ECONOMIC UPDATE

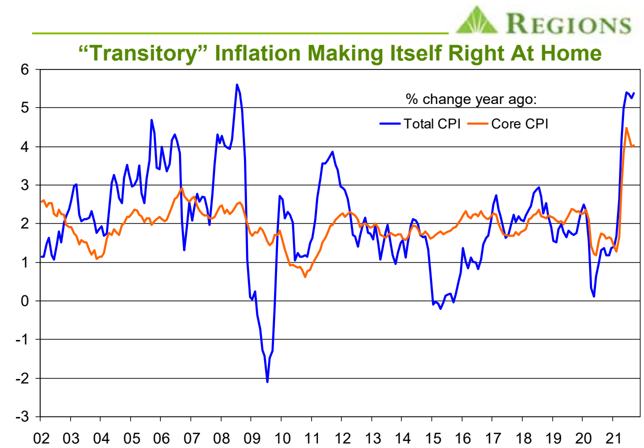
REGIONS

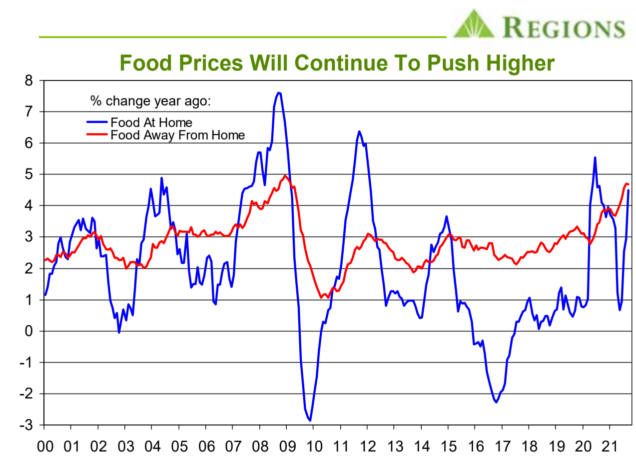
October 13, 2021

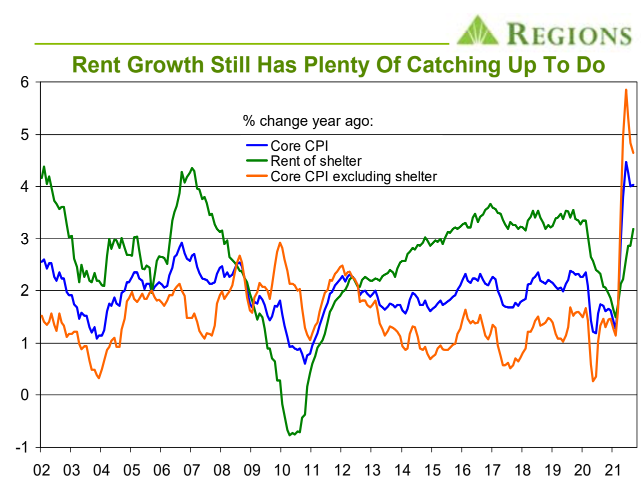
September Consumer Price Index: "Transitory" Inflation Making Itself Right At Home

- The total CPI <u>rose</u> by 0.4 percent in September (up 0.412 percent unrounded); the core CPI <u>rose</u> by 0.2 percent (up 0.243 percent unrounded)
- On a year-over-year basis, the total CPI is <u>up</u> 5.4 percent and the core CPI is <u>up</u> 4.0 percent as of September

The total CPI rose by 0.4 percent in September, matching our above-consensus forecast, while the core CPI rose by 0.2 percent, matching the consensus forecast but falling short of the 0.3 percent increase we anticipated. Our miss on our core CPI forecast is largely a function of medical care costs having been flat in September while our forecast called for a 0.2 percent increase. More significantly, food prices and prices for consumer durable goods rose sharply in September, reflecting supply constraints and higher shipping costs, while rent growth accelerated, all in line with our expectations. From the time inflation began to accelerate, our view was that inflation pressures were likely to persist longer than many, particularly those advancing the "inflation is transitory" argument, were anticipating, and we've yet to see a compelling case to change our view. Instead, with global supply chain and logistics bottlenecks showing signs of persisting well into 2022, which will continue to support upward pressure on goods prices, accelerating rent growth, and labor costs continuing to rise at a rapid rate, it could be that inflation pressures will persist even longer than we had been anticipating. This isn't merely an academic debate, as the longer inflation remains elevated, the greater the odds that market-based measures of inflation expectations move higher, following the path already set by consumer-based measures. Moreover, despite hourly wages growing at a faster rate than would be the case in the absence of labor supply constraints, nominal wage growth continues to lag behind inflation, and this is likely to remain the case over the next several months. Lower-income households, who devote a greater share of their budgets to food, energy, and shelter, will be much more impacted by higher inflation than will be the case for higher-income households. To be sure, inflation will eventually subside, but in the interim higher inflation is much less benign than implied by the "transitory" label many still attach to it.







Energy prices rose by 1.3 percent in September, and while retail gasoline prices were up by 1.2 percent, prices for fuel oil and natural gas were up by significantly more. Supply constraints are apparent across the globe, leaving many households (and businesses) in a precarious position heading into the winter months. At the same time, higher costs for fuel inputs are making electricity generation more expensive, as is reflected in hefty increases in electricity costs as measured in the CPI. Food prices were up by 0.9 percent in September, with prices for food consumed at home jumping by 1.2 percent while prices for food consumed away from home rose by 0.5 percent. Prices for processed and prepared foods are rising at rapid rates, reflecting higher input, packaging, and shipping costs, and we've not seen the last of such increases. On an over-the-year basis, total food costs are up 4.6 percent as of September.

Prices for new motor vehicles rose by 1.3 percent in September and are up 8.7 percent year-on-year, reflecting strong demand and increasingly lean inventories. While prices of used motor vehicles logged a second straight monthly decline in September, the Manheim Index shows used vehicle prices on the rise again, and these increases will at some point, perhaps as early as the October data, be reflected in the CPI data. The September CPI data also show further fading of the "reopening effects" that helped push inflation significantly higher in the summer months, with air fares, rental car rates, and lodging rates all falling again in September.

Still, any benefits from fading reopening effects figure to be offset by faster rent growth. Primary rents rose by 0.453 percent in September, the largest (unrounded) increase since May 2001. Owners' equivalent rents rose by 0.429 percent, the largest monthly increase since June 2006, which has a somewhat ominous connotation. In each case, however, the CPI measures of rent are significantly lagging other measures, which is one reason we anticipate the CPI data will show accelerating rent growth propping up headline and core CPI inflation over the next several months. Though the effects won't be as pronounced in the PCE Deflator, the FOMC's preferred gauge of inflation, they will nonetheless contribute to inflation remaining elevated over coming months.

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