

## US ENERGY AND RENTS PUSHING UP CONSUMER PRICES

*\*The US CPI advanced 1.7% yr/yr in November, an acceleration from October as energy prices contributed positively to year-on-year growth for the second consecutive month*

*\*The gap between core CPI and the Fed's preferred measure of inflation, core PCE deflator, has narrowed after widening for more than a year due to an acceleration in healthcare prices this year*

*\*The likely large fiscal stimulus package expected to be proposed by the Trump Administration and enacted by Congress is expected to boost economic growth and put upward pressure on inflation*

The US Consumer Price Index (CPI) advanced 1.7% yr/yr in November, an acceleration from the 1.6% gain in October, as energy prices contributed positively to year-on-year growth for the second consecutive month after being a drag since August 2014 (see Charts 1 and 2). As a result, headline CPI and core CPI (excludes food and energy) inflation are now converging. Expect the recent surge in energy prices to continue push up headline inflation in coming months.

The Core CPI advanced 2.1% yr/yr and has been above 2% since November 2015, unlike the Fed's preferred measure of inflation, the core PCE deflator, which is still slightly below 2%.

The gap between core CPI and core PCE deflator has narrowed after widening for more than a year (see Chart 3). Because the PCE deflator contains purchases on behalf of consumers, medical care spending accounts for a larger share of the PCE than CPI. On the other hand, the cost of shelter accounts for a larger share of households' out-of-pocket consumer costs as measured by the CPI. The acceleration in health care prices this year has caused PCE to accelerate more than CPI this year (see Chart 4). The likely changes to health care policy will probably impact healthcare prices.

Core goods CPI (excludes energy) dropped in November by 0.3% m/m (-0.7% yr/yr) and the recent strong appreciation in the US dollar will continue to lower prices of imports and exert downward pressure on the CPI.

Core services CPI has decelerated recently, but is still increasing at a relatively fast pace (over 3%), as medical care services price inflation has slowed somewhat. Rent prices have continued to accelerate and will likely continue due to low vacancy rates and as the recent jump in mortgage rates will probably make renting more attractive than buying (see Charts 5 and 6).

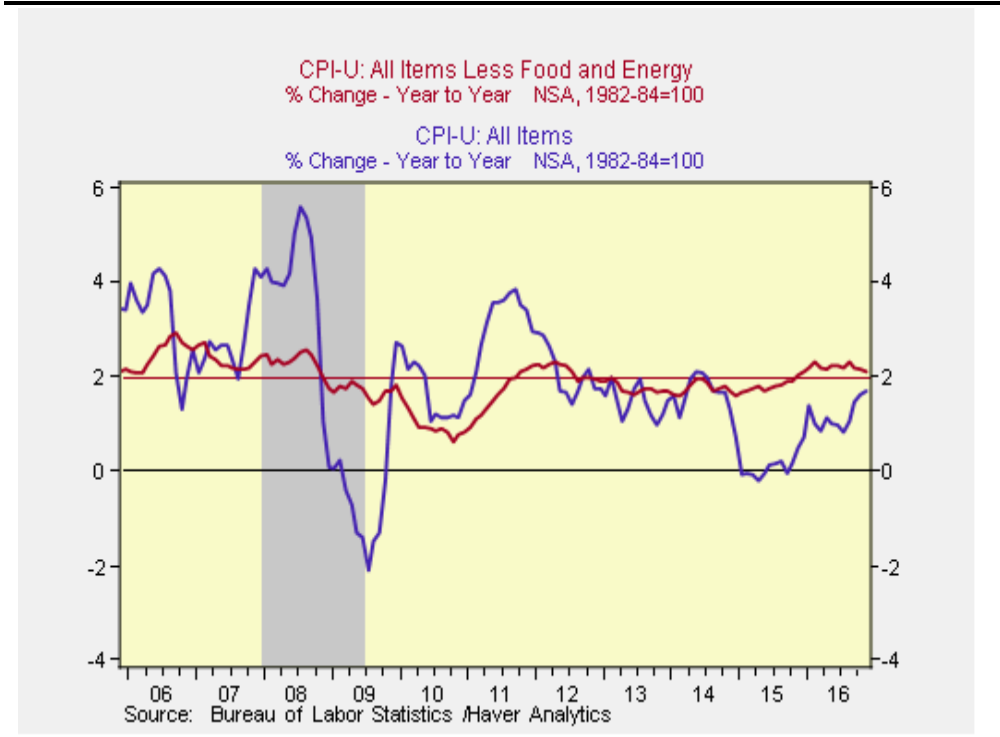
The likely large fiscal stimulus package expected to be proposed by the Trump Administration and enacted by Congress is expected to boost economic growth and put upward pressure on inflation. Indeed, market-based measures of inflation compensation have risen notably, although they still remain low (See Chart 7). However, consumers still have tempered expectations for prices with consumer inflation expectations historically low.

