October 11, 2018

# US CPI Softer Than Expected, But Not Uniformly So

**U.S., CPI (m/m%;y/y%), September:**
Actual: 0.1 / 2.3
Scotia: 0.2 / 2.4
Consensus: 0.2 / 2.4
Prior: 0.2 / 2.7 (Unrevised)

**U.S., Core CPI (m/m%;y/y%), September:**
Actual: 0.1 / 2.2
Scotia: 0.2 / 2.3
Consensus: 0.2 / 2.3
Prior: 0.1 / 2.2 (Unrevised)

- At the margin, a softer than expected CPI report might help to assuage bond market concerns. The key is that core CPI was unchanged at +2.2% y/y and hence against expectations for a somewhat further upward drift. So far, the market effect is minimal as the US two year Treasury yield is down only about 1bp post-data which only unwinds the run-up in the two hours leading up to the figures. The USD on a DXY basis is unchanged. There have been times when a tenth here or there would impact bond markets and the USD more materially.
- Why is there not a bigger reaction? For one thing, the bond market's concern is about more than just inflation; it's about the carry out of foreign markets and how the rise of FX hedging costs and the cross currency basis have walloped foreign appetite for US Treasuries. There are bigger concerns overhanging world markets as explained in the morning note.
- Another reason for a muted market reaction is that the underlying components are mixed. In fact, one major factor held back core CPI against other sources of upward pressure. Owners' equivalent rent decelerated by a tenth to 0.2% m/m (0.3% prior) and since that carries about a 24% weight in CPI it played a significant role in the downside surprise.
- Vehicle prices were soft, but in weighted terms had a minor effect especially in terms of the headlines about a drop in used vehicle prices. New vehicle prices were down 0.1% m/m with a 3.7% weight so that only knocked -0.005% m/m off of headline CPI. Meh, that's not worth getting out of bed for. Used vehicle prices were down 3% m/m with a 2.3% weight so that knocked 0.07% m/m off headline CPI. Therefore the combined vehicle price effect on CPI was minor at about -0.07%.
- Also note that services were up 0.2% m/m which was unchanged from the prior month.
- Other categories exhibited marginally greater price pressure. For example, apparel prices were up 0.9% m/m (-1.6% prior). Medical care prices were up 0.2% m/m (-0.2% prior). Recreation prices were up 0.3% m/m (-0.1% prior). Food/beverage price inflation was unchanged at +0.1% m/m.
- Please see the three updated charts with Sam Fraser's help. Chart 3 shows the relative lack of breadth to inflation pressures in terms of weighted contributions. Chart 1 shows that we're long past the point when inflation one-

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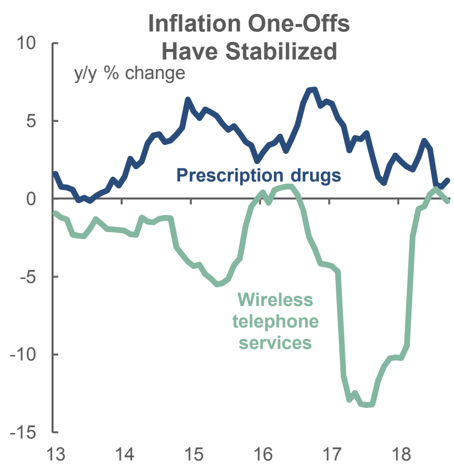
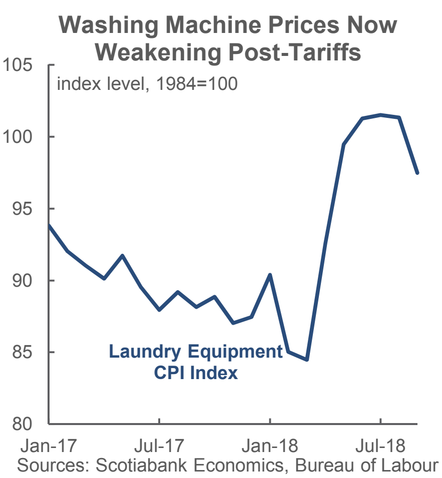
Chart 1




Sources: Scotiabank Economics, BLS.

