ECONOMIC UPDATE

REGIONS

October 11, 2018

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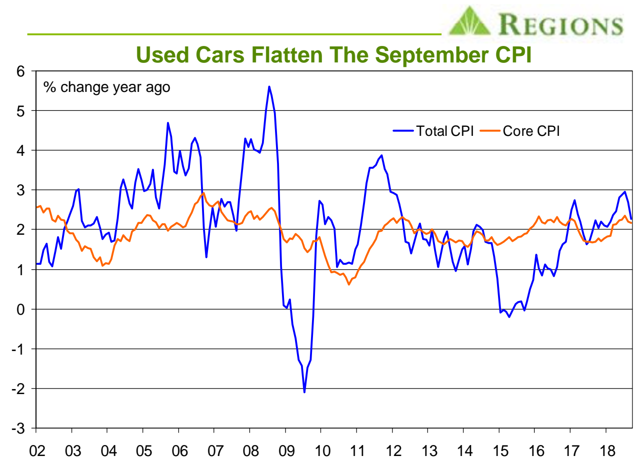
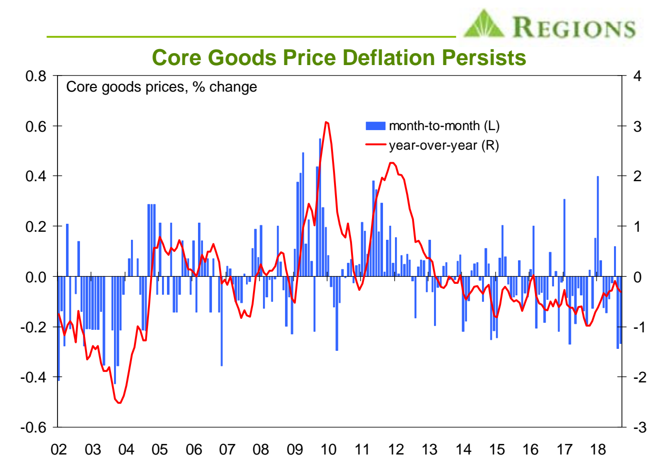
September Consumer Price Index: Used Car Prices Flatten The September CPI

- The total CPI rose by 0.1 percent (0.059 percent unrounded) in September; the core CPI was up 0.1 percent (0.116 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.3 percent and the core CPI was up 2.2 percent in September

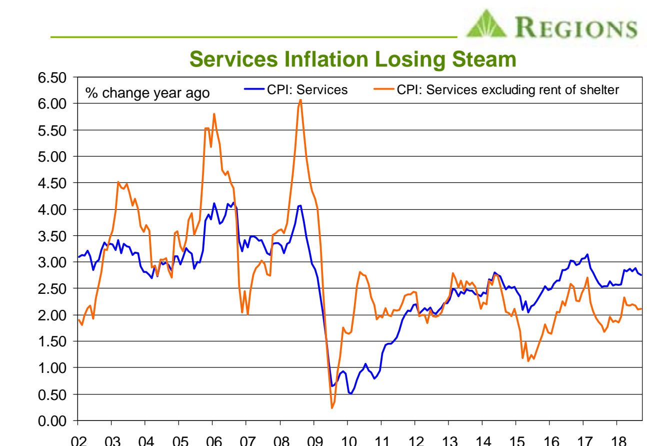
This is how you know the economic forecasting gods have it in for you: for months your forecast anticipates apparel prices and medical care costs will rebound from a series of oddly large declines that seem more noise than anything else, and for months those rebounds don't come, so your forecasts of the headline and core CPI consistently miss to the upside. Undeterred, you stick to your call and, lo and behold, those rebounds finally materialize but, instead of your forecast for the total and core CPI being spot on, your forecast still misses to the upside because given your laser-like focus on jumps in apparel prices and medical care costs you don't see the ridiculously large decline in used car prices coming, and your forecast gets flattened. Whatever.



In any event, both the total CPI and the core CPI rose by 0.1 percent in September, below our forecast of a 0.2 percent increase in the total CPI and a 0.3 percent increase in the core CPI. This leaves the total CPI up 2.3 percent year-on-year and the core CPI up 2.2 percent, milder increases than we and the consensus expected. Don't, however, take this as a sign that the FOMC can take their collective foot off the gas when it comes to raising the Fed funds rate. We say this not because the reported 3.0 percent decline in used car prices, the largest monthly decline in 15 years, is so ridiculously large that it can be dismissed out of hand, but for a more fundamental reason – even though the FOMC no longer characterizes it as such, monetary policy very much remains accommodative, and the FOMC very much wishes to change that and, as such, will continue to raise the funds rate. How the inflation data do come into play here is that with inflation remaining moderate, the FOMC can continue to raise the funds rate at a gradual pace.



As to the details of the September CPI, food prices were flat as a decline in prices for food consumed at home negated higher prices for food consumed away from home. Retail gasoline prices fell by 0.2 percent, but are nonetheless up 9.1 percent year-on-year. The overall energy index fell by 0.5 percent in September. Apparel prices jumped by 0.9 percent, though this doesn't come close to reversing the cumulative decline of almost three percent seen over the prior three months and still leaves apparel prices down 0.6 percent year-on-year. New car prices fell by 0.1 percent, as our forecast anticipated. The ridiculously large decline in used car prices came after a string of hefty increases, but to the extent there is a spike in demand in the wake of Hurricane Florence and Hurricane Michael, used car prices could jump over coming months, as was the case in Q4 2017 after Hurricanes Harvey and Irma. For now, though, lower prices for both new and used motor vehicles contributed to a 0.3 percent decline in core goods prices, which follows what in August was the largest monthly decline in core goods prices since April 2010. Year-on-year, core goods prices are down 0.3 percent, the 64th year-on-year decline in the past 66 months. sort of meaningful trends.



Market rents and owners' equivalent rents posted below-trend increases in September, with each up 0.2 percent. On an unrounded basis, the 0.182 percent increase in owners' equivalent rents is the smallest monthly increase since July 2013. We noted in our weekly *Economic Preview* that slowing house price appreciation could bias growth in owners' effective rents lower over coming months, though, admittedly, the link between the two was not as strong to the upside over the past several quarters as we expected, so at this point we won't read too much into the September data. Lodging costs fell by 1.0 percent in September, and shelter costs in general contributed to a softer print on core services inflation. Core services inflation has eased over recent months, even though services prices are generally seen as being more sensitive to changes in labor costs.

The two main drivers of core inflation over coming months will be the extent to which higher labor costs push core services prices higher and the extent to which tariffs push core goods prices higher. With overall inflation remaining fairly well contained, however, the FOMC will remain focused on removing remaining policy accommodation.

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