If the anticipated fiscal reforms generate an acceleration in economic growth from a starting point of low unemployment, the long awaited pick up in wage inflation will

15 December 2016

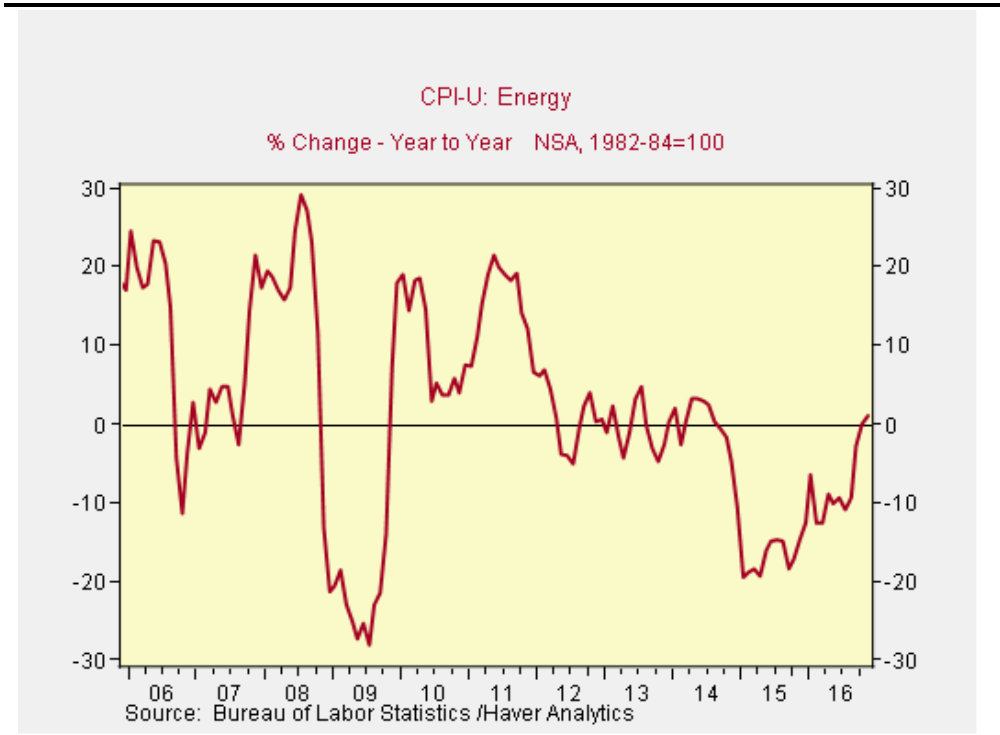
finally unfold. Moreover, if the infrastructure spending increases demand in construction and related sectors that already face labor shortages, expect to see a more rapid pick up in wages.

