

SOFT US CPI PARTLY DUE TO ANOMALOUS FACTORS AND CORE RETAIL SALES STRONG

Consumer Prices

The Consumer Price Index (CPI) declined by a sizable 0.3% m/m (+2.4% yr/yr) in March due to lower retail gasoline prices and a stunning 0.1% m/m decline in the core CPI (excludes food and energy) – the first decline in this metric since January 2010 – pulling the yr/yr gain down 0.2pp to 2.0% (see Chart 1).

The downward surprise came in prices for wireless telephone services, which fell by 7% m/m - the largest decline in the 20 year history of the series – and subtracted 0.1pp from the headline CPI (see Chart 2). The drop is likely due to pricing competition among various cellphone companies over the last few months including the removal of data limits. Going forward, the price index for wireless telephone services will likely be at a new lower level, but the month-to-month change should not be as drastic as it was in March. Therefore, expect less of a drag from this category on CPI in coming months.

Elsewhere, important price measures were on the soft side. Shelter prices which make **up 34% of the CPI grew by only 0.1% m/m, as owners' equivalent rent of residences** grew 0.17% m/m, much slower than its recent 0.3% trend (see Chart 3). (Owners' equivalent rent is the value that homeowners would charge if they decided to rent out their homes). The dropoff here is surprising given that home prices continue to accelerate and the supply of homes remains limited (see Chart 4). Lodging away from home prices also fell off sharply, but tends to be a more volatile series and could easily bounce back next month (see Chart 5).

The soft CPI number today places some downside risk on the Fed's preferred measure, the Personal Consumption Expenditures (PCE deflator), in March - released in a couple of weeks. If the March weakness is temporary as suspected, underlying factors such as the tight labor market (unemployment rate at 4.5%) and growing confidence from businesses that they can charge high prices could lead to a sustained acceleration in broader inflation.

Retail Sales and Sentiment

Total retail sales declined 0.2% in March primarily due to motor vehicle parts and sales falling off as expected. Elsewhere, sales gained momentum to close Q1, as control retail sales (excludes gasoline stations, food services and drinking places, motor vehicles and building materials) - an input to GDP - advanced a strong 0.5% m/m – a surprise that was to some extent canceled out by the 0.3pp downward revision (+0.1% to -0.2%) to February sales (see Chart 6). That said, the robust gains during the last month of Q1, provides a favorable starting point for sales in Q2.

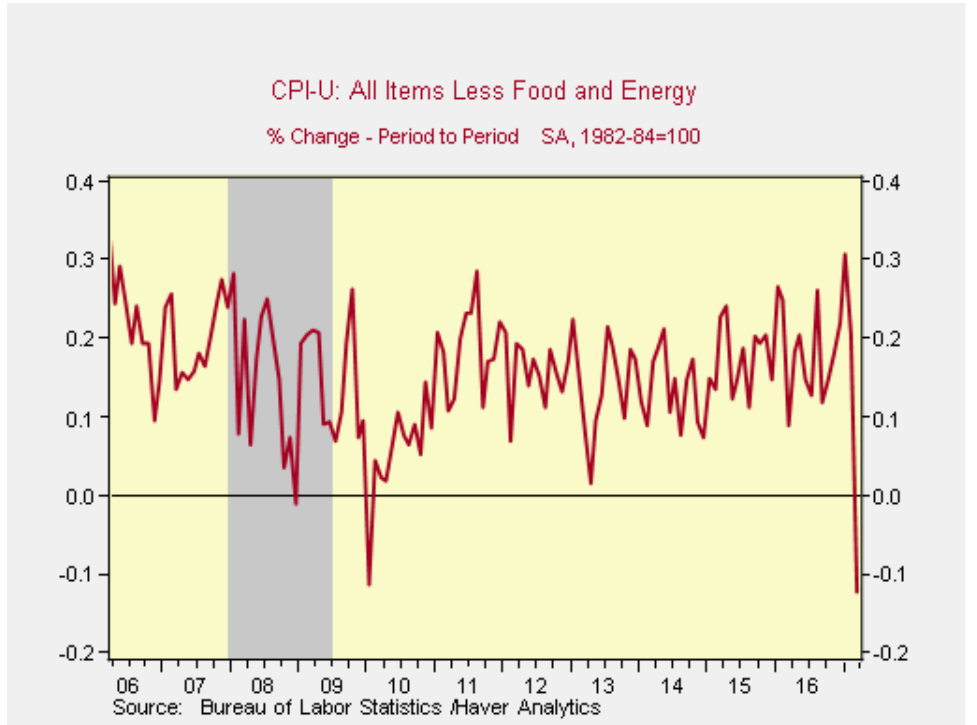
Note the continued rapid pace of sales at nonstore retailers (includes online), reflecting the structural shift from traditional brick-and-mortar stores (see Chart 7). The March employment report showed retailers shedding jobs for the second consecutive month (-61k total in February and March). Some of these jobs will shift to logistics and transportation and warehousing but it probably won't be one for one.

