

US: CORE CONSUMER PRICES FIRING AND RETAIL SALES SOLID IN OCTOBER

**Headline CPI rose 0.1% m/m and 2% yr/yr in October (from 0.5% m/m and 2.2% yr/yr in September) as the post-hurricane run-up in retail gasoline prices faded*

**Core CPI (excludes food and energy) increased by 0.2% m/m (unrounded: 0.225%) and 1.8% yr/yr, slightly higher than expected and indicative of a firming in the underlying inflation trend (see Chart 1)*

**U.S. retail sales rose by 0.2% m/m in October after the outsized 1.9% gain in September due to more modest gains in vehicle sales (still elevated from strong storm-damage replacement demand) and a decline in the nominal value of gasoline station sales (due to lower gas prices). Sales were broadly solid, with only 3 of the 13 major categories declining*

Consumer Price Index

Retail gasoline prices remained elevated in October but were down from September, weighing on the gains in the headline CPI. Retail regular gasoline prices are increasing again in November (averaging \$2.54/gallon after \$2.48/gallon in October) and may push up the headline CPI in the next report (see Chart 2).

Core service prices (excludes energy) rose by a trend-like 0.3%, but core commodities prices rose by 0.1% m/m, the best gain since January (see Chart 3). The acceleration in used cars and trucks prices (up 0.7% m/m – the best gain since May 2012) from strong vehicle-replacement demand and tobacco and smoking products prices (up by an outsized 1.6%) is responsible for the pick-up in commodity prices (see Charts 4 and 5).

Based on the change in the core CPI, the Fed's preferred measure of inflation, the headline and core PCE deflators (scheduled for release on November 30) probably increased by 1.5% yr/yr (from 1.6% prior) and 1.4% yr/yr (from 1.3% prior), respectively, still below the Fed's 2% target, but firming after the prolonged soft patch earlier this year.

The firming of prices is evident in the number of CPI categories increasing in October - 39 of the 62 main CPI categories increased in October, compared to just 28 in June (see Chart 6). Moreover, the three-month annualized change in the core CPI picked up to 2.4% in October from 2% in September, the best rate since February (see Chart 7).

The recent price data are probably enough for the Fed to conclude that the soft patch in prices earlier this year was temporary and that inflation will continue to rise modestly. Inflation has been the only missing piece from an environment of strong economic growth, solid labor market performance, and very supportive financial conditions. Given these favorable economic conditions, the Fed would quicken its pace if inflation drifts up toward 2%. The Fed remains on track to raise its policy rate again in December and stay close to its projected policy path next year.

Retail Sales

Control retail sales (excludes sales at food services and drinking places, gasoline stations, building materials, and auto stores), which factor directly into GDP, are on

15 November 2017

pace to advance by a solid 3% annualized again in Q4 and sets a decent baseline for broader private consumption.

The effects of the hurricane rebuild and repair were again evident in this report, as furniture sales advanced a strong 0.7% m/m and building material sales gave back less than half of its strong September gains (declined 1.2% m/m in October after surging 3% in September).

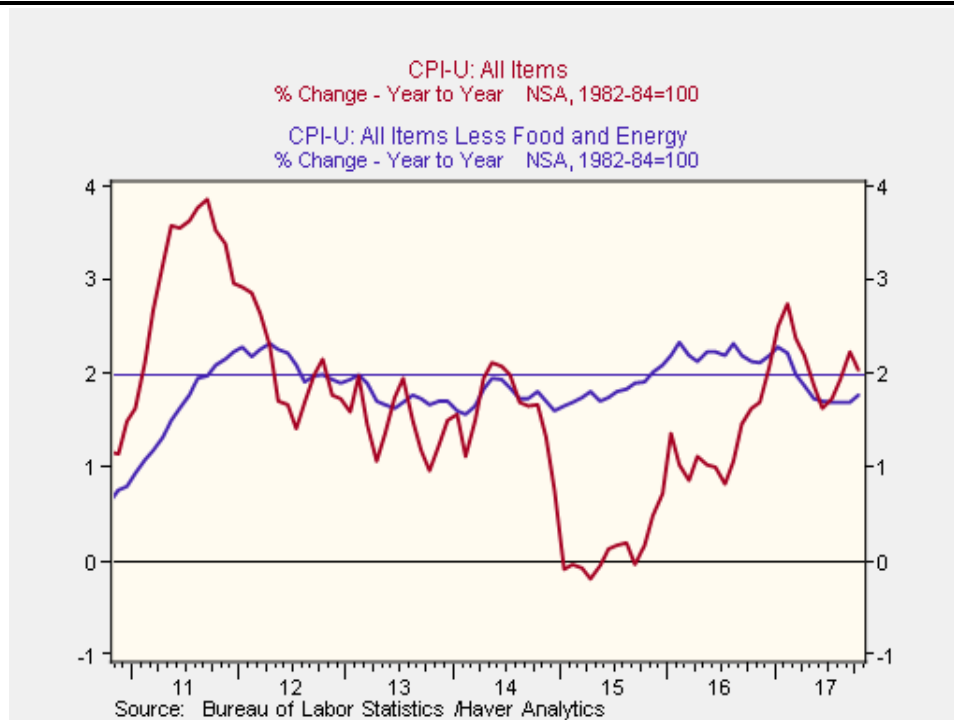
Spending on discretionary categories was strong, providing an indication of improved consumer confidence in finances and willingness to spend on non-essential goods and services:

