

US: FED'S PREFERRED PRICE MEASURE FIRMS, DISPOSABLE INCOMES PICK UP IN OCTOBER

**U.S. private nominal consumption rose 0.3% m/m in October, paring back from the outsized storm replacement-driven 0.9% m/m acceleration in September. Adjusted for inflation, consumption rose by a smaller 0.1% m/m but was up 2.6% yr/yr (see Chart 1)*

**Personal incomes increased 0.4% m/m and the personal saving rate remained near historical lows, at 3.2% (see Chart 2)*

The PCE deflator increased 0.1% m/m and 1.6% yr/yr. Core PCE deflator (excludes food and energy) rose 0.2% m/m and 1.4% yr/yr in October and was revised up from 0.1% to 0.2% m/m, and from 1.3% to 1.4% in September, **suggesting that the Fed's preferred measure of consumer prices has been firming more than expected (see Chart 3)*

**On an unrounded basis, the core PCE deflator rose 1.447% yr/yr in October, very close to 1.5%, and solid improvement from 1.3% in August. A December Fed rate hike is locked in*

Although real consumption was revised down in September, setting a slightly lower starting point for Q4, it is still on track to advance over 2% (annualized rate) in Q4 and should continue to outpace real disposable income gains. Note that real disposable incomes showed signs of life in October, accelerating by 0.3% m/m, the best gain since May, and picking up to 1.6% yr/yr from 1.1% in September, the best gain since July 2016 (see Chart 4).

If the acceleration in disposable incomes continues, real private consumption will remain robust, especially given the already elevated levels of confidence (see Consumer Chart pack attached). The elevated confidence this year – fueled by the stock market rally and strong labor market performance – has boosted private consumption in the absence of solid real disposable income growth. Successful new tax legislation would provide a modest lift to real disposable income growth in the near term.

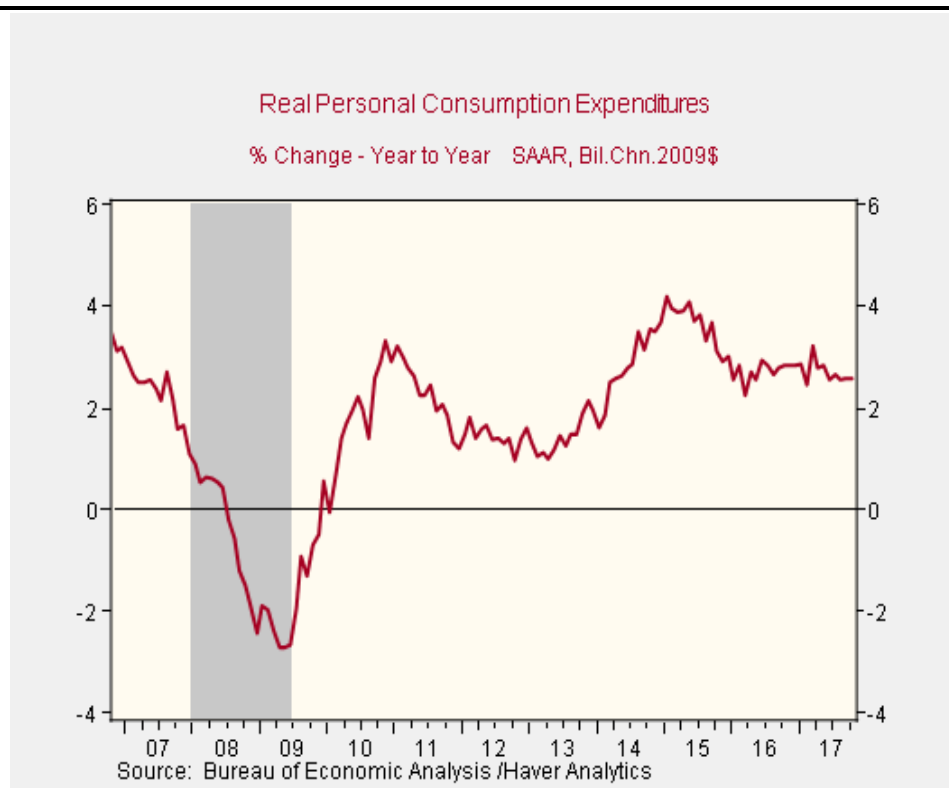
The very low saving rate is being overstated to some extent by storm-replacement of damaged goods - vehicle sales remained high in October. That said, the saving rate was trending lower before storm disruptions. A low saving rate is positive for current economic conditions, reflecting increased confidence and willingness to take on debt, but it also points to small consumer buffer from any adverse shock.

At 1.4%, core PCE inflation remains below the Fed's 2% target, but it is heading in that direction, increasing by an annualized 1.9% over the last three months (see Chart 5). This progress is more than enough for the Fed to increase its policy rate at its December meeting.

