

US: SEPTEMBER CORE CPI SOFT AND RETAIL SALES STRONG

**The CPI increased by a strong 0.5% m/m and 2.2% yr/yr in September, boosted by a 13% m/m increase in gasoline prices that have been elevated since Hurricane Harvey (see Chart 1)*

**Core CPI (excludes food and energy) increased by 0.1% m/m and 1.7% yr/yr, both 0.1pp below the Consensus expectation, after a strong 0.25% m/m gain in August (see Chart 2)*

**US retail sales advanced a strong 1.6% m/m in September due to the large 3.6% m/m bounce in vehicle sales and 5.8% m/m surge in nominal value of gasoline station sales (due to higher gas prices) (see Chart 3). Excluding autos and gas, retail sales advanced by a more moderate 0.5% m/m*

Consumer Price Index

Although retail regular gasoline prices are still elevated at \$2.48/gallon (compared to \$2.36 average in August), they are coming down (see Chart 4). As a result, energy prices are on track to subtract -0.1pp from the monthly percent change in the October headline CPI. Besides energy and possibly lodging away from home prices (+1.5% m/m), the hurricane effect was not apparent in other categories. For example, despite the heightened replacement demand for vehicles in September, new and used vehicles CPI fell 0.4% m/m and 0.2% m/m, respectively, and food prices advanced only 0.1% m/m.

Taking today's CPI report at face value, the Fed's preferred measure of inflation, the headline and core PCE deflators (set for release on October 30th) probably rose by 1.6% yr/yr and 1.3% yr/yr, respectively.

Despite the softer-than-expected gain in September core prices, the widespread slowdown observed between March and June is reversing. Of the 62 main CPI categories, 37 increased on a month-to-month basis in October, compared to just 28 rising in June (see Chart 5).

The Fed will look beyond the recent Hurricane boost in headline prices, and focus more on core prices in the near-term for a gauge of the underlying trend in prices. The results over the last couple of months suggest that the worst of the soft patch in consumer price inflation is behind us, but that price gains will continue to be only modest, but enough for the Fed to increase its policy rate at its December meeting. However, beyond December, the Fed will pause its rate hikes due to the growing inflation uncertainty. Our expectation is that after December it will wait until June 2018 before raising its policy rate again.

Retail Sales

The quick rebound in motor vehicle sales in September and the solid 0.4% m/m gain in control retail sales (excludes sales at food services and drinking places, gasoline stations, building materials and auto stores) point to upside risk to other activity indicators affected by the hurricane. A similar-quick rebound in other sectors would imply a muted negative hurricane impact on Q3 economic activity.

Control retail sales that factor directly into GDP advanced 2.6% annualized in Q3, a

13 October 2017

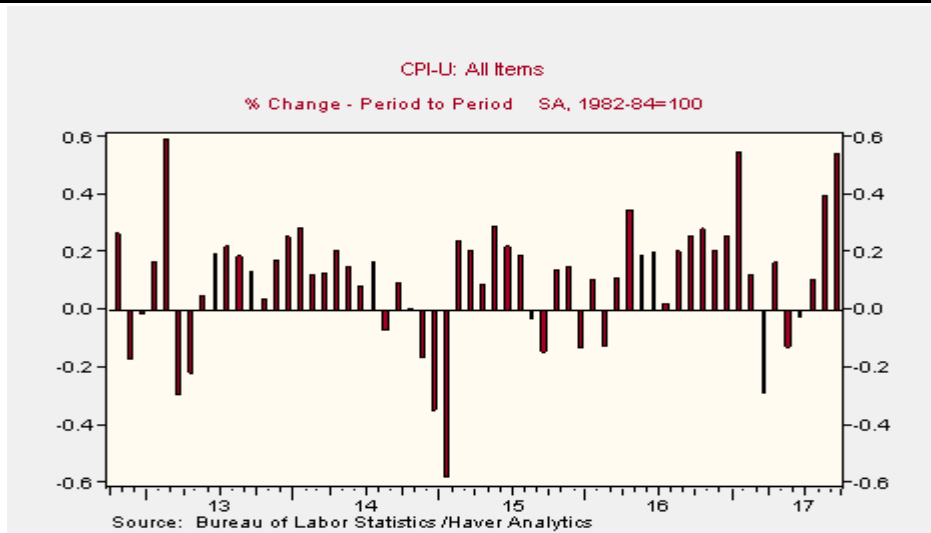
slight deceleration from the 3.9% gain in Q2, but provides a solid-enough baseline for Q3 real private consumption (see Chart 6).

