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January Consumer Price Index: Inflation Heats Up, But By How Much?

- > The total CPI was up 0.6 percent (up 0.551 percent unrounded) in January; the core CPI was up 0.3 percent (0.308 percent unrounded).
- > On a year-over-year basis, the total CPI was up 2.5 percent and the core CPI was up 2.3 percent in January.

The total CPI rose 0.6 percent in January, double the expected increase of 0.3 percent, while the core CPI was up 0.3 percent, above the expected increase of 0.2 percent. On an over-the-year basis, the total CPI is up 2.5 percent and the core CPI is up 2.3 percent. This is the largest over-the-year increase in the total CPI since March 2012. In our weekly *Economic Preview* we noted the difficulty in getting the seasonal adjustment factors for the month of January right, across the realm of economic data, and we see evidence of seasonal adjustment noise in the CPI data. So, while we by no means are implying the January CPI report should be dismissed as one-off noise, neither do we think inflation is running as hot as today's report implies.

On a seasonally adjusted basis, retail gasoline prices advanced 7.8 percent in January, leaving them up 20.3 percent year-on-year. January is typically a month in which retail pump prices decline, so an out-of-character 5.3 percent increase in unadjusted prices was reported as the 7.8 percent increase on a seasonally adjusted basis. On the whole, household energy prices were up 4.0 percent in January. Apparel prices are another source of seasonal adjustment noise in the January CPI report. On a seasonally adjusted basis, apparel prices are reported to have risen 1.4 percent in January. The issue here is that January typically sees declines in apparel prices on a not seasonally adjusted basis, in part because retailers are attempting to clear the shelves after the holiday season to prepare for the arrival of spring lines. For instance, between 2012 and 2016 unadjusted apparel prices declined by an average of 1.1 percent in the month of January, but this January unadjusted apparel prices rose 0.4 percent. In part, this could be that the declines in November and December 2016 were larger than normal, so there was less post-holiday discounting to be done. Either way, the reported seasonally adjusted increase is far more noise than signal. One can make the same case with the reported increases in electronics prices. We also cast a suspicious eye towards the 0.9 percent increase in prices for new vehicles, with new car prices reported to have jumped 0.9 percent and new truck prices up 0.8 percent. It seems odd that while inventories of new autos, particularly smaller more fuel efficient models, are piling up on dealers' lots prices would be up so sharply.

It is notable that in a month in which core inflation accelerated, growth in the biggest driver of core inflation – rents – tailed off. Market rents were up 0.268 percent, the smallest gain since December 2015, while owners' equivalent rents were up 0.239 percent, the smallest gain since November 2015. These gains translate into year-over-year increases of 3.9 percent and 3.5 percent, respectively. This is something that will bear watching in the months ahead – we've noted for the past few months that rent growth has slowed for rental apartments but rent growth for single family homes, now a significantly larger share of the rental housing stock, continue to advance at a rapid rate. Rents account for roughly 40 percent of the core CPI, and should apartment rent growth continue to slow that will have a bigger impact than further gains in rents on single family homes and, as such, core inflation should remain fairly restrained. This assumes we are correct in our assessment of the degree of seasonal adjustment noise in the January data

Elsewhere in the data, food prices were up 0.1 percent with the 0.4 percent increase in prices for food consumed away from the largest monthly increase since September 2015 while prices for foods consumed at home were flat. Core goods prices jumped 0.4 percent in January, the largest such increase since October 2009 but, again, this increase reflects a considerable degree of seasonal adjustment noise. Air fares were up 2. percent for the month, which still leaves them down 3.3 percent year-on-year.

The January CPI data certainly warrant attention, but we think they overstate the inflation case. Fortunately for the FOMC, they will have the February data to sift through as they convene in March. A month free of seasonal adjustment noise will give them a better basis on which to deliberate the possibility of a March funds rate hike.

