Pullback by inflation and housing starts

HIGHLIGHTS

- Housing starts tumbled from an annualized level of 1,021,000 in March to 853,000 in April. This 16.5% decline comes on the heels of a 5.4% gain in the previous month.
- The consumer price index (CPI) fell back by 0.4% in April after a 0.2% dip in March. Energy prices sank by 4.3%, while food prices ticked up by 0.2%. Just as in March, the core index, which excludes food and energy, edged up by just 0.1%. The annual change in the total CPI slid from 1.5% to 1.1%. Core inflation diminished from 1.9% to 1.7%.

COMMENTS

At first glance, the decline in housing starts may appear dramatic. However, it is really just an adjustment from the abnormally high level that was recorded in March. However, the downturn is a bit larger than was expected, in particular by the consensus forecast. We now expect housing starts to quickly pick up steam. The 14.3% escalation in building permits in April and the improvement in the NAHB homebuilder confidence index in May (after a few months of stagnation) suggest an imminent surge in new construction.

Once again, gas prices have greatly affected the monthly change in consumer prices. As in March, the drop in prices at the pump was magnified by seasonal adjustments; consequently, gas prices within the CPI fell by 8.1%. This is the largest drop since December 2008, obviously generating a contraction of the total CPI. The situation should stabilize in May, however. Apart from energy, we note softness in some other prices. For the second month in a row, the core index has ticked up by a mere 0.1%. As was the case in March and February, we note a pullback in clothing prices. And a rare event: the price of medical services has gone down, a first since the summer of 2010. Core inflation, at 1.7%, is now at its lowest rate since June 2011, but we do not expect it to subside much further.

Implications: The pullback in gas prices is nearing its end, and its influence on the CPI should be more neutral in May.

Francis Généreux
Senior Economist

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