Sales of building materials and supplies increased by a strong 2.1% m/m in September, likely boosted by rebuild and repair efforts in the storm-affected regions.

Elsewhere, sales at food services and drinking places advanced a strong 0.8% m/m, the best gain since January, an indication of improved confidence in finances and willingness to spend on more discretionary services. Nonstore (includes online) sales advanced 0.5% m/m in September, after an anomalous 0.4% decline in August (online consumer marketplaces offering special promotional sales in July stole some of August sales).

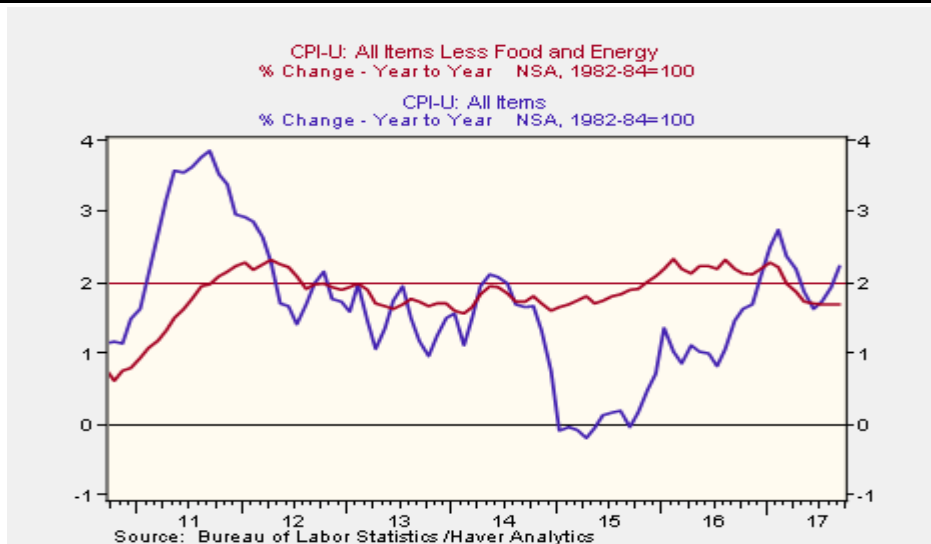
Whenever consumer confidence is near historical highs, it tends to be a better predictor **of consumer spending than incomes. That has happened so far this year (see “[U.S. confidence points toward sustained momentum](#)”, October 9, 2017). The combination of rising employment and improving labor markets, plus further increases in household net worth, is driving confidence and spending.**

Chart 1: CPI: All items (month-over-month, %)



