

## US: HIGHER INFLATION, OPTIMISTIC SENTIMENT, SPARKLESS ACTIVITY DATA

The economic data continue to reflect better sentiment and an acceleration in **inflation, but unimpressive improvement in the activity/“hard” data. The Fed is on track** to increase rates at its meeting later today and there is some upside risk on its future policy rate path. Even if activity data remain sluggish, as long as employment and inflation continue to improve at a robust pace, the Fed will be forced to act.

### Empire State Manufacturing

The Empire State manufacturing index, which provides the first read on sentiment for the month, remained at an elevated 16.4 in March, and its components suggested a positive read for the economy. The pace of increase in shipments slowed, but demand continues to run very high, as the new orders subindex rose to its highest level since April 2010 and the unfilled orders subindex rose to the highest since March 2006 (see Chart 1). These data points suggest that firms will have to continue ramping up activity and hiring to meet demand. Indeed, the number of employees (+6.8 pts to 8.8) and average employee workweek subindexes also registered significant gains in March (+10.9pts to 15.0).

Business plans for capital spending also remained elevated (above 20 for the last four months), suggesting that firms are patiently awaiting progress on deregulation and tax reform promised by the Trump Administration.

### Consumer Price Index

The headline CPI advanced 0.1% m/m in February (following a strong 0.6% m/m gain in January), lifting the yr/yr rise to 2.7% yr/yr, a five year high, reflecting the acceleration in energy prices (up 15.2% yr/yr) and to a lesser extent, favorable base effects (see Chart 2). The declines in energy prices so far in March may temper the acceleration in headline inflation somewhat, but crude oil prices were under \$40 last March, so the growth on a yr/yr basis will still be quite sizable. Core CPI rose by 2.2% yr/yr, reflecting the upward pressures exerted by prices of medical care (up 3.5% yr/yr) and housing services (up 3.2% yr/yr).

The strong gains in CPI in February point to an increase in the PCE deflator to 1.9%-2.0% (set for release at end of March). Expect the Fed to upgrade its characterization of inflation in its Policy Statement today.

### Retail Sales

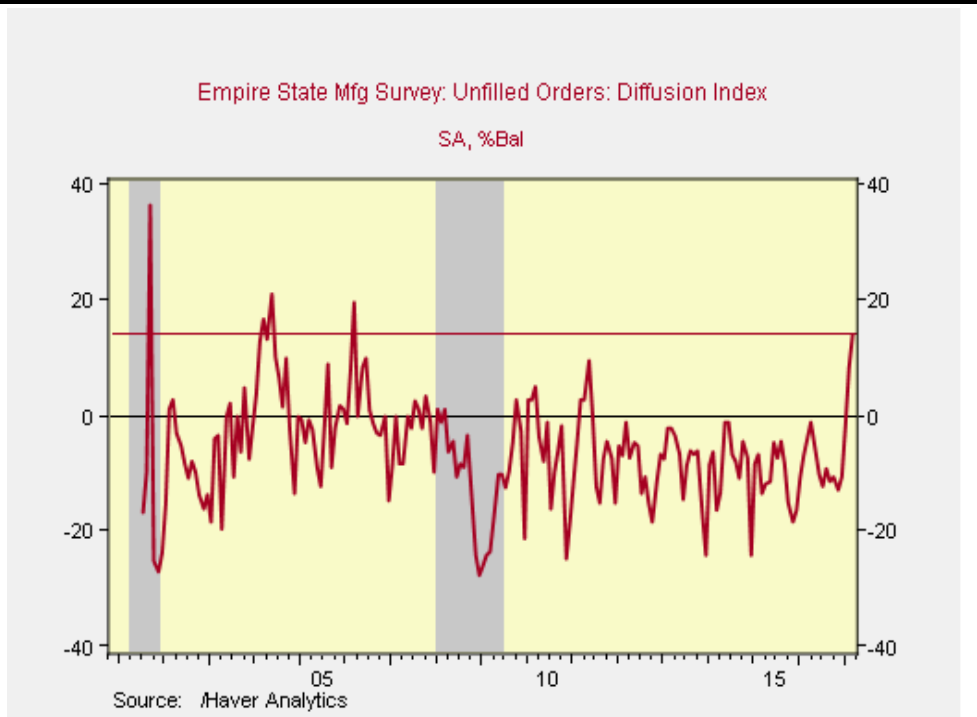
The report on February retail sales was mixed – **sales were up only 0.1% but January’s sales were revised up markedly** – but on net provide a slight positive for private consumption in GDP relative to expectations. Sales were broadly slow, with the exception of building materials and furniture sales – likely helped by the warmer weather pulling forward home improvement and construction activity – and non-store retail sales (includes online sales), which are on a steep upward trend (see Chart 3).

Control retail sales (excludes gasoline, building materials, autos and food services and drinking places sales), which are directly counted toward private consumption in GDP, rose 0.1% and January was revised up to a 0.8% gain from an originally reported 0.4%.

