ECONOMIC UPDATE

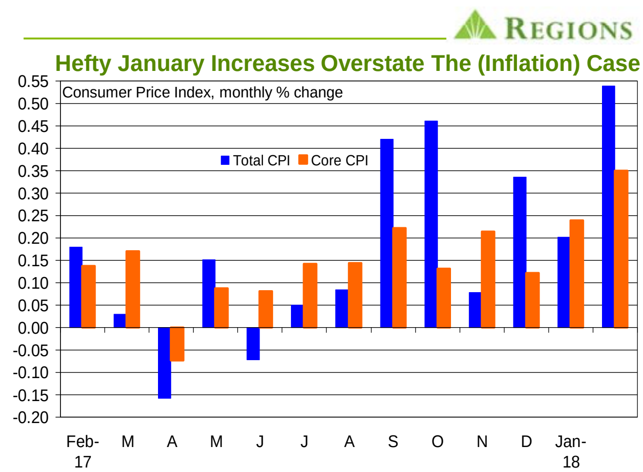
REGIONS

February 14, 2018

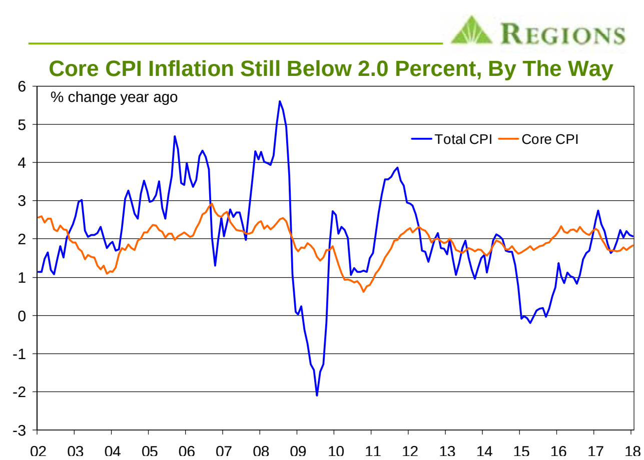
January Consumer Price Index: Hefty Increases Overstate The (Inflation) Case

- The total CPI rose 0.5 percent (0.539 percent unrounded) in January; the core CPI was up 0.3 percent (0.349 percent unrounded)
- On a year-over-year basis, the total CPI was up 2.1 percent and the core CPI was up 1.8 percent in January

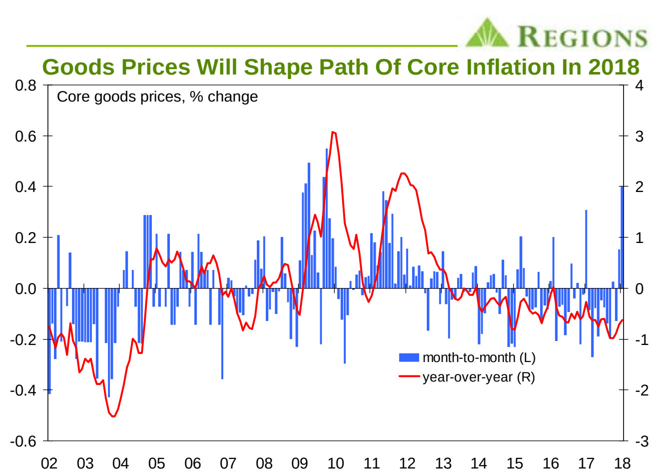
The total CPI rose by 0.5 percent in January, ahead of both our forecast of a 0.4 percent increase and the 0.3 percent consensus forecast. The core CPI rose by 0.3 percent, in line with our forecast and ahead of the 0.2 percent consensus forecast. January's increases leave the total CPI up 2.1 percent and the core CPI up 1.8 percent year-on-year. On the surface, the January CPI report seems to fit the narrative, initially spun in the wake of the January employment report, that the FOMC will have boldness thrust upon it by rapidly rising wages and prices. But, just as we wrote regarding the wage data in the January employment report, there is less to the headline numbers on the January CPI report than meets the eye. That won't stop market participants from trading on the headline numbers, but those numbers won't change the FOMC's approach to monetary policy, particularly with the FOMC's preferred measure of core inflation still well below their target rate.



In our weekly *Economic Preview*, we noted the odd pattern seen in apparel prices over the past several years, i.e., a large increase in January followed by a string of declines over the remainder of the year. As such, we built in a sizeable increase in apparel prices in our forecast of the January CPI, which proved to not be sizeable enough as the 1.7 percent increase reported for January topped even our expectations. Still, this leaves apparel prices down 0.6 percent year-on-year, which illustrates our point about the intra-year patterns in the apparel index. The sizeable increase in apparel prices contributed to the 0.4 percent increase in core goods prices in January, the largest monthly increase in this component since October 2009. Again, though, core goods prices are still down 0.6 percent year-on-year, which marks the 56th time in the past 58 months core goods prices were down year-on-year. As we discussed in our *2018 Economic Outlook*, the path of core goods prices will be a key influence – along with rents and medical costs – on the path of core inflation in 2018, and our expectation was that a weaker U.S. dollar would lend support to core goods prices. That said, one simply cannot take the January increase as evidence that a weaker dollar is working its magic on core goods prices given the oddity in the data on apparel prices. Well, okay, one can, as some analysts already are, but one simply should not do so.



Retail gasoline prices were up 3.2 percent in January on a not seasonally adjusted basis; as this increase is out of line with recent seasonal patterns, it was amplified in the seasonally adjusted data, which show a 5.7 percent increase in gasoline prices in January, leaving them up 8.5 percent year-on-year. Food prices were up by 0.2 percent in January, topping our forecast, but what stands out is the reported 0.4 percent increase in prices for food consumed away from home, which mainly captures restaurants. Again, for those who can be troubled to go through the details of the data, this is in keeping with a pattern in recent years in which January has seen a sizeable increase in this component that comes nowhere close to being sustained through the year.



Elsewhere in the January data, market rents were up 0.3 percent, leaving them up 3.7 percent year-on-year. Market rents are one of our, with all apologies to *This Is Us*, big three inflation drivers this year, and we expect rent growth to gradually slow as the year progresses. Medical costs were up 0.6 percent in January, leaving them up 2.0 percent year-on-year, but of our big three we are most uncertain about the path medical costs will take over the remainder of 2018, as they have wandered somewhat aimlessly for some time now. Our sense, however, is they will be consistently firmer than has been the case over recent quarters. Ex-shelter core inflation came in at 0.8 percent in January – that is the year-on-year change, not the monthly change – still somewhat anemic but nonetheless the fastest pace since last March.

As we've often noted, while we anticipate moderately faster inflation in 2018, inflation is only a big story if it accelerates far more than the FOMC anticipates. The January CPI report notwithstanding, at present there is no evidence that is the case.

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