Why Was US Core PCE Revised Down?

- The drivers were narrowly based, idiosyncratic and likely temporary. The Fed should continue to look through it in anticipation of a rebound in core PCE, but it will remain in heightened data watch mode as it evaluates whether or not higher core PCE inflation does indeed transpire.
- Monitor Vice Chair Clarida's speech today at 12pmET for potential reaction.
- Tomorrow's PCE inflation and the Dallas Fed measure will further inform the inflation debate.
- Other revisions in the second swing at Q1 GDP figures were relatively bland.

The stand-out in the US GDP revisions was a downward revision to core PCE inflation in Q1 that potentially adds fuel to rate cut bets. The drivers, however, play more to the transitory and idiosyncratic narrative that Chair Powell has spoken to. **That should mean that the Fed doesn't get overly fussed by weaker core PCE and remains in cautious watch mode to test whether a rebound lurks ahead over the duration of 2019.**

The downward revision to core PCE at 1.0% q/q SAAR from 1.3% is new info compared to the tracking of the monthly core PCE deflators and ahead of tomorrow's April update. One point that merits a mention before digging into the drivers is that **it's difficult to tell the distribution and timing of the revisions over Q4 and Q1 without getting the revised monthly figures tomorrow. Stay tuned on that count.**

There were two main drivers of the downward revision to core PCE: used vehicles and financial services fees.

Used motor vehicle margin estimates were revised down by 2.3% for autos and light trucks. The initial estimates are drawn from producer prices for sales at used car dealers and they've replaced those interim estimates with revised sources.

Prices for financial services were revised down through the 'furnished without payment for commercial banks' category that was revised down by a hefty 13.4%. The initial estimates are drawn from the Fed's call reports but the new estimate reflects 'a judgemental trend' applied to fresher info.

Recall that at the May 1st press conference, Powell dismissed the deceleration in core PCE during Q1 as transient in favour of an unchanged base line expectation for inflation to be at 2% over time. He referenced developments in slack in the economy as the US economy has pushed into excess demand conditions and how this should lift inflation. Powell gave examples of transient downside pressures upon core PCE that included apparel prices, temporary softness in portfolio management services after Q4 market developments that have since turned, and airfare prices.

Powell also noted that measures like the Dallas Fed's trimmed mean inflation rate have remained around 2% (1.96% y/y as of March) throughout the period in which headline PCE diminished and so only components in the tails of the price distribution are distorting inflation composites while the bulk of the basket of prices is more stable. **We'll get a fresh reading on the Dallas measure tomorrow** that incorporates the monthly PCE estimates and revisions so watch for that.

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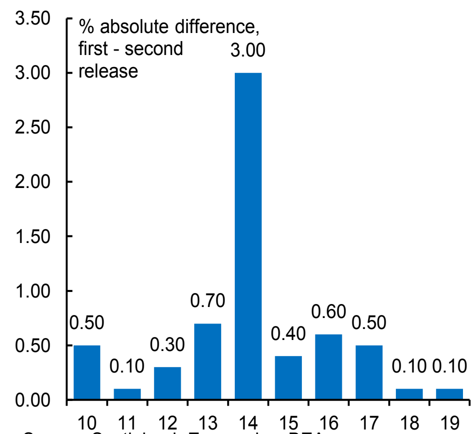
Q1 U.S. GDP
Second Release Revisions



Source: Scotiabank Economics, BEA.

The overall takeaway is that there shouldn't be great reason to get excited by the downward inflation revision. The drivers are narrowly based, have been previously cited by Fed officials, and Chair Powell has said these are viewed as transitory/idiosyncratic drivers that are expected to reverse in future.

We're nevertheless clearly in more heightened watch mode for the inflation readings. It merits noting that the last time we got a print this low was in 2015Q4 and it did indeed jump higher the next quarter to 1.7% in 2016Q1 and then 2.1% in 2016Q2. I think it's quite likely that something similar happens going forward.

Otherwise, this was a fairly bland set of GDP revisions. Q1 growth was revised down a tick to 3.1% (3.2% initial, consensus expected 3.0%). As the accompanying chart demonstrates, this continues the pattern whereby Q1 revisions are usually fairly modest in transitioning from the advance to second readings pending the next revision on June 27th that will incorporate more services information. Q1 consumption growth was revised up a tick to 1.3%. Across the revised GDP components there is nothing terribly interesting as there was a little softer investment contribution, a slightly stronger consumption contribution, and contributions from trade and inventories were little changed.