Chart 1: Headline CPI and Core CPI (Year-Over-Year, %)



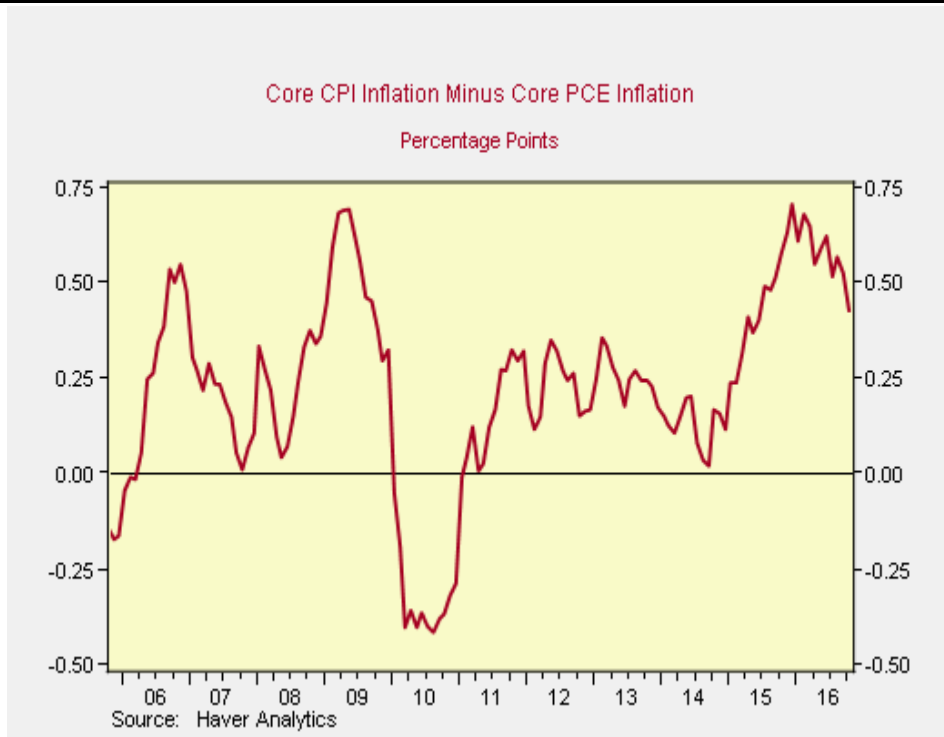
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: Energy CPI (Year-Over-Year, %)



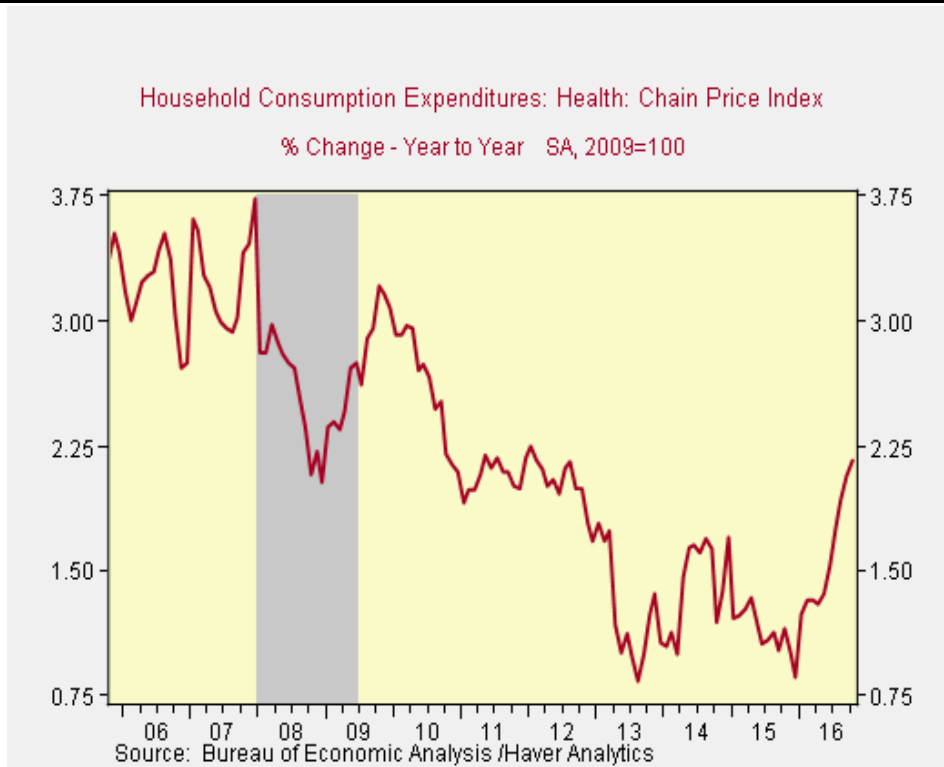
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: The Difference Between Core CPI and Core PCE Inflation



