



UNITED STATES

A time of substantial disinflation has begun!

HIGHLIGHTS

- The consumer price index (CPI) fell by a monthly record of 1.0% in October after holding steady in September.
- Clothing (-1.0%) and transportation (-5.4%) were the components with the largest declines.
- Overall, energy prices were down 8.6% in October. With energy excluded, however, core inflation is still down. The month's 0.1% decline is the first time core inflation has dipped since 1982.
- The CPI's annual change went from 4.9% in September to 3.7% in October. Core inflation slowed three tenths of a point from 2.5% to 2.2% that month.

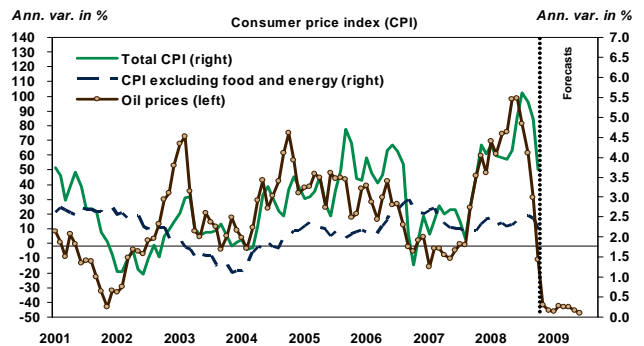
COMMENTS

Like several of the other economic statistics published for October, this morning's results for inflation provide yet more evidence of a sharp economic slowdown south of the border. With the labour market deteriorating, home prices tumbling, fears surrounding the financial crisis and sharp downturn in commodity prices, the disinflation period (decline in the price growth rate) we had been expecting is now well underway.

The precariousness of consumers' situation is being reflected in clothing prices, which dipped 1.0% that month. Transport prices are also down substantially, reflecting the tumble by gas prices (-13.9%), as well as a third straight drop in prices for the new and used vehicle component (-0.7%). Core inflation (which excludes food and energy) thus exceeded our forecast to the downside, recording its first monthly drop since the recession in the early 80s.

The substantial drop in energy prices since July is now fully reflected in year-over-year inflation. With a smaller upward contribution (in October, energy prices were still 11.5% higher than in 2007), annual inflation fell more than expected, from 4.9% in September to 3.7% in October. Except for the 1.8-point drop recorded in September of 2006, this is the biggest plunge ever recorded by the year-over-year change. With little to indicate that oil prices will bounce back substantially any time soon, year-over-year inflation could close in on 0% by mid-2009.

Energy prices' sharp drop should quickly slash total inflation



Sources: Bureau of Labor Statistics and Desjardins, Economic Studies

October's slowdown by core inflation, to 2.2%, is also steeper than forecast and could give the Federal Reserve (Fed) some cause for concern. The increase in excess production capacity and downside pressure on wages as a result of job losses should fuel ongoing disinflation until the end of 2009.

Implications: The economic and financial situation is clearly deflationary. Sooner or later, the impacts of the drop in oil prices will dissipate, but deleveraging by banks and consumers' probable return to savings means that core inflation will remain low for a long time. Consequently, the Fed is very likely to lower its key rate again in the months to come.

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