The University of Michigan (U Mich) sentiment consumer sentiment index held at a relatively elevated level in the preliminary April reading as consumers felt better about current conditions. It appears that the growing political uncertainty and lack of any

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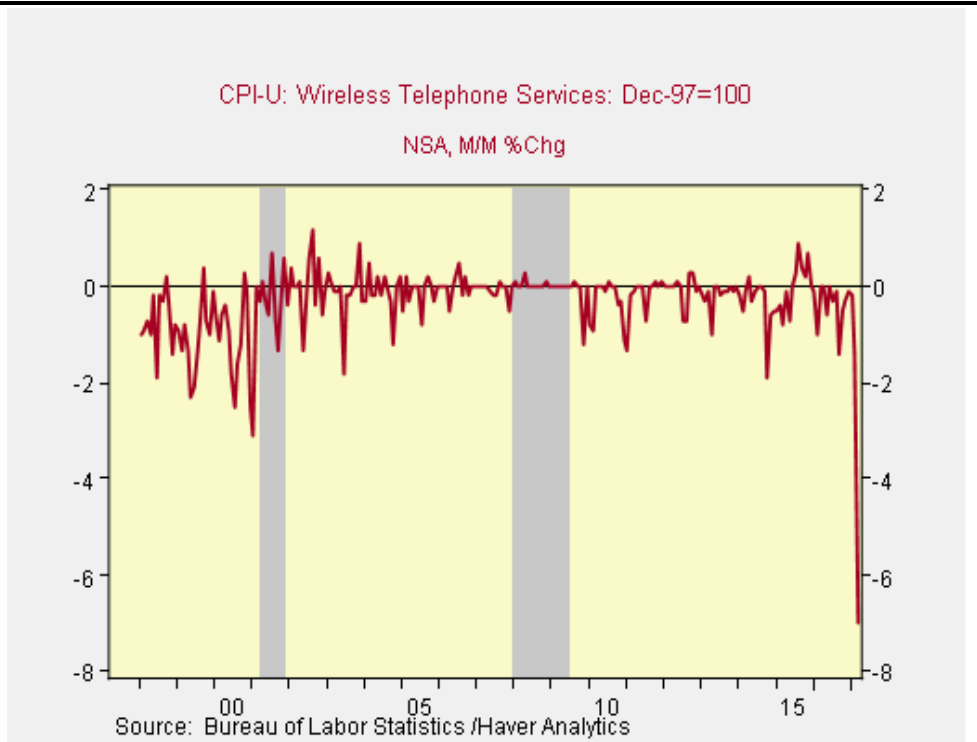
material progress on reform has not yet fed through. The U Mich survey also showed that consumers buying plans for large household durables, vehicles and homes increased, pointing to solid gains in retail sales in the coming months.