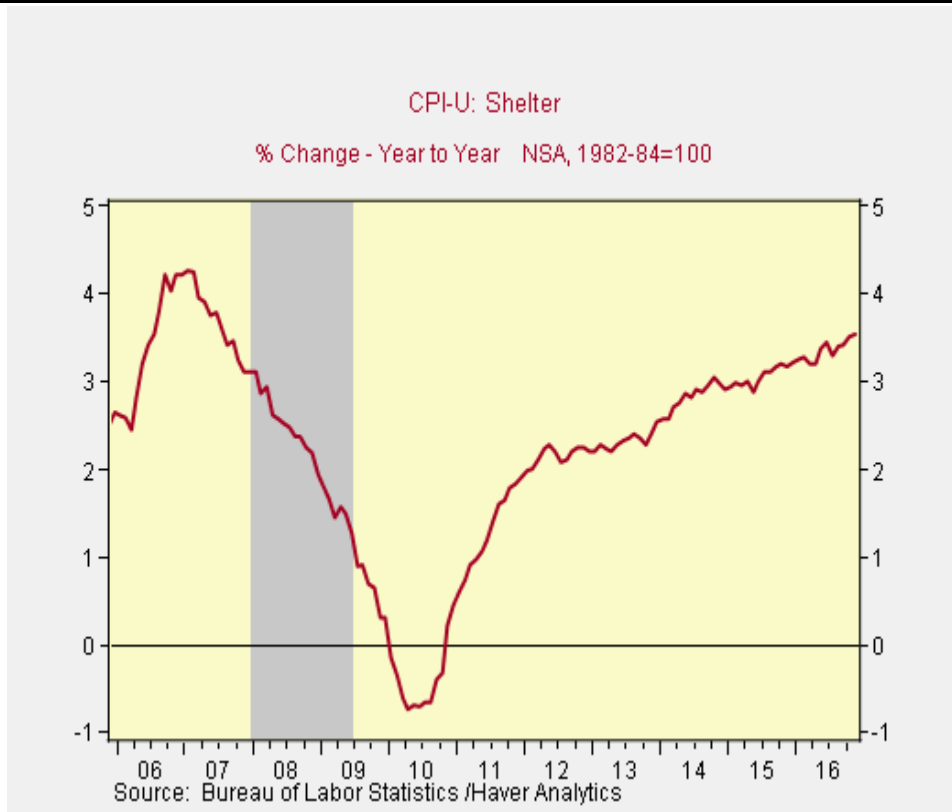
Source: Monthly data. Source: Bureau of Labor Statistics, Bureau of Economic Analysis and Haver Analytics