In the medium term, solid economic growth, further declines in the unemployment rate, easy financial conditions, and new tax legislation will enable the Fed to continue policy normalization. The U.S. dollar –which feeds through to consumer price inflation with a lag – has weakened for most of this year and is expected to place upward pressure on consumer prices over the next year. The risks for policy rate hikes in 2018 are tilted to the upside.

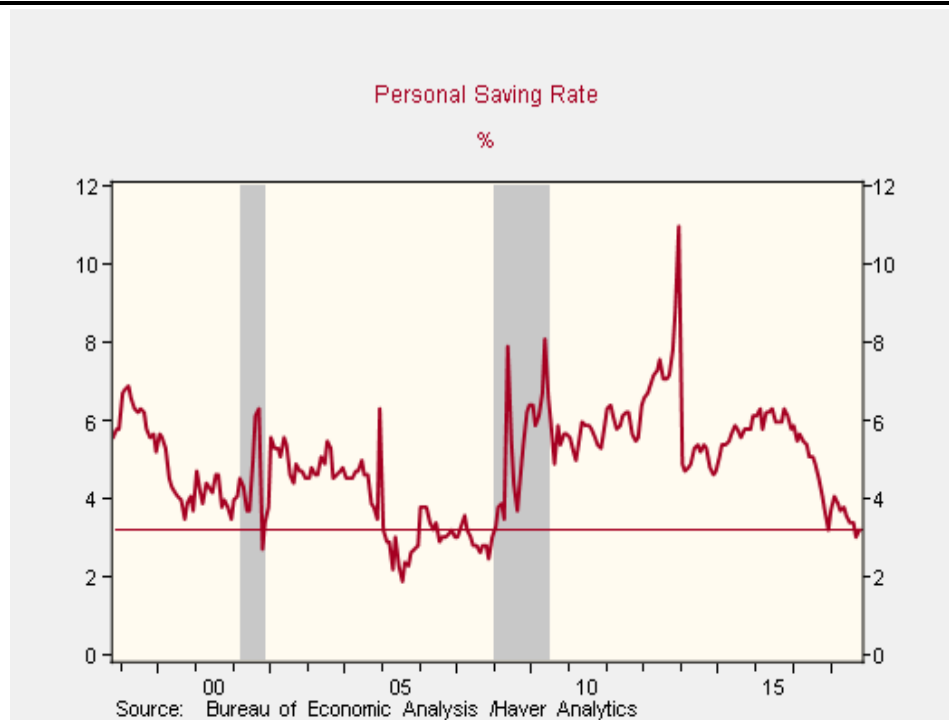
30 November 2017

Chart 1: Real Personal Consumption Expenditures (year-over-year, %)



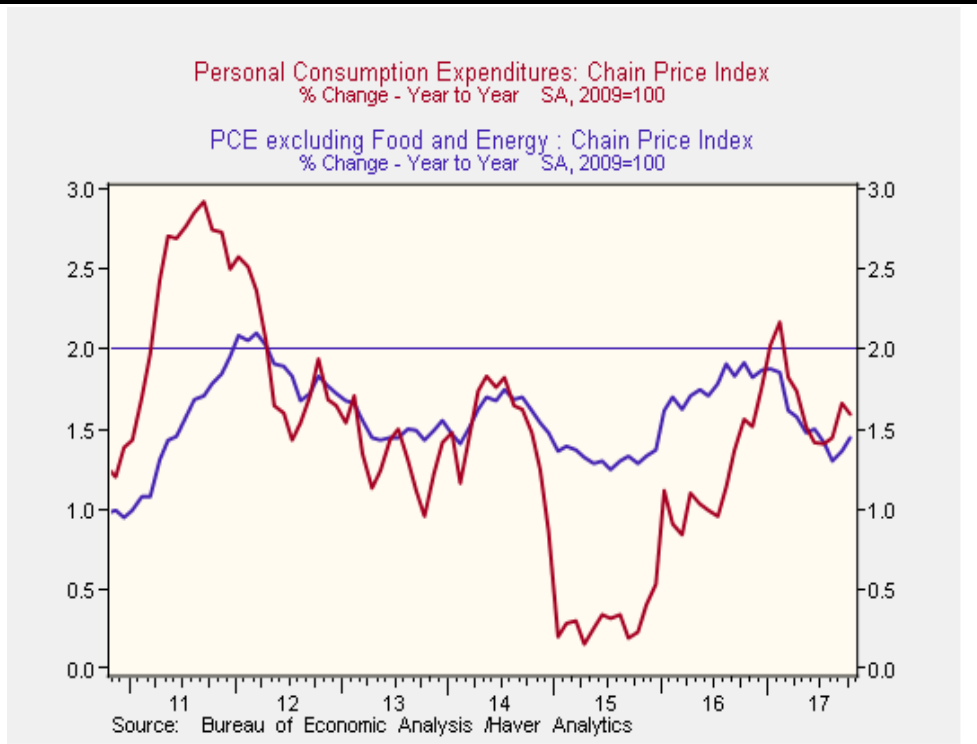
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 2: Personal Saving Rate