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



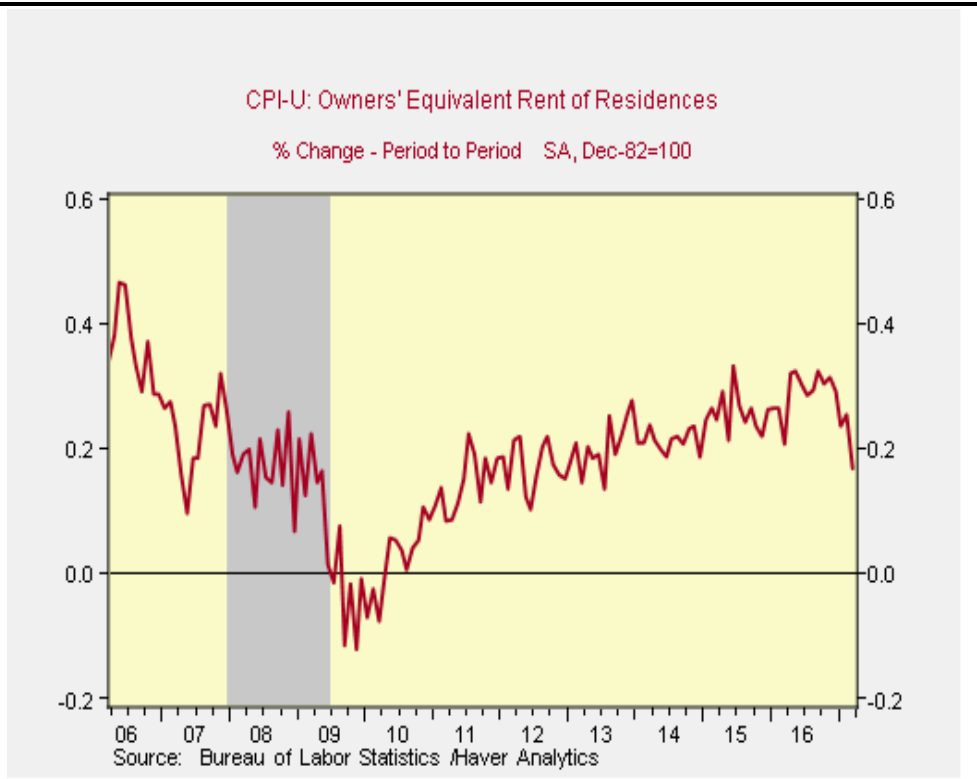
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 2: CPI: Wireless Telephone Services (month-over-month, %)



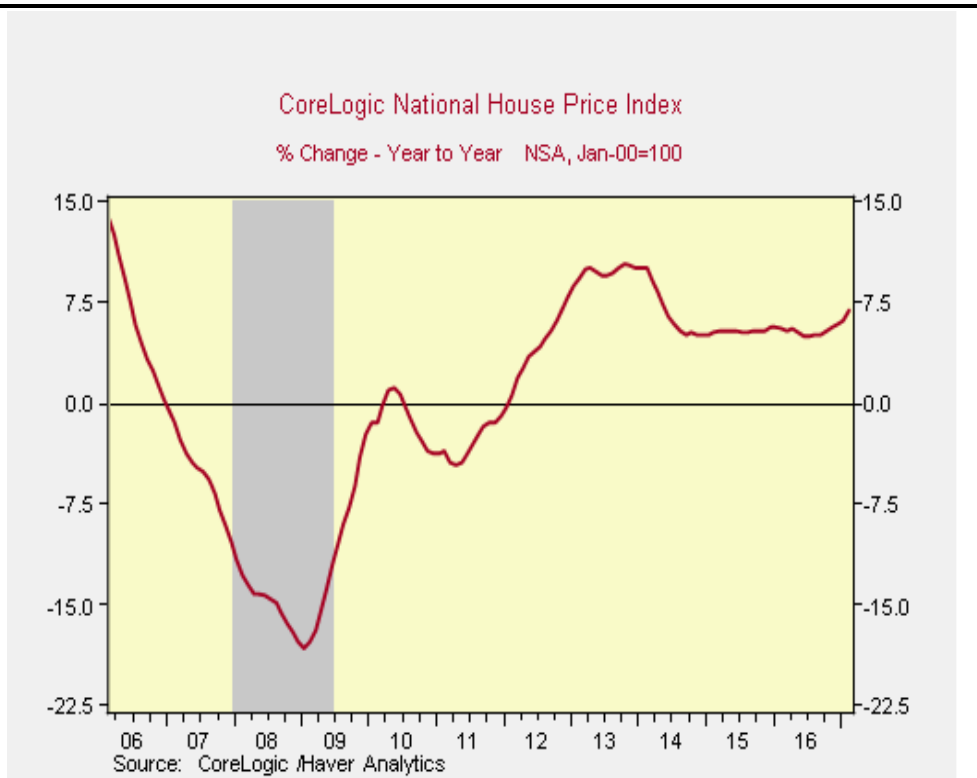
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 3: CPI: Owners' Equivalent Rent of Residences (month-over-month, %)