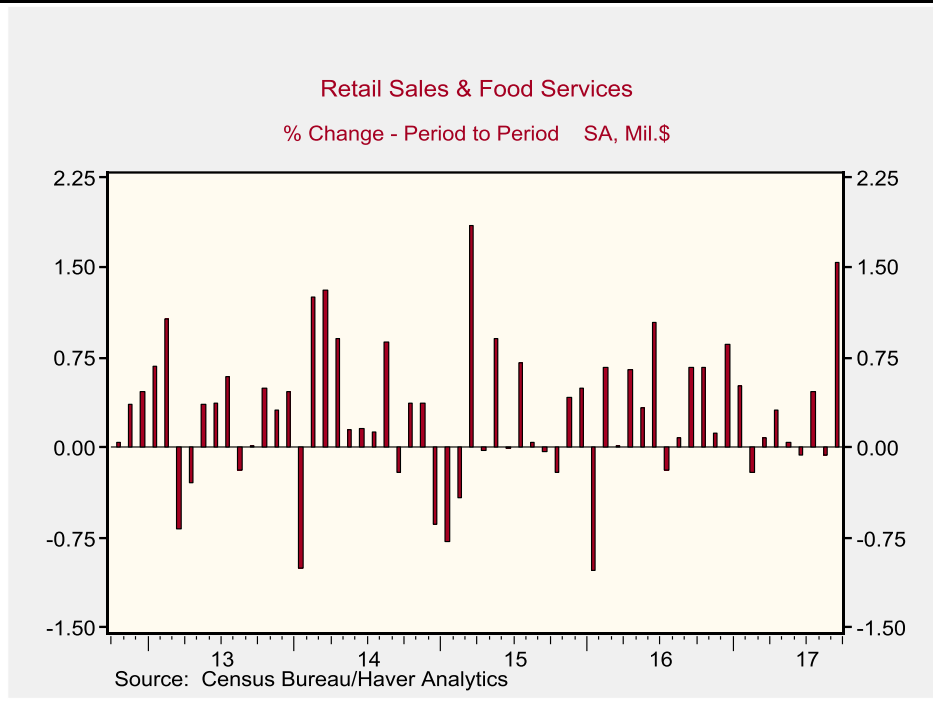
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: CPI - All items and CPI - Less Food and Energy (year-over-year, %)



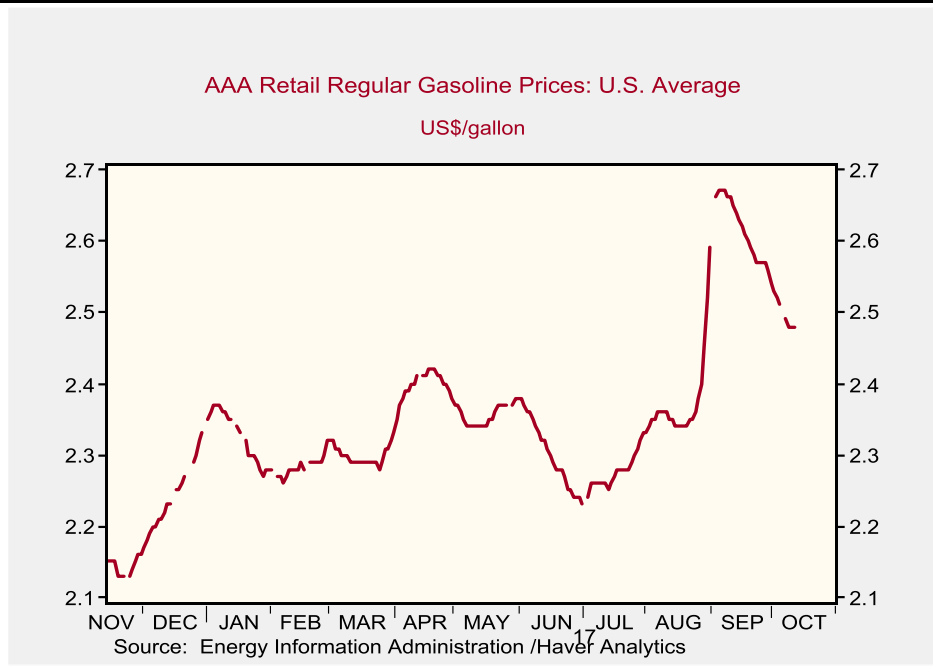
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: Retail Sales and Food Services (month-over-month, %)



