ECONOMIC UPDATE

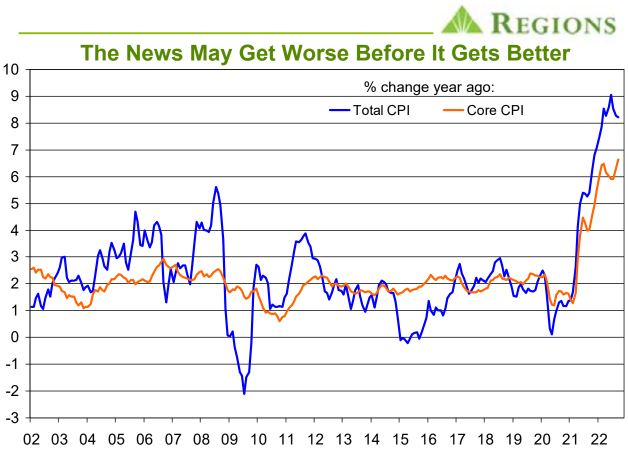
REGIONS

October 13, 2022

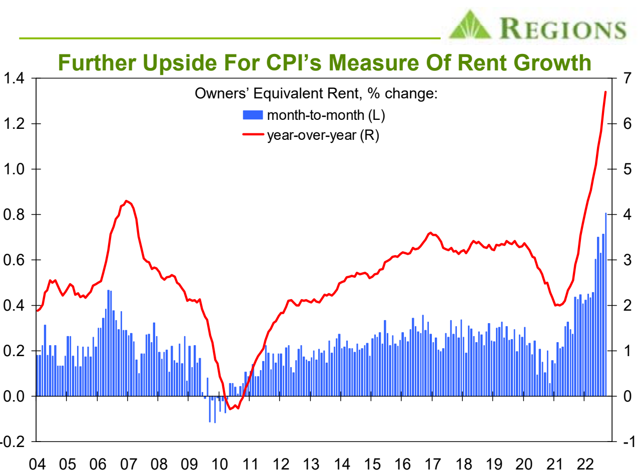
September Consumer Price Index: The News May Get Worse Before It Gets Better

- The total CPI <u>rose</u> by 0.4 percent in September (up 0.386 percent unrounded); the core CPI <u>rose</u> by 0.6 percent (up 0.576 percent unrounded)
- On a year-over-year basis, the total CPI is <u>up</u> 8.2 percent, and the core CPI is <u>up</u> 6.6 percent as of September

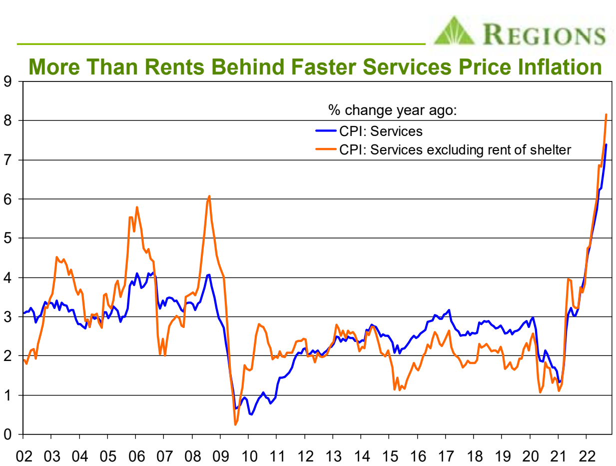
The total CPI rose by 0.4 percent and the core CPI was up 0.6 percent in September, each double the consensus forecast and further ahead of our below-consensus calls. While gasoline once again acted as a drag on the monthly change in the total CPI, that was more than made up for by a host of factors, most notably further acceleration in rent growth and in medical care cost inflation. More broadly, while core goods price inflation is slowing, core services price inflation is accelerating, and rather rapidly at that, and with services carrying a much higher weight in the CPI (and the PCE Deflator for that matter), the slowing pace of core goods price inflation is simply being overwhelmed in the measure of overall services price inflation. The news will get even worse in the months ahead; with retail gasoline prices having turned higher, gasoline will add to the monthly change in the total CPI, rather than deducting from it as has been the case in each of the past three months. That will become apparent in the October data, and we think higher gasoline prices will add at least three-tenths of a point to the October change in the headline CPI. While the slowing rent growth being picked up in other measures will ultimately make its way into the CPI data, that won't happen for a few more months. And, to make matters even worse, there is more to faster rent growth behind the acceleration in services price inflation. All of which puts the FOMC in a rather uncomfortable spot, and the more uncomfortable it gets for the FOMC, the more uncomfortable it gets for the U.S. economy as several FOMC members have noted they think the cost of the Committee going too far in raising the Fed funds rate is less than the cost of them not going far enough.



Retail gasoline prices were down by 4.9 percent in September, a smaller decline than our forecast anticipated. As noted above, pump prices have been rising over the past few weeks and will likely push higher over the next few weeks, if not more. The overall energy index fell by 2.1 percent in September but is nonetheless up 19.8 percent year-on-year. The overall food price index posted a second straight 0.8 percent monthly advance, smaller than the increases seen over the prior several months but which still leaves food prices up 11.2 percent year-on-year. Prices for food consumed at home have been rising at a slower, albeit still fast, pace but prices for food consumed away from home have been rising at a faster pace. It is worth noting, however, that the faster pace of growth in prices for food consumed away from home is being driven by prices for food consumed as schools and employee sites while prices at restaurants, limited service and full service, have been rising at a slower pace over recent months.



Core goods (non-food, non-energy) prices were flat in September, and while this still leaves them up 6.7 percent year-on-year, don't rule out monthly declines going forward. Retailers sitting on unwanted inventories of goods ranging from apparel to appliances have been engaging in aggressive discounting, which is likely to intensify as we head toward the holiday shopping season. In stark contrast, however, core services prices were up by 0.8 percent in September, the largest monthly increase since June 1982, leaving them up 6.7 percent year-on-year, the largest such increase since August 1982. Faster rent growth is the ringleader behind accelerating services price inflation; primary and owners' equivalent rents each rose by 0.8 percent in September. Given the lag involved in the CPI measures of rents, don't rule out further acceleration in rent growth over coming months before these measures turn lower. Also, keep in mind that rents account for over forty percent of the core CPI but carry a much lower weight in the core PCE Deflator, the FOMC's preferred gauge of inflation. Still, there is more to faster services price inflation than faster rent growth. For instance, medical care costs rose by 0.8 percent in September, which yields a year-on-year increase of 6.0 percent, the largest such increase since July 1993. In addition to higher health insurance premiums, the recent acceleration in medical care cost inflation has been driven by the services side, i.e., doctor and dentist services and in-patient care facilities. While growth in health insurance premiums will likely ease, there may not be much, if any, relief from providers' prices any time soon. If not, medical care will be a source of persistent upward pressure on core inflation.



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