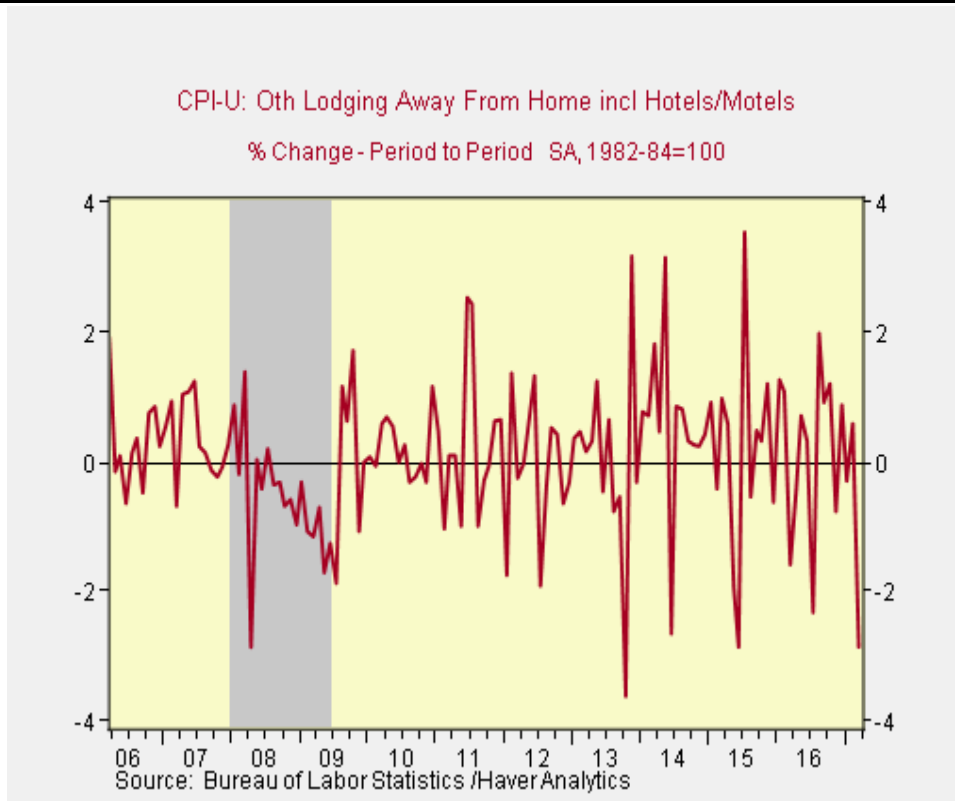
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

Chart 4: CoreLogic National House Price Index (year-over-year, %)



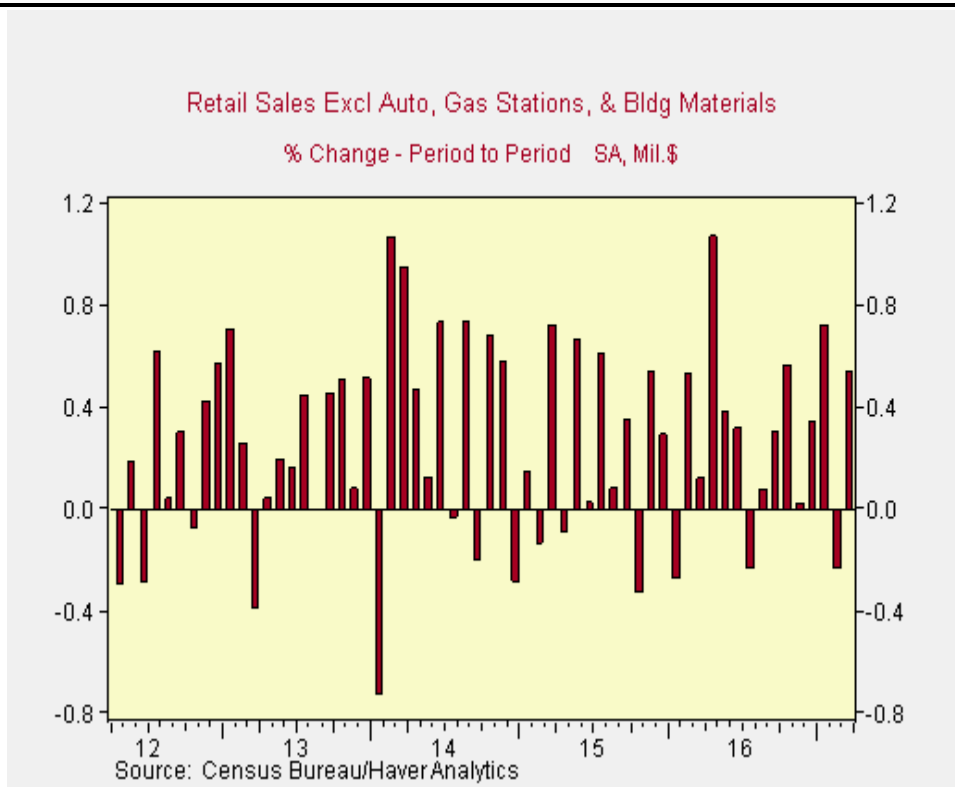
Source: Monthly data. Source: CoreLogic and Haver Analytics

