TD Bank Financial Group

TD Economics

Commentary

November 19, 2008

U.S.: CPI SURPRISINGLY SOFT

- **U.S. CPI was softer than expected, with headline CPI falling 1.0% M/M in October and core CPI falling 0.1% M/M. On an annual basis, headline CPI was 3.7% in October, while core CPI was 2.2% Y/Y.**
- **There were a number of categories which posted sizable monthly declines. Energy and transportation saw the largest declines in October.**
- **The monthly decline in headline CPI was the largest ever. The core CPI posted the first monthly decline in 26 years.**

The slowing pace of economic growth is clearly having an impact on price pressures in the U.S. Headline CPI posted its largest monthly decline ever, with a 1.0% M/M drop in October. That pushed headline CPI lower to 3.7% Y/Y from 4.9% Y/Y in September. Core CPI was also softer than expected with a 0.1% M/M decline, which left the annual rate at 2.2% Y/Y. This was the first negative monthly reading on the core measure in more than two decades.

Lower energy prices played quite a significant role in the moderation in headline inflation in October, as energy prices fell 8.6% (SA) M/M. That too, is the largest monthly decline in the energy component in the history of this data series. Core CPI on a three month annualized trend is now a slight 1.1%, compared to 2.7% in September. Core CPI on a six month annualized trend also saw some deterioration in October. It is now 2.3% as compared to 2.6% in September.

There was some softness in other components. Housing prices were flat in October on a seasonally adjusted basis, following two consecutive monthly declines. In addition, food and beverage prices were up only 0.3% M/M (SA) in October, which is the smallest monthly gain since May 2008. As consumers continue to sharply pare back spending, prices for apparel saw a massive 1.0% (SA) M/M decline in October. This was the largest monthly decline since September 1998. Moreover, recreation prices are seeing much of the same downward price pressure as discretionary spending takes a holiday. Recreation prices were up only 0.1% M/M (SA) in October, which is the smallest gain since June 2008.

On balance, this report confirms the view that the retrenchment in economic activity is taking care of any inflationary pressures that previously existed in the U.S. economy. The hawks on the FOMC now have little to worry about. The bigger concern is clearly the dwindling pace of economic growth and the concern about inflation is definitely in the rear view mirror. These data provide further support for the Fed to provide additional stimulus. And we are therefore still of the view that the Fed will deliver easing to leave the fed funds rate at 0.50%, with some downside risks.

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