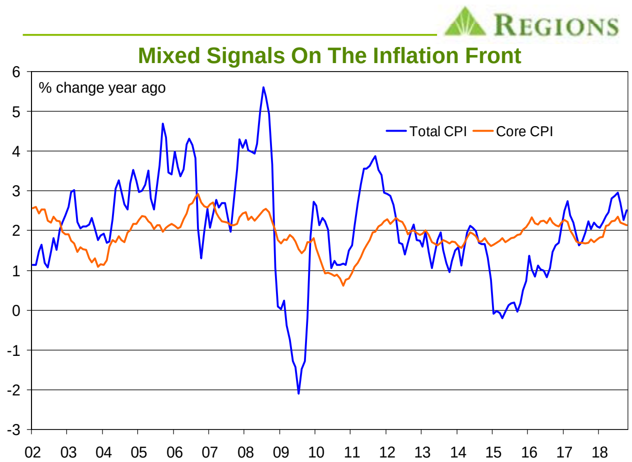
ECONOMIC UPDATE
REGIONS
November 14, 2018

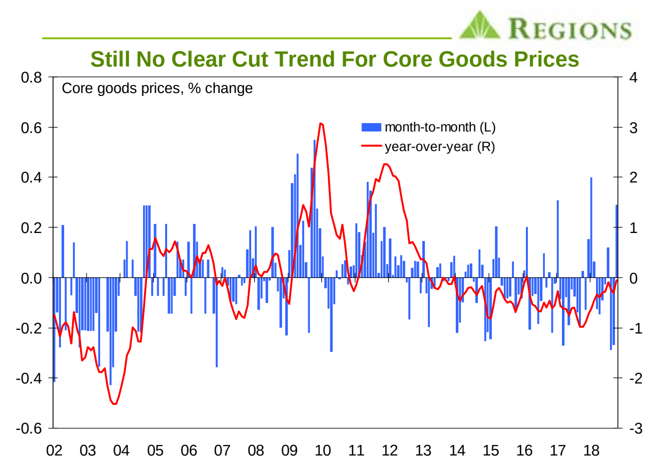
October Consumer Price Index: Mixed Signals On The Inflation Front

- The total CPI rose by 0.3 percent (0.331 percent unrounded) in October; the core CPI was up 0.2 percent (0.193 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.5 percent and the core CPI was up 2.1 percent in September

The total CPI rose by 0.3 percent in October, with the core CPI up by 0.2 percent, each matching the consensus forecast. On a year-over-year basis, the total CPI is up 2.5 percent and the core CPI is up 2.1 percent. Our forecast of a 0.4 percent increase in the total CPI proved a bit too high – our unrounded forecast was 0.359 percent compared to the actual increase of 0.331 percent – and our forecast of a 0.3 percent increase in the core CPI was also on the high side. The October CPI report is not free from noise (really, what data release ever is?) but, even allowing for this noise, there are mixed signals on the inflation front in today's release. Perhaps of more significance, the October CPI report gives the FOMC no grounds for either speeding up or dialing down the gradual pace at which it is removing remaining monetary accommodation.

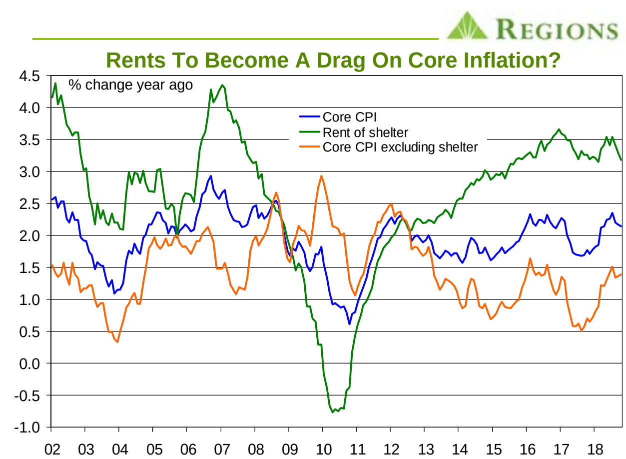


As we anticipated, the October CPI data brought payback for the ridiculously large (3.0 percent) decline in used car prices that flattened the September CPI, with used car prices reported to have risen by 2.6 percent in October. It is worth noting that in January the BLS changed how it incorporates used car prices into the CPI, moving to a single-month basis from a three-month moving average basis. This adds to the volatility in used car prices and can, as in both September and October, lead to measured changes in used car prices that can add/deduct one-tenth of a point from the change in the core CPI while telling us nothing of value about underlying trends in core inflation. Prices for new motor vehicles fell by 0.2 percent in October, in line with normal seasonal patterns. Retail gasoline prices rose by 3.0 percent on a seasonally adjusted basis in October, leaving them up 16.1 percent year-on-year. Keep in mind, however, that the year-on-year change is biased by last year's swings in retail gasoline prices – rising sharply in September then falling sharply in October – triggered by Hurricanes Harvey and Irma. Recent declines in crude oil prices mean gasoline should be a drag on the total CPI over coming months. The broader energy index was up 2.4 percent in October.



Food prices were down by 0.1 percent in October, with prices for food consumed at home (think grocery store prices) down 0.2 percent and prices for food consumed away from home (think restaurant prices) up just 0.1 percent. While the former is not surprising, the latter is, at least to some degree given how strong restaurant sales have been over the past several months. Apparel prices were up 0.6 percent in October, the latest in a series of moves which seem to have little rhyme or reason but which nonetheless have left apparel prices down 0.3 percent year-on-year.

As to our "big three" drivers of core inflation, medical care costs rose by 0.2 percent in October, leaving them up 1.7 percent year-on-year, hardly the acceleration we have been anticipating. After a notably below-trend increase in September, our forecast anticipated a much larger increase in primary rents in October, but this did not materialize, which is the biggest factor behind our miss on our core CPI forecast. Primary rents were up just 0.2 percent in October, matching September's advance. The softening in apartment rents comes as no surprise, as growth in supply outpaces what remains robust growth in demand, but it could be that growth in rents on single family homes has topped out, hence flagging growth in overall primary rents. While it is too soon to make this call, this will be a key driver in the path of core CPI inflation over coming months. So too will be core goods prices, which jumped 0.3 percent in October but are still down year-on-year for the 65th time in the past 67 months. As seen in our middle chart, month-to-month increases have not been unusual, but neither have they been sustained. While a firmer U.S. dollar would suggest downward pressure on core goods prices, the wild card here is tariffs, specifically whether or to what extent they will be imposed on consumer goods.



Inflation remains fairly well behaved, at least for now. But, with rising input costs having been a prime topic on the latest round of corporate earnings calls, core inflation pressures seem likely to intensify, thus keeping the FOMC on its course of gradual funds rate hikes.

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