# ECONOMIC UPDATE

REGIONS

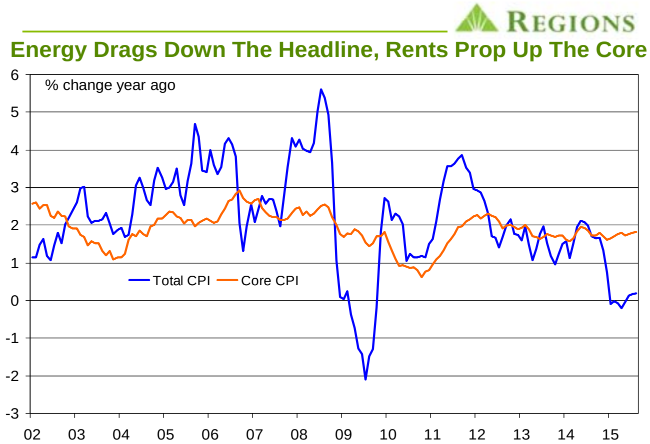
September 16, 2015



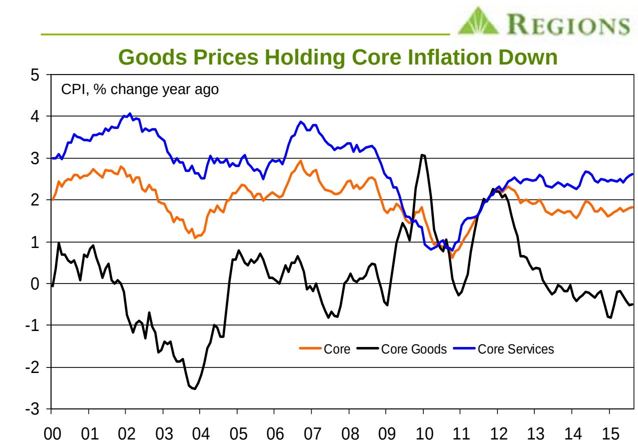
## August Consumer Price Index: Energy Drags Down The Headline, Rents Prop Up The Core

- The total CPI fell by 0.1 percent (down 0.071 percent unrounded) in July; the core CPI was up 0.1 percent (up 0.074 percent unrounded).
- On a year-over-year basis, the total CPI was up 0.2 percent and the core CPI was up 1.8 percent in August.

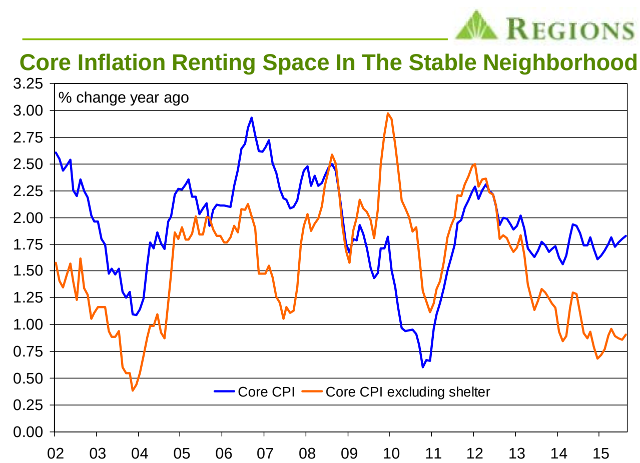
As we pored through our Excel file after downloading the latest CPI data, our initial reaction was "it's here, it's here, the inflationistas have been vindicated, and not only will the FOMC surely go tomorrow but a 50-basis point hike in the Fed funds rate is now in play!" Our excitement didn't last long, however, as we soon realized we had misplaced a decimal point and instead of right on (FOMC) target inflation of 2.0 percent, we were instead left with another 0.2 percent print on headline inflation. Sure, that day will come, not today but definitely over the "medium term" which, as best as we can tell, falls somewhere between tomorrow and the end of time. As for today, the BLS reports the total CPI fell by 0.1 percent in August, in line with the consensus estimate, while the core CPI rose, albeit just barely, with an unrounded increase of 0.074 percent rounded up to a 0.1 percent increase.




Energy costs were a drag on the CPI in August, with overall energy costs falling 2.0 percent, fueled by an atypical August decline in retail gasoline prices. As measured in the CPI data seasonally adjusted retail gasoline prices fell 4.1 percent in August, leaving them 23.3 percent below their year-ago level. Retail pump prices have fallen further to date in September, more than 8 percent below their August average, and seasonal patterns in gasoline demand combined with what we expect will be further declines in crude oil prices over coming weeks suggest gasoline will continue to act as a significant drag on the total CPI over the remainder of 2015.




Food prices rose 0.2 percent in August, with prices for food consumed at home up 0.3 percent and prices for food consumed away from home up 0.2 percent. On an over-the-year basis, this translates into increases of 1.6 percent, 0.9 percent, and 2.7 percent, respectively. Apparel prices rose 0.3 percent in August but are nonetheless down 0.9 percent year-on-year. Prices for medical care were flat in August and up 2.5 percent year-on-year. As measured in the CPI increases in medical care costs have moderated over recent months – recall in the CPI medical costs are measured on the basis of consumers' out of pocket expenditures, in contrast to the PCE deflator which measures revenues collected by service providers. Air fares and overall public transportation costs fell further in August, and are down sharply on a year-over-year basis.




Market rents were up 0.3 percent in August with owners' equivalent rents up 0.2 percent – the smallest monthly increase in the latter since last December. Year-over-year, market rents are up 3.6 percent and owners' equivalent rents are up 3.0 percent. To us, this illustrates the biggest hole in the argument made by some that with headline inflation distorted by transitory declines in energy costs, core inflation is a more accurate signal of underlying inflation pressures. Keep in mind that rents account for roughly 42 percent of core CPI inflation, so with this much of the core CPI rising at a better than 3 percent clip while overall core inflation runs at a 1.8 percent pace, this suggests prices of goods and services that make up the remainder of the core CPI are either rising at a much slower pace or falling. We have argued core CPI inflation is overstated due to the influence of rents, and indeed looking at core inflation excluding shelter costs (of which rents account for more than 90 percent) is running at just 0.9 percent, as seen in the bottom chart. Moreover, prices for core goods have fallen on a year-over-year basis for 29 consecutive months and are now working on a streak of four straight declines on a month-to-month basis. Global weakness and expectations of a looming Fed funds rate hike, even if not this week, have fueled U.S. dollar appreciation which is holding down prices of imported goods and pressuring domestic manufacturers to hold the line on prices. To the extent these patterns hold over coming months, there will be less inflation pressure in the economy than implied by the core CPI inflation.

As we have stated before, low inflation need not rule out a hike in the funds rate, but at the very least should ensure subsequent rate hikes will come at only a very gradual rate.

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