- 1) Sales at food services and drinking places accelerated by 0.8% in October, the best gain since January
- 2) Sporting goods, hobby, book, and music sales advanced 1.5%, the best gain since September 2016
- 3) Electronics and appliances sales increased by a strong 0.7% m/m (though some of this may be linked to storm-damage replacement)

There was a surprise decline in non-store retail sales (includes online) in October, but we expect to see a pick-up in sales in this category during the holiday shopping season.

The decent momentum in broad retail sales over the last couple of months, very optimistic consumer confidence, solid job growth and low unemployment, and continued increases in net worth all point to a robust holiday shopping season (see [“U.S. confidence points toward sustained momentum”](#), October 9, 2017).

Chart 1: CPI - All items and CPI - Less Food and Energy (year-over-year, %)



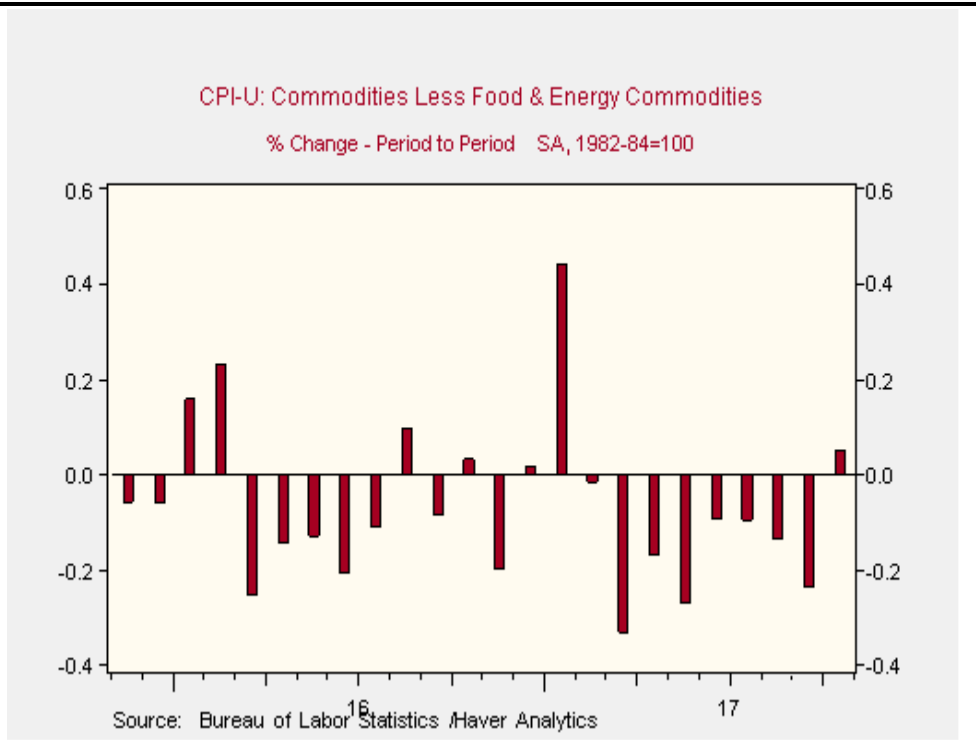
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: AAA Retail Regular Gasoline Prices – US Average



