

## US PCE DEFLATOR EXCEEDS FED'S TARGET, BUT PRIVATE CONSUMPTION SOFT

*\*The US PCE deflator rose to 2.1% yr/yr in February, **exceeding the Fed's 2% target** for the first time since April 2012, while the core PCE deflator is now up 1.8% yr/yr; the upward drift in inflation suggests continued Fed rate increases are appropriate*

*\* US private consumption rose only 0.1% in February and declined by 0.1% in real terms, likely due to transitory factors. Expect a bounce back in March and upcoming months: fundamentals such as improving incomes, solid job growth, buoyant confidence and rising household net worth are positive*

*\*Personal income rose 0.4% and real disposable personal income rose 0.2%, lifting its yr/yr increase to 2.3%. Largely due to transitory factors in Jan-Feb, the rate of personal saving has increased to 5.6%*

**The rise in the PCE deflator above the Fed's 2% target, and the rise in the core PCE deflator to 1.8%** highlights the upward drift in inflation (see Chart 1). With many high frequency data and strong confidence measures pointing toward improving economic growth, we expect the Fed to continue to raise rates and normalize monetary policy.

The tight supply of labor is pushing up wages and businesses appear to be growing more confident in their ability to increase selling prices as the outlook for the economy improves. A crucial issue is how the Fed interprets its reference to **"symmetry"** of its inflation goal in its March FOMC statement.

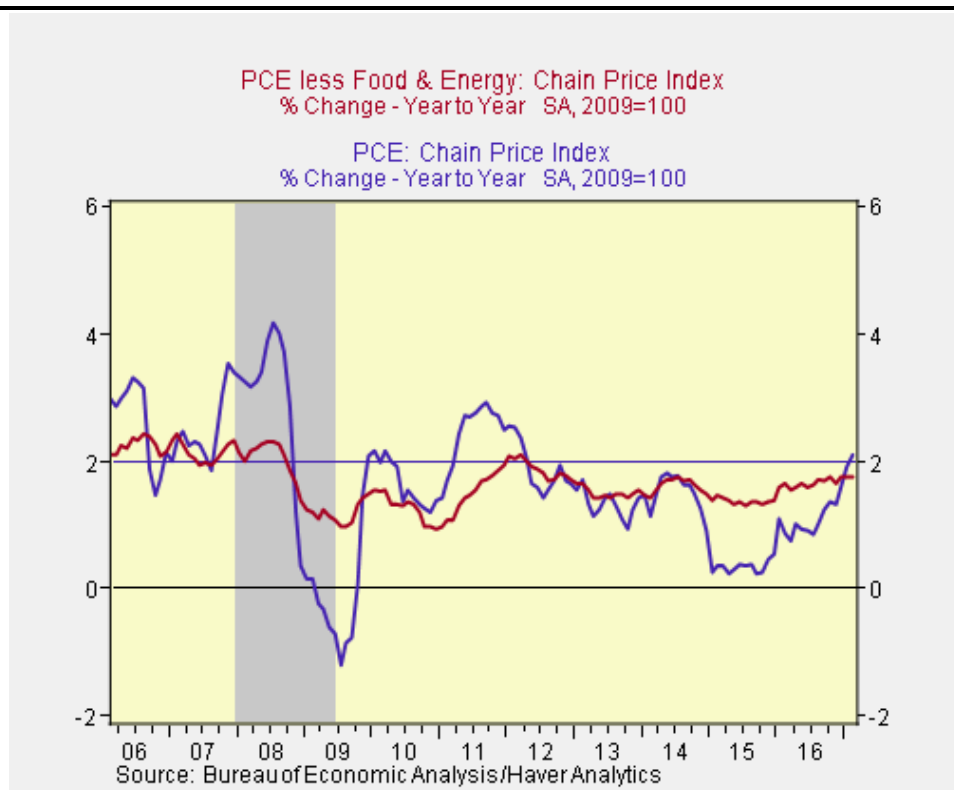
The slow 0.1% rise in nominal private consumption and decline of 0.1% in real consumption February was somewhat offset by upward revisions in December and January (see Chart 2). In part, **February's weakness reflected the transitory drag** from an unseasonably warm winter that reduced consumption of energy services, plus the delay in tax refunds for some households and the acceleration in consumer prices. This will result in real consumption growth below 2% annualized, following its strong 3.5% gain in Q4.

