# ECONOMIC UPDATE

REGIONS

August 15, 2013



## July Consumer Price Index/July Industrial Production

- The total CPI rose by 0.2 percent in July, with the core CPI also up by 0.2 percent; on a year-over-year basis, these translate into increases of 2.0 percent and 1.7 percent, respectively.
- Total industrial production was unchanged in July, with output in the manufacturing sector falling by 0.1 percent.

CPI: The total CPI rose by 0.2 percent in July, in line with expectations, which puts headline inflation at 2.0 percent. The core CPI also rose by 0.2 percent, which translates into an over-the-year increase of 1.7 percent. Core inflation as measured by the CPI has stabilized at around 1.7 percent over the past several months, but nonetheless remains well above core inflation as measured by the PCE deflator, the Fed's preferred measure of core inflation.

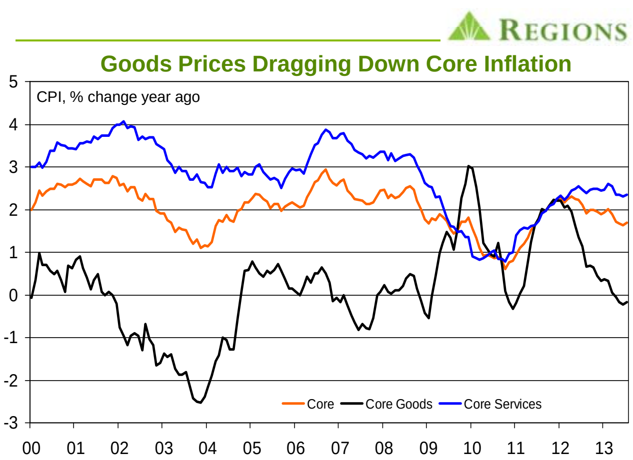
Despite declining on a not seasonally adjusted basis, retail gasoline prices rose by 1.0 percent in the seasonally adjusted CPI data, leaving them up by 5.2 percent on a year-over-year basis. Following a 0.9 percent increase in June, apparel prices posted a 0.6 percent increase in July. Higher apparel prices in July reflect steep increases in prices for girls' and women's apparel, up by 3.9 percent and 1.8 percent, respectively. Meanwhile, prices for men's apparel fell by 1.5 percent as prices for men's suits fell by 6.1 percent, thanks in part to those "buy one get 872 free" sales popular with a certain retailer. Higher tobacco prices contributed to a 0.3 percent increase in the "other goods and services" component.

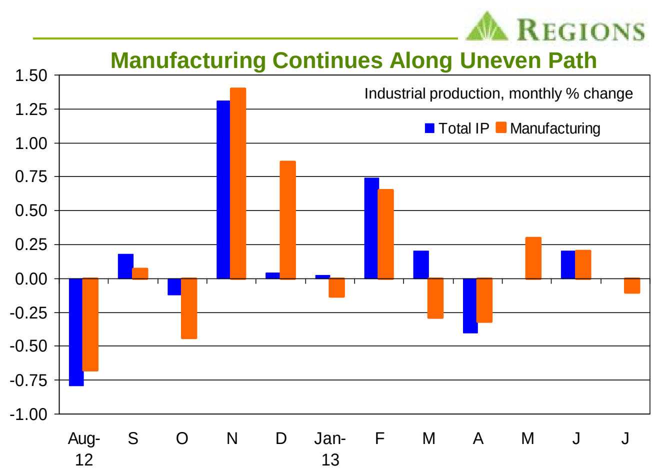
While rents posted their typical increases in July, overall housing costs were unchanged in the CPI thanks to falling prices for household fuels and utilities and lower prices for household furnishings. Air fares posted a second consecutive monthly decline. New car prices were flat in July, reflecting aggressive incentives that lowered final retail prices, in part inspired by producers trying to clear stock ahead of the new model year. Used car prices fell by 0.4 percent, the third straight monthly decline.

While much has been made of low core inflation, it is interesting to break this down into prices for goods and prices for services. As seen in the chart below, core services inflation is running at a steady pace of around 2.4 percent. Falling prices for core goods have been responsible for dragging overall core inflation down and holding it down. The trend in core goods prices as measured by the CPI reflects weakness in pricing for items such as computers, home electronics, and appliances. Throwing in the lower prices for medical services as measured in the PCE deflator gets you to a rate of core PCE inflation well below the Fed's 2.0 percent target. When looked at in this light, however, it becomes a bit more difficult to see how continuing the current rate of large-scale asset purchases is going to change the course of core inflation.

Industrial Production: With declining output in manufacturing and utilities offsetting higher mining output, total industrial production was unchanged in July. The decline in manufacturing output was fairly broad based, led by a surprisingly large 1.7 percent in motor vehicle output. Wood products, industrial machinery, computer and electronic equipment, chemicals, and textiles were amongst the industry groups in which output fell in July, with primary metals and aerospace equipment among the few industry groups reporting higher output. The decline in motor vehicle output reported in the industrial production data comes despite an increase in payroll employment amongst vehicle producers as they curtailed or cancelled the annual retooling shutdowns.

Overall capacity utilization fell to 77.6 percent in July, with the utilization rate in the manufacturing sector falling to 76.4 percent. Within the motor vehicles industry group, capacity utilization fell to 74.7 percent in July. Aside from the reported dip in production in July, the utilization rate has been notably low despite the strength of retail vehicle sales over the past several months. As with many other segments of manufacturing, the auto industry is contending with a legacy of excess capacity. Not only does this weigh on capital spending, but it also is a factor in the lack of pricing power amongst goods producers that is such a key driver behind the trends in core inflation. It will take a sustained period of faster economic growth, both at home and abroad, to reverse this trend.

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