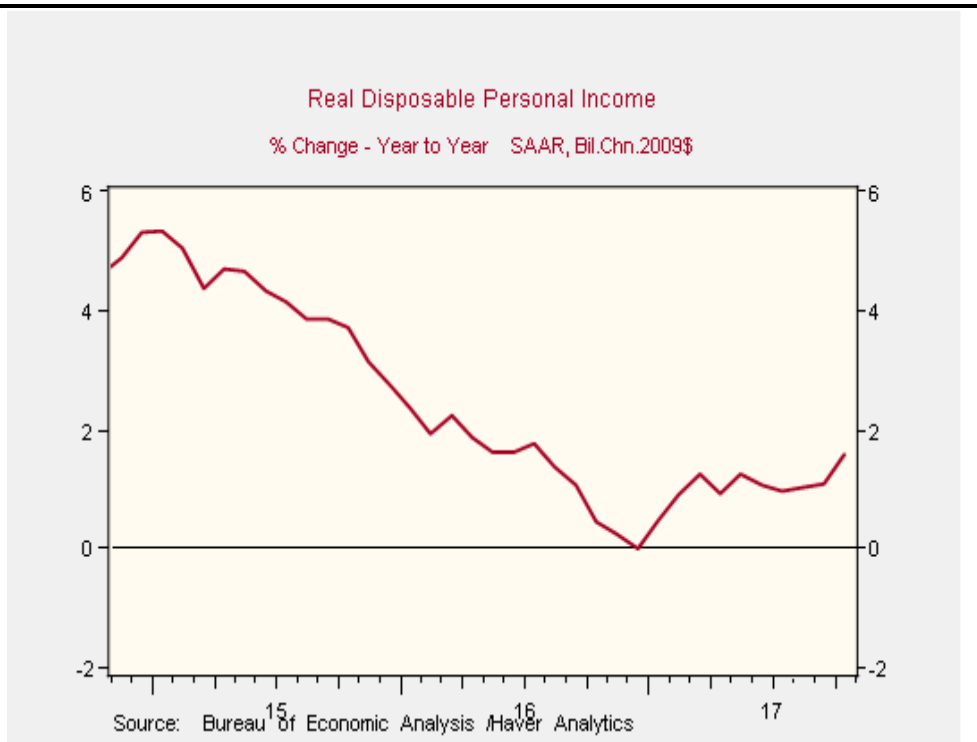
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 3: PCE Deflator: Headline and Core (year-over-year, %)



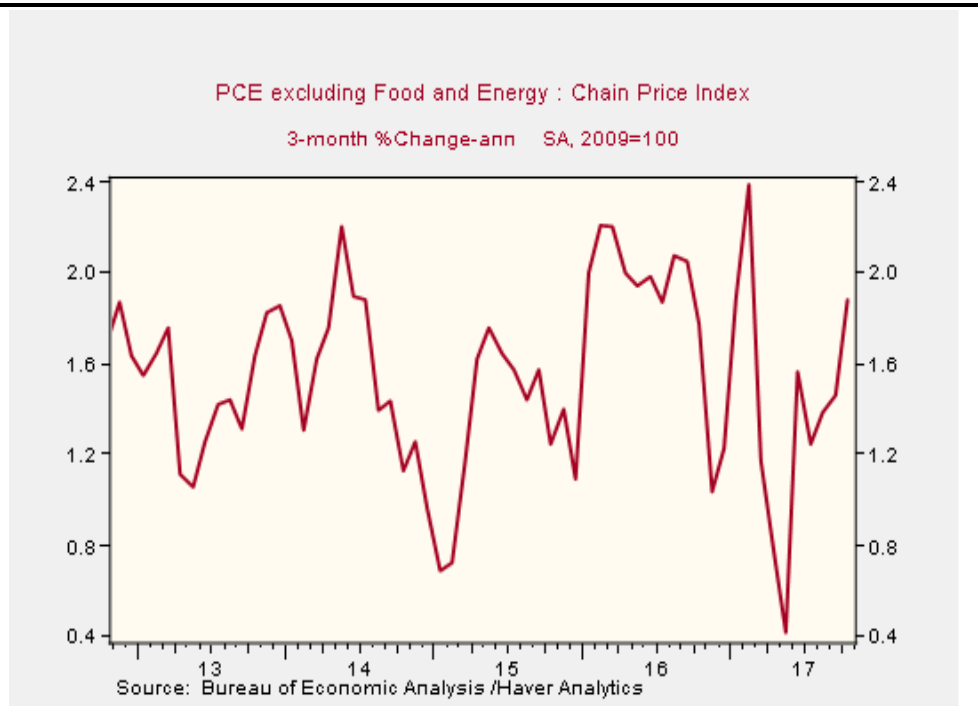
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 4: Real Disposable Personal Income (year-over-year, %)



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

Chart 5: Core PCE Deflator (three-month, annualized percent change)



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

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