Real disposable incomes rose by 0.2% m/m and 2.3% yr/yr, the fastest pace of increases in a few months (see Chart 3). The personal saving rate ticked up by 0.2pp to 5.6% in February.

Improving employment, wages and incomes, a strong surge in optimism in early March, in addition to a rebound from the transitory factors mentioned above will support a bounce back in private consumption in March, lifting the starting point for Q2 (see Chart 4). The risk is the potentially negative response to recent policy missteps in Washington.

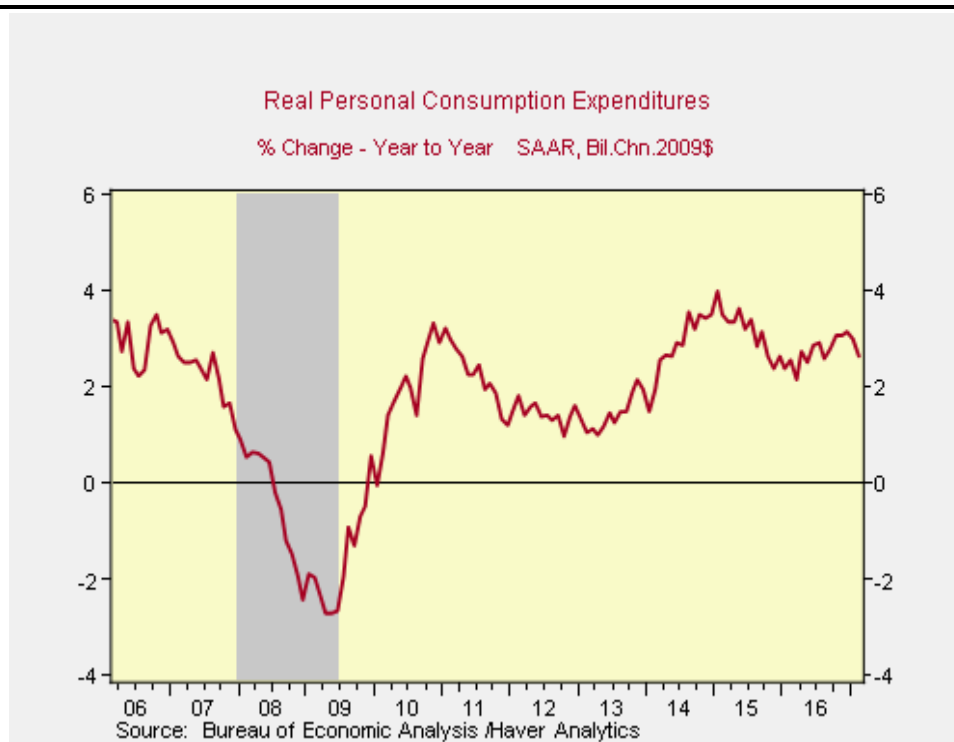
31 March 2017

Chart 1: PCE Chain Price Index: Headline and Core (Year-Over-Year, %)



