# ECONOMIC UPDATE

REGIONS

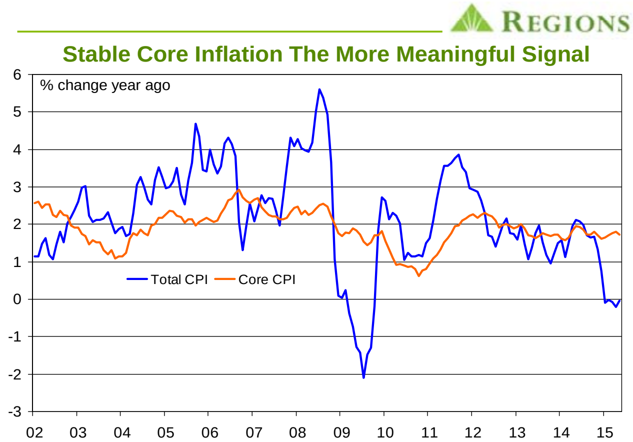
June 18, 2015



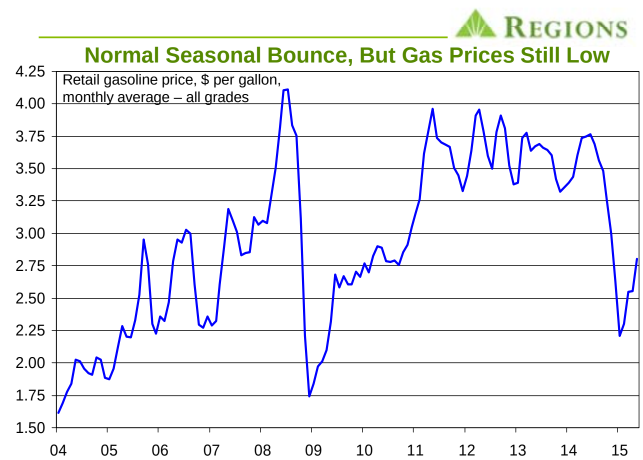
## May Consumer Price Index: Stable Core Inflation The More Meaningful Signal

- The total CPI rose 0.4 percent (up 0.445 percent unrounded) in May; the core CPI was up 0.1 percent (up 0.145 percent unrounded).
- On a year-over-year basis, the total CPI was unchanged and the core CPI was up by 1.7 percent in May.

The total CPI rose a smaller than expected 0.4 percent in May. As has been the case for some time now, swings in retail gasoline prices greatly impacted the headline CPI in May, but even with sharply higher retail pump prices the headline CPI was unchanged on an over-the-year basis, though this is in part a reflection to the increases seen last May (this will also be the case for June). Given the extent to which changes in retail gasoline prices have been driving headline inflation over the past several months, the core CPI remains a more reliable indicator of underlying inflation pressures. In May, the core CPI rose by 0.1 percent, also below expectations, which translates into a year-on-year increase of 1.7 percent. Core inflation has been notably stable over the past two years, never straying far from the average rate of 1.7 percent over this time span. Over this time, though, core goods prices have fallen each month while core services prices have risen at an average rate of 2.4 percent (these are year-over-year changes).

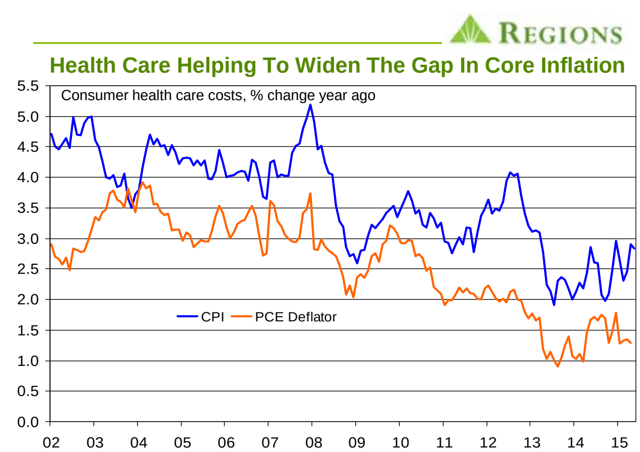



Retail gasoline prices as measured in the CPI were up 10.5 percent in May, the second monthly increase of better than 10 percent in the past three months. May's rising gasoline prices are consistent with normal seasonal patterns, but still leave retail pump prices 25 percent below their-year ago level. Aside from gasoline, rents provided upward pressure on May's CPI, with both primary (i.e., market) rents and owners' equivalent rents posting 0.3 percent increases. On a year-over-year basis, primary rents are up 3.5 percent and owners' equivalent rents up 2.8 percent. We have been operating on the premise that over-the-year increases in primary rents will moderate over coming quarters, as what will be a faster rate of completions on new multi-family rental units will lead to some moderation in rent growth while at the same time the over-the-year comparisons will be more challenging given inflation in primary rents has been running at better than 3 percent for the past 14 months. At the same time, we think what has been a pick-up in the pace of house price appreciation of late will be supportive of faster growth in owners' equivalent rents. On the whole, then, rents will remain a source of upward pressure on inflation, especially core inflation, over coming quarters.




Food prices were unchanged in May, with prices for food consumed at home down 0.2 percent, marking the fourth decline in the past five months, while prices for food consumed away from home were up 0.2 percent. This pattern has been in place for some time now, with restaurant sales one of the fastest growing segments of retail sales, hence allowing for some pricing power amongst restaurant operators. On a year-over-year basis, food prices were up 1.6 percent, with prices for food consumed away from home up 3.0 percent and prices for food consumed at home up just 0.6 percent, though last May through September saw hefty increases in prices for food consumed at home, hence raising the bar on over-the-year comparisons for the same months in 2015.

It is worth noting what has been a larger than normal disparity between core CPI inflation and core inflation as measured by the PCE deflator (the Fed's preferred measure). One factor is rents are weighted far more heavily in the CPI (roughly 40 percent of the core CPI). The other main factor is the measurement of health care costs. In the CPI data, health care costs are measured on the basis of out of pocket costs to consumers, while the PCE data measure changes in health care costs based on revenue received by providers, which over the past several months have been held down by institutional factors, and also note health care is weighted more heavily in the PCE data.




This is relevant because the FOMC acknowledges the significance of core inflation given the extent to which swings in energy prices are distorting headline inflation. Our contention is core CPI inflation is at present the more reliable measure of core inflation, and would go further in helping the FOMC become "reasonably confident" (this is their characterization) inflation will ultimately move back to the 2.0 percent target.

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