ECONOMIC UPDATE
REGIONS
January 20, 2016

December Consumer Price Index: Inflation Chills Out In A Warm December

- The total CPI fell 0.1 percent (-0.111 percent unrounded) in December; the core CPI was up 0.1 percent (0.127 percent unrounded).
- On a year-over-year basis, the total CPI was up 0.7 percent and the core CPI was up 2.1 percent in December.

December may have been unseasonably warm across the U.S. but inflation nonetheless managed to chill out, with the total CPI falling by 0.1 percent and the core CPI rising by 0.1 percent. Our forecast was for the headline CPI to have been unchanged and the core CPI up by 0.1 percent; consensus estimates were for an unchanged total CPI and a 0.2 percent increase in the core CPI. On a year-over-year basis the total CPI was up a scant 0.1 percent for 2015 as a whole, with the core CPI up 1.8 percent.

Food and energy were weights on the total CPI in December. Food prices were down 0.2 percent with prices for food consumed at home down 0.5 percent and prices for food consumed away from home up a mere 0.1 percent. The past two months have seen a deceleration in the rate at which prices for food consumed away from home have risen (restaurants are the biggest component). This seems a bit out of line with data showing restaurants the strongest performing category of retail sales in 2015, which would suggest a greater degree of pricing power than apparent in the CPI data of late. Declines in prices at grocery stores were seen almost across the board in December.

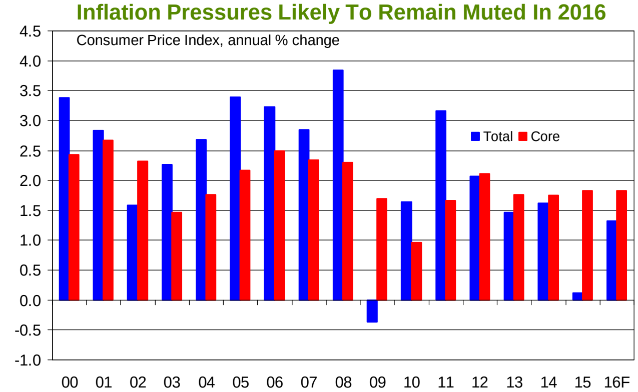
The overall energy price index was down 2.4 percent in December with prices down for gasoline, home heating oils, natural gas, and electricity. On a not seasonally adjusted basis, retail gasoline prices were down 5.9 percent in December – larger than the typical December decline and thus not fully accounted for by seasonal adjustment; seasonally adjusted pump prices were down 3.9 percent. On an over-the-year basis retail gasoline prices were down 19.7 percent in December, well shy of the better than 30 percent over-the-year declines seen earlier in 2015 but still substantial. And, with retail pump prices having fallen even further in the early stages of 2016, the drag on the total CPI from energy may lessen in severity but isn't going away any time soon.

Another drag on headline inflation comes in the form of core goods prices, which fell in December for the seventh time in the past eight months and were down year-on-year for a 33rd consecutive month. Goods price deflation has become broader based but this is a story consistently missed by many analysts when it comes to discussing the monthly retail sales data. We expect core goods prices to decline further over coming months, thus acting as a persistent drag on headline inflation and making the retail sales data look softer than is actually the case.

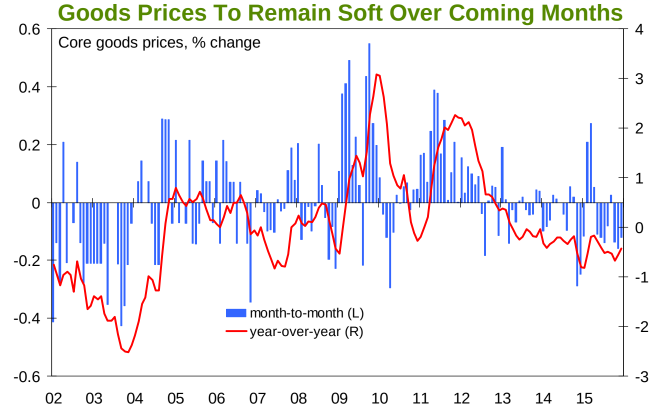
In our weekly preview we noted owners' equivalent rents and market rents posted their smallest declines of 2015 in November, raising the question of whether rent growth was simply taking a breather or settling into a slower trend rate. We had anticipated somewhat of a bounce back in December, which turned out not to have been the case (this accounts for the difference between our forecast for no change in the headline CPI and the actual decline of 0.1 percent). For the second consecutive month, both market rents and owners' equivalent rents were up 0.2 percent in December, translating into year-over-year increases of 3.7 percent and 3.1 percent, respectively. This, to us, will be one of the stories of most interest over the course of 2016 – we have been for some time noting the growing time gap between starts and completions of multi-family housing units (the vast majority of which are built as rental apartments) and have noted that when completions begin to catch up with starts rent growth would slow, perhaps sharply. It is too soon yet to conclude this is what is at play here, but does make it worth watching the measures of rent in the CPI data even more closely in the months ahead. Another reason to watch rents is they make up roughly 42 percent of the core CPI and were clearly the main factor behind the acceleration in core inflation in 2015.

We've consistently stated our view there is less inflationary pressure in the economy than implied by core CPI inflation and expect headline inflation to accelerate only modestly in 2016. Energy, rents, and medical costs are the areas to watch most closely.

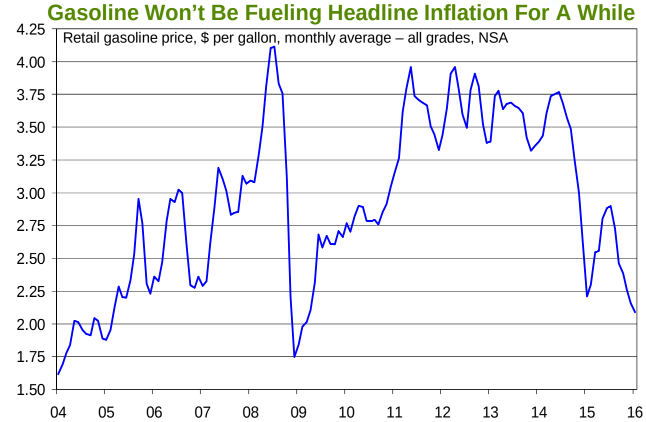
Inflation Pressures Likely To Remain Muted In 2016



Goods Prices To Remain Soft Over Coming Months



Gasoline Won't Be Fueling Headline Inflation For A While



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