ECONOMIC UPDATE

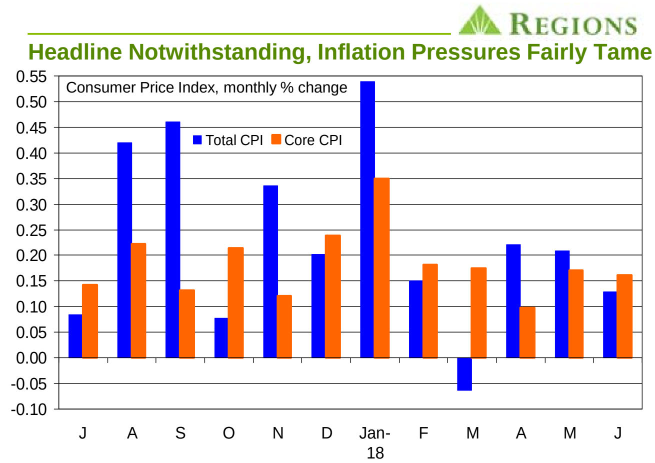
REGIONS

July 12, 2018

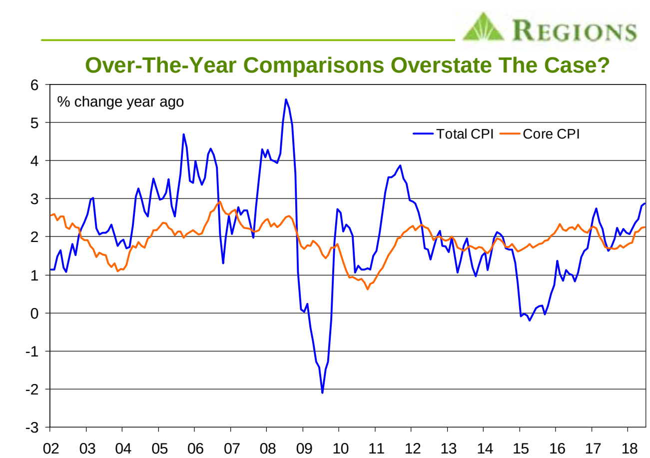
June Consumer Price Index: Over-The-Year Comparisons Overstate The Case?

- The total CPI rose by 0.1 percent (0.129 percent unrounded) in June; the core CPI was up 0.2 percent (0.162 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.9 percent and the core CPI was up 2.3 percent in June

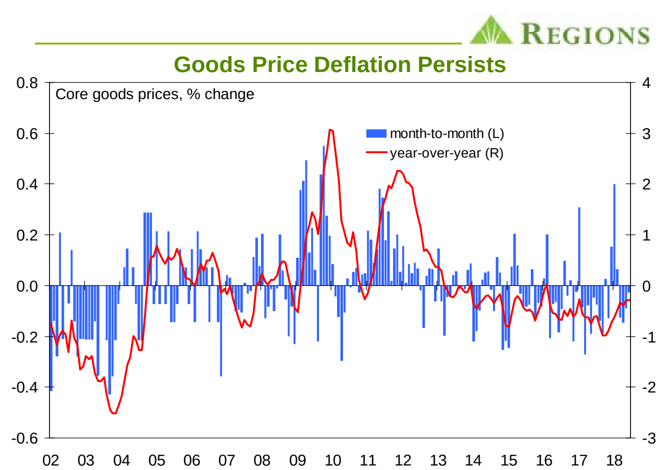
To be sure, the fastest rate of retail-level inflation since 2012 is going to be the headline atop any story about the June CPI report, which is not to say that is necessarily the biggest story in the June CPI report. The total CPI rose by 0.1 percent in June, below what we and the consensus expected. The unrounded increase in the total CPI was 0.129 percent; our forecast was 0.149 percent, which we opted to round up rather than down. So it goes. The core CPI was up 0.2 percent, as we and the consensus expected, but this too was a close call as seen in the unrounded increase of 0.162 percent. So while the 2.9 percent year-on-year increase in the total CPI and the 2.3 percent year-on-year increase in the core CPI will certainly garner more attention, the fairly muted month-to-month changes suggest inflation pressures are more tame than implied by the over-the-year changes. Therein lies the beauty of the June CPI report – regardless of how concerned, or not, one is about inflation, they can point to the June CPI report to support their view.



Gasoline prices were up 0.5 percent on a seasonally adjusted basis in June, leaving them up 24.3 percent year-on-year. Despite higher gasoline prices, the overall energy index fell by 0.3 percent, reflecting a 1.4 percent decline in electricity costs. It is also interesting to note that what used to be a fairly stable link between fuel prices and air fares seems to have broken down of late. Air fares were down both month-to-month (0.9 percent) and year-on-year (5.9 percent) in June, which of course leaves consumers extra cash with which to buy their own peanuts. Motor vehicle prices were up strongly in June, with prices for new vehicles up 0.4 percent and prices for used vehicles up 0.7 percent, breaking a string of four consecutive monthly declines. Food prices were up by 0.2 percent in June, with prices for food consumed at home and for food consumed away from home both rising by 0.2 percent. This leaves overall food prices up 1.4 percent year-on-year, though prices for food consumed away from home rising at a more robust 2.8 percent rate. Medical care costs were up 0.4 percent in June and are up 2.5 percent year-on-year. Apparel prices were down by 0.9 percent in June, slightly more than the 0.8 percent decline our forecast anticipated. We noted in our weekly *Economic Preview* that apparel prices thus far in 2018 have not followed what over recent years had become typical seasonal patterns, and while the decline in June aligns apparel prices more closely with those patterns, it remains to be seen whether that continues over coming months.



The decline in apparel prices is one factor behind the modest decline in core goods prices in June, and the 0.3 percent year-on-year decline marks the 61st such decline in the past 63 months. Both primary rents and owners' equivalent rents were up 0.3 percent in June, and on a year-on-year basis are up 3.6 percent and 3.4 percent, respectively. While we expect further gradual deceleration in primary (or, market) rents over coming months, we expect continued gradual acceleration in owners' equivalent rents. This reflects the robust rate of house price appreciation over the past several months, which we believe will bias owners' perspectives on the prospective rental value of their homes higher. Given the outsized weight (better than 40 percent) of rents in the core CPI, however, this will act as a steady upward force on core CPI inflation, an effect not seen to nearly the same degree in the PCE deflator. To illustrate the impact of rents on the core CPI, ex-shelter core inflation came in at 1.4 percent in June, though it is worth noting that ex-shelter core inflation has picked up steam over the past few months.



As to which is the better gauge of overall inflation pressures, the month-to-month change or the year-on-year change in the June CPI, as is usually the case with life in general, the "truth" lies somewhere in between. Labor costs rising at an accelerating rate, even if only gradually, will support faster services inflation. While a stronger U.S. dollar has helped tamp down core goods prices, should tariffs extend to consumer goods that will change. Moreover, faster growth in costs of nonlabor inputs could at some point prompt firms to become more aggressive on pricing on the retail level. As such, it is quite possible that inflation pressures will grow into the headline inflation rate on the June CPI report.

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