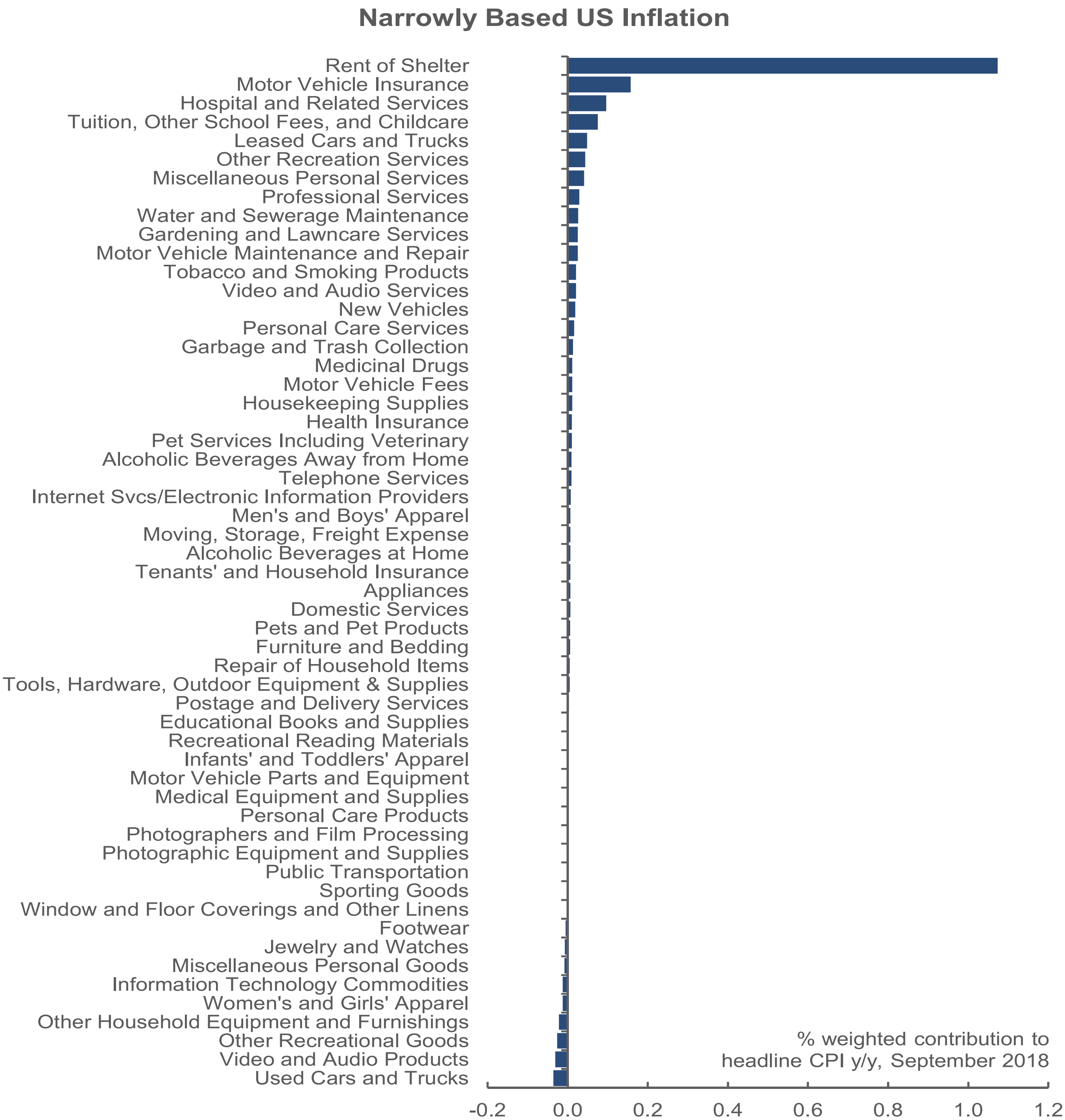
Chart 2




Sources: Scotiabank Economics, Bureau of Labour Statistics.

offs were distorting, such as drug prices and wireless telephone service package pricing. Indeed, the emphasis Trump is placing upon drug price inflation is misplaced versus prior years. Chart 2 shows that the tariff effect on prices of laundry machines is waning; note that the chart plots the index level and not just the year-ago percentage change that would be expected to cool. Is the first round effect of tariff pass-through on washing machine prices now resulting in pressure to ease prices in the face of the demand effects? IF so, that's a negative for margins.

**Chart 3**




Sources: Scotiabank Economics, BLS.