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November Consumer Price Index: Headline And Core Inflation Go Their Own Ways

- > The total CPI was unchanged (up 0.019 percent unrounded) in November; the core CPI was up 0.2 percent (0.209 percent unrounded)
- > On a year-over-year basis, the total CPI was up 2.2 percent and the core CPI was up 2.2 percent in November

The total CPI was unchanged in November while the core CPI was up by 0.2 percent, in each case matching what we and the consensus expected. On an over-the-year basis, both the total CPI and the core CPI are up 2.2 percent as of November. Energy acted as a significant drag on the total CPI in November, which will also be the case with the data for December given what have been further declines in retail gasoline prices. Still, while headline inflation will likely ease further in the months ahead, core inflation is likely to trend higher, particularly if the recent firming of core goods prices is sustained. Though some will look at moderating headline inflation as grounds for the FOMC to forego raising the Fed funds rate at this month's meeting, the Committee will be more focused on the behavior of core inflation, which continues to accelerate, albeit at a gentle pace. While we expect core inflation to pick up, we see it as being highly unlikely that core inflation would accelerate to a degree sufficient to cause the FOMC to push the funds rate up at a faster pace, meaning the more relevant question is whether core inflation will move slowly enough to give the FOMC grounds to pause.

The broad energy index fell 2.2 percent in November, with retail gasoline prices down 4.2 percent. As we noted in our weekly *Economic Preview*, retail pump prices fell by better than seven percent on a not seasonally adjusted basis, which simply overwhelmed the seasonal adjustment factors, thus leaving prices down better than four percent on a seasonally adjusted basis. Prices for home heating fuels also fell in November, as prices for electricity and residential natural gas rose modestly. Food prices were up 0.2 percent in November, matching our forecast, which is the largest monthly increase since June. Prices for food consumed at home (think grocery stores) were up 0.2 percent and prices for food consumed away from home (think restaurants) were up 0.3 percent.

Following up on a 0.3 percent increase in October, core goods prices rose by 0.2 percent in November, which is noteworthy as core goods prices are up 0.2 percent year-on-year. While that may not seem like much, keep in mind that prior to November core goods prices had been down year-on-year in 65 of the past 67 months. Along with medical care costs and rents, core goods prices are a key driver of core inflation, particularly as measured by the CPI, so to the extent the firming seen over the past two months is sustained, that would be a source of steady upward pressure on core inflation. That said, should the U.S. dollar continue to strengthen over coming months, that will blunt any upward impulse in core goods prices. Our sense is that we won't see large moves in either direction, meaning core goods prices won't have much influence on core inflation one way or the other, with the obvious caveat that tariffs loom as a wild card here. Apparel prices fell by 0.9 percent in November, leaving them down year-on-year for a fourth consecutive month. Prices for used motor vehicles rose 2.4 percent in November, which follows a 2.6 percent increase in October and a 3.0 percent decline in September. These changes are pure noise – a change in how BLS measures used car prices has added considerable volatility in this series, and the changes seen over the past three months are sufficiently large to move the core CPI (another reason to focus on the PCE deflator when assessing inflation pressures). Medical care costs rose by 0.4 percent in November, matching our forecast, but given the erratic behavior of this series over the past several months, we simply cannot draw any conclusions as to how medical care costs will impact core inflation over coming months. Primary rents were up 0.4 percent in November, the largest monthly increase since April, while owners' equivalent rents posted a trend-like 0.3 percent in November. We do look for rent growth to ease over coming months, which would lessen the impact of rising core goods prices and rising medical care costs.

We look for headline and core inflation to move on divergent paths over coming months, as lower energy prices act as a drag on the former. Services prices will remain prone to pass-through effects from higher labor costs, meaning that the behavior of core goods prices will take on added significance in determining the path of core inflation.

