

US Consumption Soars, Core Inflation Decelerates

United States, Personal Income / Consumption, % m/m, March:

Actual: 0.1 / 0.9

Consensus: 0.4 / 0.7

Scotia: 0.4 / 0.8

Prior: 0.2 / 0.1

United States, PCE / core PCE deflators, y/y % change, March:

Actual: 1.5 / 1.6

Consensus: 1.6 / 1.7

Scotia: 1.6 / 1.7

Prior: 1.3 / 1.7

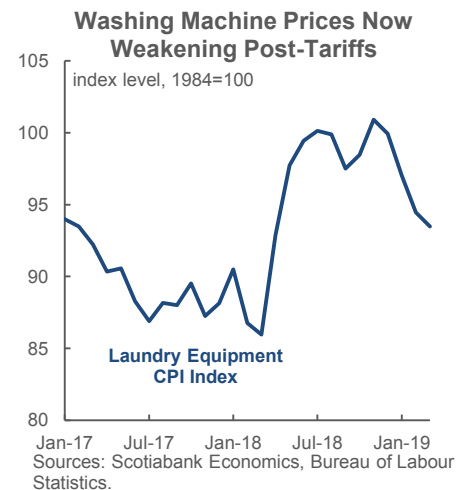
- The Fed policy risk involves how to read competing influences of strong consumption growth versus another slip in core PCE inflation. The best course of action to the Fed may well be to retain 'patience' as it awaits much greater evidence on how transitory both trends may or may not be. **There are several areas of uncertainty behind what is driving core PCE inflation softer**, with plausible effects being US dollar influences, methodological questions surrounding used vehicle prices that contributed 0.1 points to the deceleration in core PCE in year-ago terms, and the very early beginnings of tariff unwinding in categories with so far low (but about to rise) weights in the inflation basket like appliances. Controlling for such effects will take time during which income dynamics need to be evaluated as drivers of sustainable consumption growth. Personally I think decelerating core inflation faces several plausible explanations that may be transitory.
- **In inflation-adjusted terms, consumption growth tied with two other months (March 2017, August 2014) for the strongest monthly gain since 2009.** The 0.7% real gain indicated that most of the 0.9% m/m rise in the value of spending was due to higher volumes and not prices.
- Ending Q1 consumption on a solid note matters for Q2 expectations. **What's baked in for Q2 US consumption growth?** About 1.8% q/q SAAR based solely upon the way Q1 ended and the average quarterly math. This is before we get any actual Q2 spending numbers. So we're already tracking higher than the 1.2% actual consumption growth in Q1 but solely in terms of the hand-off math.
- **Core PCE inflation eased to 1.6% y/y (1.7% prior).** It has been declining since floating around 1.9-2.0% over March through December of last year. In month-ago terms, core PCE inflation was flat in March after rising by just 0.1% m/m in each of the prior two months. More on the drivers below.
- While core PCE inflation is softening, patience is a virtue here in that we're likely paying the price for last year's broad dollar strength that has since flat lined. As 2019 evolves, we're likely to get firmer core PCE inflation but may not yet be at the trough. The US moved aggressively into excess aggregate demand only over the past year and there are lagged effects in translating this to a core PCE forecast even with a flatter relationship than historically. Then it depends upon forecasting the broad USD—if it remains sideways as it has generally trended for months now, then the disinflationary effects of last year's strength get worked through by around mid-year.

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707

Scotiabank Economics

derek.holt@scotiabank.com



- **Income growth was softer than expected (+0.1%, consensus 0.4) so the saving rate pulled back to 6.5% in order to finance the consumption gain.** The saving rate overshoot into the end of 2018 and start of 2019 by soaring to 7.7% so there is a mixed message here. The saving rate is coming back down to earth as pent-up consumption gets unleashed but we need firmer income growth on a trend basis to take over as 2019 further unfolds. Bring on Friday's nonfarm payrolls and wages for the next incremental piece of evidence in this regard.
- **Drivers of the deceleration in core PCE inflation included softer used vehicle prices that remain an area of controversy** (-2.7% y/y, -0.3% prior). The Manheim used car price index continues to show prices up 4.0% y/y. The Manheim index, however, captures wholesale auction prices without adjustments for depreciation or quality changes versus inflation data that makes such adjustments to a different set of used car price data. For CPI, the BLS uses a sample of 480 vehicles from sales data collected by J.D. Power Company for vehicles aged between two and seven years which may be a limited sample. Further information on methodology is available [here](#).
- Other categories that decelerated included furnishings and durable household equipment (1.4% y/y, 1.7% prior) that masked decelerating increases in appliance prices (8.6% y/y, 11.2% prior) as **the effects of tariff hikes** into early 2018 dissipate partly on year-ago base effects in terms of the inflation consequences but also as higher prices likely dent demand (see chart). There will be more of this as pass-through of higher steel/aluminum prices and tariffs on Chinese imports gets re-based. There were also falling clothing prices (-2.2% y/y, -1.0% prior), and a slight deceleration in service price inflation (2.3% y/y, 2.4% prior). Within services, accommodation prices climbed at a slower rate of 3.1% y/y (4.8% prior), financial services and insurance prices were up 2.1% y/y (2.5% prior).