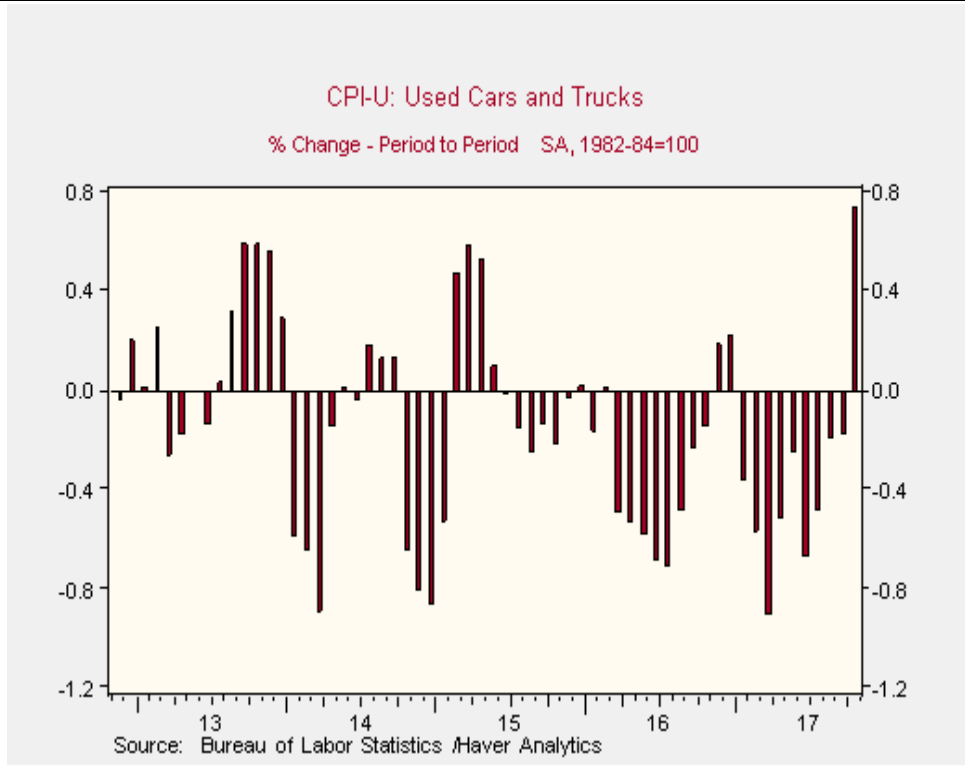
Source: Daily data. Source: Energy Information Administration and Haver Analytics

Chart 3: CPI: Commodities Excluding Food and Energy (month-over-month, %)



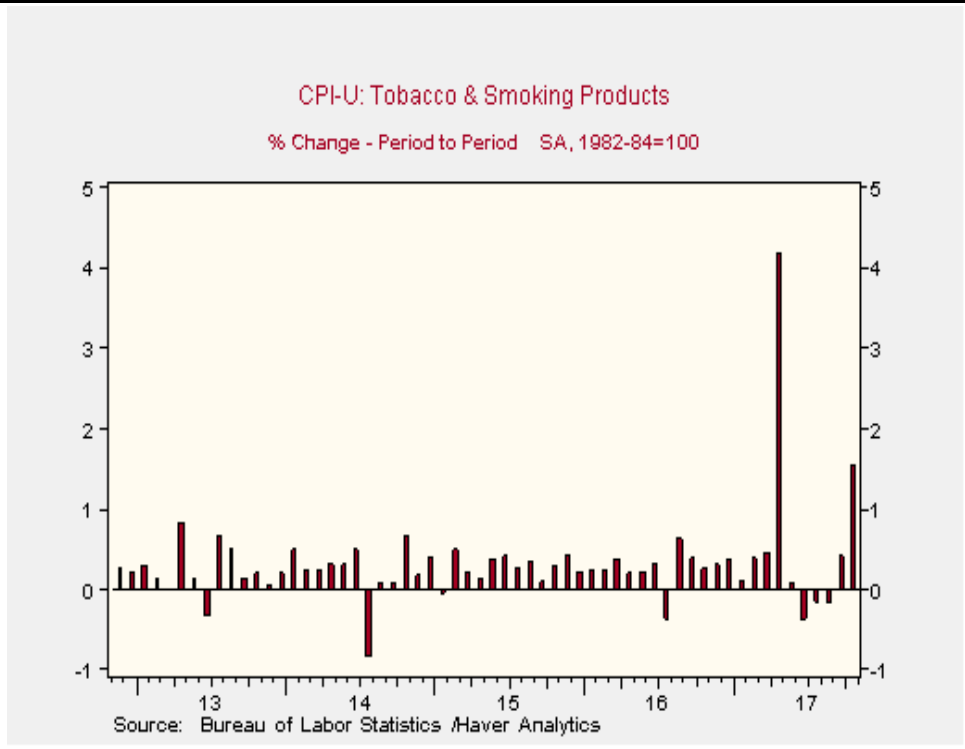
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 4: CPI: Used Cars and Trucks (month-over-month, %)



