ECONOMIC UPDATE

REGIONS

February 13, 2019

January Consumer Price Index: Energy Prices Dragging Headline Inflation Lower

- The total CPI was unchanged (down 0.020 percent unrounded) in January; the core CPI was up 0.2 percent (0.250 percent unrounded)
- On a year-over-year basis, the total CPI was up 1.6 percent and the core CPI was up 2.2 percent in January

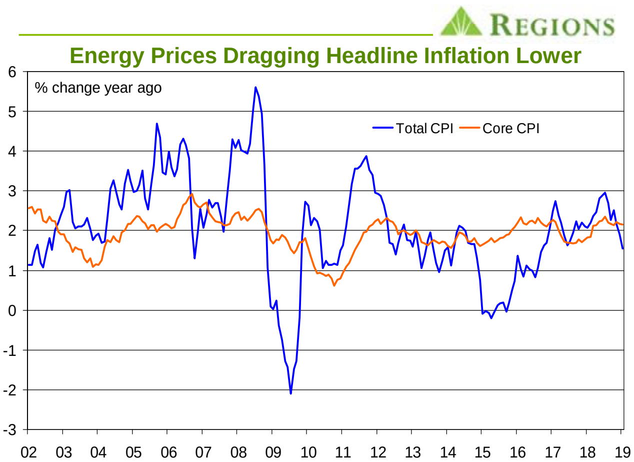
The total CPI was unchanged in January (we and the consensus expected a 0.1 percent increase) and is up 1.6 percent year-on-year. The core CPI rose by 0.2 percent, matching the consensus forecast but below the 0.3 percent increase we expected (our unrounded forecast was 0.261 percent, which we rounded up), and core CPI inflation is running at 2.2 percent as of January. The January data incorporate the BLS's annual revisions to the CPI data and corresponding seasonal adjustment factors such that the past five years of seasonally adjusted data have been revised. While the revisions alter the paths of some of the CPI components, measured CPI inflation is little changed after the revisions. More broadly, our view on inflation remains intact – inflation lacks clear direction and is unlikely to muster enough upward momentum over the course of 2019 to alarm the FOMC. Instead, inflation is likely to remain tame enough to afford the FOMC the option of a patient pause, which is the policy stance incorporated into our baseline 2019 forecast.

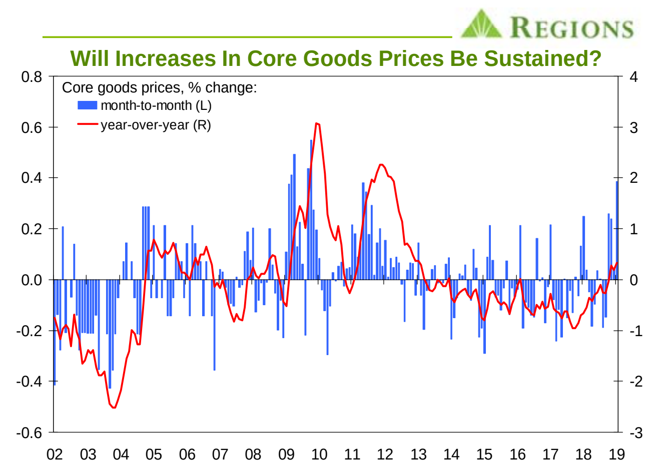
The broad energy index was down 3.1 percent in January, with gasoline prices dropping by 5.5 percent. In and of itself, the decline in gasoline prices took two-tenths of a percent off of the monthly change in the total CPI. Prices for electricity and home heating fuels also fell in January. That energy prices fell more than our forecast anticipated accounts for our miss on the headline CPI. Elsewhere in the data, food prices were up by 0.2 percent in January, with prices for food consumed at home (think grocery store prices) up by 0.1 percent and prices for food consumed away from home (think restaurant prices) up by 0.3 percent. Prices for food consumed at home are up just 0.6 percent year-on-year while prices for food consumed away from home are up 2.8 percent; this split, which has been in place for some time now, simply reflects the intense pressures facing main line grocers thanks to competition on a number of fronts including discount grocery chains and online sales, while restaurant operators continue to enjoy at least some pricing power.

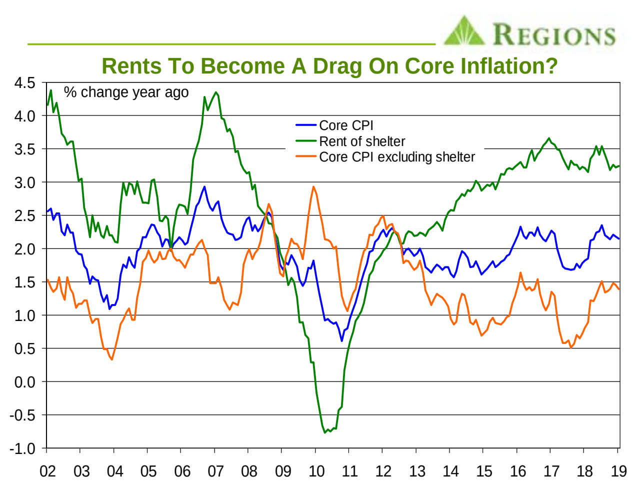
Apparel prices jumped by 1.1 percent in January but, as we noted in our weekly *Economic Preview*, there is typically a high degree of seasonal noise in the CPI data on apparel prices for the month of January as holiday season discounting, which varies from year to year, is unwound. That said, apparel prices are up just 0.1 percent year-on-year and the persistent weakness in apparel prices seen over recent years is unlikely to reverse in 2019. The jump in apparel prices contributed to a 0.4 percent increase in core goods prices in January, the unrounded increase of 0.386 percent is the largest monthly increase in core goods prices since October of 2009. This leaves core goods prices up 0.3 percent year-on-year, and while that may not seem all that noteworthy, January marks the third straight month in which core goods prices are up year-on-year after an extended run of persistent core goods deflation. Core goods prices are one of our "big three" drivers of core inflation (along with rents and medical care costs), and in our 2019 outlook we noted our expectation that firmer core goods prices would be a support for core inflation. January's increase in core goods prices is somewhat overstated thanks to the artificially large increase in apparel prices, and it is much too soon to know if our forecast for core goods prices will be on the mark. One factor that may derail the recent momentum in core goods prices is a stronger than expected U.S. dollar – to the extent this persists, core goods prices will again come under downward pressure.

As we expected, primary rents and owners' equivalent rents each rose by 0.3 percent after notably weak December increases. That said, our 2019 forecast anticipates decelerating rent growth which, given the outsized weight rents carry in the core CPI, would offset any contribution to core CPI inflation made by firmer core goods prices. Medical care costs rose by 0.2 percent in January, leaving them up 1.9 percent year-on-year.

With energy prices acting as a weight on headline inflation, the path of core inflation will be a more telling sign of the extent of inflation pressures in the broader economy. Either way, we expect inflation to remain muted over the first half of 2019.







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