15 March 2017

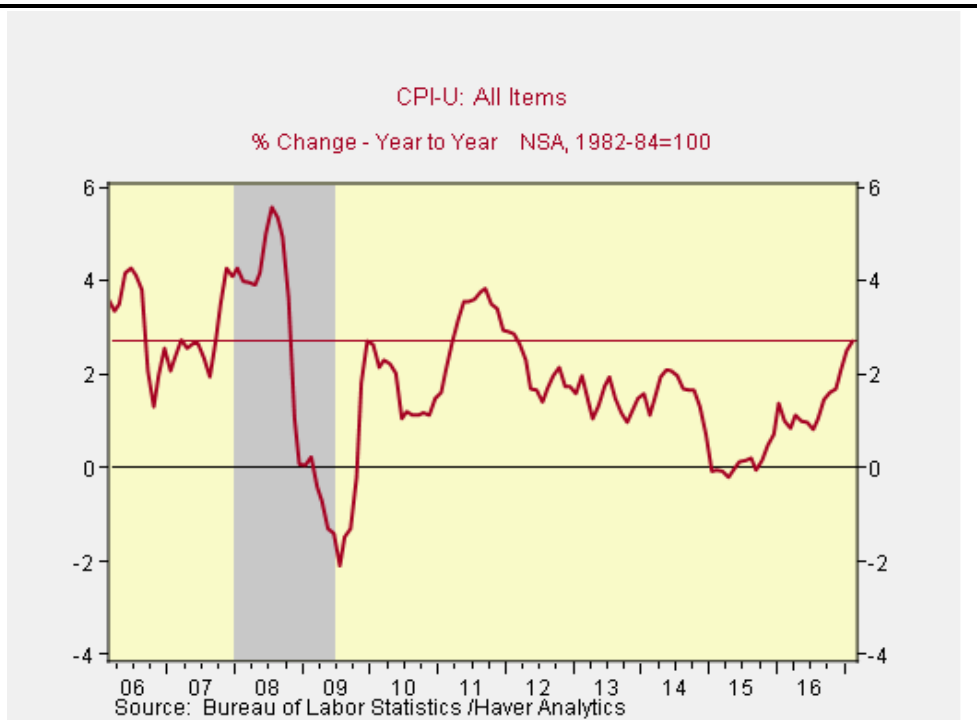
This places Q1's retail sales growth on track to exceed Q4's healthy pace (+4.2% annualized in Q1 compared to 3.7% in Q4). Real private consumption Q1 will be held down by the acceleration in consumer prices and unusually warm weather in January and February that depressed energy service consumption.

Chart 1: Empire State manufacturing unfilled orders index



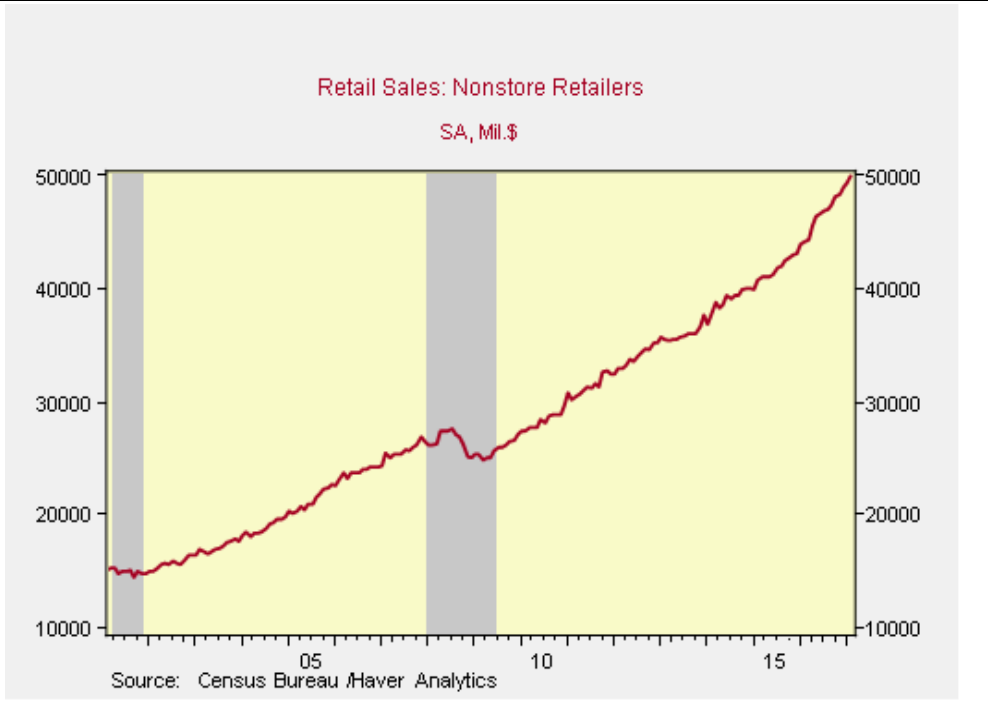
Source: Monthly data. Source: Federal Reserve Bank of New York and Haver Analytics

Chart 2: CPI: All items (year-over-year, %)



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

Chart 3: Sales at Nonstore Retailers



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

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