surprise, or at least should not be, and discounting the noise from gasoline prices, virtually everyone – the FOMC included – expects inflation to pick up over coming months. To the extent that pick-up remains orderly, it won't alter the FOMC's view of the appropriate path of monetary policy.

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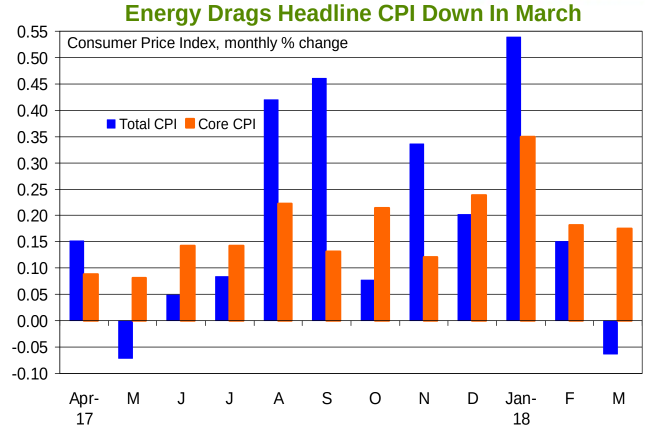
Energy Drags Headline CPI Down In March



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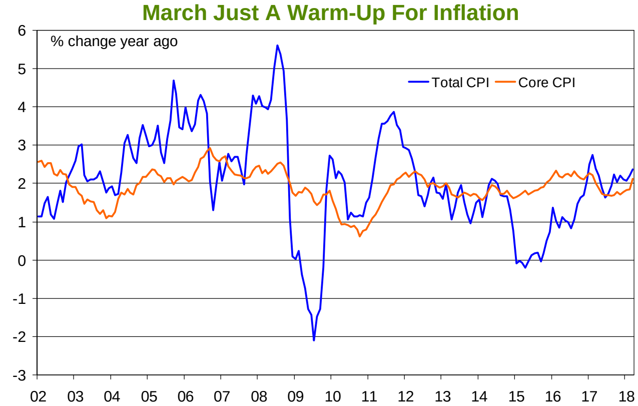
March Just A Warm-Up For Inflation



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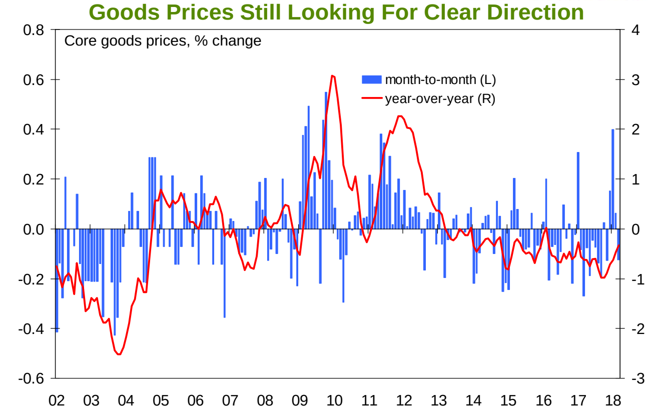
Goods Prices Still Looking For Clear Direction



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