This report has been prepared by Scotiabank Economics as a resource for the clients of Scotiabank. Opinions, estimates and projections contained herein are our own as of the date hereof and are subject to change without notice. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness. Neither Scotiabank nor any of its officers, directors, partners, employees or affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

These reports are provided to you for informational purposes only. This report is not, and is not constructed as, an offer to sell or solicitation of any offer to buy any financial instrument, nor shall this report be construed as an opinion as to whether you should enter into any swap or trading strategy involving a swap or any other transaction. The information contained in this report is not intended to be, and does not constitute, a recommendation of a swap or trading strategy involving a swap within the meaning of U.S. Commodity Futures Trading Commission Regulation 23.434 and Appendix A thereto. This material is not intended to be individually tailored to your needs or characteristics and should not be viewed as a "call to action" or suggestion that you enter into a swap or trading strategy involving a swap or any other transaction. Scotiabank may engage in transactions in a manner inconsistent with the views discussed this report and may have positions, or be in the process of acquiring or disposing of positions, referred to in this report.

Scotiabank, its affiliates and any of their respective officers, directors and employees may from time to time take positions in currencies, act as managers, co-managers or underwriters of a public offering or act as principals or agents, deal in, own or act as market makers or advisors, brokers or commercial and/or investment bankers in relation to securities or related derivatives. As a result of these actions, Scotiabank may receive remuneration. All Scotiabank products and services are subject to the terms of applicable agreements and local regulations. Officers, directors and employees of Scotiabank and its affiliates may serve as directors of corporations.

Any securities discussed in this report may not be suitable for all investors. Scotiabank recommends that investors independently evaluate any issuer and security discussed in this report, and consult with any advisors they deem necessary prior to making any investment.

This report and all information, opinions and conclusions contained in it are protected by copyright. This information may not be reproduced without the prior express written consent of Scotiabank.

™ Trademark of The Bank of Nova Scotia. Used under license, where applicable.

Scotiabank, together with "Global Banking and Markets", is a marketing name for the global corporate and investment banking and capital markets businesses of The Bank of Nova Scotia and certain of its affiliates in the countries where they operate, including, Scotiabanc Inc.; Citadel Hill Advisors L.L.C.; The Bank of Nova Scotia Trust Company of New York; Scotiabank Europe plc; Scotiabank (Ireland) Limited; Scotiabank Inverlat S.A., Institución de Banca Múltiple, Scotia Inverlat Casa de Bolsa S.A. de C.V., Scotia Inverlat Derivados S.A. de C.V. – all members of the Scotiabank group and authorized users of the Scotiabank mark. The Bank of Nova Scotia is incorporated in Canada with limited liability and is authorised and regulated by the Office of the Superintendent of Financial Institutions Canada. The Bank of Nova Scotia is authorised by the UK Prudential Regulation Authority and is subject to regulation by the UK Financial Conduct Authority and limited regulation by the UK Prudential Regulation Authority. Details about the extent of The Bank of Nova Scotia's regulation by the UK Prudential Regulation Authority are available from us on request. Scotiabank Europe plc is authorised by the UK Prudential Regulation Authority and regulated by the UK Financial Conduct Authority and the UK Prudential Regulation Authority.

Scotiabank Inverlat, S.A., Scotia Inverlat Casa de Bolsa, S.A. de C.V., and Scotia Derivados, S.A. de C.V., are each authorized and regulated by the Mexican financial authorities.

Not all products and services are offered in all jurisdictions. Services described are available in jurisdictions where permitted by law.