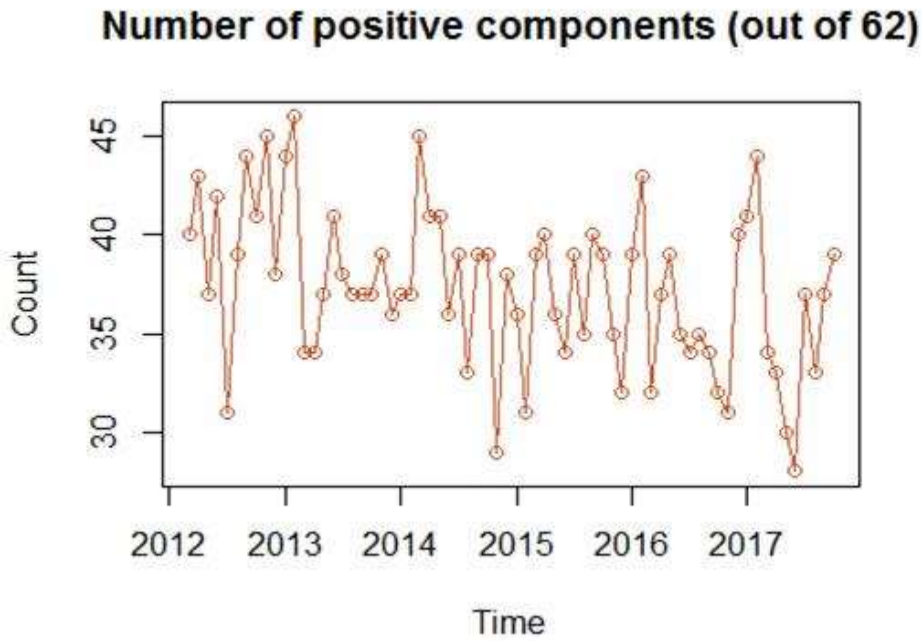
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 5: CPI: Tobacco and Smoking Products (month-over-month, %)



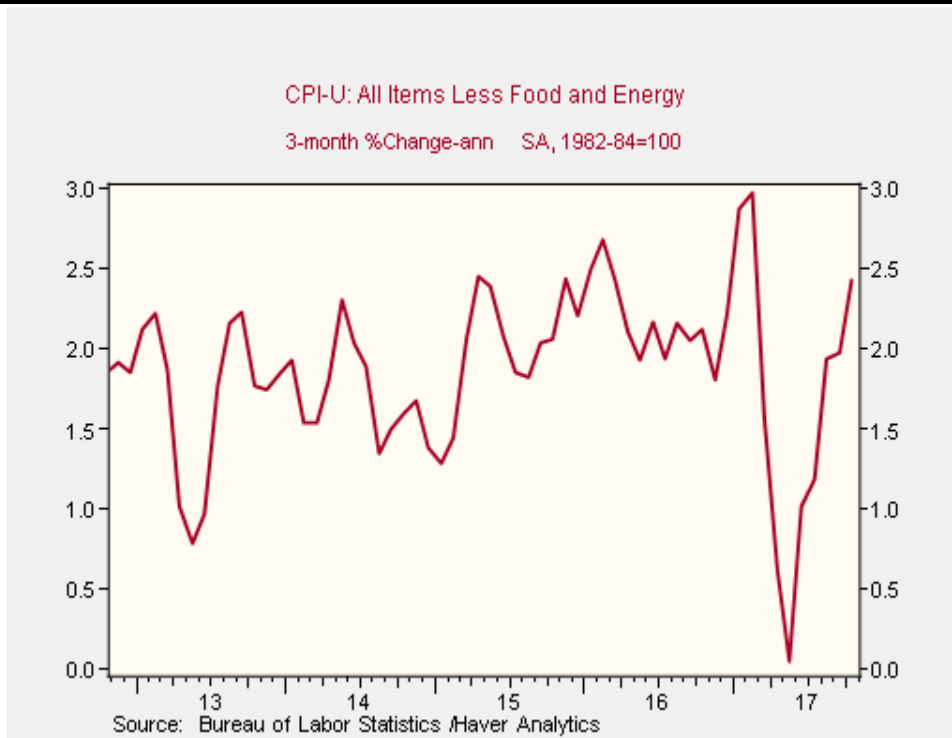
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 6: Number of CPI Components Increasing On a Month-Over-Month Basis



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

Chart 7: CPI: All Items Excluding Food and Energy (three-month, annualized % change)



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

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