

## US: Deflation on its way

Both headline and core consumer price inflation undershot expectations as the economy began its slide. The subsequent collapse in energy prices and surging unemployment means inflation pressures will evaporate with negative headline CPI soon set to arrive



### Energy and apparel feel the squeeze

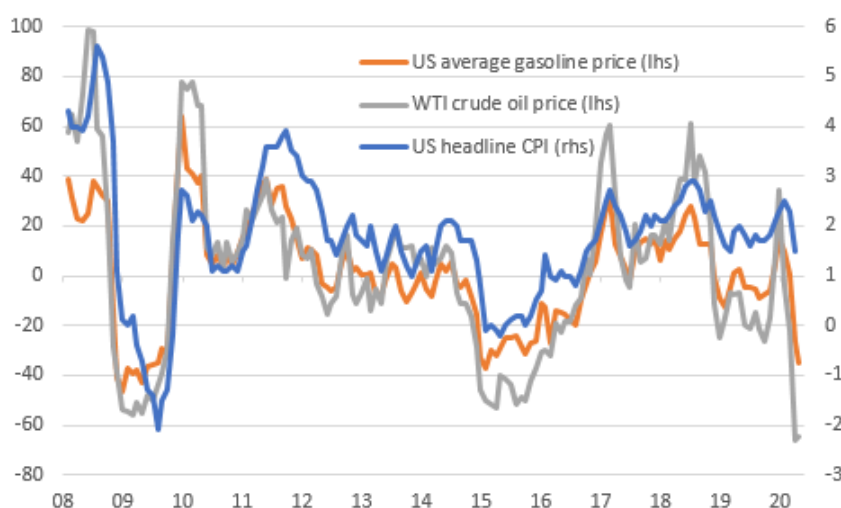
The US consumer price inflation report showed prices fell 0.4% month on month in March, dragging the annual rate of inflation down to 1.5%. This was a touch weaker than the -0.3% MoM figure expected with energy responsible for most of the decline – this component saw price falls of 5.8% MoM as gasoline prices began their long descent. Apparel was also weak (-2% MoM) while transport costs were also sharply lower (-2.9% MoM).

Outside of these components there was very little upside threat. Tobacco saw the biggest gain, up 1% MoM while medical care rose 0.4%, food rose 0.3% with owners' equivalent rent also up 0.3%. Service sector inflation was very benign with a MoM price fall of 0.1% and annual inflation of 2.1% versus 2.4% in February.

We see further downside risk to inflation over coming months. Huge falls in energy prices will continue to feed through into lower retail gasoline prices, utilities and other components, which account for around 8% of the index. Shelter, accounting for 33% of the basket, is also likely to be weak with reduced activity depressing housing prices and rent inflation with hotel accommodation prices plunging.

Then there is services ex shelter (26% of the index), which is typically driven by wage inflation. With initial claims data showing the economy having lost nearly 17 million jobs in the past three weeks and with millions more at risk there is unlikely to be much inflation pressure being generated here. The main threat is likely to come from food prices, particularly if containment shutdowns result in less production, but we have to remember that food is less than 14% of the inflation basket.

## US CPI & energy prices (YoY%)



Source: Bloomberg, ING

## Further price falls are coming

The Federal Reserve also see little inflation threat whether the economy gradually re-opens over the summer or if lockdowns continue through to early next year. The minutes to the March FOMC meeting, released on Tuesday, state that “in both scenarios, inflation was projected to weaken, reflecting both the deterioration in resource utilization and sizable expected declines in consumer energy prices.”

Of course, we hear the argument that the Federal Reserve “unlimited” quantitative easing is bound to eventually generate inflation, but we heard that after the Fed’s QE1, QE2 and QE3 programmes. The key question is will the money find its way into the pockets of consumers, or is it going to stay in financial assets? Last time round QE certainly contributed to asset price inflation, yet CPI remained stubbornly low and, at least at this stage, we see little reason for it to be different this time round.

Our base case is one that sees the economy contract 12% peak to trough before we start to see a rolling process of re-opening in the US from mid-May. This will involve some form of social distancing with stricter testing coming into place meaning that a return to “business as usual” could take many months – we don’t expect the lost output to be fully recovered until mid-2022. This means new job opportunities for the millions of workers laid-off will be limited, unemployment will be slow to fall and there will be few wage pressures. Inflation pressures will therefore remain modest at best with little reason for the Fed to consider interest rates changes within the next twelve months.

## Author

**James Knightley**

Chief International Economist, US

[james.knightley@ing.com](mailto:james.knightley@ing.com)

## Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies).* The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit [www.ing.com](http://www.ing.com).