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TD Economics

Commentary

May 14, 2008

U.S. CPI WAS SOFTER THAN EXPECTED IN APRIL

- **Core inflation was up 0.1% M/M in April and rose 2.3% Y/Y.**
- **Headline inflation gained 0.2% M/M and 3.9% Y/Y.**
- **Food was a large contributor to headline inflation, but there was not much pass through from energy prices. Most other categories posted soft readings.**
- **All in all, if conditions persist, this could let the Fed get back on the rate cutting trail.**

In April, CPI was softer than expected. The headline pace of inflation was up 0.2% M/M in April while core inflation was a tame 0.1% M/M. To three decimal places, core inflation was a modest 0.104% in April, so it is legitimately tame and not just due to rounding down. Seasonal factors drove energy prices down in April, even though prices at the pump were high. On a year ago basis, headline inflation was 3.9% in April compared to 4.0% in March, while core inflation was 2.3% compared to 2.4% in March. Both annual figures were the lowest since October 2007. On a three month annualized trend, core CPI was 1.2% which is down significantly from 2.3% in March, while on a six month annualized trend, core CPI was 2.2% in April compared to 2.3% in March.

The drivers of inflation in April can be traced back to higher food and beverage prices, which rose 0.9% M/M, which is the largest monthly gain since February 1990.

Apparel prices were also relatively firm with a 0.5% monthly gain, which comes on the heels of two consecutive monthly declines. But there were other interesting downside factors in this inflation report. There was a 0.7% M/M drop in transportation prices, and a 0.1% M/M drop in recreation, while housing continues to remain generally consistent with recent trends with a 0.3% monthly gain.

We do find the flat reading for energy prices interesting, especially following the massive 1.9% M/M gain in March. This, however, is entirely due to seasonal factors. On a non-seasonally adjusted basis, gasoline prices were up 5.6% on the month. So when looking beneath the headlines, the energy component remains quite hot.

The takeaway from this report does suggest some moderation in price pressures in the U.S. This should provide a sigh of relief for the hawks on the FOMC, who continued to dissent even at the last meeting on April 30. It seems that the softness in the economy is starting to take hold, with a lackluster job environment leaving wage gains tepid or non-existent. This has taken some of the upside out of many components in inflation. This does provide additional support to our view that the Fed should not be dissuaded from further cuts, given the weakness in the U.S. economy, as economic growth concerns continue to trump inflation concerns.

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