October 31, 2019

US Inflation Dip Adds to Fed Doubts

- A dip in core PCE inflation and soft Chicago PMI…
- ...are adding to richer Treasuries…
- ...following negative trade headlines
- Markets expect a Fed rate cut by Spring
- Few categories are driving overall PCE inflation
- Americans are hording tax stimulus through a higher saving rate

United States, Personal Income / Consumption, % m/m, September:
Actual: 0.3 / 0.2
Consensus: 0.3 / 0.3
Scotia: 0.3 / 0.2
Prior: 0.5 / 0.2 (revised from 0.4 / 0.1)

United States, PCE / core PCE deflators, y/y % change, September:
Actual: 1.3 / 1.7
Consensus: 1.4 / 1.7
Scotia: 1.4 / 1.8
Prior: Unrevised from 1.4 / 1.8

Core PCE inflation slipped unlike guidance from core CPI that had held firm. That's not a big deal, but it's the first dip in the year-ago rate since May and at the margin feeds the risk that progress toward 2% has stalled out. One day after the Fed's pause signal, softer inflation combined with a big miss in the Chicago PMI that fell to a nearly four year low to push Treasury yields lower. This adds to pre-data momentum that was derived from negative headlines on US-China trade negotiations. Pricing for another Fed rate cut by Spring has strengthened.

Consumption growth in the US slightly disappointed in September due to upward revisions to prior months. The overall quarter landed at 2.9% consumption growth in keeping with what was already factored into yesterday's GDP accounts.

That said, it's a touch weaker than expected hand-off into Q4 momentum for the consumer. Based solely upon the hand-off to end Q3, Q4 has baked in consumption growth of 0.7% at a seasonally adjusted and annualized rate before we get any actual Q4 consumption data.

Furthermore, the hand-off from inflation-adjusted income growth in September bakes in 1.6% income growth in Q4 before we actually get any Q4 data. That's impressive following 2.9% income growth in Q3. Even just modest monthly average gains in income growth over Q4 could lift quarterly income growth well over 3%.

As for hand-off math to Q4 inflation expectations, it points to the risk of cooling. Again, based solely on the way Q3 exited as a hand-off to Q4, headline inflation is tracking 0% q/q at a seasonally adjusted and annualized rate while core PCE is tracking 0.3% q/q. This follows Q3 increases of 1.5% and 2.2% in headline and

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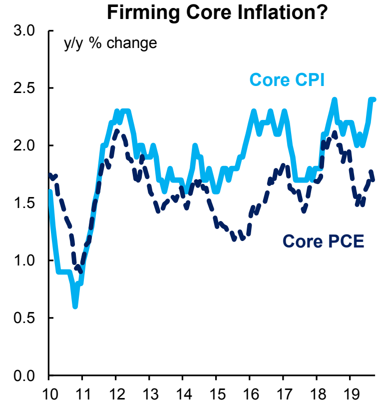
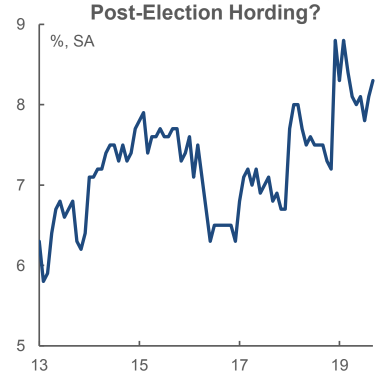
Firming Core Inflation?



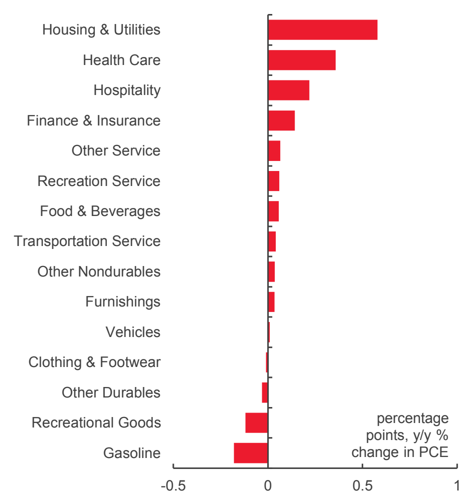
Source: Scotiabank Economics, BLS, BEA.

US Personal Saving Rate: Post-Election Hording?



Sources: Scotiabank Economics, Bureau of Economic Analysis.

Contributions to September US Personal Consumption Expenditures



Sources: Scotiabank Economics, BEA.

core PCE respectively over the prior quarter. Monthly core PCE gains consistent with the recent trend would lower the pace of increase in core PCE inflation to under 2%.

The saving rate edged higher again to 8.3%. That on its own is interesting in that at the margin one cannot in any obvious way deny that a fair portion of the Tax Cuts and Jobs Act of January 2018 has been horded by consumers. Chart 2 shows the saving rate's climb since then.