Chart 5: CPI: Lodging Away From Home (month-over-month, %)



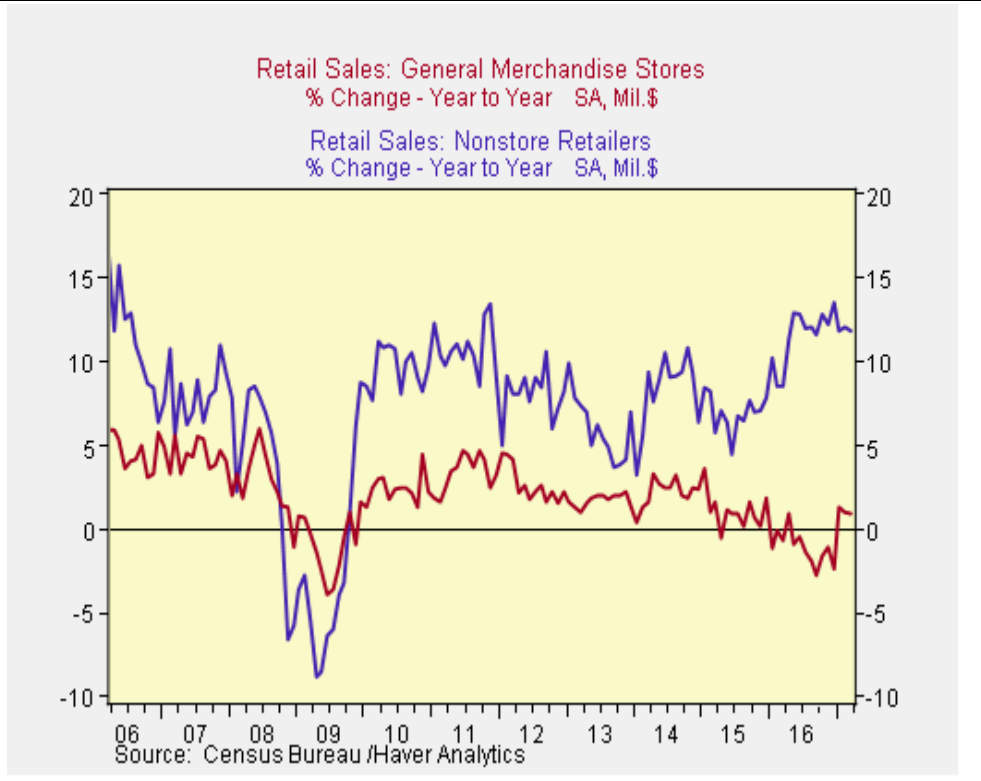
Source: Monthly data. Source: Bureau of Labor Statistics and Haver Analytics

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



Source: Monthly data. Census Bureau and Haver Analytics

Chart 7: Retail Sales: General Merchandise Stores vs Nonstore Retailers (year-over-year, %)



Source: Monthly data. Census Bureau and Haver Analytics

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