ECONOMIC UPDATE
REGIONS
January 18, 2017



## December Consumer Price Index/December Industrial Production

- The total CPI rose by 0.3 percent in December (0.282 percent unrounded); the core CPI rose by 0.2 percent (0.230 percent unrounded).
- On a year-over-year basis, the total CPI is up 2.1 percent and the core CPI is up by 2.2 percent.
- Total industrial production rose by 0.8 percent in December, with output in the manufacturing sector rising by 0.2 percent.

**CPI:** The total CPI rose by 0.3 percent in December, as expected, which puts headline CPI inflation at 2.1 percent, the fastest since May 2014. The core CPI rose by 0.2 percent, matching expectations, which leaves core CPI inflation at 2.2 percent. On an annual average basis, the total CPI was up 1.3 percent in 2016 with the core CPI up 2.2 percent.

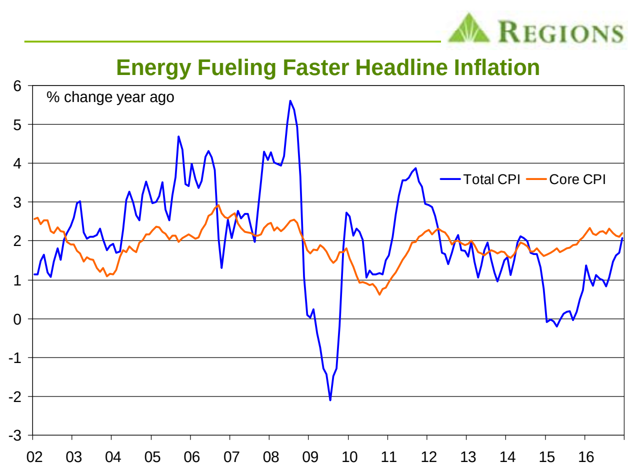
Energy prices have been a primary driver of the acceleration in inflation over the past few months. Retail pump prices rose over the final few months of 2016, contrary to typical seasonal patterns. As a result, these increases have been magnified in the seasonally adjusted data, which in turn has led to faster headline inflation. This simply marks a reversal of what we saw in 2015, when falling gasoline prices held down headline inflation and, as such, will raise no concerns with the FOMC.

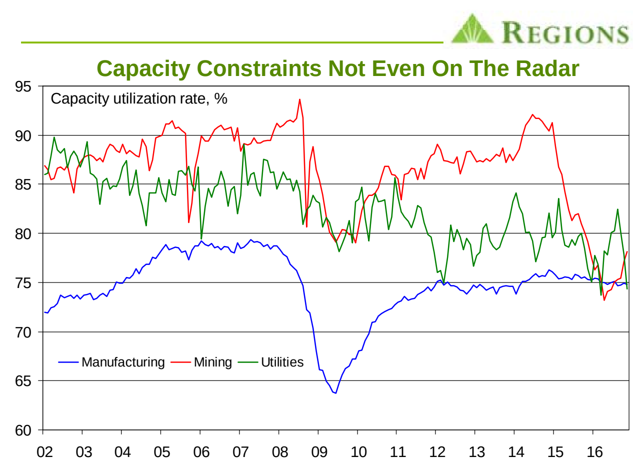
Elsewhere in the CPI data, the inflation story remains pretty much the same. Food prices continue to drift lower, with prices for food consumed at home falling year-on-year for a 13th consecutive month in December. This is also impacting restaurant prices, as least for those chains for which prepared foods purchased in grocery stores can be seen as a reasonable substitute. While prices for food consumed away from home rose better than two percent for 2016 as a whole, there is clear deceleration in the rate at which these prices are rising. Core goods prices were flat in December but fell year-on-year for the 44th time in the past 45 months, a trend we expect to remain in place in 2017. After falling 0.55 percent in November, apparel prices fell 0.70 percent in December and are down 0.17 percent year-on-year. Going through the details of the CPI report shows prices for electronics, home furnishings, appliances, and other consumer goods down, in many cases significantly so, on an over-the-year basis.

This pretty much leaves rents, which account for roughly 40 percent of the core CPI, as the primary driver of core inflation. Market rents were up 4.0 percent year-on-year in December, the largest such increase since November 2007, and owners' equivalent rents were up 3.6 percent year-on-year, their largest such increase since April 2007. There is some question, at least to us, as to whether rent growth will continue at this pace in 2017 – we think not – but this will clearly be a key determinant of the path of core inflation. It is worth noting that, excluding shelter, core inflation is running at a fairly tame 1.2 percent, consistent with our assessment of a considerable degree of slack in the broader economy. While this slack will be further pared down in 2017, we expect inflation pressures to remain somewhat muted in 2017.

**Industrial Production:** Total industrial production rose 0.8 percent in December, beating the consensus forecast but below the 0.9 percent gain we expected. Utilities output jumped 6.6 percent with the arrival of winter weather, while manufacturing output was up 0.2 percent and mining output was flat. The increase in utilities output was the largest monthly increase since December 1989. The increase in manufacturing output was lighter than expected, and excluding motor vehicle production output in the factory sector was flat for the month. One bright spot has been recent growth in output of information processing equipment, a sign of at least some life in business capital spending, but performance in the broader business equipment category remains spotty. While there is hope for firmer capital spending in the months ahead, the reality is that at present capital spending, here and abroad, remains a drag on the factory sector.

Overall capacity utilization rose to 75.5 percent in December but, as seen in the chart below, utilization rates in each of the three broad sectors remain depressed. Many analysts overlook this considerable excess capacity in their assessment of the degree of slack in the U.S. economy but to us this has been, and remains, a key component of our outlook for fairly muted inflation pressures. Unused manufacturing capacity weighs on capital spending and is also a factor in the lack of pricing power amongst goods producers that is such a key driver behind the trends in core inflation. It will take a sustained period of faster economic growth, both at home and abroad, to reverse this trend.

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