ECONOMIC UPDATE

REGIONS

October 15, 2015

September Consumer Price Index: Different Month, Same Inflation Story . . .

- The total CPI <u>fell</u> by 0.2 percent (down 0.153 percent unrounded) in September; the core CPI was <u>up</u> 0.2 percent (0.211 percent unrounded).
- On a year-over-year basis, the total CPI was <u>unchanged</u> and the core CPI was <u>up</u> 1.9 percent in September.

The total CPI fell by 0.2 percent in September primarily due to a steep decline in energy costs, while the core CPI rose by 0.2 percent. On an over-the-year basis, the total CPI was unchanged while the core CPI was up 1.9 percent, the "strongest" print since July 2014. Beneath the headline numbers, however, the story for September is much the same as it has been for many months now – divergent paths for services prices and goods prices, few sources of sustained upward price pressures outside of rents, and little prospect of headline inflation returning to 2.0 percent any time soon.

Overall energy costs fell by 4.7 percent in September (down 18.4 percent year-on-year) led by a 9.0 percent decline in retail gasoline prices. As measured in the CPI data, this leaves retail pump prices 29.5 percent below their September 2014 level. Prices for household fuels and electricity were also down in September and both are below their year-ago levels. Reflecting the decline in gasoline prices, transportation costs were down 2.3 percent in September, but prices for new and used vehicles were also down in the month – used car prices have taken a beating over recent months as sales of new motor vehicles have jumped. Air fares were down for a third consecutive month but September's 0.1 percent decline was considerably smaller than those seen in July and August. Air fares are down 6.0 percent year-on-year. Apparel prices were down 0.3 percent in September, though there were sharp differences in pricing for men's/boys' apparel (up 1.2 percent) and women's/girls' apparel (down 0.9 percent). These splits are common within the broader apparel category but more significantly apparel prices are down year-on-year in almost every sub-category within apparel.

Food prices rose 0.4 percent in September, the largest monthly increase since last May, with prices for food consumed away from home up 0.5 percent – the largest monthly gain since September 2008 – and prices for food consumed at home up 0.3 percent. In yesterday's PPI report food prices on the wholesale level were down sharply so it will remain to be seen whether this turns up in the form of lower prices in grocery stores in the October CPI report. On an over-the-year basis, overall food prices are up 1.6 percent with prices for food consumed at home up 0.8 percent and prices for food consumed away from home up 2.9 percent. Restaurants are enjoying some extra pricing power over recent months as this is one expenditure type which has clearly benefitted from lower retail gasoline prices.

As has been the case for some time now, rents remain the source of the most significant sustained inflation pressure in the U.S. economy. In September, market rents were up 0.4 percent and owners' equivalent rents were up 0.3 percent, translating into over-the-year increases of 3.7 percent and 3.1 percent, respectively. 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 are clearly the primary driver of core inflation. Stripping out shelter costs (of which rents account for more than 90 percent) leaves core inflation running at just 0.9 percent. Prices for core goods were flat in September after having declined in the prior four months, but have fallen on an over-the-year basis for 30 consecutive months now. It is true core services inflation has accelerated a bit over recent months but, at 2.7 percent in September, remains well below its historical norm. This is largely a reflection of what remains tepid growth in labor costs which we expect will suppress overall services inflation until late 2016. At the same time, a weak global growth environment and at least the possibility the FOMC will raise the Fed funds rate will likely sustain downward pressure on core goods prices. To the extent these patterns hold over coming months, there will be less inflation pressure in the economy than implied by the reading on core CPI inflation.

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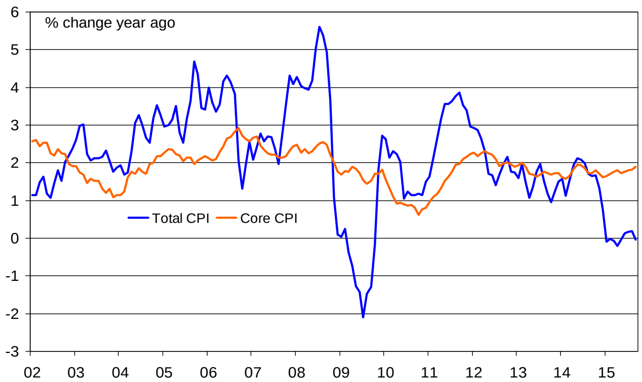

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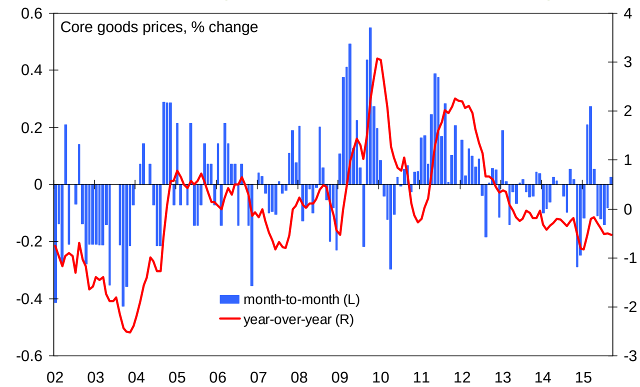
Goods Prices Likely To Remain Soft Over Coming Months



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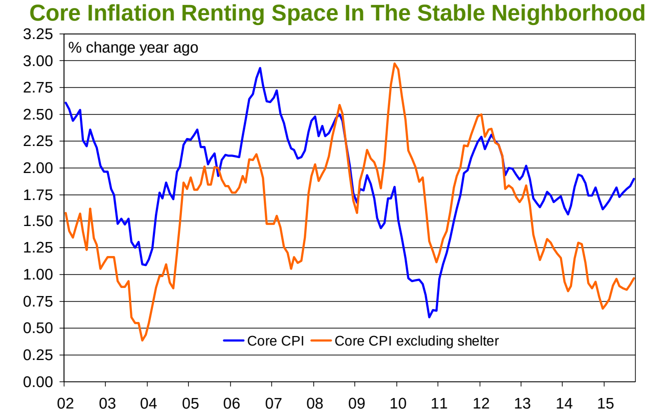
Core Inflation Renting Space In The Stable Neighborhood



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