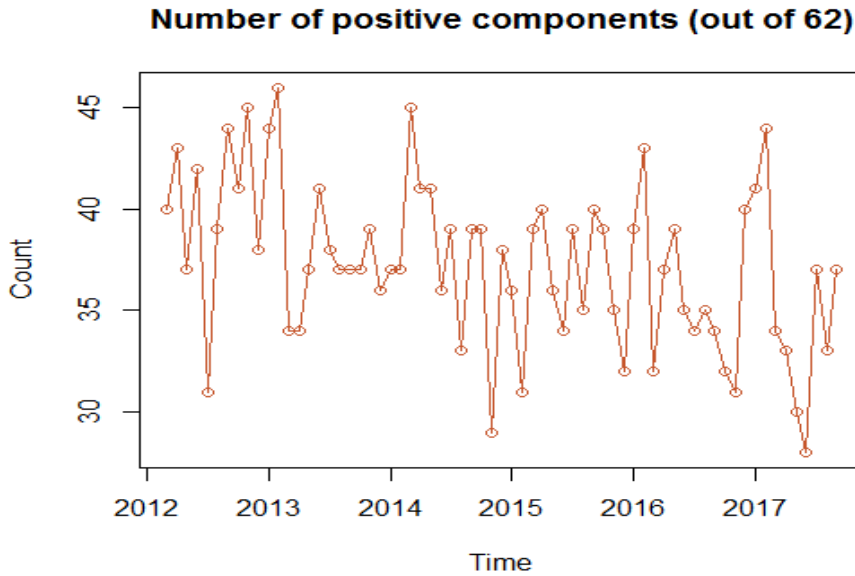
Source: Monthly data. Source: Census Bureau and Haver Analytics

Chart 4: AAA Retail Regular Gasoline Prices – US Average



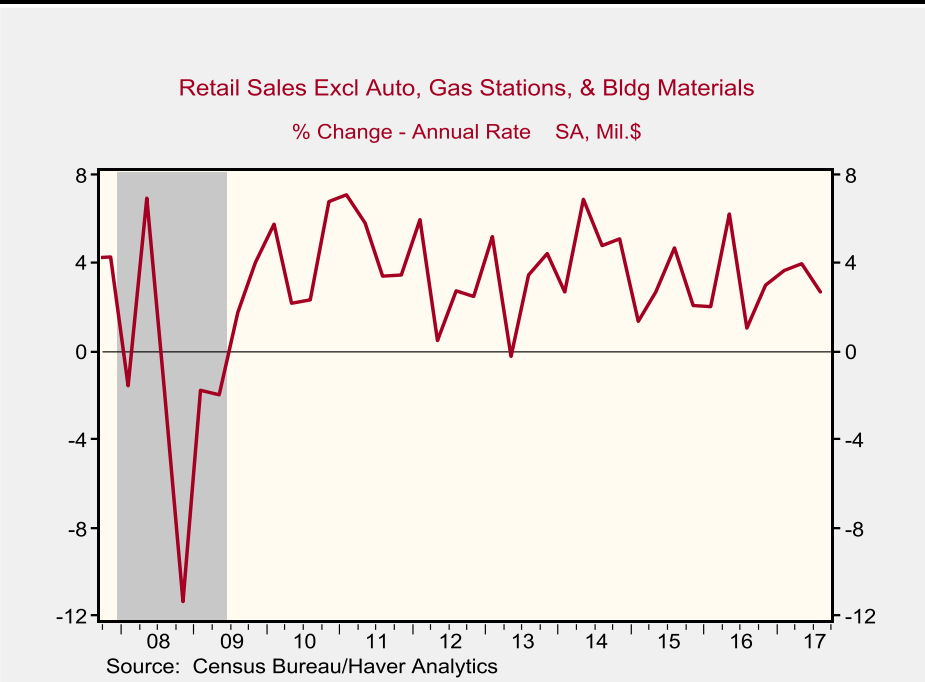
Source: Daily data. Source: Energy Information Administration and Haver Analytics

Chart 5: Number of CPI Components Increasing On a Month-Over-Month Basis



Source: Monthly data. Source: Bureau of Labor Statistics and Berenberg Capital Markets

Chart 6: Control Retail Sales (quarter-over-quarter, %)



Source: Quarterly data. Source: Census Bureau and Haver Analytics

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