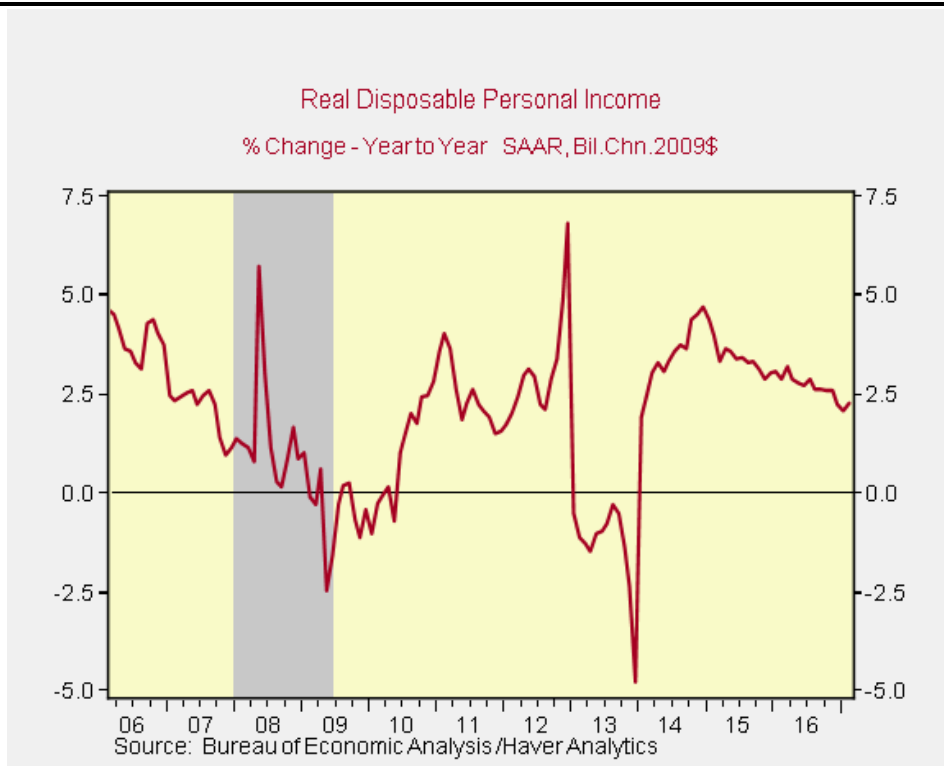
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 2: Real Personal Consumption Expenditures (Year-Over-Year, %)



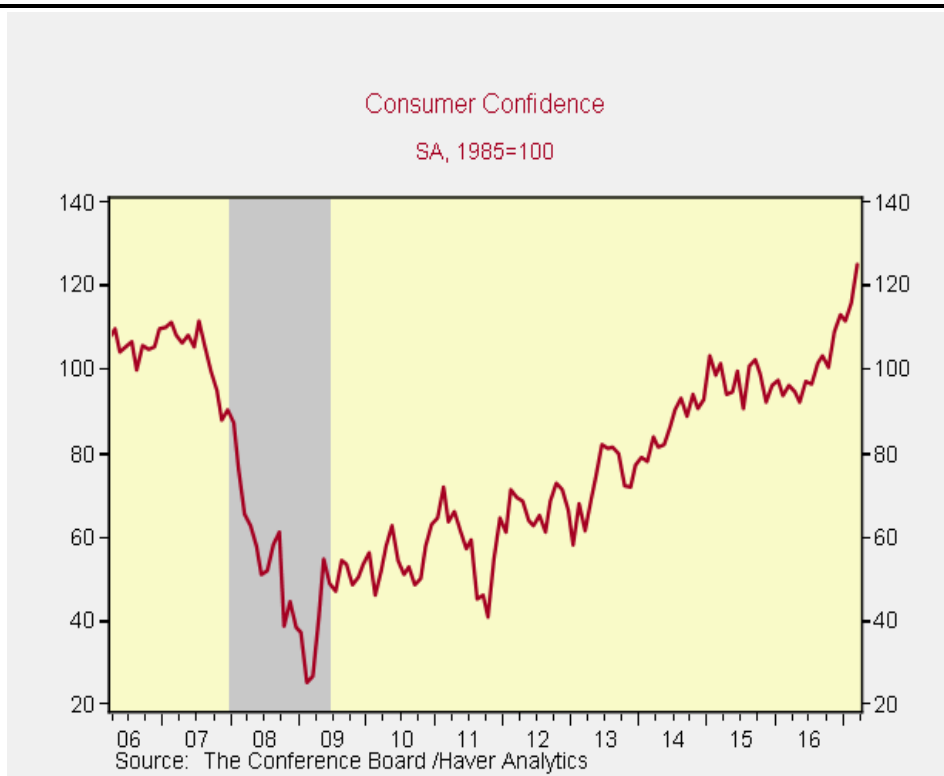
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 3: Real Disposable Personal Income (Year-Over-Year, %)



Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 4: Consumer Confidence Index



Source: Monthly data. Source: The Conference Board and Haver Analytics

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