



## ECONOMICS GROUP

Mark Vitner, Senior Economist  
[mark.vitner@wachovia.com](mailto:mark.vitner@wachovia.com) • 704-383-5635

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### Consumer Prices Dip Into Negative Territory

*The Consumer Price Index declined 0.1 percent in March, bringing the year-to-year change in the headline CPI to -0.4 percent. Core inflation rose a bit more than expected, however, with the ex food and energy series climbing 0.2 percent in March. The increase was concentrated in two quirky components: owners' equivalent rent and tobacco.*

#### Deflation Arrives In The Headline CPI Figures

The Consumer Price Index declined 0.1 percent in March, bringing the year-to-year change to minus 0.4 percent. This marks the first year-to-year decline in the headline CPI since August 1955. Inflation is not dead, however. Nearly all the drop is due to a 23 percent year-to-year decline in energy prices, which skyrocketed last year. Gasoline prices, which declined a seasonally-adjusted 4.0 percent in March, are down 39.3 percent on a year-to-year basis. And the price index for fuel oil and other household fuels is down 30.5 percent over the past year. We expect the headline CPI to remain in negative territory for much of this year and project a 1.2 percent decline for the year as a whole.

Declines in energy prices and smaller rises in food prices will help bolster household purchasing power. The benefit to household budgets will not be as great as the headline numbers suggest. Most of the decline in the headline CPI has been in energy prices and you cannot eat oil. Excluding energy, the CPI rose 0.1 percent in March and is up 2.2 percent year-to-year. Food prices fell 0.1 percent, with modest declines in virtually every product category. Dairy prices were one notable exception, with prices plunging 2.4 percent in both February and March. Milk is selling for less than \$3.50 a gallon at many grocers and a few chains are even selling it for under \$3.00. Year-to-year, food prices remain 4.3 percent above their year-ago level. We expect further moderation in food prices, particularly fresh fruits and vegetables and meat, poultry and fish. On a year-to-year basis, food prices should still see an increase of 3 percent this year.

#### Core Inflation Remains In Positive Territory

Excluding food and energy, the core CPI rose 0.2 percent in March and remains up 1.8 percent over the past year. An 11 percent jump in the price of tobacco products was responsible for over sixty percent of the rise in the core CPI during March. One other notable price hike was owners' equivalent rent, which rose 0.2 percent. The rise in owners' equivalent rent is one of the more quirky elements in the CPI. Many rental properties include utilities in the monthly rent. As a result, falling energy prices cause the measured rent used in the CPI calculations to increase. Rents are falling in the real world and this will eventually show up in the CPI figures, resulting in a moderation in rent of primary residence, owners' equivalent rent, and the core CPI. The decline in the headline CPI will almost certainly get tongues wagging about deflation again. As we frequently noted in the past, we expect the CPI to decline in 2009 but do not expect a problematic deflation to take hold in the economy. Core inflation is expected to moderate to around a 1.0 percent pace later this year, which is still solidly in positive territory.

