ECONOMIC UPDATE

REGIONS

February 19, 2016

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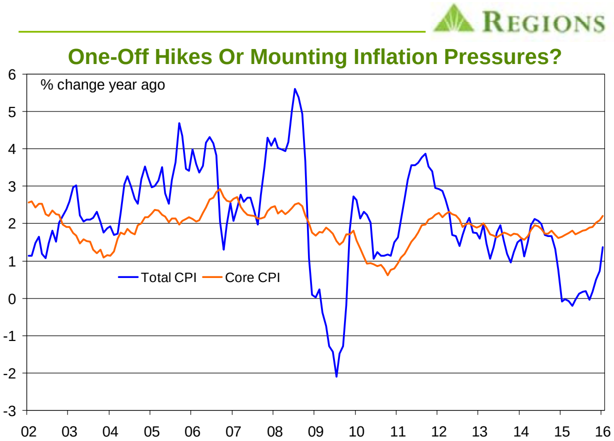
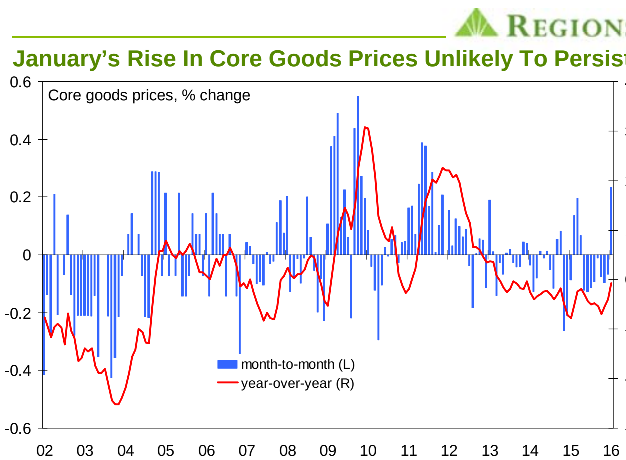
January Consumer Price Index: One-Off Hikes Or Mounting Inflation Pressures?

- The total CPI was unchanged (up .028 percent unrounded) in January; the core CPI was up 0.3 percent (0.293 percent unrounded).
- On a year-over-year basis, the total CPI was up 1.4 percent and the core CPI was up 2.2 percent in January.

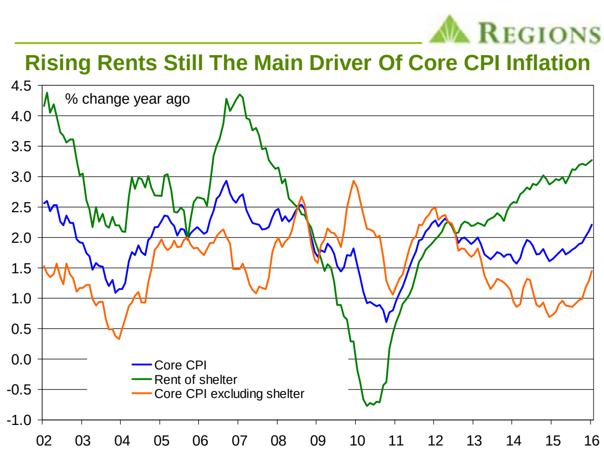


The total CPI was unchanged in January, leaving it up 1.4 percent year-on-year, but more notable is the 0.3 percent increase in the core CPI, the largest monthly increase since August 2011, which translates into a 2.2 percent year-on-year increase. Before the inflationistas – who have been warning about a surge in inflation since the very first day of the very first round of the Fed's QE program – take a victory lap, and before anyone else starts to worry the U.S. is on the road to becoming Venezuela – which posted a 159.1 percent inflation rate for 2015 – we'd suggest holding off. As we peruse the details of the January CPI report there are several jumps in prices that stand out, or at least make us wonder whether they are one-off in nature or are heralding the start of a sustained acceleration in inflation. Our 3.624 cents worth (which, prior to today's CPI report was two cents) is that it is more one-off than sustained in nature.

Medical costs were up 0.5 percent in January, one element of which stands out is the 1.1 percent increase in medical insurance costs. With the new year higher premiums kick in which, to be sure, is the case each year but this year's premium hikes were larger than has been the case over the past several years, and higher co-pays also take effect. In addition, costs for in-patient hospital services and prescription drugs also jumped. Note health care costs in the CPI are measured on the basis of out-of-pocket expenditures by consumers, while in the PCE deflator revenues received by service providers are the basis on which medical costs are measured. As such, shifting a greater share of costs to consumers combined with higher prices help explain January's increase in medical costs, which we would not expect to be sustained at the same rate over coming months.



Apparel costs were up 0.6 percent in January, which to some extent reflects seasonal adjustment issues. On a not seasonally adjusted basis apparel costs fell by less than is normal for the month of January, which reflects steeper than normal discounting in December in the midst of what was – for retailers – a soft holiday sales season. As such, it is highly unlikely January's spike in apparel coasts – seasonally adjusted – will not likely be repeated, especially as it came on the heels of four consecutive monthly declines. New car prices rose 0.3 percent, which does not seem at all odd in light of what in 2015 were record unit motor vehicle sales, but what does stand out is this is the largest monthly increase in new car prices since July 2014. Air fares were up 1.2 percent, which contributed to a 0.7 percent increase in the broader public transportation category.



Market rents were up 0.3 percent in January, leaving them up 3.7 percent year-on-year, which has been the average rate of growth over the past five months. Our suspicion is this will mark the peak for growth in market rents as measured by the CPI as a greater number of new multi-family rental units come on line in 2016. Owners' equivalent rents rose by 0.2 percent in January, leaving them up 3.2 percent year-on-year. Rents account for roughly 42 percent of the core CPI and are clearly the most significant driver of core inflation, but core services prices are rising at a faster rate – January's 3.0 percent year-over-year increase is the largest since 2008. The 0.2 percent increase in core goods prices in January stands out as an oddity, but even with this increase core goods prices were down on a year-over-year basis for the 34th consecutive months. Goods price deflation is a global story and one we expect to continue over coming months.

As is by now a familiar story, retail gasoline prices were down 4.8 percent in January – prior to last year normal seasonal patterns would see retail pump prices rise in the month of January. Food prices were flat in January, with prices for food consumed at home down slightly and prices for food consumed away from home up 0.3 percent.

The January CPI report does not alter our belief that there is less inflationary pressure in the economy than implied by core CPI inflation. Coming months will tell whether this is the right call or the wrong call.

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