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## Importing goods deflation

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- The disinflation trend continued in October for the PCE Price Index, the Fed's preferred inflation measure. Annual growth in core prices fell to 3.5% and monthly growth decelerated back to rates seen this past summer. Much of the monthly disinflation is being driven by core goods, where price growth has been hovering near 0% and is approaching the pre-pandemic average. The poor economic recovery and deflation of consumer prices in China is helping drive the price of goods down here in the US. However, housing poses an upside risk to prices where disinflation has slowed in recent months, helping keep core services inflation elevated.
- Growth in consumer spending eased in October after a strong Q3, consistent with our forecast of a slowdown in Q4. Further slowing is expected in November and December, especially in goods consumption where growth was especially high in Q3. Overall, we expect personal consumption expenditures to grow by 1.4% (annualized) in Q4, down from 3.6% in Q3.

### The disinflation trend continues

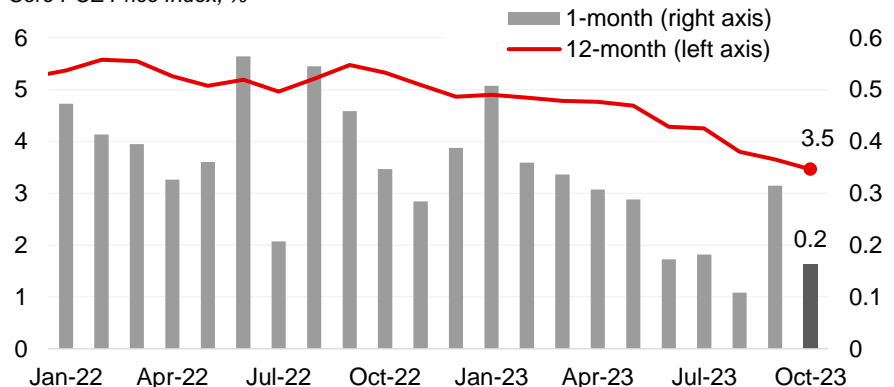
After a slightly unnerving September, monthly price growth has fallen back down to rates experienced this past summer. Overall, disinflation is continuing in the US, supporting our baseline view that the Fed is likely done hiking rates. Going forward, core goods and housing inflation will be key spending categories to watch.

Energy prices have become less worrisome in recent months as the situation in China continues to weigh on demand and with markets expecting output in the US to slow. Headline PCE inflation rose by 3% annually in October, down from 3.4% in September, with the drop being supported by falling energy prices. The expected shock to oil prices from the Israel/Hamas war has not materialized, and despite OPEC announcing production cuts, oil prices are not expected to change by much for the rest of this year. A de-anchoring of inflation expectations coming from energy prices is less of a risk factor.

Core PCE inflation remains more elevated, with annual growth at 3.5% and monthly growth at 0.2%. Monthly core goods inflation rose by 0.02% in October after 4 straight months of negative growth (i.e., deflation), and core services inflation eased to 0.2%.

### October price growth is largely in line with expectations

Core PCE Price Index, %



Source: BEA, MUFG Bank Economic Research

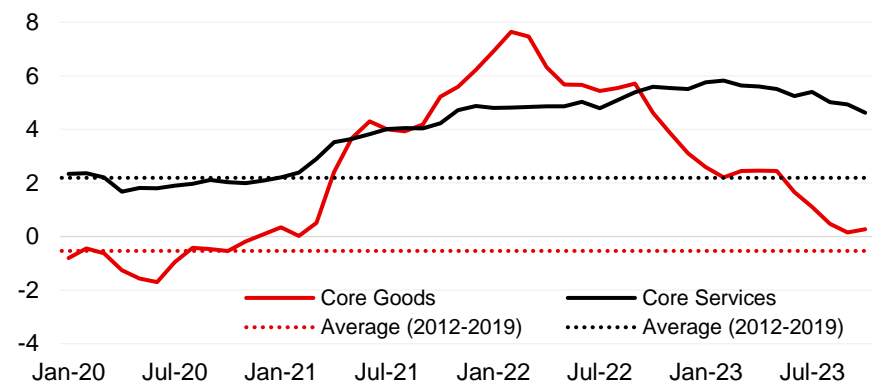
## China's economy is helping inflation in the US

The recovery in China has been less than remarkable, and inflation has been essentially 0% over the past few months. With over 16% of US imports coming from China, deflation in Chinese goods has helped drive goods inflation down in the US. Annual growth in core goods in the US has hovered just above 0% since September, driven by both durable and non-durable goods.

As it stands, annual growth is still above the pre-pandemic trend where average core goods inflation was negative. We can expect some further deterioration of prices in the goods sector as consumer spending slows in Q4 and as base effects fade. Upside risks to inflation are mostly in the services sector, where annual inflation is still well above the pre-pandemic average.

### Core goods inflation is hovering near 0%

PCE Price Index, % Y/Y



Source: BEA, MUFG Bank Economic Research

Consumer spending is expected to slow for services as well, but housing inflation may keep overall core services elevated above the pre-pandemic average for longer. The monthly growth trend in PCE housing prices has been essentially flat since June, and September provided a temporary scare where price growth jumped 0.14 percentage points, only to fall back down in October. It has generally been accepted that housing inflation will continue to ease given the interest rate sensitivity of the housing sector, but the rate of easing has certainly slowed in recent months.

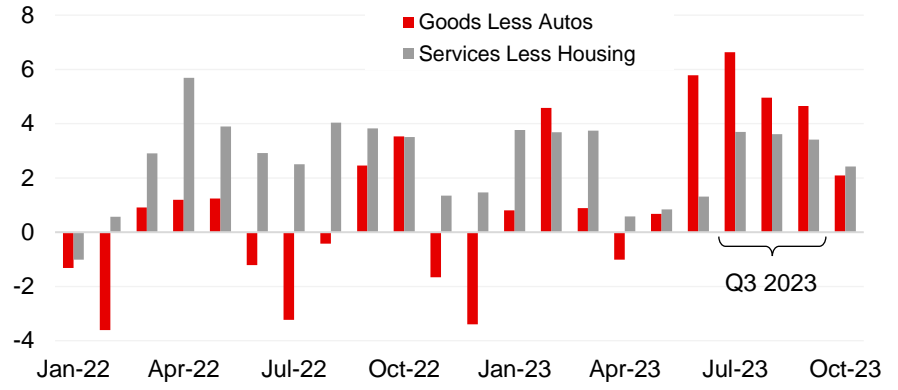
### Spending is showing signs of slowing

Consumer spending was strong in Q3, with real PCE growing at an annual rate of 3.6%. We expect spending to slow in Q4 and are forecasting growth to expand at an annual rate of 1.4%.

Consumption in October is already showing signs that Q4 will indeed reflect a slowdown. Excluding autos in the goods sector, the annualized 3-month growth rate fell to 2.1% in October, down from 4.7% in September. For services (excluding housing), growth fell to 2.4% in October, down from 3.4% in September. Accounting for seasonal factors, additional slowing is expected in the next two months as consumer credit transactions slow and as student loan repayments begin to weigh on household finances.

### Consumer spending is set to slow in Q4 after a strong Q3

Real PCE, 3-month change, % AR



Source: BEA, MUFG Bank Economic Research

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