ECONOMIC UPDATE

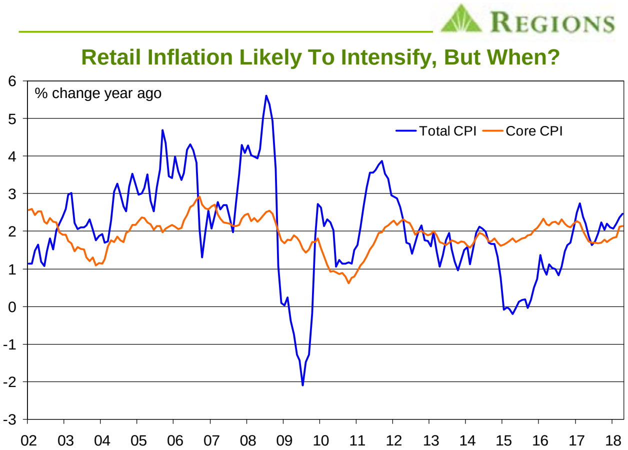
REGIONS

May 10, 2018

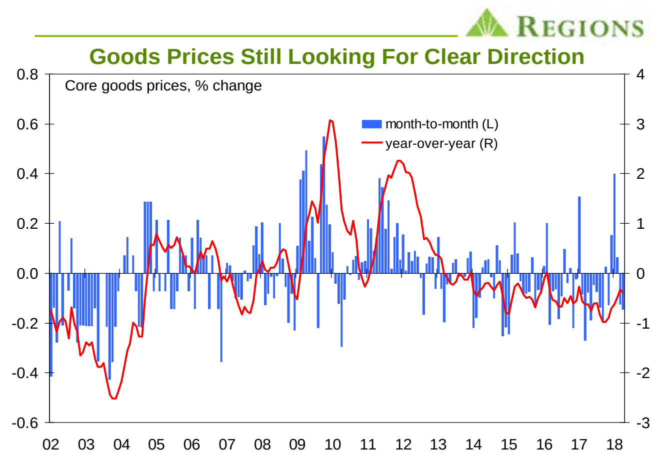
April Consumer Price Index: Retail Inflation Likely To Intensify, But When?

- The total CPI <u>rose</u> by 0.2 percent (0.221 percent unrounded) in April; the core CPI was <u>up</u> 0.1 percent (0.098 percent unrounded)
- On a year-over-year basis, the total CPI was <u>up</u> 2.5 percent and the core CPI was <u>up</u> 2.1 percent in April

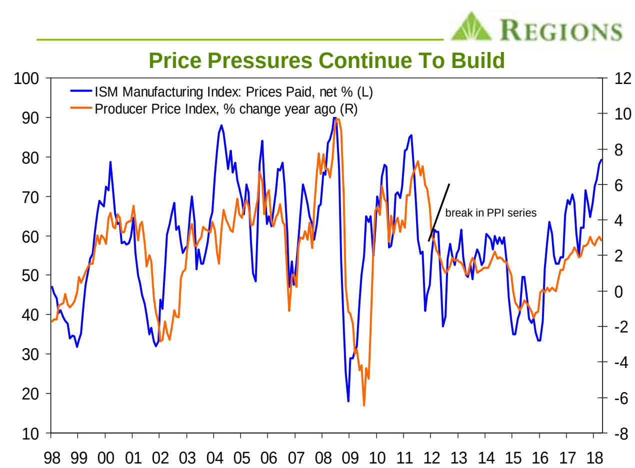
The total CPI rose by 0.2 percent in April while the core CPI was up by 0.1 percent (albeit only barely so). We and the consensus were looking for increases of 0.3 percent in the total CPI and 0.2 percent in the core CPI. The total CPI is up 2.5 percent year-on-year, and the core CPI stands 2.1 percent higher on an over-the-year basis. What is puzzling, at least to us and admittedly that's a low bar to clear, is not so much the top-line numbers coming in softer than expected, but rather that the details of the April CPI report constitute a jumbled mass of mixed messages. Add to this the reality that the year-on-year changes in the CPI, both headline and core, are being biased higher by noise in the data stemming from the behavior of prices for cell phone service plans last year. As such, anyone looking for clarity on the inflation report need not look to the April CPI report for guidance, nor is it likely to be of much use to the FOMC as a signal of inflation pressures in the U.S. economy. But, what is clear is that prices for raw materials and other non-labor inputs are rising at a much faster pace than are prices for consumer goods and services. Throw in labor costs rising at a faster pace and significant upward pressure on transportation costs, and it does seem clear that price pressures on the retail level will intensify. When that will happen, however, is another question.



As we noted in our weekly *Economic Preview*, retail gasoline prices rose much more than is typical for the month of April, thereby overwhelming the seasonal adjustment factors and leaving prices up 3.0 percent month-to-month. On an over-the-year basis, gasoline prices are up 13.4 percent as measured in the CPI and, given the recent behavior of crude oil prices, these increases figure to get larger in the months ahead. Vehicle prices were a significant drag on the CPI in April, with new vehicle prices down 0.5 percent while prices for used vehicles plummeted by 1.6 percent. What seems to be happening with prices for used vehicles is that a persistent downward trend was interrupted by a few months of rising prices in the wake of Hurricanes Harvey and Irma, but with April marking a third consecutive month of declines, that downward trend in used vehicle prices has resumed. As for prices of new vehicles, prices for sedans and smaller, more fuel efficient vehicles will likely continue to fall, even as gas prices push higher, while dealers will resort to increased incentives to move higher priced SUVs/light trucks. All in all, the pricing environment for used and new motor vehicles is likely to remain soft.



Prices for food consumed at home rose by 0.3 percent in April, the largest increase in over a year, and overall food prices were also up 0.3 percent. Apparel prices posted a 0.3 percent increase, notable only because coming in April it bucks the pattern seen in recent years in which apparel prices jump in January then drift lower over the remainder of the year. Still, prices for core goods fell in April, a second straight monthly decline after having appeared to have some upward momentum in prior months, at least in part due to a weaker U.S. dollar. With the dollar having reversed course, core goods prices could easily extend a run that has seen them down year-on-year in 59 of the past 61 months. This is something to watch over coming months. Market rents jumped 0.4 percent in April, the largest monthly increase since October 2012. This is notable in that it is at odds with what has been deceleration in apartment rents, and while rents on single family homes continue to rise at a solid clip and single family homes make up a larger share of the CPI's rent surveys, the jump in market rents in April feels overstated. Medical costs continue to march to their own beat, up just 0.087 percent in April after rising by 0.4 percent in March, and seem unlikely to settle into any sort of pattern any time soon.



Coming months will tell us how firms respond to rising input, transportation, and labor costs. It could be that with the 2017 tax bill lowering tax burdens, firms can absorb a greater share of rising costs than would have been true in the past and still maintain margins, but this can only last for so long. It seems likely that at some point firms will have to find out whether, or to what extent, they have any pricing power. When that time will come is anybody's guess, the FOMC included.

Regions Financial Corporation, 1900 5th Avenue North, 17th Floor, Birmingham, Alabama 35203

Richard F. Moody, Chief Economist • 205.264.7545 • richard.moody@regions.com