ECONOMIC UPDATE

REGIONS

September 13, 2018

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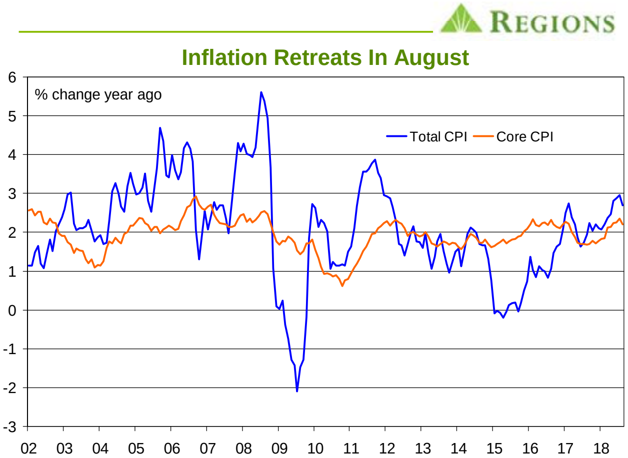
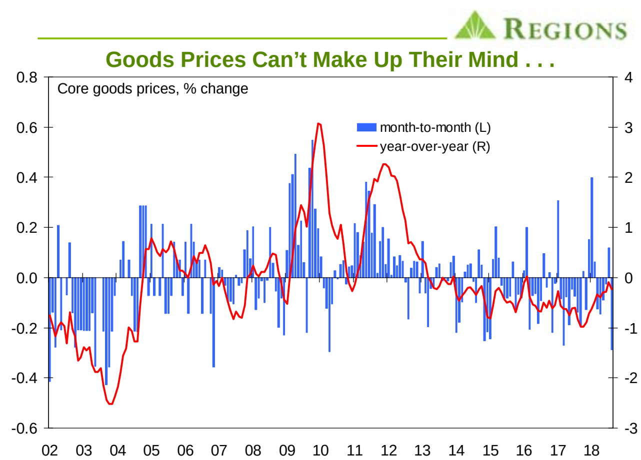
August Consumer Price Index: Inflation Retreats In August

- The total CPI rose by 0.2 percent (0.222 percent unrounded) in August; the core CPI was up 0.1 percent (0.082 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.7 percent and the core CPI was up 2.2 percent in August

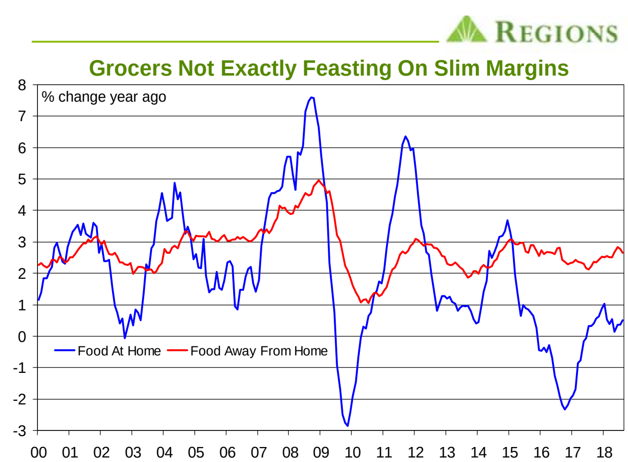
The total CPI rose by 0.2 percent in August, with the core CPI rising by 0.1 percent, with lagging the consensus forecasts of 0.3 percent and 0.2 percent increases, respectively. Our forecasts of a 0.4 percent increase on the headline CPI and a 0.3 percent increase on the core CPI were even further off the mark. With August's increases, the total CPI is up 2.7 percent year-on-year, and the core CPI up 2.2 percent, each backing off the pace seen in July. While we had noted our expectation that the 2.9 percent year-on-year increase in the total CPI in July would be the peak for 2018, we had expected core inflation to continue to pick up steam, but the August data show otherwise. At least for now. The reality is that the reads on many of the components of the core CPI have been all over the map in recent months, and it is getting harder and harder to establish any sort of meaningful trends. More broadly, there is little, if anything, in the CPI data that is at odds with the FOMC's gradual approach to removing remaining monetary accommodation.



In our weekly *Economic Preview*, we noted the risks to our above-consensus forecasts for the total and core CPI were to the downside. Our premise, however, was that the declines seen in apparel prices in both June and July and in medical care costs in July would be reversed in the August data, which left our forecast for the change in the total CPI at 0.36 percent. So, not only did we not get the reversals anticipated by our forecast, but apparel prices flat out mocked our forecast by falling 1.6 percent – that's the month-to-month change for August, not the year-on-year change. Plugging the actual changes in apparel prices and medical care costs into our CPI model left us with a 0.233 percent increase, just above the actual unrounded increase of 0.222 percent. In other words, most of the rest of the CPI data behaved as our forecast anticipated. The other thing that caught us off guard in the August data is the magnitude of the decline in core goods prices. On an unrounded basis, core goods prices fell by 0.287 percent in August, which is the largest such decline since April 2010, and which leaves core goods prices down 0.23 percent year-on-year, the 63rd such decline in the past 65 months. The decline in core goods prices in August is notable because recent months had brought evidence of some firming in core goods prices – progressively smaller month-to-month declines capped off by an increase in July. This goes to our earlier point – which way is up for core goods prices, or, is it which way is down? A firmer U.S. dollar would be a source of downward pressure on core goods prices, but should the U.S. impose tariffs directly on consumer goods – thus far they have been mainly imposed on raw and intermediate goods – that would push core goods prices higher. Core services prices, more sensitive to changes in labor costs, were up 0.2 percent in August, leaving them up 3.0 percent year-on-year.



As we anticipated, gasoline prices were up 3.0 percent on a seasonally adjusted basis – unadjusted prices were down by 0.3 percent but this is a smaller than normal decline for the month of August, hence the sizeable boost provided by the seasonal adjustment factors. Primary rents rose by 0.4 percent in August, while owners' equivalent rents were up 0.3 percent, resulting in year-on-year increases of 3.6 percent and 3.3 percent, respectively. As noted above, medical care costs fell by 0.2 percent in August, a second straight monthly decline which leaves them up by just 1.5 percent year-on-year. Food prices were up 0.1 percent in August, with prices for food consumed at home (think grocery store prices, mainly) up 0.1 percent and prices for food consumed away from home (think restaurants/fast food establishments) up 0.2 percent. On a year-on-year basis, this leaves prices for food consumed at home up by just 0.5 percent, while prices for food consumed away from home are up 2.6 percent. Retail food stores continue to face intense pressure on margins, and there are no signs this will change any time soon.



We don't see any implications for the FOMC in the August CPI data. We expect the FOMC to push the Fed funds rate to neutral, roughly four rate hikes from where we are today, then pause to assess the outlook for growth and inflation. Clearly the path of core inflation will be key, but right now what that path will be is anything but clear.

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