ECONOMIC UPDATE

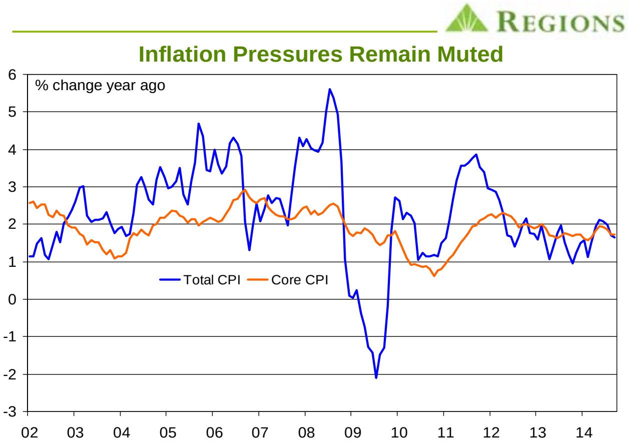
REGIONS

October 22, 2014

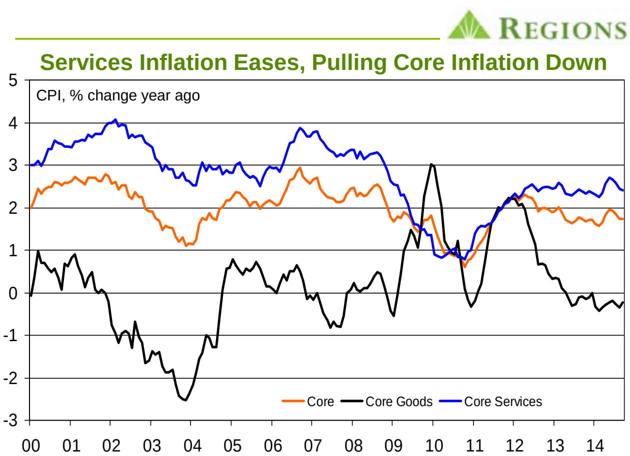
September Consumer Price Index: Inflation Pressures Remain Muted

- The total CPI was <u>up</u> 0.1 percent (0.086 percent unrounded) in September; the core CPI was <u>up</u> 0.1 percent (up 0.139 percent unrounded).
- On a year-over-year basis, the total CPI was <u>up</u> by 1.66 percent and the core CPI was <u>up</u> by 1.73 percent in September.

The headline CPI rose by 0.1 percent in September, though it took some friendly upward rounding to top the consensus estimate of no change. The core CPI rose 0.1 percent, lagging the consensus estimate of a 0.2 percent increase. On a year-over-year basis both the total CPI and the core CPI were up 1.7 percent. With each new month of data showing little inflation pressure, on either the wholesale or retail levels, the "Great Inflation Scare" of 2014 becomes a more distant memory. Surely you remember that one, when May and June saw the headline CPI post year-over-year gains of 2.1 percent and there were those analysts warning inflation was just getting heated up while those who from day one of QE-1 were warning of significantly higher inflation thought vindication for their call was at hand. We felt no such alarm and, more importantly, neither did most FOMC members, most notably Chairwoman Yellen. That is not to say the September CPI data won't cause concern amongst the FOMC, as there will likely be concern over inflation drifting further away from the 2.0 percent target rate. Drifting away to the downside that is. With energy prices having slumped and a more uncertain global growth outlook, inflation pressures figure to remain muted over coming months.

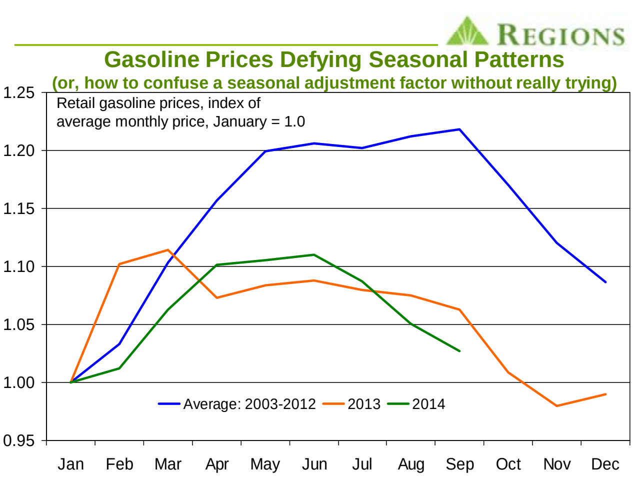


Energy prices fell 0.7 percent in September on the heels of a 2.6 percent decline in August. Retail gasoline prices fell 1.0 percent in September on a seasonally adjusted basis (not seasonally adjusted pump prices fell 2.1 percent) and electricity prices fell 0.7 percent. Though unadjusted gasoline prices typically fall in September, the decline this year was larger than normal. More significantly, gasoline prices continue to act as a drag on the total CPI in that they for some time now have not followed typical intra-year seasonal patterns, meaning the seasonal adjustment factors are not adequately capturing the patterns seen this year and last. With crude oil prices having fallen sharply over recent weeks, gasoline will continue to be a drag on retail inflation.



To be sure, there was more than energy prices holding down the total CPI in September, as air fares fell 0.5 percent, prices for apparel and new motor vehicles were unchanged, and medical costs rose by just 0.16 percent. Prices of core goods logged a 17th straight year-over-year decline in September, which has been a persistent drag on core inflation. Of late, however, core services inflation has moderated, coming in at just 2.4 percent in September. Services prices tend to be more immune to global forces than is the case with goods prices, so the recent moderation in core services inflation is of note and, should it continue, will act as a further drag on overall core inflation.

That leaves food prices and rents as the main sources of inflation pressure. Food prices posted a 0.3 percent increase in September, with prices for both food consumed at home and food consumed away from rose by the same 0.3 percent. On a year-over-year basis, prices for food consumed at home rose by 3.2 percent and prices for food consumed away from home rose by 2.7 percent, which mark the fastest rates of food price inflation since mid-2012.



Rents bounced back in September after posting below-trend increases in August. Market rents rose 0.33 percent, for an over-the-year increase of 3.3 percent, a rate of rent inflation last seen in 2008. Owners' equivalent rent rose 0.24 percent in September and over-the-year increases have settled at 2.7 percent over recent months, a rate last seen in late-2007/early-2008. For the near term, market rents will continue to rise at a healthy clip but once multi-family completions catch more fully up with what has been a rapid rate of multi-family starts, rent growth will begin to ease.

The September CPI data affirm inflation pressures remain muted. While outright deflation is a long shot, we could see further disinflation, meaning it will be some time until inflation becomes a pressing concern for the Fed.

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