Chart 4: PCE Deflator: Health Care



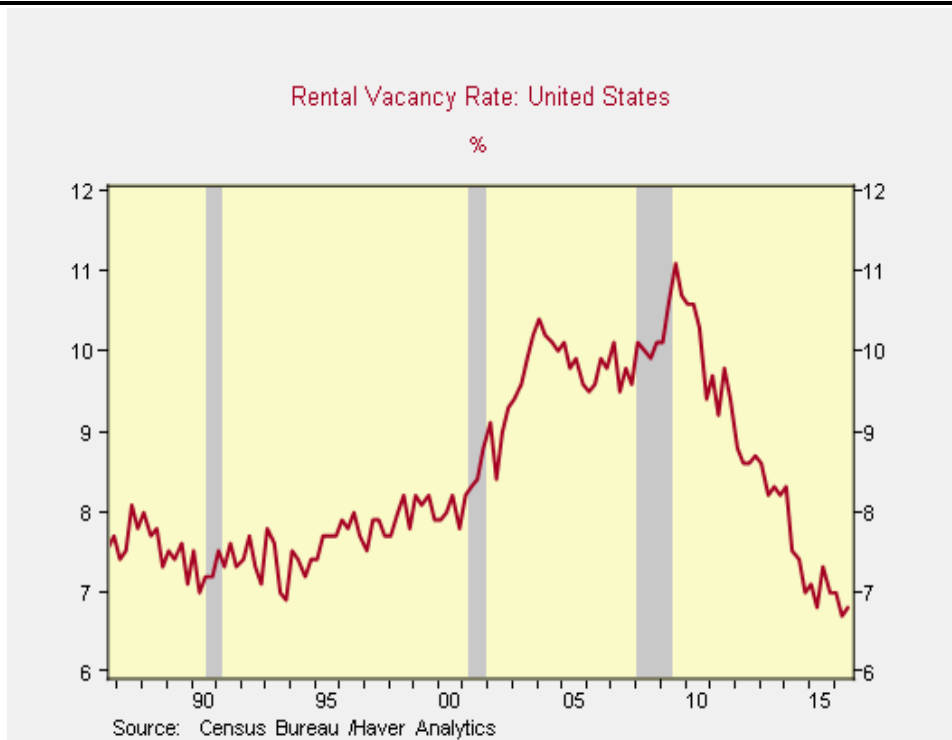
Source: Monthly data. Source: Bureau of Economic Analysis and Haver Analytics

Chart 5: Shelter CPI (Year-Over-Year, %)



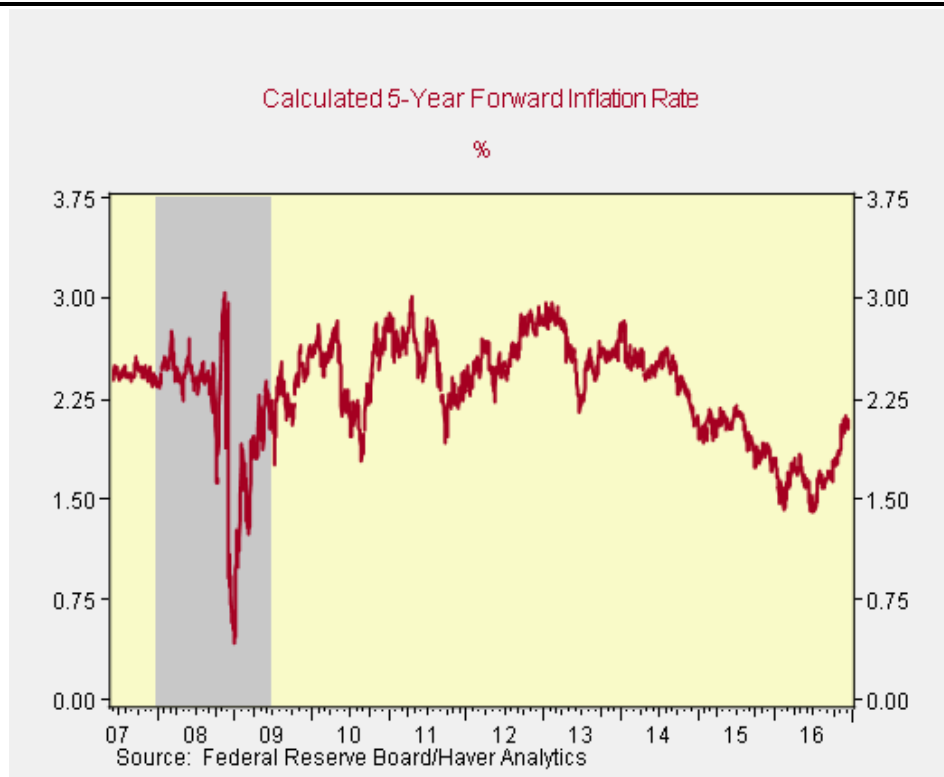
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 6: Rental Vacancy Rate



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

Chart 7: Implied 5-Year Forward Inflation Rate



Source: Daily data. Source: Federal Reserve Board and Haver Analytics

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